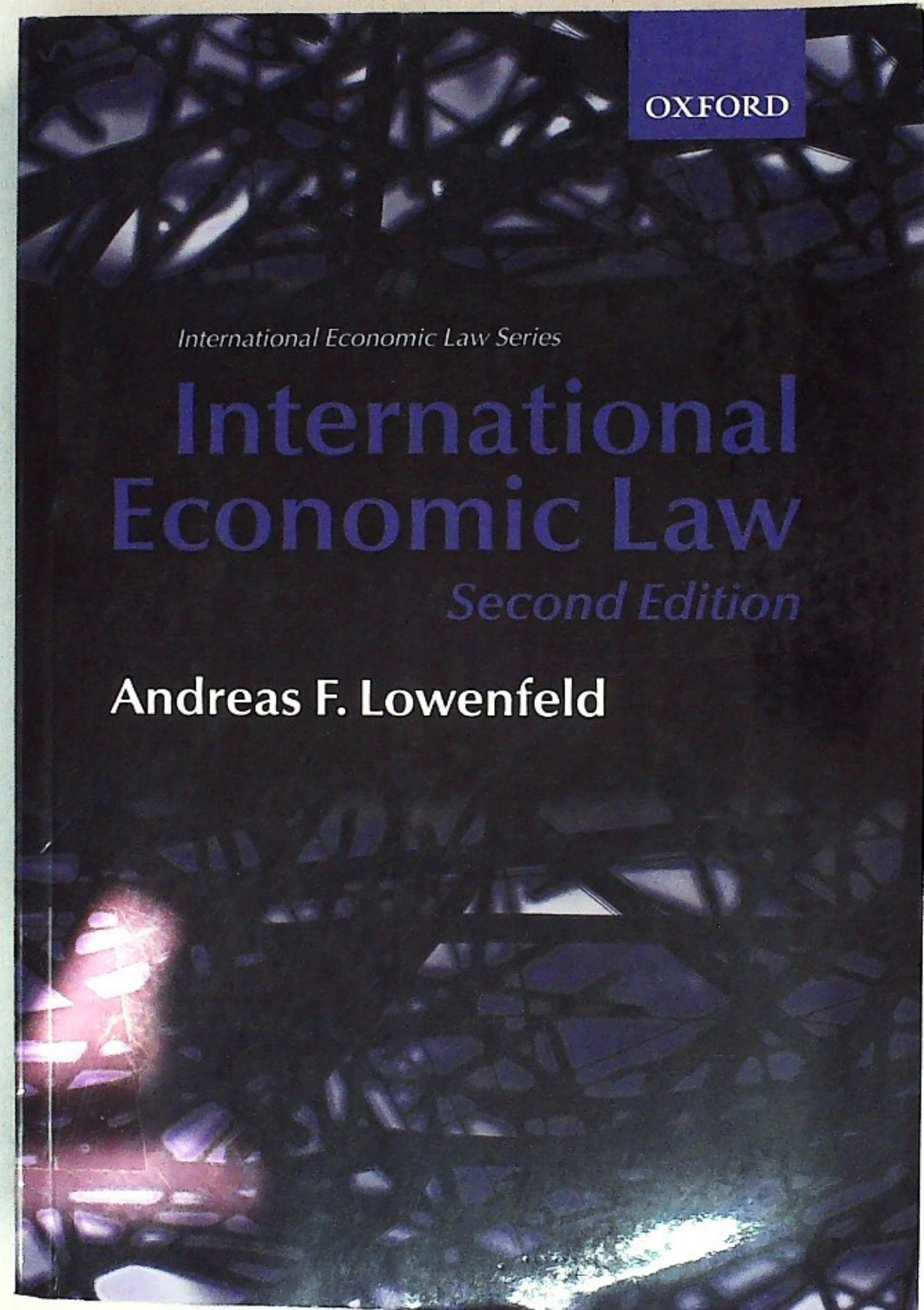
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Economic Law and the Laws of Economics

1.1 Introduction

If international economic law is not necessarily congruent with the laws of international economics, it is nevertheless true that economics—knowledge, faith, skepticism included—has had a strong influence on the shape and evolution of the international law of international trade, investment, and financial transactions. Indeed, the General Agreement on Tariffs and Trade, which forms much of the foundation for the subjects addressed in this volume, is clearly based on the perception that international trade is beneficial, that the gains to society from trade outweigh the losses to those who are hurt by competition from abroad, and that value is created through specialization and exchange in open markets. It is this perception that leads to the overriding principle of the GATT/WTO system that barriers to trade imposed by government should be subjected to international discipline, and that regular procedures should be established looking to reduction or elimination of such barriers.

In short, the doctrine of comparative advantage has informed, if not quite dominated, the GATT since its creation in the early post-war years, and has sustained that fragile enterprise for half a century, climaxed by establishment of the World Trade Organization in 1994.[1] But the doctrine of comparative advantage is not self-evident, and doubts about its validity, as well as about its political sustainability, have also informed the GATT, as well as the behaviour of its member states.[2] It seems useful therefore

[1] See Ch. 5.

[2] Jacob Viner, one of America's leading economists a generation ago, wrote in mid-century:

to begin this volume with a brief exegesis of the theory of comparative advantage, not with a view to making a contribution to the literature of economics, but as an introduction for those readers not schooled in that subject and as background to the detailed exploration of tariffs and quotas, subsidies and dumping, non-discrimination and preferences that make up the public law of international trade.

1.2 A First Look at Comparative Advantage

We may begin, as Adam Smith did, with the analogy of a state to a household. Smith wrote:

> It is the maxim of every prudent master of a family, never to attempt to make at home what it will cost him more to make than to buy. The tailor does not attempt to make his own shoes, but buys them of the shoemaker. The shoemaker does not attempt to make his own clothes, but employs a tailor. The farmer attempts to make neither the one nor the other, but employs those different artificers. All of them find it for their interest to employ their whole industry in a way in which they have some advantage over their neighbours, and to purchase with a part of its produce, or what is the same thing, with the price of a part of it, whatever else they have occasion for.
>
> What is prudence in the conduct of every private family, can scarce be folly in that of a great kingdom. If a foreign country can supply us with a commodity cheaper than we ourselves can make it, better buy it of them with some part of the produce of our own industry, employed in a way in which we have some advantage. The general industry of the country, being always in proportion to the capital which employs it, will not thereby be diminished, no more than that of the above mentioned artificers; but only left to find out the way in which it can be employed with the greatest advantage. It is certainly not employed to the greatest advantage, when it is thus directed towards an object which it can buy cheaper than it can make.[3]

> The contrast is striking between the almost undisputed sway which the protectionist doctrine has over the minds of statesmen and its almost complete failure to receive credentials of intellectual respectability from the economists. The routine arguments of the protectionist politician differ somewhat from country to country . . . capturing their audiences in spite of—or perhaps by—the absence of any visible means of intellectual support . . . . They are fairly adequately disposed of in any one of a large number of elementary text books, and what importance they have is due mainly to the fact that the general public does not read economic textbooks.
>
> Jacob Viner, *International Economics: Studies*, Ch. 6, 'The Tariff Question and the Economist', 109 (1951).
>
> While it is probably still true that the general public does not read economics textbooks, both of the major propositions stated by Viner—that politicians are typically protectionist and that economists are united in support of free trade—would need substantial qualifications at the start of the twenty-first century.

[3] Adam Smith, *An Inquiry Into the Nature and Causes of the Wealth of Nations*, Book IV, Ch. 2, 414 (1776, repr. Modern Library edn., 1937).

This statement is not yet comparative advantage, but is an important step toward the doctrine. It makes clear that if Patria is more efficient or productive (whether measured in unit labour cost, or dollars, or any other relevant commitment of resources) in a given industry (say farming) than Xandia, and Xandia is more efficient or productive in another industry (say weaving), and both countries have need of the product of both industries, Patria should specialize in one, Xandia in the other. Trade between the two countries in the two products will be beneficial (i.e. will conserve resources and create value) for both.

David Ricardo took the theory one major step further.[4] Even if Patria is more efficient at producing both wheat and cloth (or the tailor is more skilled at making shoes than the shoemaker), the critical question, as he showed, is the relative or comparative advantage in producing wheat versus cloth in Patria, as compared to producing wheat versus cloth in Xandia, or to come back to the simplest example, how much more efficiently the tailor can make suits than the shoemaker, compared with how much more efficiently the tailor can make shoes compared with the shoemaker. Even if the tailor performs both tasks with less commitment of resources than the shoemaker, Ricardo demonstrated, the tailor should concentrate on making suits, and buy the shoes he needs from the shoemaker.

To take Ricardo's own example:

> Suppose in England a gallon of wine costs 120 and a yard of cloth 100 units of work, while in Portugal a gallon of wine costs 80 units and a yard of cloth costs 90 units. Portugal has an *absolute cost advantage* in both wine and cloth; but England has a *comparative advantage* in cloth, since the production of a yard of cloth in England involves giving up production of $\frac{5}{6}$ (100/120) of a gallon of wine, whereas production of a yard of cloth in Portugal involves giving up $1\frac{1}{8}$ (90/80) of a gallon of wine. Assuming constant costs, prices accurately reflecting costs, and ignoring transport and handling, a price of cloth anywhere between $\frac{5}{6}$ and $1\frac{1}{8}$ of the price of wine would make it profitable for Portugal to import cloth and export wine, and for England to export cloth and import wine. If the same amount of resources as before trade are committed, the output for the two countries will be both more wine and more cloth.[5]

[4] David Ricardo, *Principles of Political Economy and Taxation* (1817).

[5] Ricardo's discussion appears in *Principles of Political Economy and Taxation*, Ch. VII, 'On Foreign Trade', 82–87 (Everyman's Edition, repr. 1987). The presentation here follows the reformulation by Harry G. Johnson in the entry on 'International Trade: Theory', in the *Encyclopedia of the Social Sciences*, Vol. 4 (1968). The reformulation uses 'units of work' rather than hours of work, in order to get away from Ricardo's labour theory of value in favour of a more generalized opportunity cost of resources.

1.3 Some complications

Ricardo's demonstration has retained its validity for almost two centuries as the starting point for analysis of the gains from trade, and in particular for distinguishing between *absolute advantage* which would compare, say, steel from Patria with steel from Xandia without taking opportunity cost into account, and *comparative advantage*, which compares ratios between two products in the two countries and leads to the analysis that even the country that is more efficient and productive in both products gains from specialization and trade.

It is evident, however, that Ricardo's illustration is a vast simplification. *First*, it assumes one homogeneous level of input (for Ricardo it was hours of labour) and perfect ability and willingness on the part of the units of input to shift from creating one product (wine in England, cloth in Portugal) to creating another (cloth in England, wine in Portugal). *Second*, it assumes two products and two countries—far from the real world. *Third*, it assumes constant costs and constant prices, also improbable over time. *Fourth*, it takes no account of variation within products, of the role of firms, and of the fact that increasingly the subjects of exchange are themselves combinations of ingredients from various sources.[6]

Numerous economists in the twentieth century have endeavoured to refine and build on the Ricardo model. The best-known model, developed by two Swedish economists, Eli Hekscher and Bertil Ohlin, focused on differences in endowment among countries in the several factors of production. The Hekscher–Ohlin model[7] also works with two countries, two products, and assumes a perfectly competitive economy, as well as constant returns to scale, but looks at two factors of production, say *K* (for capital) and *L* (for labour). Hekscher–Ohlin predicts that each country will export the product that uses its relatively abundant factor more intensively. Thus if Patria is comparatively better endowed with *K*, it will export *K*-intensive products, and will import products that call for a greater proportion for input of *L*, in which Patria is comparatively less endowed than, say, Xandia. By 'well endowed', Hekscher–Ohlin means that the country in question has a higher ratio of the factor in question to other factors than other countries do; by 'factor-intensive' product, Hekscher–Ohlin means a product whose costs in the country in question of the factor focused on are a greater share of its value than they are of the value of other products.

[6] It also assumes, like the other models discussed in this chapter, a single invariable currency. For more on this subject, see Ch. 2.

[7] See Eli Hekscher, 'The Effects of Foreign Trade on the Distribution of Income' (1919), English translation in Howard S. Ellis and Lloyd A. Metzler (eds.), *Readings in the Theory of International Trade* (1949); Bertil Ohlin, *Interregional and International Trade* (1933). See also Paul H. Samuelson, 'International Trade and the Equalization of Factor Prices', 58 Econ. J. 163 (1948) and later writings by Samuelson.

Thus cloth, for instance would be labour-intensive, wheat land-intensive. A country such as the United States, with relatively larger land supply compared to the rest of the world than labour supply compared to the rest of the world, ought to export land-intensive products such as wheat, and import labour-intensive products such as cloth. In conditions of trade, the land-intensive country has a comparative advantage in wheat, the labour-intensive country, a comparative advantage in cloth, and trade benefits both.

Hekscher–Ohlin pushes the analysis further, suggesting that trade will tend to equalize product prices and eventually factor prices, with the conditions of trade determined by relative factor endowments and factor intensities. Of course, focusing on land and labour (or even on one or two additional factors of production) conceals differences among different areas of land, and among different classes of labour—skilled, semi-skilled, and unskilled, plus scientists, engineers, and managers, and among different skills as well. As in the Ricardian model, it assumes mobility of factors of production, so that clothmakers will become wheat farmers and less productive farmland will be used to locate factories.

1.4 From Economic Theory to Policy, Politics, and Law

At some level, most persons who have thought about policy or politics in connection with international trade accept the theory sketched in the preceding pages, even when attempts to prove the various formulations of the propositions stated are only partly successful. Compare Professor Paul Samuelson's famous dictum:

> There is essentially only one argument for free trade or freer trade, but it is an exceedingly powerful one, namely: Free trade promotes a mutually profitable division of labor, greatly enhances the potential real national product for all nations, and makes possible higher standards of living all over the globe.[8]

But the theory of comparative advantage has never been wholly satisfying. One major shortcoming, even when expanded beyond the two-country, two-product, two-factor model, is that it would lead to the expectation that countries with similar levels of economic development would trade little with each other, apart from goods directly linked to geography, such as the products of agriculture or mining. In fact, industrial countries trade in great volume with one another, often in the same sector and products. Of course the preceding sentence, though it may reflect annual or monthly statistics, is seriously misleading: with some (diminishing) exceptions, countries do not engage in trade, firms do, and firms differ from one another not

[8] Paul A. Samuelson, *Economics*, 692 (10th edn., 1976).

only in the classical factors—labour, land, and capital—but in such factors as marketing, management, and innovation, plus economies of scale. Also, the rise of multinational enterprises has led to vast amounts of trade among affiliated firms in different countries, and to international investment as an alternative and supplement to trade, to a degree wholly unforeseen by the economists who developed and explored theories of international trade.

Perhaps a more serious concern for policy-makers has been that while the theory of comparative advantage predicts, with fair accuracy, that global welfare will be enhanced over time by expanded exchange of goods and services, it gives less assurance to individual countries and particularly to comparatively disadvantaged sectors within countries. In the long term, the answer is adjustment, that is commitment of factors of production to economic activity in which they are comparatively more advantaged; not all factors of production, however, are equally mobile, or equally patient. How to give some time for adjustment without creating permanent distortions is one of the themes of the law of international trade.[9]

Another matter of concern is the extent to which the factor endowments that make up comparative advantage can be altered by government intervention. For instance, if technical skill and innovation are important factors, may governments sponsor research and development targeted to particular industries? What about making university education free to students? Should other countries be permitted to counteract such efforts to alter comparative factor endowments?[10] More generally, is the teaching of the economists that trade must be free limited by a proviso that it must be fair? And if it is indeed *fair trade* to which countries are prepared to commit themselves, what is, and what is not fair?[11]

In short, economic theory, and statements such as the one quoted above from Samuelson, do not provide clear guidelines for international economic law. But it would be wrong to dismiss the theory as too abstract, too removed from the 'real world' to matter. In fact a good case can be made that most of the rules of international economic law have been developed against the backdrop of the theory of international trade, and of the question—sometimes explicit, at other times tacit—how far deviations from the theory should be allowed.

One significant factor—generally not considered in discussion of the theory of comparative advantage—has been omitted thus far—the role of money, exchange rates, and the balance of payments. This subject is addressed—again only by way of introduction—in Chapter 2.

[9] See in particular Ch. 5, Sect. 5.4 on Safeguards.
[10] See Ch. 9 on Subsidies.
[11] See, in particular, Ch. 10 on Dumping and Anti-Dumping.

2

Money, Exchange Rates, and the Balance of Payments

2.1 Introduction

Louis XIV and his advisers, Mazarin and Colbert, believed that a nation's wealth (and not incidentally its power) depended on its store of gold and silver. The way to increase that store would be to maximize exports paid for in hard currency, and to limit imports. The heritage of that belief, generally referred to as mercantilism, has survived, even when the theory has failed to withstand analysis. Nations still seek to promote exports and restrain imports by a variety of means, and when they lower barriers to imports, for instance by reducing tariffs, they think of such action as concessions. A brief introduction to the role of international exchange and payments is presented here, as a complement to the discussion of the theory of international trade introduced in Chapter 1. The legal rules of the international monetary system are discussed in Part VII.

2.2 Three Approaches to Exchange Rates and the Adjustment Process

(a) The Gold Standard

It is perhaps easiest to understand the international system of payments by beginning with a description of the gold standard, though such a system existed only for short periods, and never in as complete a form as the textbook model suggests.

In a pure gold standard system, each national currency is defined in terms of a stated weight of gold, and thus stands in a fixed ratio to each other currency. If money were all specie (and disregarding the costs of smelting and recasting), a given number of pounds could be converted without loss of value into francs or dollars or roubles, and back again. Of course money was generally expressed in paper—i.e. in notes issued by national treasuries or central banks—and a more accurate description of the system would be a gold exchange standard—i.e. a system based on promises by the national treasury or central bank to exchange notes for gold at the proclaimed rate. The nation's gold supply need not be in a ratio of 1:1 with the amount of notes outstanding, but the understanding was that there was to be a fixed ratio of gold to currency in circulation.

For purposes of international exchange, the fixed ratio was to be maintained. Thus, for instance, when the value of the British pound was fixed at ¼ ounce of gold, the US dollar at $\frac{1}{20}$ ounce of gold, and say the French franc at $\frac{1}{80}$ ounce of gold, one pound sterling would equal five US dollars, one US dollar would equal four French francs, and so on. Under this system, the demonstrations of Ricardo and those who came after him, as described in Chapter 1, could be carried out without distortion by substituting dollars or pounds for the abstract units of value in the model. Even if the workers in Portuguese vineyards are paid in escudos and the workers in English textile mills are paid in pounds, so long as both currencies represented a fixed weight of gold, their relation to each other could be easily calculated, and payment for each country's exports to the other could be made in either currency or in a third currency.

If an exporter of cloth from England was paid in escudos, he could exchange them at an English bank for gold or, more likely, for pounds. The Portuguese treasury or central bank was obligated at any given time or at the end of an accounting period to exchange the escudos held by foreigners for gold, or for the equivalent in a currency that the holder was willing to accept—e.g. pounds—because he knew that the issuer of that currency was willing and able to perform its promise to pay gold on demand.

If a country—Portugal in our example—were unable to make the exchange promised, the value, that is the external value, of the escudo would inevitably decline, to reflect the extent to which persons outside

Portugal were now willing to hold escudos, or to accept payment in escudos for their goods or services. If Portugal declared that it would no longer offer one pound for 30 escudos but only, say, 18 shillings (or one pound for 33⅓ escudos), that would constitute a devaluation of the escudo. The effect on international trade would be that a given product, say a case of wine with a domestic value of 360 escudos, would now cost 10.8 pounds, instead of 12 pounds as before. If Portuguese wine competed in England with Spanish or Italian wine, the expectation would be that Portuguese wine would have gained an advantage; conversely, a Portuguese merchant considering the cost in his own currency of a purchase from abroad would find that £100 worth of cloth would now cost not 3000 escudos as before but 3333 escudos. The effect—expected and often intended—would be to discourage imports into Portugal in favour of purchase of local products.

The theory of the gold standard, however, went a significant step beyond this simple example. To return to the hypothetical countries Patria and Xandia, the theory, as developed first by the philosopher David Hume,[1] writing even before Adam Smith, posited that if Patria exported more to Xandia than Xandia exported to Patria, then at the end of the year gold would flow out of Xandia and into Patria. As a result, since the money supply in Xandia depended on its store of gold, (i) Xandia's money supply would be reduced; (ii) it followed that prices and wages in Xandia would be reduced; (iii) imports by Xandia would be reduced because foreign goods had become more expensive in comparison with domestic goods; and (iv) exports from Xandia would increase, because its products had become relatively less expensive when expressed in foreign currency.

The opposite effects would be occurring in Patria—an increase in money supply, increase in prices and wages, increased imports and reduced exports. Hume argued that these processes would reverse the prior trend, and thus that the system was self-correcting, toward equilibrium. Accordingly, tariffs and similar restraints on international trade imposed by governments were unnecessary and counterproductive.

The pure gold standard had two major difficulties. For one thing, the downward shift in prices and wages in Xandia predicted by the theory often did not occur. Wages, in particular, are difficult to reduce. For another, governments were unlikely to pursue the hands-off policy assumed by the theory in the face of economic contraction, unemployment, and even depression in Xandia, and inflation in Patria. Typically, states imposed trade barriers and exchange controls, or devalued their currency rather than awaiting the results of the 'self-correcting mechanism'. To a considerable extent such intervention through changes in the exchange rate or

[1] See David Hume, 'Of the Balance of Trade' (1752), in *Essays: Moral, Political and Literary* (repr. Oxford 1963). Also in Richard N. Cooper (ed.), *International Finance: Selected Readings*, Ch. 1 (1969).

restrictions on the use of foreign exchange had similar aims and similar effects as tariffs and import quotas. But whereas tariffs could be imposed to protect a given industry or sector, interference with the value or use of currencies tended to affect the entire economy of a nation, and perhaps several nations. It is worth adding that while there were certain undertakings and conventions among central banks participating in the system (for instance about the purity of gold and about the exchange rates reflecting the declared values of the currencies), no international treaties or institutions restricted the actions of individual states in the field of finance in the age of the gold standard.[2]

The gold standard was never followed as regularly as would be required to test the theory of self-correction toward equilibrium, and the system, anchored by the British pound, collapsed with the onset of World War I. Traces of the system, however, survived or were re-established in the system put in place after World War I.

The period between World War I and World War II saw a largely unchecked and chaotic pattern of government intervention in the use of currencies across national frontiers. Only the United States, among major countries, maintained the promise to exchange its notes for a fixed quantity of gold, and that promise was substantially impaired when the United States changed the rate from $20 = 1 ounce to $35 = 1 ounce in 1934. Other countries adopted a variety of measures—often discriminatory—that were believed by the architects of the post-World War II system to have contributed to the causes of the war. It is not necessary in the present context to describe these measures, except to point out that one objective of the post-war system was to avoid such measures in the future. The post-war monetary system, therefore, was a system of rules, designed in significant part to prevent the unilateralism of the inter-war period.

(b) Fixed Exchange Rates and the Bretton Woods Scheme

Following World War II, a different system was introduced by the victorious powers and eventually by almost every other country except the Soviet Union, the People's Republic of China, and some of their satellite states. The details of the system and its demise in the 1970s are described in Chapter 18. For this introduction, we focus only on the theory.

The nations that gathered at Bretton Woods, New Hampshire a year before the end of World War II to plan the post-war monetary system were concerned above all to avoid the monetary practices of the inter-war period. They insisted on a multilateral regulatory system with fixed exchange rates,

[2] For a description of the relevant national statutes, particularly in Great Britain, see Kenneth W. Dam, *The Rules of the Game: Reform and Evolution in the International Monetary System*, Ch. 2, esp. 24–29 (1982).

pegged to the US dollar. Only the dollar was linked expressly to gold. All other member states of the International Monetary Fund were required to define the rate of exchange of their national currency in terms of the dollar. Member states were forbidden to change the par value of their currency without approval of the IMF, and approval was to be given only in case of 'fundamental disequilibrium'.

As in the gold standard, if Patria held more Xandian crowns than it chose to hold, Xandia was obliged to redeem its crowns in return for Patrian pesos, or dollars, or other currencies acceptable to Patria. If Xandia did not have sufficient resources to redeem its crowns, it could draw on the resources of the IMF, on the basis of undertaking to adopt policies designed to return its balance of payments to equilibrium within a stated period. Furthermore, member states were prohibited from imposing multiple exchange rates or discriminatory practices, and (with important exceptions) from imposing exchange controls.

Thus the emphasis was on stability and equilibrium. States were encouraged (not to say required) to achieve equilibrium in their balance of payments, and not to rely on changes in exchange rates or on the supply of money to do so. From the point of view of commerce, fixed exchange rates were a great convenience: a typical export/import transaction had no (or very slight) risk of a change in the value of the currencies involved, and indeed it did not make much difference, so long as the system worked, whether a given transaction between Patria and Xandia was denominated in Patrian pesos or Xandian crowns or US dollars. As under the gold standard, the Ricardian model of comparative advantage discussed in Chapter 1 could be illustrated without distortion in terms of dollars, or pounds, or escudos, because each of these currencies, by definition and international agreement, bore a fixed relationship to each other's currency.

(c) Floating Exchange Rates

The system of fixed exchange rates with infrequent changes, as noted above, had significant advantages for persons engaged in commercial transactions, and (not incidentally) for the establishment and analysis of economic statistics. But by the end of the 1960s, it had become clear that the system of fixed exchange rates involved predictions about the relative growth of different countries and regions, predictions that were in practice impossible to make with any degree of accuracy. Furthermore, when changes in the value of major currencies did occur—notably the devaluation of the British pound in 1967—the shocks were too sharp, the disruptions too massive, to be tolerated in the long run.

Moreover, it became clear at about the same time that the system that had functioned relatively well for a quarter century (1946–71) depended increasingly on the willingness of certain creditor countries, particularly

Japan and West Germany, to hold US dollars (line 22, Table 2.3, page 17 *infra*), and that this willingness was wearing thin. The events that led to the demise of the Bretton Woods system and its partial reconstruction are set out in Chapters 18 and 19. For this introduction it is necessary only to describe in general terms a third monetary system, based neither on gold nor on par values, but (at least in theory) solely on market forces.

The basic concept is that governments no longer have an obligation to maintain their currencies at any particular value, and that there is no pre-arranged ratio between the value of any currency and any other. Of course such a system cannot function without an active market, and for many lightly traded currencies it proved more practical to be pegged to one of the major currencies—the dollar, the yen, the D-mark, the pound, and later certain baskets of currencies. But for the major currencies, the concept was to treat them like cotton or copper or coffee—with spot and futures markets and no fixed anchor. If the market pushed up Patrian pesos and pushed down Xandian crowns, the expectation—similar to the vision of Hume (Sect. 2.2(a) *supra*)—was that the consequences would be self-correcting, with Xandian goods and services becoming cheaper and therefore in greater demand, Patrian goods becoming more expensive in terms of Xandian (and other) currencies and therefore less in demand.

The market in currencies soon developed, not in a stock or commodities exchange, but in a system of electronic transfers among financial institutions linked by computers and almost instantaneous communications, largely free of governmental controls. It was also true that the need to achieve 'balance'—a feature and obligation of the fixed rate system—was not as pressing, as there was no longer an *obligation* to redeem one's currency held abroad. But the self-correcting mechanism predicted by the advocates of freely floating exchange rates did not develop, and indeed the market for currencies often showed patterns quite different from the pattern of movement of goods and services, of internal prices for comparable goods, of the flow of investment, or of the real growth of the economies of the issuing countries. On and off the major countries—alone or in coordinated moves—sought to intervene in the market, that is to participate as buyers or sellers to counter market movements deemed to be excessive when compared to underlying facts.

The European Community, disturbed at the distortions in commerce of the volatile exchange movements, attempted, with mediocre success, to establish a mini-Bretton Woods system, with fixed rates among the participants;[3] when the Community changed its name to the European Union in the Treaty of Maastricht in the early 1990s, the principal symbol of the 'union' was to be the common currency, which would bind all the member states—or all the participating member states—to a single

[3] See Ch. 22, Sects. 22.1–22.2.

monetary and fiscal policy and common interest rate, in the way that all the states of the United States are bound together by the dollar. After some delay, the common currency, named the *euro*, entered into effect as of 1 January 1999, with eleven of the fifteen states then making up the European Union (but not Great Britain) as full participants. This meant that there could be no movement in the exchange rate among the currencies of the participating states, and indeed the separate currencies were eliminated in the early months of 2002. The euro itself floated against the dollar, the yen, and other currencies, including (as of mid-year 2007) the British pound. Thus elements of both a fixed rate and a floating rate system seem likely to survive, with residual influences of the gold standard as well.

2.3 The Balance of Payments

The balance of payments, it is important to bear in mind, includes much more than the balance of trade as contemplated by David Hume, Adam Smith, and even, it appears, the designers of the Bretton Woods system. The components of Patria's balance of payments include not only receipts for exports and expenditures for imports, but remittances for pensions, expenditures by troops stationed outside their own country, foreign assistance and credits, and investment across national frontiers, as well as dividends, interest, and royalties attributable to investments. Various versions of balance of payments accounting are discussed in economic literature, and changes of detail have been made in the way different countries account for their international transactions. For present purposes, the critical fact is that an outflow of funds on current account can be offset by an inflow of funds on capital accounts and vice versa.

(a) Balance of Payments Accounting Illustrated

In highly stylized fashion, Patria's balance of payments for a given year might be presented as in Tables 2.1 and 2.2 below.

One can draw a number of inferences from these figures, which would be still more accurate if some of the aggregates were broken down further. For instance we see that Patria has a merchant marine, but that it also patronizes foreign ships (line 2). It has substantial exports, but less than its imports. It has some private inward but no significant outward investments, and it receives substantial government credits.[4] Whether the statement represents a healthy economy or not cannot be told from a single year, but if the figures were compared with prior years and showed, for instance, a sharp increase in imports over the prior years, the government of Patria

[4] In fact the model is based on Colombia in 1965.

TABLE 2.1

I. Current Account ($ million)	Credit	Debit	Net
Private transactions			
1. Merchandise	550	700	
2. Freight on merchandise	25	35	
3. Trade balance (lines 1 & 2)			–160
4. Travel expenditures	15	25	
5. Income on investments (interest & dividends)		40	
6. Remittances	15	4	
7. Miscellaneous services	30	66	
8. Balance on services			–75
9. Balance on goods & services (lines 3 & 8)			–235
Governmental transactions			
10. Short-term loans	12	4	
11. Misc. receipts & repts.	5	7	
12. Current govt. trans.			+6
13. Balance on current acct. (lines 9 and 12)			–229

TABLE 2.2

II. Capital account	Credit	Debit	Net
14. Direct private investment	20		
15. Private loans (long-term)	53	12	
16. Govt. bonds (long-term)	22	8	
17. Miscellaneous	4	7	
18. Loans received by govt. and Central Bank	145	20	
19. Balance on capital acct. (lines 14 to 18)			+197
20. Balance on Current and capital acct. (basic balance) (lines 13 and 19)			–32

Adapted from Paul Host-Madsen, *Balance of Payments: Its Meaning and Uses* (IMF Pamphlet Series No. 9, 1967).

TABLE 2.3

III. Cash and Reserve Account	Credit	Debit	Net
21. Transfer of gold (export = credit)	8		
22. Foreign holdings of Patrian pesos (increase = credit)	24		
23. Patria holdings of foreign currency (increase = debit)		7	
24. Balance on cash and reserve account (lines 21 to 23)			+39
25. Errors and omissions		–7	
26. Balance (lines 20, 24, and 25)			0

might consider taking steps to stimulate exports or reduce imports—steps that might run into restraints imposed by the GATT.[5]

The most important lesson, however, from the above figures is that a comparatively large deficit on current account is largely offset by the surplus on capital account. This phenomenon explains (at least in part) why Great Britain was able for many years to cope with its current account deficit by selling off its overseas investments and repatriating the proceeds, and why the United States has been able to cope with large and continuing deficits on current account for more than three decades by attracting both direct and portfolio investment, as well as sales of US government securities (lines 14–18). Other countries, for instance Japan, experienced the opposite phenomenon—with capital outflow offsetting surpluses on current account.

While current and capital accounts may largely offset one another, it is apparent from the figures presented that there is not a perfect equality between the current and the capital accounts. For accounting purposes, there is therefore a third, offsetting account. Continuing with the figures presented above, the account might look as in Table 2.3 above.

Table 2.3 calls for some explanation. Line 21 is similar to the assumptions of David Hume. If Patria spends more than it takes in, it must transfer gold to redeem its pesos held abroad. But if its position is generally sound (and it is prepared to pay interest), foreign holders of Patrian pesos may not insist on redeeming them. In effect these foreign holders (public and private) are extending credit to Patria (line 22); conversely, reduction of Patrian holdings of foreign currencies (line 23) serves to offset the deficit in the basic balance. The fact that the accounts still do not balance—the ever-present

[5] See Ch. 3.

entry of errors and omissions—may be attributable to unreported transactions, some criminal, such as the drug trade or arms smuggling or tax avoidance, and some simply not caught by the record keepers.

(b) The Balance of Payments and the Bretton Woods Scheme

The balance of payments as presented here is consistent with the fixed exchange system as created at Bretton Woods. If the movements toward deficit in Patria's current and capital account reinforced rather than offset each other, the system stood ready to help. As set out in detail in Chapter 18, the international community was prepared to help by exchanging reserve currencies for Patrian pesos, thus extending credit to Patria—usually on medium term (lines 18 and 22). If that strategy failed, but only if it failed, were more radical steps, that is a change in the value of the Patrian peso, supposed to take place. As noted above, the assumption of the Bretton Woods fixed exchange rate system was that member states were to aim for equilibrium, that is to keep the entries shown on Table 2.3 as small as possible. Whether the obligation to strive for equilibrium applied equally to countries with a surplus in their basic balance (line 20) became an important issue—but only ambiguously part of a rule of law—in the 1970s.[6]

2.4 Some Preliminary Observations

Two observations may usefully conclude this introductory part, prior to plunging into the legal descriptions and analysis that occupy the bulk of this volume.

First, money—including foreign exchange—has turned out to be not only a medium of exchange and a storehouse of value, but an investment asset, with auctions, futures markets, derivative and index trading, and other traits that one would not associate with a unit of account. Each international transaction, public or private, is to some extent involved with exchange risk; statistics over time are less reliable than they once were; and governments are less able than they once were to govern the outcome of international transactions.

Second, in 1950 or 1965 the institutions created in the wake of World War II devoted to international finance—the International Monetary Fund and the World Bank—seemed strong not only as resource bases but as sources of law, while the agreement on trade issues—the GATT—seemed vulnerable, without a full-fledged institution, with an incomplete membership, and with a legal structure both fragile and ambiguous. At the beginning of the twenty-first century the situation is the reverse. The International

[6] See Ch. 19.

Monetary Fund no longer administers a code of conduct applicable to the major developed states, while the GATT has grown into the World Trade Organization, with enforcement powers, almost universal membership, and an agenda that has expanded well beyond trade in goods, to include services, investment, intellectual property, and perhaps competition law and the environment as well.

It seems that micromanagement, particular laws for particular problems, is becoming more sophisticated, and more representative of consensus; macro-management—that is taming the laws of economics into economic law by treaty—no longer holds the appeal that it did at the close of World War II.

Modern GATT Law

A Treatise on the Law and Political Economy of the General Agreement on Tariffs and Trade and other World Trade Organisation Agreements

Second Edition
Volume I

Professor Raj Bhala

SWEET & MAXWELL

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CHAPTER 6

Foreign Exchange Markets

SECTION I: FX MARKET PARTICIPANTS

6–001 The foreign exchange (also known as FX or Forex) market is not one single place, nor even a few locations.[1] Comprised of several over the counter (OTC) and exchange-traded instruments, it is truly global, and is the largest financial market in the world. Major FX centers include New York, London, and Tokyo, and major regional centers include Paris, Milan, Dubai, and Hong Kong, Singapore.

The FX market never sleeps. It is a 24-hour a day market (minus weekends). Trading runs from 20:15 Greenwich Mean Time (GMT) on Sunday through 22:00 GMT Friday. In other words, when trading ends in Asia, trading in Europe is just getting started.

6–002 FX market participants are diverse. They include traders, such as large banks, central banks, institutional investors, currency speculators, corporations (both multinational and local), governments, other financial institutions, and retail investors. Depending on applicable regulations (such as the United States "Volker Rule," implemented under the Dodd-Frank Act), these traders may engage in proprietary (or "prop") trading, which is to say they buy and sell currency for their own account. Or, they may trade currency for the account of a customer. Accordingly, their motivations, though at bottom (with the exception of central banks), their goal is to make money in one way or another (e.g. through profitable trades, or through fee-based income).

To say the FX market is "global" is to connote that FX traders are located around the world. They are linked by the apparatuses of information technology (IT). They negotiate, execute, clear, and settle transactions using computers, telephones, and other information channels. They operate under a set of ethical and professional standards—or, at least, are supposed to. Often, they specialise in a particular type of FX instrument. For example, different traders, each working for the same financial institution, yet focusing on a particular type of instrument, and each working on the same exchange trading floor, will enter into deals in the instrument in which they specialise.

SECTION II: SIZE OF FX MARKETS AND MOST COMMONLY TRADED CURRENCIES

6–003 Publicly available data on foreign exchange (FX) market statistics are limited. However, trading values and volumes are collected by central banks via a survey every three years for the month of April. The data are then aggregated by the Bank of International Settlements (BIS) in Basle, Switzerland.

According to a survey coordinated by the BIS, in 2010, the daily average global FX exchange turnover in all currencies was about US $4 trillion a day.[2] Compare that to a

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[1] The material discussed in this and the next several sections is draws on International Money and Capital Markets, Class Notes, February 24 and March 3, 1993, Professor Tony Cordello, New York, New York.

[2] See The Bank of International Settlements, *Triennial Central Bank Survey Report on global foreign exchange market activity in 2010*, at *http://www.bis.org/publ/rpfxf10t.pdf*.

daily average turnover of US $1.5 trillion in 1998.[3] The distinction evinces the tremendous growth in the FX market over a short period.

Compare that, too, to the Gross Domestic Product (GDP) of the American economy: roughly US $15 trillion. Manifestly, FX transactions are worth many multiples more than the output of the world's largest economy. That fact is a clue to a key motivation for FX trading. Contrary to the conventional wisdom, currencies are not bought or sold mainly to pay for imports (i.e. receive payment for exports), or to facilitate tourism. Rather, traders trade for the same reason they have since Ancient times—to make money, in this market, by dealing with one currency against another, which conceptually is no different from selling dates for spices, or silks for carpets. What is odd, to the layperson, is to think of selling or buying a currency as a "good." Indeed, as a legal matter, it is not that; rather, it is a payment versus a payment (or one electronic credit entry against another).

6–004 Also consider a comparison between the volumes of trading done on the FX market to that on the New York Stock Exchange (NYSE). In April 2010, FX daily average transaction volume was approximately US $4 trillion. The daily average NYSE turnover for the same month was approximately US $51 billion.[4] While substantial, this amount, is obviously far less than the daily volume of trading on the FX market.

Of the trillions in currency traded daily on the FX market, a large percentage of trades, approximately 90 per cent, involve US Dollars (USD). That makes the dollar the most liquid of currencies. ("Liquidity" refers to the degree to which a currency is traded and accepted as a means of payment for cross-border trade in goods, services, and intellectual property, and for cross-border financial investments.) The attractiveness of the dollar arises from the strength of the American economy, which in turn are connected to a global perception that the United States offers relatively lower levels of political, legal, and other risks than do other countries. In consequence, the dollar not only is widely traded and used as a means of payment, but also is the leading reserve currency.

6–005 Other currencies that account for significant amounts of trading include the Euro (EUR or €) and Yen (JPY or ¥), 40 per cent and 19 per cent, respectively. Prior to the introduction of the Euro, and before 1999, the German deutsche mark (DM) was represented in approximately 30 per cent of trades. Most FX market trades include one of four major currency pairs. Not surprisingly, the USD is included in each of the four pairs. The currency pairs are the EUR/USD, JPY/USD, plus CHF/USD (where "CHF" refers to the Swiss franc) and USD/GBP (that is, British pound sterling, or £, against dollar). (Note that by convention, all currencies are quoted against the United States dollar with the exception of sterling, where dollars are quoted per pound).

Section III: Post-Second World War Fixed Exchange Rate System

• *1944 Bretton Woods Conference*

6–006 The end of the Second World War marked the beginning of the modern international financial system.[5] By the end of the War, the United States had accumulated the vast majority of monetised gold in the world (partly because during the War, many countries transferred their gold to the Federal Reserve in New York to keep it from falling into the

[3] See The Bank of International Settlements, *Triennial Central Bank Survey of Foreign Exchange and Derivatives Market Activity in 1998*, at http://www.bis.org/publ/r_fx98.htm.

[4] See Daily NYSE Group Volume in NYSE Listed, 2010 at *http://www.nyxdata.com/nysedata/asp/factbook/viewer_edition.asp?mode=table&key=3141&category=3*.

[5] For excellent and detailed accounts of this period of international financial history, see *The Rules of the Global Game* (2001) and *The Rules of the Game* (1984), both by Kenneth W. Dam, and Harold James, *International Monetary Cooperation Since Bretton Woods* (1996).

hands of the Axis Powers). In contrast, most other countries, throughout Europe and Asia, suffered the near total destruction of their economies.

Planning for the post-Second World War foreign exchange regime began before hostilities ended. Understanding that a new international financial architecture was essential for post-War economic reconstruction and development, 730 delegates from all 44 Allied nations gathered at the Mount Washington Hotel in Bretton Woods, a resort town in New Hampshire, for the United Nations Monetary and Financial Conference. This meeting, commonly known as the Bretton Woods Conference, aptly named after the town it was held in, took place from July 1–22, 1944, as the War raged on.

The two leading figures at the Bretton Woods Conference were John Maynard Keynes, a well-known and highly regarded economist from Britain, and Harry Dexter White, a respected senior official at the United States Department of the Treasury. Before coming to Bretton Woods, Lord Keynes had been highly influential through his writings. In his book, *The Economic Consequences of the Peace*, published in December 1919, he argued powerfully that the cause of another world war (following the Armistice that ended the First World War on November 11, 1918) would be the extremely heavy, vindictive reparation payments that Germany was forced to pay under the 1919 Treaty of Versailles. Keynes wrote:

> "Carthaginian peace is not practically right or possible ... You cannot restore Central Europe to 1870 without setting up such strains in the European structure and letting loose human and spiritual forces as ... will overwhelm not only you and your 'guarantees,' but your institutions and the existing order of your society."[6]

6–007 Unfortunately, Keynes' arguments proved true when the Nazis were elected to power in Germany. Of course, Keynes also was renowned for his 1936 book, *The General Theory of Employment, Interest, and Money*, in which he articulated fiscal policies to deal with recession and depression. Interestingly, Keynes also made millions through his personal investments in the foreign exchange market. In brief, he was well positioned to help design a new international financial architecture. Given Keynes' background, it is easy to understand his influence at Bretton Woods. Even though 44 nations participated in the conference and eventually signed the Bretton Woods Agreement, its terms resulted primarily from negotiations between him and White.

The negotiation strategy of Keynes and the British team derived from arguments previously developed by Keynes regarding the Carthaginian peace terms, specifically, the reparation payments, which had been imposed on Germany after the First World War. Keynes was successful in persuading the Allies of the Second World War that exacting reparations from the vanquished was not in the self-interest of the victors. The Bretton Woods Conference participants appreciated that the Second World War occurred in part because the victorious parties in the First World War had mismanaged the peace. The victors had adhered to the principle that in war, the loser must compensate the winner, hence the need for German reparation payments. But, reparation payments were a seed for hyperinflation in the Weimar Republic. Hyperinflation undermined the savings of ordinary Germans, created bitter resentment among them, and rendered them vulnerable to extreme nationalist ideology. To put into perspective the hyperinflation, around 1918, at the end of the First World War, US $1 could be exchanged for DM 8. In November 1923, at the height of hyperinflation, when the price of goods changed hourly, US $1 could be exchanged for DM 4.2 trillion.

In addition to rejecting the previously failed system of reparation payments, the Bretton Woods Conference participants also recognised the existing financial markets were too independent of one another, when in fact they were likely to become increasingly interdependent in the post-Second World War era. They believed countries could better revive

[6] See *John Maynard Keynes, The Economic Consequences of the Peace* (1919) (New York, New York: Harcourt, Brace, and Howe, Inc., January 1920).

their economies through stable linkages with one another, and mutual assistance, rather than through financial, investment, and trade autarky.

- ***Goals of Liquidity and Stability and Operation of Bretton Woods System***

6–008 This recent pre-Second World War History profoundly shaped the key goals on which Bretton Woods Conference participants agreed for a post-Second World War international financial system: liquidity and stability. First, a key concept behind the Bretton Woods design for a new international financial system was the one that underlies the modern (but now defunct) European Monetary System (EMS): liquidity. Keynes realised a problem of the 1920s was the gold standard, or rather the strict and rigid application of the gold standard. In 1924, the central banks of the United Kingdom and United States implemented the gold standard. That was not the first time either country had done so. In 1900, the United States passed the Gold Standard Act, essentially replacing the bimetallism system (a monetary standard consisting of two metals, especially gold and silver, in a fixed ratio of value) with a true gold standard. However, after passage of the Act, the United States did not adhere to the gold standard permanently, but rather implemented and suspended it a number of times. For example, like other countries, the United States suspended the gold standard (twice) during the First World War, until re-implementing it in 1924.

The move to implement the gold standard by both America and Britain in 1924 proved disastrous. In Britain, the country faced deflation, unemployment, and strikes. Furthermore, implementation caused crashes in various asset markets, because of competing devaluations. While initially the decision to return to the gold standard was generally popular, and, indeed, championed by Winston Churchill, it was not popular with Keynes. In response to the move, Keynes wrote, *The Economic Consequences of Mr Churchill*,[7] arguing the return to the gold standard at the pre-War parity in 1925 would lead to a world depression. The Great Depression verified Keynes point.

6–009 Another fact that bothered Keynes was the availability of gold. In the short term, the quantity of gold in the world is fixed. In the medium and long terms, the supply of gold is dictated by factors completely unrelated to economic activity. What determines the supply of gold in the world is mining in Russia, South Africa, and other resource-rich countries. Therefore, the supply of gold expands and contracts without reference to the level of economic output or employment. Such fluctuations could lead to instability in currency valuations tied to gold—hence the second goal of the Conference, stability.

Thus, given the recent pre-Second World War history, participants at the Bretton Woods Conference set two goals:

1) Provide sufficient monetary liquidity, and avoid a rigid link to the gold standard.
2) Provide stability in exchange rates, and avoid wanton revaluations and devaluations.

- ***Operation of Bretton Woods System and Role of Gold***

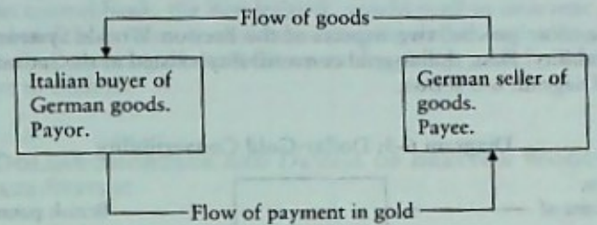
In respect of the first goal, liquidity, in 1944, Keynes argued the international medium of exchange is not gold, but the US dollar. At the time, there was no other hard, freely convertible currency besides the greenback.

6–010 As noted, before the Second World War, gold was a medium of exchange for international transactions. Under the gold standard, if an individual in Italy bought goods from an individual in Germany, the German would accept payment in gold. The German would not accept payment in Italian *lira*, because in 1944 the Italian economy had collapsed and there were foreign exchange restrictions. On the other hand, gold always was

[7] See *John Maynard Keynes, The Economic Consequences of Mr. Churchill* (1925).

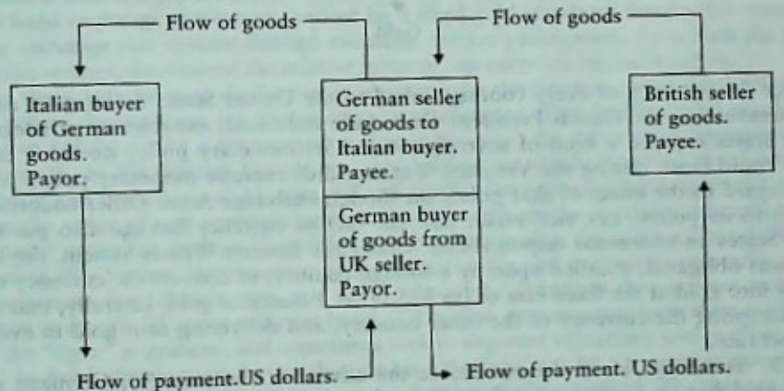
accepted. Thus, one meaning of the term "gold standard" arose in the context of the settlement of international transactions, where only gold was accepted as a means of payment for trade in goods, as Diagram 6-1 shows.

Diagram 6-1: Gold as a Means of Payment



But once again, gold does not expand or contract according to the level of economic activity. Thus, Keynes proposed that everyone accept dollars. By accepting dollars, transactions would improve, and instead of only a two-party transaction (outlined above), trade could be facilitated between three or more parties, as Diagram 6-2 demonstrates.

Diagram 6-2: Dollars as a Means of Payment



Ultimately, the United States dollar became the international medium of exchange, and the first goal of the Bretton Woods Conference was realised.

Nevertheless, human beings have never been able to ignore gold. The second goal of the Conference, stability, referred to stabilizing foreign exchange rates. Gold was used as the anchor to provide that stability.

6–011 After the Second World War, the United States had large gold reserves. As noted earlier, that was because as the armies of the Axis Powers conquered country after country in the early years of the War, those countries sent their gold to America for safekeeping. While Fort Knox, Kentucky, is a renowned gold depositary, it is actually the Federal Reserve Bank of New York that holds the largest deposit of monetised gold in the world. Those deposits—the actual gold bricks—are segregated in country-specific sections in a highly protected vault against which there has never been a successful theft attempt.

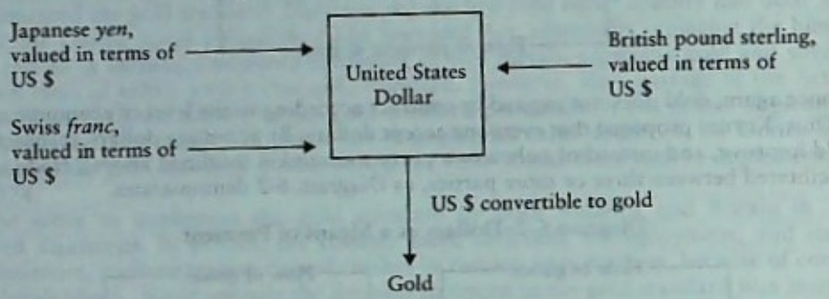
Under the Bretton Woods System, gold was used to buttress the United Stataes dollar as the medium of exchange, and in turn provide stability for exchange rates that priced one currency in terms of another currency. That is, each country in the System valued its

currency in terms of the dollar, and the dollar was backed by gold. So, for example, the exchange rate of Japanese *yen* to dollars could be set at 200 *yen* per dollar.

For holders of *yen*, what certainty and predictability did they have that the value of their *yen* would not erode over time, perhaps because of inflation in the United States? In a word, gold. They could rely on the ultimate convertibility of *yen* into gold at a set rate.

6–012 To be more precise, two aspects of the Bretton Woods System contributed to exchange rate stability. First, dollar-gold convertibility existed at the set rate of US $35.00 per 1 ounce, as Diagram 6-3 shows.

Diagram 6-3: Dollar-Gold Convertibility

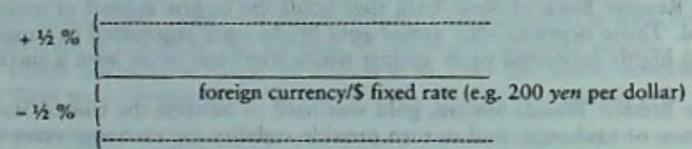


The fact the currency of every country linked to the United States dollar gave America an enormous (or, as French President De Gaulle indicated, exorbitant) privilege. The United States enjoyed a kind of sovereignty over its monetary policy no other country had. It could (and, during the Vietnam War era, did) exercise monetary policy without much regard to the effect of that policy on foreign exchange rates. Other countries had to react to its policy, not vice versa. But, the fact of currency linkage also put on the United States an enormous responsibility. Under the Bretton Woods System, the United States was obligated, if called upon by a foreign country, to convert the currency of that country into gold at the fixed rate of US $35.00 = 1 ounce of gold. Literally, that would mean accepting the currency of the other country, and delivering to it gold in exchange at the set rate.

6–013 For example, in the era before the advent of the euro (€), Germany would accept the dollar (in exchange for their *Deutsche marks* (DM)) to the point it felt it had a sufficient number of dollars. Then, if Germany felt "flooded" with dollars, it could convert their dollars to gold at a rate of US $35.00 = 1 ounce.

Currency bands were the second aspect of the Bretton Woods System that contributed to stability. The bands were set at one-half per cent above and below the exchange rate of the currency in question against the United States dollar. The bands created flexibility for exchange rate movements, but only fluctuations of one-half per cent above or below the agreed-upon fixed rate versus the dollar. Diagram 6-4 depicts a band:

Diagram 6-4: One-Half Percent Currency Fluctuation



If the currency of any country fluctuated beyond the one-half per cent bands, either up or down, then country was required, by virtue of the *Bretton Woods Agreement*, to implement macroeconomic measures to get its currency back within the band.

For example, in the pre-euro era, if the German *mark* fluctuated outside of the band, say by appreciating in value against the dollar above the one-half per cent upper bound, then the German central bank, the Bundesbank, would need to intervene to get the mark back within the band. Intervention would mean buying dollars and selling *marks*. That, in turn, would entail a loosening of domestic monetary policy, namely, an increased supply of marks relative to dollars.

Section IV: Dollar Shortage and Demise of Bretton Woods Fixed Exchange Rate System

- *Overview*

6–014 The Bretton Wood System of fixed exchange rates lasted from 1944 to 12.00 Eastern Standard Time (EST) on August 15, 1971. At that moment, per order of President Richard M. Nixon, the "gold window" was closed. Technically, President Nixon suspended the convertibility of foreign currencies into gold. Later in 1971, the United States officially devalued the peg to US $38 = 1 ounce of gold, and in 1973 did so again to US$ 42 per ounce of gold. These watershed events marked an historical shift in the foreign exchange (FX) regime: gone was the old fixed exchange rate system backed by a fixed gold standard; thereinafter was a new floating exchange rate system. Foreign exchange market participants, from both the private and public sectors, determined the relative value of one currency against another.

Note, then, an important distinction in terminology: devaluation (or its opposite, revaluation) versus depreciation (or its opposite, appreciation). Devaluation (and revaluation) refer to an official act by a government to lower (or raise) the value of its currency against a benchmark. In the Bretton Woods era, devaluation (or revaluation) occurred under the auspices of the International Monetary Fund (IMF). Depreciation (and appreciation) is a drop in the value of one currency against another wrought by market participants. That could occur under the Bretton Woods System, but only within the currency band. With the collapse of that System, depreciation (or appreciation) is and everyday occurrence. For all hard currencies (e.g. dollars, *yen*, and euro), almost by definition they are not technically restricted to an official upper or lower band. (Of course, governments have their preferences about the "right" alignment, and sometimes seek to engineer valuations within those preferences.) In brief, devaluation (or revaluation) is an official act by a sovereign government, whereas depreciation (or appreciation) is a market-based phenomenon. The two are related, in that one can lead to another, and there can be successive iterations of that occurring.

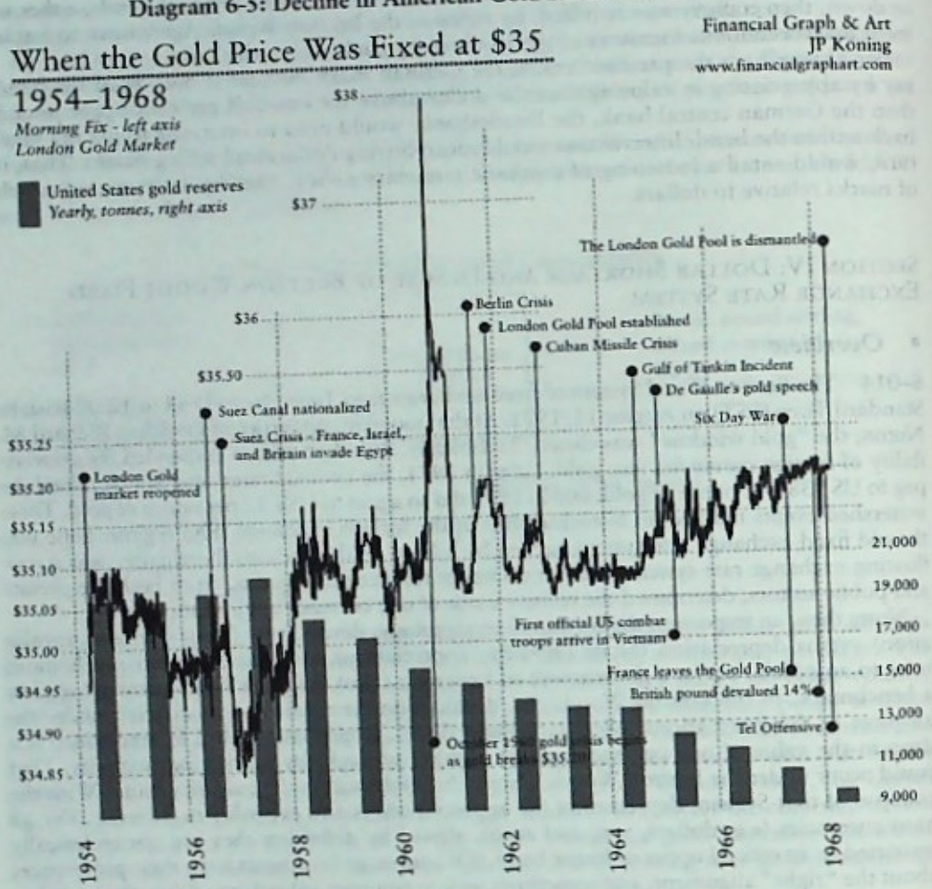
- *Explanation of Events*

6–015 To be more specific, the roots of the demise of the Bretton Woods System lie in part in the inherent inflexibility of its link to gold. While the rate of $35.00 to 1 ounce of gold was different in value and circumstances than the pre-1944 gold standard, it was a link nonetheless. The dollar was backed by gold and, so it was thought, was acceptable only because of such backing.

Consequently, the Bretton Woods System centered on the dollar. Ideally (especially from a monetarist economic perspective), the money supply should grow commensurate with increases in economic activity (e.g. the supply of dollars should expand in proportion to the increase in American Gross Domestic Product (GDP)). However, in the 1940s and 1950s, there was concern regarding a shortage of the dollar. World economic activity grew, but the dollar did not keep pace.

A dollar shortage occurs when a country lacks a sufficient supply of dollars for use in international trade, particularly to pay for imports invoiced in dollars. A country can accumulate

Diagram 6-5: Decline in American Gold Reserves (1954–68)[8]



dollars by exporting more goods than it imports. However, many countries are net importers and, therefore, do not accumulate a substantial amount of dollars through their balance of payments (BOP) activities. Hence, in the first few decades after the Second World War, if a country had a critical dollar shortage, it requested assistance from the United States government for temporary liquidity. In that way, the United States became banker to the world. Between 1947 and 1958, the United States encouraged an outflow of dollars, and ran a BOP deficit, with the intent of providing liquidity for the international economy.

6–016 By the 1960s, the concern regarding a dollar shortage subsided. The United States had become a net exporter of dollars by virtue of lending. In fact, the world became flooded with dollars, and the alleviation of one concern, the dollar shortage, created a new concern, a dollar surplus. Countries became skeptical as to whether their dollars could be converted to gold at the rate of US $35.00 to 1 ounce of gold. Some countries indeed did make this conversion. They did not create a "run" on gold, but by the end of the 1960s, the United States gold stock reached dangerously low levels. Diagram 6-5 depicts the decline in American gold reserves between 1954 and 1968, and correlates them with major events in the international

[8] This Diagram is from John Paul Koning, *The Losing Battle to Fix Gold at $35*, Ludwig Von Mises Institute, February 18, 2012, at *http://mises.org/daily/3325*.

political economy. The low levels were a source of financial fragility, because foreign holders of dollars might at any time start a "run on" United States gold reserves.

The high levels of United States dollars in the global economy were the result of two different phenomena. First, the United States ran a BOP deficit. It did so to provide liquidity to the international economy, and also to finance its war machine during the Vietnam War era (November 1, 1955 to April 30, 1975). Second, offshore lending of Eurodollars developed and evolved. A "Eurodollar" refers to a dollar outside the United States. That is, Eurodollars are deposits denominated in dollars held at banks (whether foreign banks or foreign-based branches of American banks) located outside of the United States, and thus not under the jurisdiction (for lack of a better word) of the Federal Reserve. Hence, Eurodollar lending refers to loans made outside the United States denominated in dollars that themselves are located offshore.

6–017 First, consider the United States BOP deficit. In BOP accounting, Country A records the payments and receipts of all transactions entered into with Country B, and vice versa. When all transactions are accounted for, the payments and receipts between Country A and B must be equal, there cannot be disequilibrium. (In practice, statistical errors and omissions are listed to assure the equilibrium.) Excesses of payments (outflows) or receipts (inflows) create inequalities called deficits or surpluses. For example the key features of the United States BOP are depicted in Table 6-1:

Table 6-1: Key Features of United States BOP in 1940s and 1950s

Inflow of dollars into United States:	Outflow of dollars from United States:
Balance of Trade (BOT) surplus.	Lending deficit.
There was a continual inflow of United States dollars from Europe, because Europeans bought goods from the United States. The inflow caused a huge balance of trade surplus for the United States relative to Europe.	Dollars flowed out of the United States because of lending. The United States ran a huge deficit in terms of lending.

Today, and for many prior years, the situation is reversed. Table 6-2 depicts the reversal. The United States has a BOT deficit and a lending surplus. Once again, the shift from surplus to deficit began during the Vietnam War era. The United States had what French President Charles De Gaulle called the "exorbitant privilege." Because foreign exporters would accept dollars as payment for goods and services the United States bought and imported, the United States government could keep printing money. And, it did. Inflationary pressures were not the only result. The global market was flooded with dollars.

To reverse the BOP deficit, the United States endeavoured to curtail lending, and thereby stop the flow of dollars out of the United States. In 1965, it implemented the Voluntary Foreign Credit Restraint Program (VFRC). The specific goal of the program was to limit foreign lending by United States banks. However, banks were able to maneuver easily around the new restriction by making loans in dollars to foreign entities from their European branches—i.e. Eurodollar lending.

For example, if a Japanese client sought a dollar-denominated loan from Citibank, that bank would provide the loan to the client from its Tokyo-based branch, not its New York branch. Here, then, is a classic case of an unintended effect of regulatory and economic policy. Between 1964 and 1973, the number of American banks with overseas branches increased from 11 to 125. The result, foreign lending by United States banks did not slow down.

Table 6-2: Key Features of United States BOP in 2000s

Inflow of dollars into United States:	Outflow of dollars from United States:
Balance of Trade (BOT) deficit.	Lending surplus.
The United States buys more foreign goods than foreigners buy American goods. In other words, the United States imports more than it exports. Therefore, dollars are sent out to pay for the imports.	Foreigners lend money to the United States.
Note that because the United States dollar is the principal reserve currency (i.e. the currency in which other countries' central banks store a significant percentage of their reserves, now that the gold standard is abolished) it is an acceptable means of payment. Americans can buy goods from Thailand and need not pay in Thai *baht*—the Thais will accept dollars.	e.g. Chinese, Gulf Arabs, and Japanese invest in United States Treasury debt.

6–018 Not surprisingly, the American BOP deficit was not reversed, and the VFRC (along with other factors) gave birth to the Eurodollar market. That market was the second reason the global economy became flooded with dollars.

Likewise, the world was still flooded with United States dollars and countries were still worried. In particular, France and the United Kingdom were concerned with inflation because of the high level of dollars in the economy. In 1967, the United Kingdom once again devaluated the pound. In May of that same year, there was a revolution in France. Thus, both France and the United Kingdom converted their dollars into gold. The argument was the countries were facing a huge increase in the global supply of US dollars, but there was no similar increase in the supply of gold. Therefore, the countries believed it was not possible for the United States to continue to convert dollars to gold at the rate of US $35.00 to 1 ounce of gold.

6–019 As an increasing number of countries fell in line with the thinking of France and the United Kingdom, the United States closed its gold window. On August 15, 1971 President Nixon announced that effective immediately, dollars were no longer convertible to gold. The result was the price of gold skyrocketed. However, aside from an increase in the price of gold, nothing else happened. This came as a shock, as people worried that without the gold standard there would be nothing to back the dollar.

Nonetheless, there were actually two entities supporting the dollar after the gold window was closed, the size of the United States economy and the intrinsic strength of the United States government.

Section V: Enduring Impact of Bretton Woods System

6–020 The period of the Bretton Woods System, less than three decades, was but a blip in the history of international finance. Yet, during that period countries in North America, Western Europe, and East Asia enjoyed unprecedented economic growth amidst considerable political tension and change—the Cold War and decolonisation, respectively. Moreover, the System lives on through its institutions and inspiration.

- ***Bretton Woods Institutions***

The key institution of the Bretton Woods System, the IMF, remains. No longer is it the central administrator of a fixed exchange rate system. But, it is the preeminent forum in which to discuss actual or perceived exchange rate misalignments. And, its monitoring and surveillance reports are widely read by governments and the private sector.

The IMF came into existence on December 27, 1945 when 29 countries signed the *Articles of Agreement*. Today the organisation is composed of 188 member countries. The IMF was originally established with the purpose of assisting governments in maintaining the value of their currency within the one-half per cent band. Over the years, the work of the IMF has shifted away from assisting governments in maintaining their currencies to a broader mission: ". . .foster global monetary cooperation, secure financial stability, facilitate international trade, promote high employment and sustainable economic growth, and reduce poverty around the world."[9]

6–021 Originally, back in 1945, in order to assist governments in maintaining currency valuations, the IMF established a Fund. The Fund was supported by each member country through a donation made to the organisation. At the time, the Fund totaled about US $6 billion. Therefore, if a country went outside the one-half per cent band, the IMF would provide it with short-term liquidity (a loan) until the country took the necessary macroeconomic steps to stabilise its currency rate. In 1947, France was the first country to borrow from the IMF.

A key problem in the design of the IMF Fund was member countries were required to make their donations to the organisation in United States dollars. Because of the economic devastation wrought by the Second World War, few countries had dollars on hand they could contribute. In comparison, the United States had an embarrassment of riches.[10]

6–022 In 1978, with the end of the Bretton Woods System, the movement away from the gold standard, and the adoption of a floating exchange rate regime, the IMF amended its *Articles of Agreement*. The Fund no longer assisted countries in maintaining their currencies within a fixed band, but rather oversaw, and commented and reported on, individual exchange rate policies of its member states.

- ***Bretton Woods Inspiration***

Regarding the enduring example of the Bretton Woods System, consider the European Monetary System (EMS). It is similar to the Bretton Woods System, minus the gold convertibility feature. With the collapse of the Bretton Woods System, most countries in the European Economic Community (EEC) agreed to maintain stable exchange rates by preventing exchange rate fluctuations of more than 2.25 per cent above or below parity. Parity was defined in terms of a basket of currencies that did not include the United States dollar. In the early 1990s, the EMS was strained due to varying individual economic policies and conditions in the EEC. In 1993, a forced widening of the band to 15

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[9] See generally, International Monetary Fund at *http://www.imf.org/external/about.htm*.

[10] Indeed, the United States established what was known as the "52/20 Club." For 52 weeks, every American soldier received US $20. This was done to inject liquidity into the domestic market. While it was obvious the United States was not struggling, it was equally obvious other countries were. Furthermore, it was soon apparent that hardship abroad would negatively affect the American economy. With foreign countries economically devastated, there were no foreign markets for American goods. If American goods were not being purchased abroad, the United States would inevitably suffer as well. The answer to the problem was the Marshall Plan, implemented in 1948–49. In effect, the Marshall Plan was the "52/20 Club" on an international level.

Through the Marshall Plan, the United States gave US $6 billion to Europe to pump liquidity into the economies of the European countries. In turn, Europeans got the money the needed to buy American goods, which helped the United States economy. With the aid of the Plan, Europe recovered steadily through the 1950s.

per cent occurred. In brief, as an inspiration, the lasting influence of the Bretton Woods System was manifest in the EMS. The EMS itself ended in May 1998, supplanted by the European Exchange Rate Mechanism (ERM), and ultimately by the euro (€) on January 1, 1999.[11]

Section VI: Contemporary FX Rate Regimes

6–023 Currently, there are three basic FX rate regimes: (1) floating, (2) managed, and (3) fixed. The currencies of nearly all countries are exchanged for the currencies of other countries within one of these paradigms.[12]

A pure floating exchange rate regime allows for the value of the currency of a country to fluctuate according to the forces of supply and demand in the foreign exchange market. In other words, there is no intervention from the government in valuing its currency. Without intervention, floating exchange rates automatically adjust, based on relative supply and demand pressures, enabling a country to reduce the impact of shocks and foreign business cycles. Also, a floating exchange rate regime (at least in theory) preempts an unwanted balance of payments (BOP) crisis.

Graph 6-1 depicts an example, namely, the spot foreign exchange market for United States dollars against the Indian *rupee*. (By convention, the pricing is *rupees* per dollar.) The demand curve reflects the demand for dollars against rupees, while the supply curve depicts the supply of dollars relative to rupees. Graph 6-1 shows a shift outward in the supply of dollars, reflecting (for example) successive rounds of quantitative easing by the Federal Reserve that followed the September 2008 financial crisis and subsequent economic slump.

6–024 Therefore, with floating rates, a higher demand for a currency relative to another currency leads to an appreciation (increase in value) of the first against the second currency. Likewise, low demand leads to depreciation (loss of value) in the relative value of the first against the second currency. Finally, a floating exchange rate increases FX volatility. Volatility is problematic in small or less developed countries, because of potential threats to the stability of their domestic financial system.

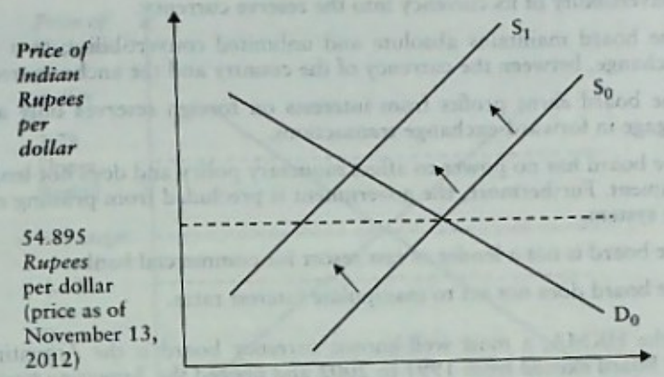
Today, the majority of the currencies of the world are floating. These currencies include the United States dollar, euro, Norwegian *krone*, Japanese *yen*, the British pound sterling, the Swiss *franc*, Australian dollar, and Canadian dollar. The last currency, also known as the "loony," most closely resembles an ideal float. The Central Bank of Canada has not interfered with the price of the Canadian dollar since 1998.

6–025 While these currencies adhere to a floating exchange rate regime, it is critical to understand these systems are not *pure* floats. Occasionally, countries intervene directly or indirectly to affect the relative value of their currencies. For example, in 1985 representatives of the Group of Five (G-5)—France, Japan, the United Kingdom, United States, and West Germany—met at the Plaza Hotel in New York City. They made a concerted effort to depreciate the American dollar in relation to the Japanese *yen* and German *deutschemark* by intervening in currency markets. In the two years following the signing of the

[11] The European Monetary Union (EMU) began on January 1, 1999. On the same date, the *euro* began being used in international transactions and on financial markets. However, the various national currencies of EMU countries circulated for three more years, until January 1, 2002, when the *euro* became available as a new hard currency. The 11 EMU countries that first adopted the *euro* included Austria, Belgium, Finland, France, Germany, Ireland, Italy, Luxemburg, The Netherlands, Portugal, and Spain. On July 1, 2002, the national currencies of the 11 countries were withdrawn from circulation.

[12] See Weerapana Akila, Associate Professor, Department of Economics, Wellesley College, *Lecture Notes*, at *http://www.wellesley.edu/Economics/weerapana/econ213/econ213pdf/lecture%20213-05.pdf*.

Graph 6-1: Dollar – *Rupee* Spot FX Market



agreement, the dollar fell more than 30 per cent. Hence, the Plaza Accord was seen as a success.

When the G-5 countries met again, this time in Paris, and with the addition of Canada, it was February 1987. The countries gathered to sign the Louvre Accord. This new Accord halted the decline of the dollar and stabilised international currency markets. The Plaza and Louvre Accords indicate that even the American foreign exchange rate regime is not truly a pure floating one. Rather, a managed system, (or put colloquially) dirty float.

A pure floating system has associated with it the possibility of instability and, therefore, uncertainty. Their opposites, stability and certainty, are two reasons a fixed exchange rate regime might be preferable, and why such a regime is attractive for businesses engaged in international transactions. But, the problem is maintaining a fixed exchange rate in the post-Bretton Woods era. After all, the Bretton Woods System was a fixed exchange rate system, and most countries operated under such a regime prior to its demise in the 1970s.

6–026 In a fixed exchange rate system, the Central Bank exchanges local and foreign currency at a pre-determined price. This price is strictly fixed. Therefore, the Central Bank must have adequate reserves of both domestic and foreign currencies. Most foreign reserves are held in dollars, euros, or Japanese *yen*, and a few other hard currencies. The foreign reserve against which the currency of a country is pegged also is called the anchor currency. The dollar is the quintessential, but not ubiquitous, anchor.

Furthermore, currency boards, found in some fixed exchange rate economies, require the Central Bank to back the entirety of its domestic currency supply with foreign currency reserves. In other words, there must be sufficient reserves to convert every unit of domestic currency to foreign currency. An example of a currency board is the Hong Kong Monetary Authority (HKMA), introduced in 1983. The Hong Kong dollar is pegged to the United States dollar. Notably, the HKMA is perhaps the most successful example of a currency board. Despite heavy pressure during the 1997–99 Asian Financial Crisis, it maintained a rate of approximately 7.8 Hong Kong dollars for every United States dollar.

6–027 In general, a currency board adheres to the following rules:[13]

[13] See *Currency Board*, Wikipedia, at *http://www.en.wikipedia.org/wiki/Currency_board*.

1) The board must hold sufficient foreign currency reserves to ensure 100 per cent convertibility of its currency into the reserve currency.
2) The board maintains absolute and unlimited convertibility, at a fixed rate of exchange, between the currency of the country and the anchor currency.
3) The board earns profits from interests on foreign reserves only and does not engage in forward-exchange transactions.
4) The board has no power to affect monetary policy and does not lend to the government. Furthermore, the government is precluded from printing money under the system.
5) The board is not a lender of last resort for commercial banks.
6) The board does not act to manipulate interest rates.

Along with the HKMA, a most well-known currency board is the Argentine Currency Board.[14] The Board existed from 1991 to 2002 and pegged the Argentine *peso* against the United States dollar. Argentina initiated a fixed exchange system to fight hyperinflation and stimulate economic growth.Its Currency Board successfully cut inflation from 3,000 per cent in 1989 to 3.4 per cent in 1994. However, there were failures in the system. Unemployment increased sharply, wage rates declined, and government debt grew. Furthermore, throughout its life Argentine Currency Board violated the general rules for currency boards. Given these failures and mounting internal political pressures, the Currency Board abandoned the peg. The Argentine *peso* was allowed to float freely, and as a result quickly depreciated.

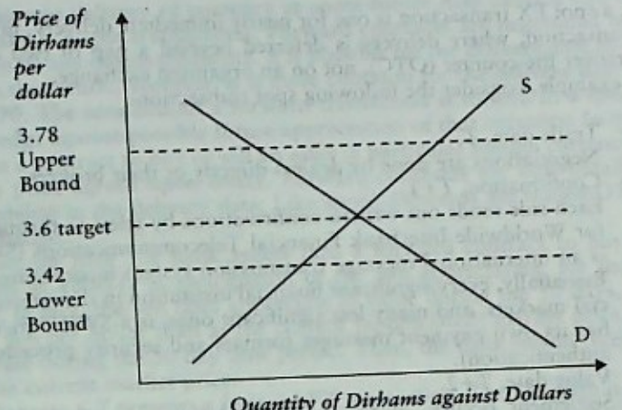
6–028 Whether a country has a currency board or not, in the fixed system, supply and demand still exits, similar to a floating exchange system. However, theoretically, in the fixed system, shifts in supply and demand do not affect the price of currency. That is, such shifts in supply and demand do not cause the currency to appreciate or depreciate as they would in a floating system. Therefore, when market forces do not value the price of the currency of a country, then the Central Bank of that country must absorb excess supply and demand. So, it is the Central Bank that buys or sells the currency of its country to counter-act market forces, and thereby maintain the fixed exchange rate.

Finally, a managed exchange system is a hybrid of the floating and fixed exchange. In such a system, the Central Bank of the country is a key player in the FX market. While there is no single set value for the currency in a managed exchange, neither is the market allowed to determine freely the value of the currency. Rather, the Central Bank has a determined target value or target range for the currency. It intervenes in the market by buying and selling currency (both domestic and foreign) to keep the exchange rate as close to the implicit value or target value as possible. Typically, this target value may be defined as a range with upper and lower boundaries, or bands.

Graph 6-2 sets out a hypothetical currency band based on the linking by the Central Bank of the United Arab Emirates of *dirhams* to the United States dollar. By assumption, the target rate set by that Central Bank is 3.6 *dirhams* per dollar. The Central Bank permits fluctuation of 10 per cent, that is, five per cent above and below that target, between 3.42 and 3.78 *dirhams* per dollar. It stands ready to intervene, i.e. buy or sell dirhams against dollars, to keep the dirham within that band.

[14] See *Argentine Currency Board*, Wikipedia, at, *http://www.en.wikipedia.org/wiki/Argentine_Currency_Board*.

Graph 6-2: Hypothetical *Dirham*– Dollar Currency Band



Section VII: Overview of FX Instruments

6–029 What types of FX instruments are traded, and how and where are they traded? As explained earlier, any FX transaction is part for part, delivery of one currency against another currency. In effect, it is a payment for a payment. (It is not a sale of goods for a price, and thus does not trigger sales of goods law, such as Uniform Commercial Code Article 2.) "Delivery" means the exchange of the funds being traded, almost always by electronic funds (wire) transfer.[15]

That is, delivery is the crediting of the account of the counterparty for the amount of the counter-value. Thus, while delivery may be physical (i.e. in cash), that is rare. Nearly invariably, delivery is effected through electronic debit and credit entries from the account of the originator of a payment with its bank (the originator's bank), through the international banking system (e.g. one or more intermediary banks), for the benefit of the account of beneficiary held at the beneficiary's bank.

- *Spots*

The two basic types of FX transactions are "spot" and "forward." Both transactions are straightforward and important, but as between the two of them, spots are more prominent. In 2010, the average daily turnover of global FX spot transactions was approximately US $1.5 trillion, accounting for 37.4 per cent of all FX transactions.[16]

6–030 Participants in a spot transaction agree to buy and sellone foreign currency against another at the present market value, i.e. the exchange rate for those two currencies. Further, they agree to settle the transaction in a matter of days (usually one, two, or three days). The standard settlement timeframe is *T*+2days (where T = trade date). There are exceptions to this standard T+2 settlement. Examples include the spot market for United States dollars and Canadian dollars (i.e. USD/CAD) and United States dollars against Mexican pesos (i.e. USD/MXN). Both settle on *T*+1day. Settlement on *T*+1 is

[15] See generally Ernest T. Patrikis, Thomas C. Baxter, Jr. & Raj Bhala, *Wire Transfers* (Chicago, Illinois: Irwin/Probus, 1993) (discussing wire transfers of dollars and the legal rules governing them).
[16] *Triennial Central Bank Survey of Foreign Exchange and Derivatives Market Activity in 2010*, Bank for International Settlements, (September 17, 2011), at *http://www.bis.org/publ/rpfxf10t.pdf*.

also called "tomnext," which means "tomorrow/next day," i.e. the day after the trade date, *T*.

Therefore, a spot FX transaction is one for nearly immediate delivery, unlike a forward or futures transaction, where delivery is deferred beyond a gap of two days. Spot FX trading occursover-the-counter (OTC), not on an organised exchange.

By way of example, consider the following spot transaction:

Day 1 = Trade date, *T*.
Negotiations are done by dealers directly or their brokers.

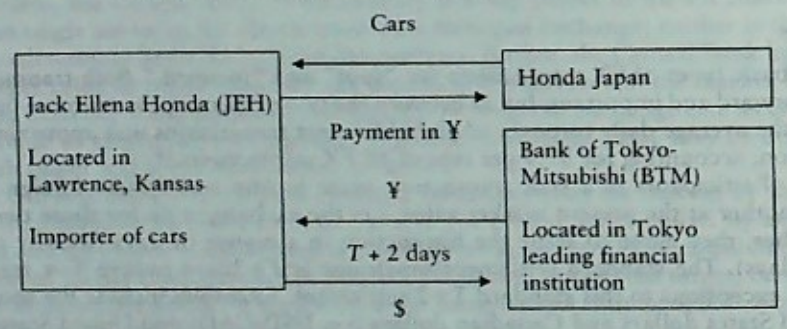
Day 2 = Confirmation, *T*+1.
Each side sends out written confirmations by telex or through the Society for Worldwide Interbank Financial Telecommunications (SWIFT), which is an international message transmission system incorporated in Belgium. Essentially, every significant financial institution in the international financial markets, and many less significant ones, is a SWIFT member. SWIFT has its own payment messages formats and security procedures (message authentication).

Day 3 = Value date, *T*+2.
Settlement occurs, in the sense of delivery of the traded currencies. Delivery is by electronic credit entries in the appropriate bank accounts. Accordingly, *T*+2 is the "value date," because it is the day on which value (the currencies) is exchanged.

6–031 A spot transaction can be quoted in either currency, but will always include two sides. The first currency listed in the transaction is the base currency, while the second listed currency is the counter currency. For example, if a spot transaction is shown as USD/JPY 100, then for every 1 United States dollar (the base currency) sold a party receives 100 Japanese *yen* (the counter currency). Diagram 6-6 depicts an hypothetical spot USD/JPY transaction.

As discussed further below, there is settlement or *Herstatt* risk associated with spot transactions. This risk refers to the possibility one party to a spot deal has delivered the currency it is obligated to deliver to the counterparty, but before it receives delivery of the currency to which it is entitled, the counterparty fails. In other words, the first party has paid out, but not been paid.

Diagram 6-6: Hypothetical Spot FX Transaction



6–032 In the hypothetical, JEH in Lawrence, Kansas buys cars from Honda of Japan to sell to its clients in the Midwest. The producer-exporter, Honda of Japan, needs to be paid in *yen*. To acquire *yen*, JEH enters into a spot transaction with BTM to receive *yen* in exchange for dollars. This transaction occur over a period of three days (*T* for the trade date, *T*+1 for confirmation, and *T*+2 for exchange of value), and the currency will be traded at present (*T*) market value.

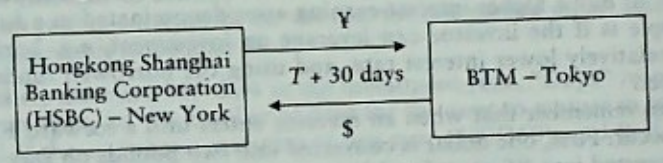
- ***Forwards***

"Forward" connotes delivery of currency at some future date beyond two days (as two days would make it a spot transaction). Forward contracts are negotiated on Day 1 (*T*), but delivery can be any day in the future. It is possible for the delivery date to be as lengthy as five years in the future. However, it is more common for the delivery date to be *T*+30, *T*+60, or *T*+90. The idea behind a forward transaction is to lock in a specific currency rate so as to hedge against possible future appreciation of that currency. In other words, a forward deal is a contract to buy or sell an asset (a particular foreign currency) on a future date, but at a price agreed upon today. Forward contracts are individually negotiated, hence the flexibility in the delivery date. Like spots, forwards are traded OTC, not on an organised exchange.

For example, on June 1 a bank enters into a forward contract to buy the requisite amount of *yen* at ¥80/$1, in anticipation of the *yen* appreciating, for delivery on July 1, (*T*+30). If, in fact, the *yen* does appreciate in value during the 30 days, the bank will receive more *yen* per dollar than at the current (appreciated) market price. It is true *yen* could depreciate during the 30 day time period. Then, the bank would receive less*yen* per dollar than the current market price.

6–033 Diagram 6-7 presents a forward FX transaction. The Diagram is similar to that for a spot deal, with the exception of the delivery date, which occurs further into the future for a forward than for a spot.

Diagram 6-7: Hypothetical Forward FX Transaction

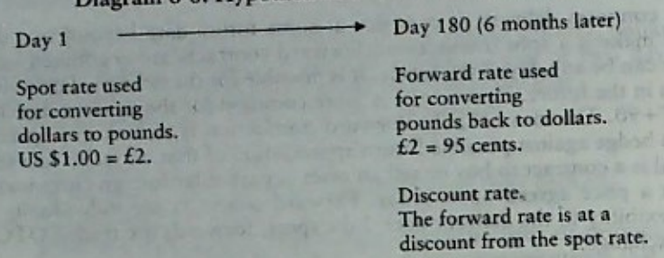


Forwards involve settlement risk, or *Herstatt* risk, because there is a spot deal executed as part of the transaction. Forwards also involve credit risk and market risk. (Both are discussed in further detail below.) As to credit risk, if a counterparty to a forward FX deal fails to make its obligatory payment, then the remaining (and presumably solvent) party must go out and find a second counterparty (to replace the one that failed to make its obligatory currency payment). That second counterparty entails credit risk, as it might not make payment. As to market risk, FX rates may have moved against the remaining bank, if and when it needs to replace its first counterparty that failed to make payment with a second counterparty.

Forward contracts also differ from spot deals in that they involve a forward rate. The forward foreign exchange rate is the rate that neutralises interest differentials. Forward rates will be at a premium or discount. Interest rates determine forward rates, because they reflect the time value of money. During the pendency of a forward FX contract (e.g. 90 days), each of the two currencies involved in the contract can be invested in an interest-bearing asset denominated in the relevant currency.

6–034 For example, assume interest rates are 5 per cent in the United States and 10 per cent in the United Kingdom. Obviously, there is a 5 per cent interest rate differential (IRD) in favour of the holder of a British asset. (The IRD is the difference in interest rate between two currencies in a pair.) Assume the spot rate of dollars to pounds is US $1.00 = £2. The spot rate must have an economic impact such that the holder of an interest-earning asset in the United Kingdom loses 5 per cent. To achieve such an impact, the spot rate must take 5 per cent away from the investor converting from dollars to pounds. The investor gets fewer dollars for the same amount of pounds. Assume the British investor has £2. This investor must lose 5 per cent, hence it must get 95 cents in return.

Diagram 6-8: Hypothetical Forward FX Transaction



On day 1, the investor takes US $1.00 and converts it at the spot rate to receive £2. Six months later, on Day 180, the investor will take £2 and convert it at the forward rate, receiving US $0.95. Therefore, there is no incentive to engage in the transaction if the investor is seeking to earn a return based on the interest rate differential: the forward rate wipes out that differential.

6–035 In that sense, it might be said "money does not follow interest rates." However, that would be an overstatement. Money indeed does follow interest rates, at least under certain circumstances. For example, for reasons of market imperfections, the forward rate for a particular currency may be mispriced temporarily. Investors may see that a particular forward rate does not wipe out an interest rate differential, and seize on an opportunity to buy a higher interest-earning asset denominated in a foreign currency. Another example is if the investor can leverage an investment, e.g. borrowing foreign currency at a relatively lower interest rate, and using the borrowed funds to invest in a high-return asset.

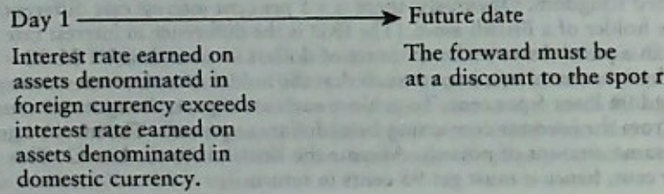
It is critical to remember that when an investor enters into a forward FX deal on Day 1, two events occur: First, one dollar is converted into two pounds on Day 1. Second, two pounds are converted into 95 cents for delivery six months hence. Therefore, the investor gains 5 per cent over six months on the IRD (10 per cent in the United Kingdom versus 5 per cent in the United States). But, the investor loses 5 per cent (5 cents) on the forward conversion. The forward rate exactly neutralises the IRD.

6–036 These concepts can be put generally into the following statements about the relationship between interest rates, IRDs, and the forward rate:

1) "Interest rate premium means forward discount"

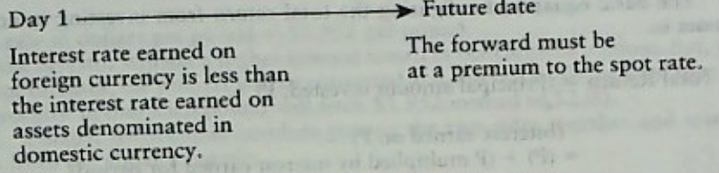
On Day 1, suppose the spot rate is quoted at $1.00 = £2 and IRD is 5 percent in favor of pound-denominated assets. Then, the forward rate is quoted at a discount. This scenario is the same as the earlier example, with an IRD of 5 percent (10 percent in the United Kingdom and 5 percent in the United States).

When the interest rate in the foreign currency is at a premium, then the forward rate for that foreign currency must trade at a discount from the spot rate, namely, 95 cents per two pounds. It is that discount that wipes out the potential gain from the IRD.



2) "Interest rate discount means forward premium"

When the interest rate in the foreign currency is at a discount, then the forward rate is at a premium. Here, the potential loss incurred from a lower interest rate in the foreign currency is offset by a gain from the forward rate. This scenario would exist if spot rate is $1.00 = £2 and IRD is 5 percent in favor of dollar-denominated assets (10 percent in the United States and 5 percent in the United Kingdom). The forward rate would be a premium over the spot rate of 105 cents per two pounds.



Generally, a forward FX rate can be calculated using a simple formula.
Assume:

"a" = currency of country A
"b" = currency of country B
"i" = interest rate
"ia" = interest rate in currency A, i.e. the interest rate earned on an asset denominated in the currency of country A.
"ib" = interest rate in currency B, i.e. the interest rate earned on an asset denominated in the currency of country B.

6–037 Further, there are 360 days in the investment year. "Days" refers to the maturity period for an asset, i.e. the number of days for the asset to mature in total.

Days equal 1 if the asset has a maturity of one year (360/360), and ½ if the asset has a maturity of six months (180/360).

With those assumptions, the formula is:

$$\text{Forward Rate} = \text{Spot rate} \cdot \left(\frac{1 + \text{ia}\frac{(\text{days})}{360}}{1 + \text{ib}\frac{(\text{days})}{360}} \right)$$

Or, expressed in an intuitively easy fashion, via algebraic manipulation, the right-hand side denominator may be brought to the left-hand side:

6–038 The first term tells what return and investor will earn if the investor takes United States dollars, converts them into a foreign currency, invests them in an asset denominated in the foreign currency for a fixed period, and then converts the principal and interest earned back to dollars at the end of the fixed maturity period.

$$(\text{Forward rate}) \cdot \left(1 + \left(\frac{\text{ib}(\text{days})}{360}\right)\right) = (\text{Spot rate}) \cdot \left(1 + \left(\frac{\text{ia}(\text{days})}{360}\right)\right)$$

The second term tells the investor what its total return will be if it invests United States dollars in an interest-bearing American asset.

The logic behind the formula can be understood by working from first principles.
Assume:

1) All exchange rates are expressed in dollars per pound.
2) The spot rate is £1 = US $2.00.
3) The investment period is six months (180 days).
4) The interest rate in the United States is 5 per cent.
5) The interest rate in the United Kingdom is 10 per cent.

6–039 The basic equation for figuring the total return from investing in an interest earning asset is:

$$\begin{aligned}\text{Total Return} &= (\text{Principal amount invested, P}) \\ &\quad + \\ &\quad (\text{Interest earned on P}) \\ &= (\text{P}) + (\text{P multiplied by interest earned for period}) \\ &= (\text{P}) + \left(\text{P}\cdot(\text{i})\cdot\frac{(\text{days})}{360}\right) \\ &= (\text{P}) + \left(1 + 1\cdot(\text{i})\cdot\frac{(\text{days})}{360}\right)\end{aligned}$$

(In the last step, P is factored out and put in front of the entire expression.)

Suppose an investor has £1, therefore P = 1 pound. The one pound is invested at 10 per cent for 180 days. The investment will earn:

$$\begin{aligned}\text{Total Return} &= 1 + \left(1\cdot(0.10)\cdot\left(\frac{180}{360}\right)\right) \\ &= 1 + 0.05 \\ &= 1.05\end{aligned}$$

At the end of 180 days, the investor will have one pound and five pence. (Observe this formula is the same as the denominator in the earlier formula.)

6–040 At the end of 180 days, the investorcan convert the 1.05 pounds back into dollars at the forward rate. What is the dollar value of 1.05 pounds in six months?

$$\begin{aligned}\text{Dollar value} &= (\text{Forward rate})\cdot(1.05\text{ pounds}) \\ &= \frac{(\text{Dollars})}{(\text{Pounds})}\cdot(1.05\text{ pounds})\end{aligned}$$

To solve, consider the alternative investment. Instead of investing 1 pound at 10 per cent, the alternative is investing US $82.00 at 5 per cent:

$$\begin{aligned}\text{Total Return} &= \text{US \$2.00} + \left(\text{US \$2.00} \times 0.05 \times \frac{180}{360}\right) \\ &= \text{US \$2.00} + (0.05) \\ &= \text{US \$2.05}\end{aligned}$$

(Notice this formula is the numerator in the earlier formula.)

The forward rate will be the rate that sets these two amounts equal to each other. The

equality reflects the fact arbitrageurs eliminate profitable opportunities from interest rate differentials, i.e. market imperfection does not persist.

$$\frac{(\text{Dollars})}{(\text{Pounds})}\cdot(1.05\text{ pounds}) = \text{US \$2.05}$$

$$\frac{(\text{Dollars})}{(\text{Pounds})} = \frac{\text{US \$2.05}}{1.05\text{ pounds}}$$

Forward rate in dollars per pound = $1.952 per pound.

Thus, the investor will get a higher interest return in the United Kingdom. But, when the investment matures, the pounds will be converted at a less favorable forward rate. The rate is less favorable in that each pound will fetch $1.952 instead of $2.00.

6–041 Finally, the formula involves putting the two sides together and inserting the numbers from the above example:

$$\text{Forward rate}\cdot\left(£1 + \cdot\left(£1\cdot(0.10)\frac{180}{360}\right)\right) = \text{US \$2.00}\cdot\left(1 + \left(1\cdot(0.05)\frac{180}{360}\right)\right)$$

(in dollars per pound)

$$(\text{Forward rate})\cdot(1.05) = \$2.00\cdot(1.025)$$

$$\text{Forward rate} = \frac{\$2.05}{(1.05)}$$

= US $1.952 per pound.

- *Futures*

Futures emerged on May 16, 1972 as a financial innovation to facilitate foreign trading and investing. Futures were first traded on the International Monetary Market (IMM), an entity of the Chicago Mercantile Exchange (CME). Recall the demise of the Bretton Woods System occurred in the 1970s. The creation of futures exchanges was in part in anticipation of the impending shift to the floating FX regime.[17]

A futures contract is a standardised contract between two parties to buy or sell an asset at a price agreed upon today (the futures or strike price). Delivery and payment are specified for a future date. That much is the same as a forward contract (though physical delivery on a futures FX contract is rare).

6–042 However, there are four main differences between a forward and futures contract:

1) Where they are traded:
   Forwards are traded OTC. Futures are traded on an exchange.
2) Individually negotiated versus Standardised contracts:
   Forwards are individually negotiated contracts between parties and, therefore, can be tailored to the needs of the parties. Futures are standardised contracts that specify amount, quote the price in minimum increments, identify the nature and quality of the deliverable asset, set maturity and delivery dates, and define the delivery process.
3) Payment flows:

[17] See Tim Weithers, *Foreign exchange: A Practical Guide to the FX markets* 129–132 (Hoboken, New Jersey: John Wiley & Sons, Inc., 2006).

Forwards, because they are OTC, do not require the buyer or seller to provide a collateral deposit for the transaction. Futures are traded on an exchange. So, it is actually the exchange, acting as a counterparty to both the buyer and seller (and because the exchange trusts neither the buyer, nor the seller, whereas both buyer and seller trust the exchange) that requires both parties to the transaction to "post margin." Margin is a collateral deposit that protects against the buyer or seller going bankrupt before the deal is settled. Therefore, exchanges(and clearing houses) in a futures deals assume the credit risk associated with each trade and ensure performance of the contract.[18] The difference in payment flows means in a forward, each party is exposed to the other (counterparty exposure), whereas for futures, the exposure lies with the exchange (and clearing house), i.e. the exchange is exposed to each party. (There is the possibility of exchange (or clearing house) failure, hence each party bears exchange (and clearing house) exposure. A variety of regulatory mechanisms are designed to minimise this risk.)

4) Delivery:
The majority of forward contracts result in *actual* delivery of the asset (i.e. the foreign currencies being exchanged). The majority of futures contracts are closed prior to the agreed upon settlement date. The result is no physical delivery of the asset.

- *Options*

An FX option, or currency option, contract gives the owner the right, but not the obligation, to exchange money denominated in one currency into another currency at a pre-agreed exchange rate on or before some datein the future. Most options trading is done OTC. There are two types of options: call options and put options.

1) A call option gives the owner (i.e. holder of the option) the right, but not the obligation, to buy, or call, a specified amount of an underlying asset at a fixed price (strike price or exercise price), on or before a set date in the future (expiration date or expiry). The owner buys that asset—foreign currency—from the seller (or writer) of the option.

2) A put option gives the owner (i.e. holder of the option) the right, but not the obligation, to sell, or put, a specified amount of an underlying asset at a fixed price (strike price or exercise price), on or before a set date in the future (expiration date or expiry). The owner sells that asset—foreign currency—to the seller (or writer) of the option.

6–043 For example, suppose Jack Ellena Honda (JEH) anticipates, but is not sure, of a booming demand for Hondas on December 1, and is also concerned the *yen* will appreciate relative to the US dollar by December 1. JEH has to import Hondas from Japan, and must pay the producer-exporter of the vehicles in Japan, i.e. Honda in Japan, for those cars in *yen*. Yet, JEH sells those Hondas in Kansas in dollars. That creates an income statement mismatch: its expenditure is in *yen*, but its revenue is in dollars. The concern of JEH is the *yen* might appreciate relative to the dollar, so its expenditures would rise.

So, to hedge this FX rusk, JEH can purchase a call option for *yen* from the Bank of Tokyo-Mitsubishi (BTM). BTM is the seller of the option, i.e. it writes the call option contract that JEH buys.

[18] A prominent exchange is the Chicago Mercantile Exchange (CME), also called "the Chicago Merc" or "the Merc." The CME, or any exchange, is in effect, the buyer to the seller and the seller to the buyer in every trade conducted through the exchange. In October 2012, the CME Group FX exchange volume averaged 709,000 contracts per day. See *http://www.cmegroup.com*.

Under this contract, JEH has the right, but not the obligation, to buy *yen* from BTM at the strike price. JEH will exercise the option if that option is "in the money," meaning the strike price allows JEH to get *yen* (to pay for the Hondas it imports from Japan) at a price denominated in dollars that is cheaper than the spot market price of *yen* against dollars.

6–044 In contrast, suppose JEH anticipates, but is not sure, of a booming demand for Hondas in Kansas on December 1, and concerned the *yen* will depreciate relative to the dollar by December 1. Here JEH faces the opposite income statement mismatch: its *yen*-denominated expenditures will fall, while its dollar-denominated revenues will rise. If that depreciation occurs, then JEH would be happy, as it were, because the cost of the vehicles falls (That is because JEH need not convert as many dollars into *yen* as before, as each dollar is worth more *yen* than before precisely because *yen* have depreciated against the dollar).

Might JEH be able to profit from *yen* depreciation via a put option contract? Suppose JEH enters into a put option contract with BTM, which is the writer of that contract. Then, JEH will be entitled to sell *yen* against dollars at a higher-than-spot-market price, if yen does depreciate against the dollar. BTM would lose money on the option, but JEH would have gained in the sense of selling an asset (*yen*) at a price higher than its spot market value. Of course, this particular hedge assumes JEH has sufficient *yen* in its account both to pay for the Hondas, and to sell to BTM.

A simple way to remember the difference between FX calls and puts is to think in terms of currency optimists versus pessimists. Buying FX calls is for optimists: they believe the spot market value of the currency of their option contract is going to rise, so they seek to lock in a cheaper value by buying a call option now.The writer of the call option has the diametric opposite view of the future direction of the spot market: it thinks the value of the relevant currency will fall, so the option will never be "in the money," and thus go unexercised, allowing it to pocket the fee from selling the option.

6–045 Conversely, buying FX puts is for pessimists: they believe the spot market value of the currency of their option contract is going to fall. So, they seek to lock in a higher sales price for that currency by buying a put option now. Again, the writer of the put option has the diametric opposite view of the future direction of the spot market: it thinks the value of the relevant currency will rise. The writer of the put believes the option never will enter into the money, and thus go unexercised, leaving it with the fee from selling the option.

- *Currency Swaps*

A currency swap is a transaction that involves the exchange of principal and interest of a loan in one currency for an equal loan in another currency. Typically, Party A makes payments in currency B, in exchange for Party B making payments in currency A. Currency swaps are traded OTC and serve to minimise foreign borrowing costs and hedge exposure to exchange rate risk. They are motivated by comparative advantage.

That is, Parties A and B face a balance sheet mismatch. Party A gets revenues from an asset denominated in currency A (e.g. an account or note receivable), but has a liability (e.g. an account or note payable) in currency B. Conversely, Party B earns revenues from an asset denominated in currency B, but bears a liability in currency A. To rectify the mismatch, the two Parties literally swap their payment obligations. Part A pays the liability of Party B, which is denominated in currency A. Then, the asset and liability of Party A is matched: both are in currency A. Likewise, Party B pays the liability of Party A, which is denominated in currency B. Then, the asset and liability are in the same currency, namely, B.

6–046 There are a number of motivations for entering into a currency swap, in addition to matching currency flows. Moreover, swaps are available for use by both sovereign and private entities. So, a party might enter into a currency swap:

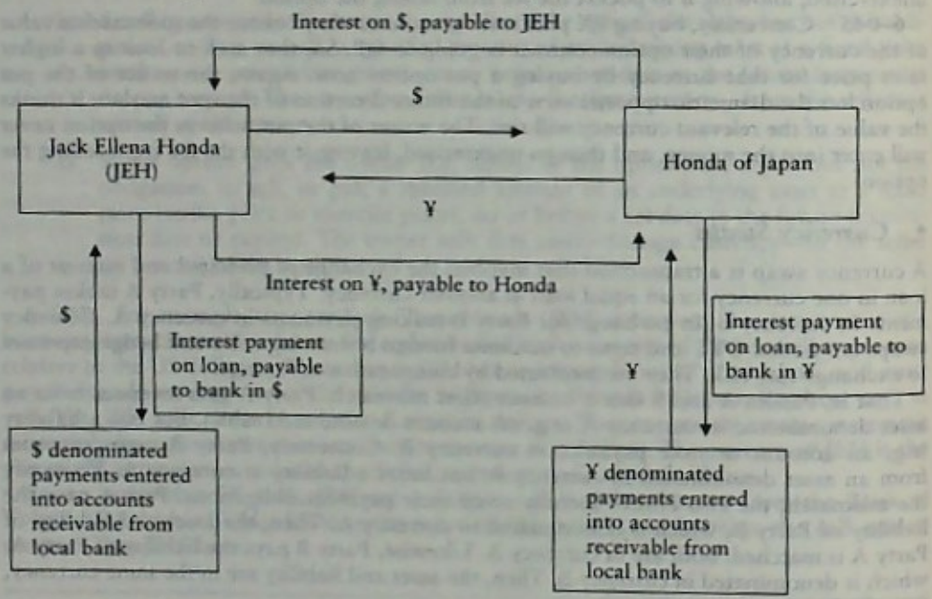
- to benefit from its better credit rating in a foreign market;
- to change a loan from one currency to another;
- to change cash flow into or out of a foreign currency;
- to hedge against exchange rate changes affect a loan;
- to use proceeds of a loan denominated in one country's currency to meet currency needs in another county; or
- to avoid capital or currency exchange controls in a particular country.[19]

For example, consider again the possibility of a currency swap between JEH and Honda of Japan.

JEH could send United States dollars that it borrowed to Honda. Honda could, in turn, send *yen* it borrowed to JEH. JEH would have borrowed dollars at the lowest possible rate, but needs to pay principal and interest in *yen* to Honda for vehicles. By getting *yen* from Honda, it matches this *yen*-based payment obligation. Likewise, Hondawould have borrowed *yen* at the lowest possible rate, but has an obligation to pay principal and interest in dollars. By getting dollars from JEH, Honda matches this dollar-based payment obligation. Diagram 6-9 shows these flows.

6–047 Note that in a currency swap, the interest rates are fixed. Interest rate swaps involve exchanging fixed for floating interest rate payments. To be sure, there exist cross-currency interest rate swaps, which combine the features of both a currency swap and an interest rate swap.

Diagram 6-9: Hypothetical Currency Swap FX Transaction



[19] Jerold A. Friedland, *Understanding International Business and Financial Transactions* 27 3rd edn (Newark, New Jersey: LexisNexis, 2010).

An influential institution in the OTC derivatives market is the International Swaps and Derivatives Association (ISDA).[20] Headquartered in New York, ISDA offices also has offices in Washington, DC, London, Hong Kong, Tokyo, Brussels, and Singapore. ISDA has over 840 members including regional banks, governments, corporations, law firms, exchanges, clearinghouses, and asset managers located around the world. The mission of ISDA is to facilitate risk management for users of derivative products, such as currency swaps. It functions as a kind of self-regulatory organisation (SRO).

6–048 To help manage credit and legal risk, ISDA publishes a Master Agreement, which is used by parties dealing in any of the asset classes in the OTC derivative market. Indeed, the Agreement is the most commonly used master contract for OTC derivative transactions in the world. ISDA last updated the Master Agreement in 2002 (the 2002 ISDA Master Agreement, or 2002 Agreement). The Master Agreement sets standard terms that apply to all transactions entered into between two parties. Therefore, new terms do not need to be re-negotiated each time the parties enter into a new transaction as the existing terms automatically apply.

There are two versions of the Master Agreement. One is for parties transacting in the same currency and located in the same jurisdiction. The other is for parties transacting in multiple currencies, located in different jurisdictions. The entire contract consists of the master agreement, schedule, confirmations, definitions, and credit support annex.

Section VIII: Correspondent Relationships and Clearing and Settlement

6–049 Recall there is no single or central FX marketplace. This decentralisation means the process of clearing and settling foreign currencies, which is important in all markets, is a challenge in FX markets. The process must be objective, promote market efficiency, and mitigate risk. But, how can these goals be achieved when there is no single market location and, therefore, no single clearing and settlement service? The answer is there exists a kind of "centralised decentralisation" of clearing and settlement services, which are (in theory, at least) well capitalised and regulated.

While clearing and settling usually go hand-in-hand, technically they are two distinct steps in the overall process of finalizing an FX transaction. Clearing is a pre-settlement activity. It is the transfer and confirmation of information between a payer and payee. Settlement is the actual transfer of funds (usually via electronic funds transfer) between the financial institution of the payer and financial institution of the payee. Settlement discharges the obligation of the payer's financial institution to the payee's financial institution in regard to the payment order. Final settlement is unconditional and irrevocable.[21]

Today, the parties involved in an FX trade usually do not clear and settle transactions bilaterally. That is because of the direct and indirect risk involved in clearing and settlement (such as *Herstatt* risk, discussed below). Rather, clearing houses handle these processes. Clearing houses are organizations that act as a third party in FX contracts. On a daily basis, clearing houses net the daily trades of their member, and require the members to post collateral. Clearing houses also centralise trade reporting, thereby increasing transparency on OTC derivatives markets.

6–050 There is currently no single central clearing house for the foreign exchange market. However, there is a push, lead by United States through the Dodd-Frank Act July 2010 [22], to centralise clearing for FX instruments classified as swaps.[23] Three of the

[20] See ISDA, at *http://www.ISDA.org*.
[21] See *Clearing and Settlement*, at *http://www.credfinrisk.com/clearing.html*.
[22] See *Dodd-Frank Wall Street Reform and Consumer Protection Act*, Public Law 111-203, H.R. 4173 (111th Congress), (July 21, 2010).
[23] See Tom Osborn, *Clearing Houses Move Their FX Pieces Into Place*, *Financial News* (November 29,

larger and more prominent clearing houses include LCH. Clearnet, CME Group, and Inter Continental Exchange.

Following clearing, settlement is often conducted through a standard payment versus payment system (PvP). In a PvP settlement, the payment instructions of both parties are settled simultaneously, thereby reducing *Herstatt* risk (which arises whenever there is a gap between settlement of one obligation against another). Today, the CLS Group (formerly Continuous Linked Settlement) is the market-standard for FX settlement. CLS uses PvP through the bank accounts of CLS members, in conjunction with local real time gross settlement (RTGS), to settle FX transactions and mitigate risk.

Section IX: Electronic Trading

6–051 The early 1990s marks the beginning of modern electronic trading in the FX markets. Today, there are two major electronic inter-dealer systems, Electronic Broking Services (EBS) and Reuters 3000 Xtra. In 1993, the EBS was founded though a partnership of 15 large member banks.[24] Today, EBS is part of the London-based ICAP plc (formerly Garban-Intercapital plc), incorporated in the United Kingdom. Reuters 3000 Xtra, released in 1999, is the competitor of EBS. Reuters 3000 Xtra essentially is a continuation of previously released Reuters programs, including Equities 2000 (1987), Dealing 2000-2 or D2002-2 (1992), and 3000 Series (1996). Many of the early design features of the various Reuters programs are still used in the current 3000 Xtra system.

Early on, and to the present day, large banks dealing in (that is, buying and selling) foreign currencies for their own account or the account of customers, are the main users of EBS and Reuters 3000 Xtra. That is unsurprising, as they set up those systems. By 1998, 50 per cent of inter-dealer FX trades were conducted electronically, while the remaining trades were negotiated directly (typically via telephone). In 2011, the percentage of trades conducted using electronic trading rose to 61 per cent.

However, electronic trading is not used uniformly on a global scale. The largest percentage users of electronic FX trading are in the United Kingdom, with 80 per cent of market participants using an electronic platform. The United States follows closely behind, with 76 per cent of participants trading electronically, but only about 50 per cent of participants in the Asia-Pacific region trade FX electronically.[25]

6–052 In general outline form, operationally, trading that does not occur electronically is arranged through direct negotiations between parties. Once they have agreed upon a price and quantity for their transaction, each party places orders to execute their deal with the appropriate department in their institution. For example, each party will issue an instruction to its clearing and settlement department to transfer the requisite currency to a designated account of the other party, on or before the required settlement date. That transfer is almost invariably electronic, via electronic funds (wire) transfer. Each party will receive a credit to its account in return for the payment it made. Hence, the buying and selling of FX amounts to (and, indeed, as a legal matter, is), a payment-for-a-payment.

When trading occurs through EBS or Reuters 3000 Xtra, each party negotiates price and quantity terms through a computer network linking the parties. Clearing and settlement then occurs through orders executed on this network. There still needs to be wire transfers

2012), *posted at http://www.efinancialnews.com/story/2012-05-14/clearing-houses-move-their-fx-pieces-into-position.*

[24] As of April 2006, when ICAP bought EBS, reportedly there were 14 shareholders. See *http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aP0F29oTaQ0w&refer=europe. ICAP paid upwards of U.S. $825 million in cash and shares for EBS.* See generally.

[25] See Armstrong, James, *Electronic Trade Improving* FX, Traders Magazine Online News, (May 14, 2012), at *http://www.tradersmagazine.com/news/greenwich-foreign-exchange-110011-1.html?pg=1.*

of funds to effect the transaction. EBS and Reuters are trading platforms, providing integrated information, analysis and transaction services.

6–053 That means that EBS and Reuters do not provide clearing and settlement services. Rather, clearing and settlement is provided for by clients of EBS and Reuters, namely, Traiana Harmony.[26] Harmony is not itself a clearing house, that is, it does not provide clearing and settlement for FX trading that occurs on the EBS and Reuters platforms.

Rather, Harmony connects FX market participants (that is, buyers and sellers of FX that use the EBS and Reuters platforms for trading) to over-the-counter (OTC) clearing and settlement firms and central counterparties (CCP). There are different firms and CCPs for different FX instruments. Examples of such firms and CCPs that clear and settle foreign exchange trades are Hong Kong Exchanges and Clearing, Limited, Japan Securities Clearing Corporation, LCH.Clearnet, CME Group,IntercontinentalExchange (Ice), and Norwegian Futures and Options Clearing House.[27] This relationship between the trading platforms and clearing firms, through Harmony, automates clearing and settlement of all FX instruments, including OTC FX derivatives, thus complying with pertinent OTC regulations on OTC clearing and settlement.[28]

Overall, the transactional process described above is called Straight Through Processing (STP). STP refers to the provision of services from the start to the end of an FX transaction, i.e. the entire range of a deal: from pre-trade analytics to front-end trade execution, then to back office confirmation, then to clearing and settlement, and finally to reporting. This seamless connectivity reduces transactions costs, reduces exposure and counterparty risk, and simplifies compliance. Yet, observe there is no single clearing and settlement service provider for all FX transactions and instruments around the globe. In other words, to say FX trading occurs via STP is not to say that trading is centralised in a global sense. To the contrary, like the players in the FX market, the infrastructure supporting them remains decentralised.

Section X: Risks and Hedging

6–054 There is no lack of risk associated with FX transactions. Notwithstanding advancements in technology and the use of third party clearing houses and settlement service providers, FX market participants still encounter risk when dealing in the market. To hedge risk, market participants employ a variety of techniques, from the simple to the unimaginably complicated. For present purposes, an overview of the major types of risks and basic hedging strategies is discussed below.

• *Volatility and Arbitrage*

Volatility is defined as a statistical measure of the dispersion of returns for a given security (or market index) using the standard deviation, or variance, between returns on the same security (or market index).[29] That security can be a stock, bond, or any financial instrument. In other words, volatility refers to the amount of risk, or uncertainty, regarding the change in the value of a security. Usually, the higher the volatility, the riskier the security. High volatility means the value of a security can fluctuate dramatically, either up or down, over a short period of time. Likewise, lower volatility means the value of the security fluctuates at a steadier pace over a period of time.

[26] See generally *http://www.traiana.com.*

[27] See Credit and Finance Risk Analysis, *http://www.credfinrisk.com/clearing.html.*

[28] See *EBS and Thomson Reuters to use Traiana Harmony for OTC FX Clearing Connectivity* (September 10, 2012), at *http://www.icap.com/news-events/in-the-news/news/2012/traiana-ebs-thomson-reuters-ccp-connect.aspx.*

[29] See definition of volatility, *Investopedia*, at *http://www.investopedia.com/terms/v/volatility.asp#axzz2DeyEbb7n.*

The concept of volatility applies to a foreign currency, as it does to a security (though the causal factors are not all the same). FX volatility can occur because of political factors. For example, suppose the British Prime Minister dies unexpectedly. The value of British pound sterling (£) may depreciate against certain other currencies, such as the United States dollar. Holders of pounds (i.e. investors that are "long" pounds) will experience a diminution in the value of their pound position as denominated in dollars.

6–055 Arbitrage always implies speculation. It is defined as the simultaneous purchase and sale of an asset so as to profit from a difference (even a minor discrepancy) in the price of the assets.[30] Therefore, by exploiting the inefficiency of the market, profits are made (on the assumption they are not dwarfed by transactions costs). Because of technological advances, and the instantaneous transmission of information around much of the globe, arbitrage opportunities are fewer than they once were. That is, it is more difficult to profit from price differences in market prices, all the more so because barriers to entry and transactions costs have fallen in many markets, making it easier for more arbitrageurs to buy and sell with less associated fees. As soon as an arbitrage opportunity appears, some arbitrageur is almost sure to seize on it, and it disappears with countervailing purchase and sale pressures from that and other quick-to-follow arbitrageurs. Indeed, computer trading systems are designed to monitor price fluctuations in financial instruments. These programs recognise and act upon inefficient pricing thereby eliminating the profit opportunity quickly.

Arbitrage principles apply to the FX markets, like any other market. Interestingly, FX market fluctuations have increased dramatically since 1971 when President Nixon closed the gold window and the Bretton Woods fixed exchange rate system ended. That is, floating exchange rate regimes (of one type or another) have associated with them greater volatility, and also greater arbitrage opportunities, than do fixed rates.

- ***Currency Risk***

6–056 Currency risk, also known as "foreign exchange exposure" or "exchange rate risk" is defined as risk that arises from the change in price of one currency against another currency. For example, currency risk can be observed from the perspective of the balance sheet of an importer of goods (or, for that matter, services). Every importer operates in a particular currency. Therefore, the balance sheet of the importer always is in one currency. Diagram 6-10 shows an example of a hypothetical balance sheet of an importer.

Diagram 6-10: Balance Sheet of Importer

Assets	*Liabilities*
Assets denominated in United States dollars	Liabilities denominated in United States dollars Capital denominated in dollars. (Capital is considered a liability to the importer, because it represents an obligation owed by the importer.)

If an asset or liability that is denominated in a foreign currency is injected onto the balance sheet, then any fluctuation in the value of that foreign currency will have a direct

[30] See definition of arbitrage, *Investopedia*, at *http://www.investopedia.com/terms/a/arbitrage.asp#axzz2DeyEhb7n*.

impact on capital. That is, there will be financial consequences for the balance sheet (specifically, on capital) if an asset or liability is held in a foreign currency.

The difficulty arises because of the currency mismatch on the balance sheet: all assets (or liabilities) are denominated in dollars, whereas the news liability (or asset) is denominated in a foreign currency. Revenues (or obligations) are in dollars, but an obligation (or a revenue stream) is in a foreign currency. The importer needs to pay attention to the possibility the foreign currency appreciates (or depreciates) against the dollar.

To minimise those financial consequences, and hence minimise currency risk, there are two approaches; hedging with a forward contract and netting. (Netting is discussed below, as it relates to *Herstatt* risk.)

6–057 Generally speaking, a hedge is designed to mitigate the risk of fluctuations in the value of a currency. In respect of hedging with a forward contract, the idea is to address the aforementioned balance sheet mismatch. Hedging refers to investing in an asset to reduce the risk of adverse price movements in a different asset.[31] Hedging with a forward contract can provide protect against the risk of currency fluctuations associated with a different asset during a specified future period.

Suppose an importer acquires an asset denominated in British pounds sterling (£). To hedge the asset denominated in pounds, the importer acquires a liability denominated in pounds. Therefore, a hedge isa countervailing asset or liability. So, similar to Diagram 6-10, Diagram 6-11 assumes the importer is an American company and the balance sheet is in dollars:

Diagram 6-11: Balance Sheet of Importer

Assets	*Liabilities*
Assets denominated in United States dollars	Liabilities denominated in United States dollars Capital denominated in dollars. (Capital is considered a liability to the importer, because it represents an obligation owed by the importer.)
Inject a pound asset. For example, the importer could make a loan in pounds.	Hedge the asset denominated in pounds by receiving a loan in pounds. In other words, deliberately create a pound liability (the hedge) to offset the pound loan.

What would happen if the importer did not hedge the risk, and the sterling-dollar exchange rate fluctuated? The currency fluctuation could either help or hurt the importer.

1) Example where currency fluctuation favors the importer:
With no hedge in place, there is simply the pound-denominated asset. If the pound appreciates against the dollar, then the pound asset is (when converted into dollars) worth more. However, while the asset is more valuable, the liabilities have not changed. The corresponding balance sheet entry is an increase in capital.

[31] See definition of hedge, *Investopedia*, at *http://www.investopedia.com/terms/h/hedge.asp#axzz2E0dw9rnY*.

2) Example where currency fluctuation hurts the importer:
Again suppose no hedge is used, so there is simply the pound-denominated asset. Assume the pound depreciates against the dollar. Now, the asset (when converted to dollars) is worth less. Consequently, the overall assets of the importer are worth less. The corresponding balance sheet entry is a decrease in capital.

If the importer is sufficiently risk averse, then it will be concerned about the harmful (second) scenario, and thus will employ a hedge.

6–058 A so-called "perfect" hedge will reduce the currency risk faced by the importer to nothing (minus the cost of the hedge). With the hedge, the currency fluctuations do not matter. If the pound asset appreciates, then so does the pound liability, and there is no change to capital. Conversely, if the pound asset depreciates, then so does the pound liability, and, again, there is no change in capital.

Consider a second example of hedging involving the profit and loss statement of the importer. A profit and loss (P/L) statement is a flow statement (dynamic), whereas the balance sheet used in the example above is a stock statement (i.e. static, or snapshot, picture of the value of assets, liabilities, and capital).

6–059 Assume an importer buys a piece of equipment that will be used in production (i.e. an input). Based on the cost of input, the importer calculates the cost of output. At issue is the impact on profitability (the pricing of output) when there are possible fluctuations in the cost of an input that is denominated in a foreign currency. In this situation, a forward contract would mitigate the associated currency risk.

For example, on day one an American importer incurs a liability denominated in British pounds sterling (£). The liability is to be paid in six months, on day 180. In other words, the American importer must pay the British exporter pounds on day 180. (In general terms, an importer must pay an exporter at sometime in the future in foreign exchange.)

For the period of the financing (the period before which the importer is obliged to pay), the importer has an obligation to pay in a currency that is not its own. Therefore, on January 1, day one, the American importer incurs an obligation to pay the British exporter pounds. On June, 30, day 180, the American importer must deliver actual payment.

6–060 Prior to delivering payment to the British exporter, the American importer can hedge its foreign exchange exposure by buying an FX forward contract for pounds. If the importer does so, then it is effectively saying: "I want a price for the delivery of dollars against pounds on June 30." Therefore, on June 30, there is a spot contract. But, the exchange rate at which this is done is negotiated not on June 28 (as would be the case with a normal $T+2$ spot), but on January 1.

The above hedge, designed to deal with FX risk to profitability, may be depicted on the balance sheet of the importer. Diagram 6-12 shows that balance sheet:

Diagram 6-12: Balance Sheet of Importer

Assets	*Liabilities*
American importer has a liability on its balance sheet, namely, importer must pay a British exporter pounds in six months for an input.	Liability denominated in pounds. An obligation to pay pounds in six months for imported input.
But, the importer can put a value on that liability now, denominated in dollars. The FX forward contract allows it to do so.	A value can be put on the liability now by entering into a forward contract.

6–061 Now consider the opposite scenario: the importer does not enter into a forward hedge contract. Then, the importer does not know the value in dollars of its pound liability. The importer must wait until June 28, when it enters into a spot dollar/pound deal for settlement on June 30, to know that value.

If, in the meantime (between January 1 and June 28), the pound weakens against the dollar, the importer will be better off. That is because the pound liability is of lesser value—the importer need not convert so many dollars to obtain pounds to pay off the liability. Conversely, if the pound appreciates relative to the dollar, then the importer will have to convert additional dollars to obtain the necessary pounds to pay off the liability.

In sum, hedging is a practice about which most importers are familiar. That also is true of exporters. (Any of the above examples can be modified to show FX risk from the perspective of exporters.) While a perfect hedge is hard to achieve in practice, it is an essential element in portfolio protection by lessening the impact of negative events. Forwards are one possibility. So, too, are FX futures contracts, which are traded on an exchange.

- ***Credit and Market Risk***

6–062 Credit risk is the risk of a loss of principal, or loss of financial return, stemming from the failure of a borrower to repay a loan or otherwise fulfill a contractual obligation.[32] In other words, there is uncertainty regarding the ability of the counterparty to meet its obligations.

To manage credit risk, a firm uses a credit exposure limit for each counterparty to which it has credit exposure. For example, a bank might subject a counterparty to a credit exposure limit of US $10 million. Therefore, the counterparty could borrow up to US $10 million from the bank, but no more. Credit card companies also use credit exposure limits.

Market riskis the possibility an investor experiences losses due to factors that affect the overall performance of the financial markets.[33] It is possible for an investor to hedge against market risk. An example of market risk is a natural disaster causing a decline in the entire market. Other examples include political disorder, recessions, terrorist attacks, and changes in interest rates. If market risk is system-wide, i.e. affecting an entire financial system or economy, then it is "systemic risk."

6–063 To manage market risk, institutions use sophisticated mathematical and statistical techniques. One such risk measure is a Value at Risk (VaR) formula.[34] A VaR formula measures and quantifies a level of financial risk within a firm over a specific amount of time. Once a risk tolerance level is established, firms must ensure risks are not taken beyond the level at which the firm can absorb the loss. VaR is measured using the amount of potential loss, probability of that amount of loss, and pertinent time frame.

Credit and market risk can (and often do) co-exist in the FX context. For example, FX forwards involve both credit and market risk. With a forward there is the risk one of the parties collapses and, therefore, is unable to fulfill its contractual FX payment obligations. That is credit risk. It is coupled with the risk the remaining and presumably solvent party must find another (substitute) counterparty, but the rates have moved against the remaining party. That is market risk.

- ***Herstatt Risk***

6–064 To participate in the FX market, banks must have current accounts in the currencies in which they trade. Upon entering into an FX transaction contract, each bank

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[32] See definition of credit risk, *Investopedia*, at *http://www.investopedia.com/terms/c/creditrisk.asp#axzz2E0dw9rnY*.
[33] See definition of market risk, *Investopedia*, at http://*www.investopedia.com/terms/m/marketrisk.asp#axzz2E0dw9rnY*.
[34] See definition of Value at Risk, *Investopedia*, at *http://www.investopedia.com/terms/v/var.asp#axzz2E0dw9rnY*.

specifies specify delivery instructions. In generic terms, bank B must deliver value to bank A (e.g. United States dollars), and Bank A must deliver the counter-value (e.g. Indian *rupees*).

It is inevitable that risk is involved in the delivery and counter-delivery. Due to time zone differences (that generate discrepancies in hours of operations at the banks), one bank is likely to make a payment before the other bank makes the counter-payment. For example, in a spot sterling-dollar deal, bank A will make a payment in British pounds first, because the time in the United Kingdom is five hours ahead of the time in New York. bank B will render payment in dollars later, after the New York business day opens, at which time the business day in London is advanced, if not over.

What if, after bank A has paid the British pounds, but before bank B has paid the dollars, bank B goes "belly up"? This specific settlement risk is called "*Herstatt* risk," named after the failure of the privately held German bank, Bankhaus Herstatt.

6–065 On June 26, 1974 Bankhaus Herstatt was declared bankrupt and required to close at the end of that day. Prior to being liquidated, Bankhaus Herstatt had been active in the FX market. Specifically, Herstatt had entered into FX contracts with numerous American banks to exchange German *deutsche marks* for United States dollars. Herstatt already had received the Deutsche Marks from the American banks but, due to time-zone differences, not paid out dollars. (Settlement of *deutsche mark* transactions, occurring in Germany, came before settlement of dollars, occurring in the United States, given that the time in Germany was ahead of that in the United States.) With the closing of the bank, *Herstatt* was not able to fulfill its contractual obligation to transfer dollars. The result was substantial loss for the American banks.

- ***Mitigating Herstatt Risk***

Following the Bankhaus Herstatt incident, changes in the FX payment system were implemented to reduce risk. Such changes included extending central bank hours. For example, in December 1998 the United States Federal Reserve Banks extended the hours of the Federal Reserve Wire Network (Fedwire). Fedwire opened at 12:30, instead of 07.00 (EST), and close at 20.00 (EST). Around the same time, the Bank of Japan (BOJ) also extended the hours of the Bank of Japan Financial Network System (BOJ-NET). These time extensions are carefully calibrated to create overlap among clearing and settlement systems in different jurisdictions and time zones. So, with overlapping Fedwire and BOJ-NET hours, a bank could pay *yen* through BOJ-NET and also receive dollars from Fedwire. The bank would not have to wait for Fedwire to open to receive the dollar payment. Simply put, overlapping hours limited intra-day exposure (the period during which payment has been made but not received) to *Herstatt* risk.

An escrow account is another method used to reduce *Herstatt* risk. This old-fashioned device simply entails setting up an escrow account, which is kept in the custody of a trusted third party, the escrow agent. That agent acts as an intermediary between the two parties involved in the FX transaction (but is not itself a party to that transaction). Therefore, the parties pay funds to and receive funds directly from the escrow agent. Furthermore, the escrow agent will not release funds to a party until it has also received the necessary funds from the same party.

6–066 Netting is a third example of risk reduction. Netting is a settlement of obligations between two parties (also called bilateral settlement netting). The process effectively reduces the number of settlement transactions between the parties. Multinational corporations (MNCs) also engage in netting to reduce FX exposure at the subsidiary level.

For example, suppose one branch of an MNC is long in *yen* (i.e., it has bought *yen* and is holding the currency in an account),while another branch of the same MNC is short *yen* (i.e., it has sold *yen* and, therefore, has an obligation to deliver *yen*).Each branch of the MNC will sell its position to a single entity, possibly a netting center. The netting center then will have a long and short position in *yen*. Therefore, each subsidiary of the MNC either will receive a single payment from the netting center, or make a single payment to the netting center.[35]

Netting is a widely used technique, and can become intricate and complicated. The New York Clearing House Interbank Payments System (CHIPs), through which dollar payments are made (and then ultimately settled on Fedwire through the books of the Federal Reserve Bank of New York) entails calculation and settlement of "net net" positions.[36]

6–067 One of the more recent entities created to mitigate FX settlement risk, and also one that engages in netting, is the CLS Group, founded in 2002.[37] CLS is located in New York, but operates globally. CLS is comprised of settlement members, each of which holds one, single currency account with CLS. When members engage in an FX transaction, they submit payment instructions to CLS. CLS authenticates, matches, and maintains the payment instructions in the system until settlement date. On any given day, the CLS settlement cycle is open for only five hours, when all real time gross settlement (RTGS) systems that are part of the CLS jurisdiction also are open and able to make and receive payments. Therefore, settlement of payments for both parties of the FX transaction is simultaneous.

On the date of settlement for any given FX transaction, CLS first determines the accounts of the participating settlement members satisfy various risk management tests. With risk tests satisfied, CLS simultaneously executes the payment instructions by making either a debit or credit entry in the respective account of the Settlement members. The actions of CLS are final and irrevocable.

CLS Settlement Service also engages in multilateral payment netting. Most Settlement members enter into more than one FX trade to settle on any given day. In reality, most major banks settle hundreds or thousands of trades a day. Therefore, on a daily basis, CLS calculates the funds required from each Settlement member on a multilateral netted basis. The result is each member is required to transfer only the net amount of its payment obligation, in each currency, as opposed to the entire amount of each individual transaction that is being settled. CLS maintains an average netting efficiency of approximately 96 per cent.[38] In brief, simply by reducing drastically the number of payment transactions made, risk associated with those transactions is reduced.

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[35] For a more in-depth discussion of netting, See The New York Foreign Exchange Committee, *Guidelines for Foreign Exchange Settlement Netting*, January 1997, at *http://www.newyorkfed.org/fxc/annualreports/ar1996/guidefx.pdf*.

[36] See generally Ernest T. Patrikis, Thomas C. Baxter, Jr. & Raj Bhala, *Wire Transfers* (Chicago, Illinois: Irwin/Probus, 1993) (explaining netting on CHIPs).

[37] See generally CLS, at *http://www.cls-group.com/Pages/default.aspx*.

[38] See Wikipedia, *CLS Group*, at, *en.wikipedia.org/wiki/CLS_Group*.

Peter Van den Bossche and Werner Zdouc

The Law and Policy of the WORLD TRADE ORGANIZATION

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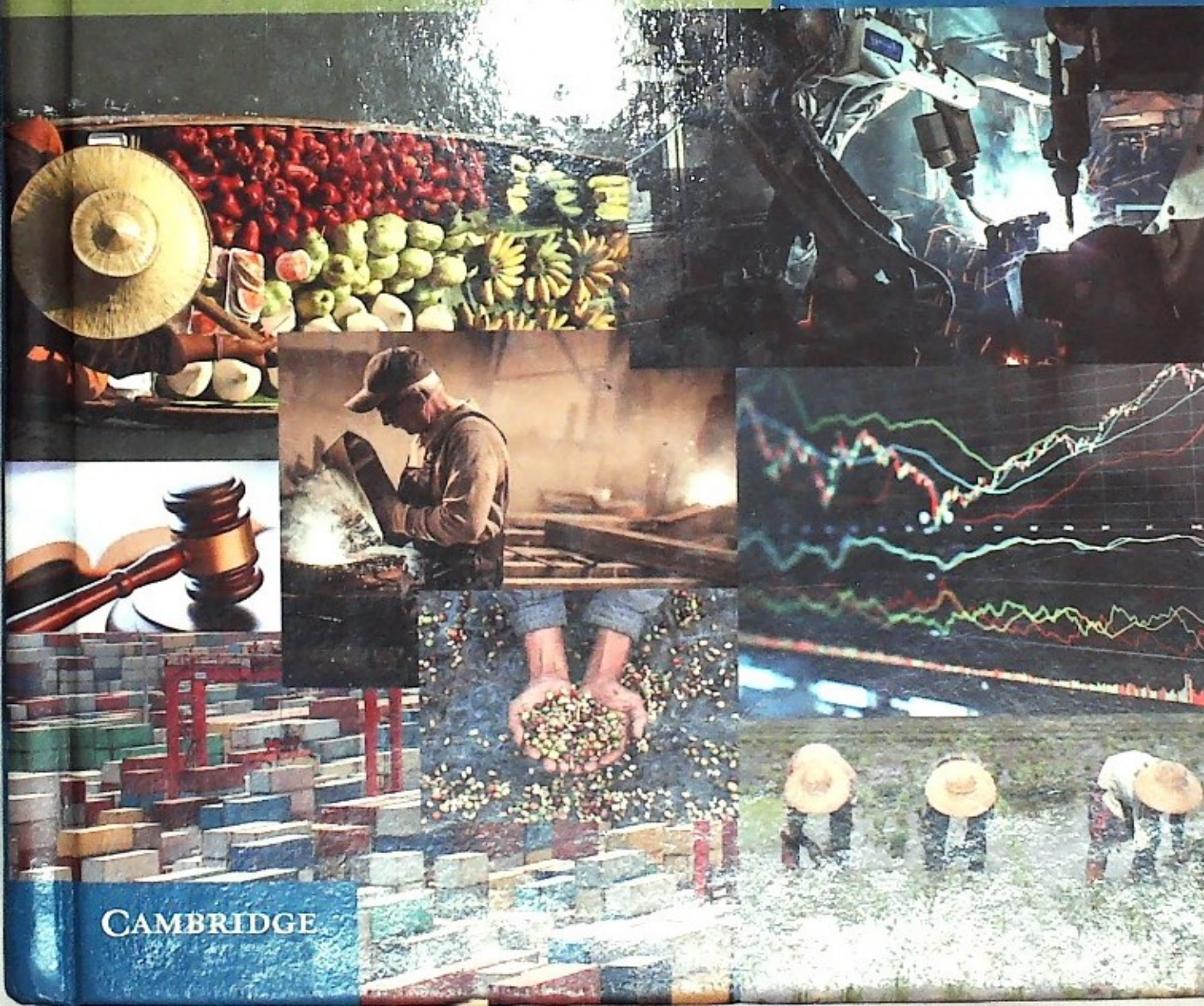

CAMBRIDGE

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1 International Trade and the Law of the WTO

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1 INTRODUCTION

On 25 September 2015, after years of intergovernmental negotiations and consultations with civil society and other stakeholders, the 193 Member States of the United Nations unanimously adopted Resolution 70/1, *Transforming our World: the 2030 Agenda for Sustainable Development*.[1] In the preamble to this Resolution, the UN Member States declared:

1 United Nations, Resolution adopted by the General Assembly on 25 September 2015, A/RES/70/1, *Transforming our world: the 2030 Agenda for Sustainable Development*.

> We are resolved to free the human race from the tyranny of poverty and want and to heal and secure our planet. We are determined to take the bold and transformative steps which are urgently needed to shift the world on to a sustainable and resilient path. As we embark on this collective journey, we pledge that no one will be left behind.[2]

Resolution 70/1 sets out a fifteen-year plan to end poverty and hunger, fight inequality and injustice, and protect our planet. This plan, the 2030 Agenda, provides for seventeen Sustainable Development Goals (SDGs), which are indivisible and balance the three dimensions of sustainable development: the economic, social and environmental.[3] The SDGs build on the Millennium Development Goals, adopted by the UN General Assembly in September 2000, and 'seek to address their unfinished business'.[4] While significant progress was made with regard to a number of Millennium Development Goals, with hundreds of millions of people emerging from poverty since 2000, billions of people continue to live in poverty and 'are denied a life of dignity'.[5] Also, there are rising inequalities within and among countries.[6] While many developing countries in Asia have made significant progress in terms of economic development and poverty reduction, most of the least-developed countries have been much less successful.[7] Also, within most countries, both developing and developed, the income gap between the rich and the rest of the population has grown markedly.[8] In its *Global Risks 2014* report, the World Economic Forum identified severe income inequality as the global risk that is most likely to manifest itself over the next ten years.[9] Such income inequality entrenches corruption and injustice, gives rise to xenophobic nationalism and religious fundamentalism, fosters political instability and leads to violence and economic destruction.

Reflecting the magnitude and nature of the challenges to be addressed, the SDGs 'go far beyond' the Millennium Development Goals.[10] As Resolution 70/1 states:

> Alongside continuing development priorities such as poverty eradication, health, education and food security and nutrition, it sets out a wide range of economic, social and environmental objectives. It also promises more peaceful and inclusive societies. It also, crucially, defines means of implementation.[11]

To achieve the SDGs by 2030, action in many different fields is needed. One of the defining features of today's world is economic globalisation and the associated

2 *Ibid.*, Preamble. 3 *Ibid.*, 14. These seventeen SDGs are further specified in 169 associated targets.
4 *Ibid.*, para. 2.
5 *Ibid.*, paras. 14 and 16. Note in 1990, 37.1 per cent of the global population (i.e. 1.95 billion people) lived in extreme poverty; in 2015 that number was down to 9.6 per cent (i.e. 702 million people). See World Bank, *Global Monitoring Report 2015/2016*, Figure 0.1.
6 United Nations, Resolution adopted by the General Assembly on 25 September 2015, A/RES/70/1, *Transforming our world: the 2030 Agenda for Sustainable Development*, para. 14.
7 See World Bank, *Global Monitoring Report 2014/15*, 22, and United Nations, *The Millennium Development Goals Report 2015*, 23.
8 See http://inequality.org/income-inequality. 9 See World Economic Forum, *Global Risks 2014*, 13.
10 United Nations, *Transforming our world: the 2030 Agenda for Sustainable Development*, para. 17.
11 *Ibid.*

high levels of international trade. The question therefore arises whether economic globalisation, in general, and international trade, in particular, can contribute to the achievement of the SDGs or whether, to the contrary, they are more likely to aggravate poverty and hunger in many developing countries and the ever-growing gap between the richest and poorest of the world.

With regard to six SDGs, Resolution 70/1 explicitly refers to the role international trade can and should play in the realisation of these goals,[12] and paragraph 68 of the resolution states:

> International trade is an engine for inclusive economic growth and poverty reduction, and contributes to the promotion of sustainable development. We will continue to promote a universal, rules-based, open, transparent, predictable, inclusive, non-discriminatory and equitable multilateral trading system under the World Trade Organization, as well as meaningful trade liberalization.[13]

This chapter deals in turn with: (1) economic globalisation and international trade; (2) the law of the WTO; (3) the sources of WTO law; and (4) WTO law in context, i.e. its relationship with other international law and national law.

2 ECONOMIC GLOBALISATION AND INTERNATIONAL TRADE

'Economic globalisation' has been a popular buzzword for many years now. Politicians, government officials, businesspeople, trade unionists, environmentalists, church leaders, public health experts, third-world activists, economists and lawyers all speak of 'economic globalisation'. This section deals with economic globalisation and international trade. It discusses: (1) the concept of 'economic globalisation' and the emergence of the global economy; (2) whether economic globalisation, the emergence of the global economy and, in particular, international trade, is a blessing or a curse; (3) what are the arguments for free trade and the arguments for restrictions on trade; and (4) whether international trade can be to the benefit of all.

2.1 Emergence of the Global Economy

Over the past three decades and as a result of the process of economic globalisation, a *global* economy has been emerging, gradually replacing the patchwork of national economies. This subsection discusses in turn: (1) the concept of 'economic globalisation'; (2) the forces driving economic globalisation and creating the global economy; (3) facts and figures on international trade and

12 These are SDG 2, 3, 8, 10, 14 and 17. See *ibid.*, 16, 17, 20, 21, 24 and 27.
13 On the role of trade in reducing poverty, see World Bank, *Global Monitoring Report 2015/16*, 20–1.

foreign direct investment; and (4) the changing nature of international trade in the global economy.

2.1.1 The Concept of 'Economic Globalisation'

The concepts of 'globalisation', and, in particular, 'economic globalisation', have been used by many to describe one of the defining features of the world in which we live. But what do these terms mean? Joseph Stiglitz, former Chief Economist of the World Bank and winner of the Nobel Prize for Economics in 2001, described the concept of globalisation in his 2002 book, *Globalization and Its Discontents*, as:

> the closer integration of the countries and peoples of the world which has been brought about by the enormous reduction of costs of transportation and communication, and the breaking down of artificial barriers to the flow of goods, services, capital, knowledge, and (to a lesser extent) people across borders.[14]

In *The Lexus and the Olive Tree: Understanding Globalisation*, Thomas Friedman, the award-winning journalist of the *New York Times*, defined 'globalisation' as follows:

> [I]t is the inexorable integration of markets, nation-states and technologies to a degree never witnessed before – in a way that is enabling individuals, corporations and nation-states to reach around the world farther, faster, deeper and cheaper than ever before, and in a way that is enabling the world to reach into individuals, corporations and nation-states farther, faster, deeper and cheaper than ever before.[15]

Economic globalisation is a multifaceted phenomenon. In essence, however, economic globalisation is the gradual integration of national economies into one borderless global economy. It encompasses both (free) international trade and (unrestricted) foreign direct investment. Economic globalisation affects people everywhere in many aspects of their daily lives. It affects their jobs, their food, their health, their education and their leisure time. Innumerable examples of how economic globalisation affects each of us could be given, ranging from the clothes we wear, the cars we drive, the movies we watch, the bananas we eat, the coffee we drink, the insurance policies we buy, the university education we get, to the smart phones we so rely on. However, to give but one example, consider the following story which featured in the *Financial Times* in August 2003, but which illustrates today's reality of economic globalisation even better than it did a decade ago:

> Clutching her side in pain, the woman with suspected appendicitis who was rushed to a hospital on the outskirts of Philadelphia last week had little time to ponder how dependent her life had become on the relentless forces of globalisation. Within minutes of her arrival at the Crozer-Chester Medical Center, the recommendation on whether to operate was being made

14 J. Stiglitz, *Globalization and Its Discontents* (Penguin, 2002), 9.
15 T. Friedman, *The Lexus and the Olive Tree: Understanding Globalisation*, 2nd edn (First Anchor Books, 2000), 9.

> by a doctor reading her computer-aided tomography (CAT) scan from a computer screen 5,800 miles away in the Middle East. Jonathan Schlakman, a Harvard-trained radiologist based in Jerusalem, is one of a new breed of skilled professionals proving that geographic distance is no obstacle to outsourcing even the highest paid jobs to overseas locations ... At present, only 35 patients' scans are transmitted each day from US emergency rooms to Dr Schlakman's small team of doctors in Israel. But with senior radiologists costing up to $300,000 a year to hire in the US and many emergency cases arriving at night, the use of medical expertise based in a different time zone and earning less than half US rates is almost certain to rise. 'It's much more expensive to use night staff in the US because they need time off the following day', says Dr Schlakman.[16]

While economic globalisation is often presented as a new phenomenon, it is worth noting that today's global economic integration is not unprecedented. During the fifty years preceding the First World War, there were also large cross-border flows of goods and capital and more economic integration than now.[17]

If one looks at the ratio of trade to GDP, Britain and France are only slightly more open to trade today than they were in 1913, while Japan is less open now than it was then.[18] However, this earlier period of economic globalisation ended abruptly in 1914 and was followed by one of the darkest periods in the history of humankind.

While today's process of economic globalisation is strong and was, at least until recently, gathering ever more strength,[19] the extent of global economic integration already achieved can be, and frequently is, exaggerated. International trade should normally force high-cost domestic producers to lower their prices and bring the prices of products and services between different countries closer together. However, large divergences in prices persist. This may be due to, *inter alia*, differences in transport costs, taxes and the efficiency of distribution networks. But this is also due to the continued existence of significant barriers to trade. Furthermore, while goods, services and capital move across borders with greater ease, restrictions on the free movement of workers, i.e. restrictions on economic migration, remain multiple and rigorous.

2.1.2 Forces Driving Economic Globalisation

It is commonly argued that economic globalisation has been driven by two main forces. The first, *technology*, makes globalisation feasible; the second, the *liberalisation* of trade and foreign direct investment, makes it happen.[20] Due to technological innovations resulting in a dramatic fall in transport, communication and computing costs, the natural barriers of time and space that separate

16 D. Roberts, E. Luce and K. Merchant, 'Service Industries Go Global', *Financial Times*, 20 August 2003.
17 Also, the Roman Empire (27 BC–476 AD) and the Chinese Song dynasty (960–1279) can be seen as (early) examples of economic globalisation.
18 'One World?', *The Economist*, 18 October 1997.
19 On the recent trend in economic globalisation, see below, pp. 6–11.
20 See also M. Wolf, 'Global Opportunities', *Financial Times*, 6 May 1997.

national economies have been coming down. As noted by Thomas Friedman in his 2005 book, *The World Is Flat: A Brief History of the Globalized World in the Twenty-First Century*:

> Clearly, it is now possible for more people than ever to collaborate and compete in real time with more other people on more different kinds of work from more different corners of the planet and on more equal footing than at any previous time in the history of the world – using computers, e-mail, networks, teleconferencing, and dynamic new software.[21]

The second driving force of economic globalisation has been the liberalisation of international trade and foreign direct investment. Since the late 1940s, most developed countries have gradually but significantly lowered barriers to foreign trade and investment. Over the last thirty years, the liberalisation of trade and investment has become a worldwide trend, including in developing countries, although liberalisation proceeds at different rates in different parts of the world. In his book, *Has Globalization Gone Too Far?*, Dani Rodrik, of the John F. Kennedy School of Government at Harvard University, observed with regard to this second driving force of globalisation:

> Globalization is not occurring in a vacuum. It is part of a broader trend that we may call marketization. Receding government, deregulation, and the shrinking of social obligations are the domestic counterparts of the intertwining of national economies. Globalization could not have advanced this far without these complementary forces.[22]

While the then US President Bill Clinton stated at the 1998 WTO Ministerial Conference in Geneva that '[g]lobalization is not a policy choice – it is a fact',[23] Lord Jordan, former General Secretary of the International Confederation of Free Trades Unions, wrote in December 2000 that globalisation 'is not an unstoppable force of nature, but is shaped by those who set the rules'.[24]

2.1.3 Economic Globalisation Today

While some politicians and opinion-makers claim otherwise, the process of economic globalisation is not irreversible. Lionel Barber, editor of the *Financial Times*, noted in 2004:

> For all its merits, globalization must never be taken for granted. The continued integration of the world economy depends on support not only from rich beneficiaries in the west but increasingly from the still disadvantaged in Africa, India, and Latin America. Cultural barriers also pose increasingly powerful obstacles to globalization. The rise of Islamic fundamentalism offers an alternative vision of society, one which will appeal to all those left behind in countries with exploding populations and persistent high unemployment among young people.[25]

21 T. Friedman, *The World Is Flat: A Brief History of the Globalized World in the Twenty-First Century* (Farrar, Straus & Giroux, 2005), 8.
22 D. Rodrik, *Has Globalization Gone Too Far?* (Institute for International Economics, 1997), 85.
23 See www.wto.org/english/thewto_e/minist_e/min99_e/english/book_e/stak_e_3.htm.
24 B. Jordan, 'Yes to Globalization, But Protect the Poor', *International Herald Tribune*, 21 December 2000.
25 L. Barber, 'A Symposium of Views: Is Continued Globalisation of the World Economy Inevitable?', *International Economy*, summer 2004, 70.

In 2016, David Lipton, First Deputy Managing Director of the IMF, observed:

> During the years since the global financial crisis, the future of globalization has darkened. Global growth has slowed, along with international trade. For many, vulnerability and insecurity have become more salient than the gains from interconnectedness, as those linkages have brought market volatility, powerful spillovers, and dislocations. Politics have soured. Whether justified or not, much of the resentment is focused on globalization.[26]

As further discussed below, the growth of international trade has been sluggish in recent years when compared with the growth before the global economic crisis of 2008–9.[27] The ratio of international trade to global GDP has in recent years not increased, but has remained constant or decreased marginally.[28] As the ratio of international trade to global GDP is often considered as a good measurement of economic globalisation,[29] this trend may be an indication that the process of economic globalisation has (at least temporarily) stopped. However, in its 2016 report *Digital Globalization: The New Era of Global Flows*, the McKinsey Global Institute noted in this regard:

> Many observers point to this trend as evidence that globalization has stopped. We have a different view: globalization has instead entered a new era defined by data flows that transmit information, ideas, and innovation. Digital platforms create more efficient and transparent global markets in which far-flung buyers and sellers find each other with a few clicks. The near-zero marginal costs of digital communications and transactions open new possibilities for conducting business across borders on a massive scale ... While global flows of trade and finance have lost momentum, the volume of data being transmitted across borders has surged, creating an intricate web that connects countries, companies, and individuals.[30]

In an address delivered at the World Trade Symposium in June 2016, WTO Director-General Roberto Azevêdo also argued that 'globalisation has not stopped'.[31] Azevêdo noted in this regard that while the growth of international trade is lower than before, the share of trade in components has not declined. This is indicative of the spread of global production chains, which is 'a defining feature of the globalization phenomenon'.[32]

2.1.4 Facts and Figures on International Trade and Foreign Direct Investment

In 1948, world merchandise exports, i.e. exports of goods, amounted to US$58 billion per year. In 2015, world merchandise exports amounted to US$16.5 trillion.[33] World exports of commercial services, marginal in 1948, amounted in

26 David Lipton, 'Can Globalization Still Deliver?', Stavros Niarchos Lecture, 24 May 2016, Peterson Institute for International Economics, at www.imf.org/external/np/speeches/2016/052416a.htm.
27 See below, p. 8. 28 See below, p. 8.
29 The trade-to-GDP ratio indicates the dependence of domestic producers on foreign demand (exports) and of domestic consumers and producers on foreign supply (imports), relative to the country's economic size (GDP). The trade-to-GDP ratio is a basic indicator of openness to foreign trade and economic integration. See http://data.worldbank.org/news/new-data-visualizers-for-trade-data.
30 McKinsey Global Institute, *Digital Globalization: The New Era of Global Flows*, Executive Summary, March 2016, 9–10.
31 R. Azevêdo, 'Trade and Globalisation in the 21st Century: the Path to Greater Inclusion', speech delivered at the World Trade Symposium, London, 7 June 2016, at www.wto.org/english/news_e/spra_e/spra126_e.htm.
32 *Ibid.*
33 See WTO Statistics Database, at http://stat.wto.org. In 1968, 1988 and 2008, world merchandise exports amounted to US$242 billion, US$2.9 trillion and US$15.2 trillion respectively. See *ibid.*

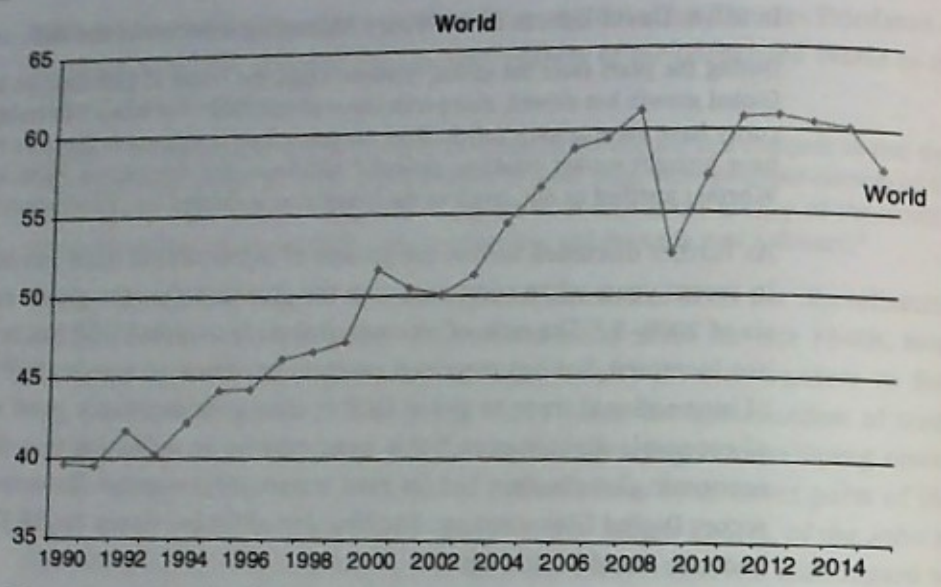

Figure 1.1 Ratio of global trade in merchandise and commercial services to global GDP (1990–2015)

2015 to US$4.75 trillion.[34] Especially during the period from 2002 to 2008 world merchandise exports and exports of commercial services boomed. In 2009, at the height of the global economic crisis, world merchandise exports shrunk by 22.3 per cent in value terms (the sharpest decline since the Second World War), but in 2010 grew again by 21.8 per cent and in 2011 by 19.8 per cent.[35] In recent years, however, world merchandise exports have grown between a mere 0.25 and 2.4 per cent in value terms; and, in 2015, fell by 13.2 per cent.[36] Exports of commercial services shrunk by 10.8 per cent in value terms at the height of the global economic crisis in 2009, but grew again by 8.7 per cent in 2010 and 13.2 per cent in 2011.[37] In 2015, the exports of commercial services declined 6.1 per cent in value terms.[38]

As shown by Figure 1.1, over the past two decades, before the crisis year of 2009, the ratio of global trade to GDP increased significantly, indicating the extent of economic globalisation in these years. As is also shown, in 2010, this trend of economic globalisation picked up again. The ratio of global trade to GDP increased from 39 per cent in 1990 to an all-time high of 61.1 per cent in 2008, plummeting to 52.5 per cent in 2009, increasing to 60.8 per cent in 2011 and remaining almost constant from 2012–14 and then dropping to 57.0 in 2015.[39]

34 See *ibid.* In 1995 and 2005, world exports of commercial services amounted to US$1.2 trillion and US$2.5 trillion respectively. See *ibid.*
35 Calculated on the basis of data found in the WTO Statistical Database, at http://stat.wto.org. In volume terms, world merchandise exports fell in 2009 by 12 per cent. In the last thirty years, the volume of world merchandise exports fell only on one other occasion, namely in 2001 by 0.2 per cent. See *ibid.*
36 See *ibid.* 37 Calculated on the basis of data found in the WTO Statistical Database, at http://stat.wto.org
38 See *ibid.* 39 See http://data.worldbank.org/indicator/NE.TRD.GNFS.ZS?end=2015&start=1990.

The degree of economic globalisation, when measured as the ratio of trade to GDP, varies from country to country, but has, until 2015, increased in all major trading nations over the past two decades.[40]

Country	1990	2015
Bangladesh	19	42
Brazil	15	27
Canada	50	65
China	30	41
EU (including intra-EU trade)	51	83
India	15	49
Indonesia	49	42
Mexico	38	73
Russian Federation	36	51
South Africa	43	63
South Korea	53	85
United States	20	28

Figure 1.2 Ratio of trade in merchandise and commercial services to GDP for selected countries (1990–2015)[41]

As shown by the data in Figure 1.2, the economies of many countries are to a large and increased degree dependent on trade. This is true for developed as well as developing countries. Note the extent to which, for example China (from 30 to 41 per cent), India (from 15 to 49 per cent), Bangladesh (from 19 to 42 per cent) and Mexico (from 38 to 73 per cent) have 'globalised' over the past two decades. It is interesting, and perhaps surprising to some, that least-developed countries are more 'globalised' than OECD countries. Brazil and the United States have the least 'globalised' economies of all major trading nations. South Korea has the most 'globalised' economy of all major trading nations. Note that the data on the EU include trade between EU Member States, i.e. intra-EU trade. When one considers only EU trade with non-EU countries, the ratio of trade to GDP for the EU was 33.9 per cent.[42]

It is not only the value and volume of world trade and the ratio of trade to GDP that have changed significantly over the years. The share of world trade of various countries and regions of the world also changed significantly.

Overall, the share of world trade of developed countries has in recent years dropped from 80 per cent in 1995 to 54 per cent in 2014, while the share of

40 For a world map of trade-to-GDP ratios, see www.wto.org/english/res_e/statis_e/statis_maps_e.htm.
41 See *ibid.* For India, the data relate to the year 2014. 42 See *ibid.*

developing countries has increased from 20 per cent in 1995 to 44 per cent in 2014.[43] Remarkable is the decline of the share of North America (the United States, Canada and Mexico) from 28.1 per cent in 1948 to 13.5 in 2014, and the modest increase of the share of Western Europe (primarily the European Union) from 35.1 per cent in 1948 to 36.8 per cent in 2014 (down from 45.9 per cent in 2003).[44] Equally remarkable are the steep decline of the shares of South and Central America (down from 11.3 per cent to 3.8 per cent) and Africa (down from 7.3 per cent to 3 per cent) and the significant increase of Asia's share (up from 14 per cent to 32 per cent).[45] The share of the least-developed countries increased in recent years from 0.5 to 1 per cent (although note that it stood at 1.7 per cent in 1970).

Further, the composition of the trade of developing countries has also undergone a change. While many developing countries remain dependent on their exports of primary commodities, the share of manufactured goods has been growing. Since the early 1990s, there has been a boom in high-technology exports, with countries such as China, India and Mexico emerging as major suppliers of cutting-edge technologies, as well as labour-intensive goods. The data referred to above clearly indicate that there is, with regard to trade in merchandise and commercial services, a 'redistribution of the geopolitical deck of cards on a global scale'.[46]

The leading exporters of merchandise in 2015 were: China (17.4 per cent), the European Union (15.2 per cent), the United States (11.5 per cent), Japan (4.8 per cent) and Korea (4.0 per cent).[47] The leading importers of merchandise were: the United States (17.3 per cent), the European Union (14.4 per cent), China (12.6 per cent), Japan (4.9 per cent) and Hong Kong, China (4.2 per cent).[48] The leading exporters of commercial services in 2015 were: the European Union (24.9 per cent), the United States (18.8 per cent), China (7.8 per cent), Japan (4.3 per cent) and India (4.2 per cent).[49] The leading importers of commercial services were: the European Union (20.2 per cent), the United States (12.9 per cent), China (12.9 per cent), Japan (4.8 per cent), Singapore (3.9 per cent) and India (3.4 per cent).[50]

43 See *WTO International Trade Statistics 2015*, 35. 44 *Ibid.*, table 1.5 45 *Ibid.*

46 See Pascal Lamy in his welcome address to the participants in the WTO's Public Forum, 24 September 2012, at: www.wto.org/english/news_e/sppl_e/sppl244_e.htm.

47 See WTO, *World Trade Statistical Review 2016*, table A7. Note that this ranking is on the basis of world merchandise trade excluding intra-EU trade. Also, note that Hong Kong, China was the sixth biggest exporter of merchandise (3.9 per cent) (before Canada (3.1 per cent), Mexico (2.9 per cent), Singapore (2.7 per cent), and the Russian Federation (2.6 per cent)); and that India was the thirteenth (2.0 per cent) and Brazil the eighteenth biggest exporter of merchandise (1.5 per cent).

48 See *ibid.* Note that India was the ninth (2.9 per cent), the Russian Federation the seventeenth (1.5 per cent) and Brazil the eighteenth biggest importer of merchandise (1.3 per cent).

49 See *ibid.*, table A9. Note that this ranking is on the basis of world trade in commercial services excluding intra-EU trade. Note also that Singapore was the sixth biggest exporter of commercial services (3.8 per cent) before Switzerland (2.9 per cent), Hong Kong, China (2.8 per cent), Korea (2.6 per cent) and Canada (2.1 per cent). The Russian Federation was the thirteenth (1.4 per cent), Brazil the twentieth (0.9 per cent) biggest exporter of commercial services.

50 See *ibid.* Note that the Russian Federation was the tenth (2.4 per cent) and Brazil the twelfth biggest importer of commercial services (1.9 per cent).

As noted above, next to international trade, the second important aspect of economic globalisation is foreign direct investment (FDI). This book does not deal with FDI, but it should be noted that inflows of FDI have – similarly to international trade flows – increased notably over the past decades. In 1990, global FDI inflows amounted to US$207 billion. In its *World Investment Report 2016*, the United Nations Conference on Trade and Development (UNCTAD) reported that, in 2015, global FDI inflows amounted to US$1.76 trillion, the highest level since the financial crisis of 2008–9.[51] FDI inflows to developing countries reached the historical high level of US$765 billion.[52] While the trend of the ratio of international trade to global GDP may, as discussed above, be an indication that the process of economic globalisation has (at least temporarily) stopped, the trend of FDI would rather indicate the opposite. In 2015, FDI inflows to developed countries accounted for 55 per cent of global FDI, up from 41 per cent in 2014.[53] FDI outflows from developed economies accounted for 72 per cent of global FDI outflows in 2015, up from 61 per cent in 2014. By contrast, FDI outflows declined in most developing and transition regions, China being an exception. China's outward FDI rose in 2015 from $123 billion to $128 billion, as a result of which it held its position as the third largest investor in the world.[54]

2.1.5 Changing Nature of International Trade in the Global Economy

For many centuries, trade was mostly about raw materials or finished products from country A being exported to country B for use or consumption in the latter country. However, as has been noted by economists and policy-makers alike, the nature of trade is changing. Trade in the globalised economy of today is increasingly trade in tasks and in value-added. Trade is increasingly trade in intermediate products. Ever more trade now takes place in international supply chains, also often referred to as global value chains (GVCs). Technological innovations, resulting in much lower transportation and communication costs, as well as the emergence of a 'rules-based', more secure and predictable trading environment (i.e. the prime focus of this book), have allowed companies to fragment, or unbundle, production across many countries. Today, products are often not produced in a single location or by a single company. Many companies no longer produce products in their entirety but focus on the production of components

51 See UNCTAD, *World Investment Report 2016*, 1. Note that a surge in cross-border mergers and acquisitions to $721 billion, from $432 billion in 2014, was the principal factor behind the global rebound. In 2009, global FDI inflows plummeted to US$1.2 trillion but in 2011 already global FDI inflows had gone up to US$1.5 trillion again, exceeding the pre-crisis average, albeit still some 23 per cent below the 2007 peak. UNCTAD forecasts that over the medium term, FDI flows are projected to resume growth in 2017 and to surpass $1.8 trillion in 2018.

52 See *ibid.*, 2. 53 *Ibid.*, 1. In 2015, the United States became the largest FDI recipient in the world. See *ibid.*, 4.

54 See *ibid.*, 3 and 5.

or related services. They do so in function of their comparative advantage. Ever more products are 'the end result of a highly coordinated series of steps carried out in many countries around the world by many people with many different skills'.[55] Rather than 'Made in China', 'Made in Australia' or 'Made in Mexico', many products are now 'Made in the World'. Karel De Gucht, the then European Commissioner for Trade, noted in April 2012:

> Most of you will be familiar with the example of the Nokia smartphone. It is listed as being made in China, but in reality 54% of its value comes from tasks that are carried out in Europe. Key components are produced in other parts of Asia and only the assembly itself actually happens in China.[56]

While many may think of the Boeing 787 Dreamliner as a product 'Made in the USA', the components that make up this aircraft 'come from more than 40 suppliers based in over 130 sites around the world'.[57]

Trade in value-added, or trade in GVCs, is not a totally new phenomenon. To some extent, it has always existed. However, in recent years it has rapidly increased in importance, breadth and depth. Trade in intermediate products increased from just under US$4 trillion in 2004 to about US$7.5 trillion in 2014.[58] This development has been described as the 'most important development in the world economy since the beginnings of globalization'.[59] In a 2016 report *Decent Work in Global Supply Chains*, the International Labour Organization (ILO) outlined the key factors resulting in the proliferation of GVCs as follows:

> First, the development of telecommunications, financial services and information technologies, which have enabled real-time coordination and logistics of fragmented production in various parts of the globe. Second, improvements in infrastructure, logistics and transport services have enabled more reliable and speedy delivery of inputs and final goods and have reduced their cost. Third, trade agreements have played a role in facilitating and reducing the costs of trade, including through tariff reduction, harmonization of institutional frameworks and liberalization of services under the General Agreement on Tariffs and Trade and subsequently the World Trade Organization (WTO) as well as bilateral and plurilateral trade agreements. Lastly, the emergence of China and India, and their participation in global supply chains, has doubled the supply of labour to the global economy.[60]

55 *Ibid.*
56 Karel De Gucht, 'Trading in Value and Europe's Economic Future', High-Level Conference on 'Competitiveness, Trade, Environment and Jobs in Europe: Insights from the New World Input Output Database (WIOD)', 16 April 2012, at http://europa.eu/rapid/press-release_SPEECH-12-264_en.htm.
57 Azevêdo, 'Trade and Globalisation in the 21st Century'.
58 UNCTAD, *Key Statistics and Trends in International Trade 2015*, 17.
59 World Trade Organization, *World Trade Report 2013*, 269 referring to Richard E. Baldwin, 'Global supply chains: Why they emerged, why they matter, and where they are going', London Centre for Economic Policy Research, CEPR Discussion Paper No. 9103.
60 International Labour Organization, *Decent Work in Global Supply Chains*, Report IV, International Labour Conference, 105th Session, 2016, 5.

For developing countries, the unbundling of production has made it possible to industrialize by joining the GVCs. In the words of WTO Director-General Roberto Azevêdo:

> The logic is that it is easier to develop the skills and infrastructure needed to make one part of an engine than it is to build the whole aircraft.[61]

In a 2015 paper *Participation of Developing Countries in Global Value Chains*, the OECD noted that:

> Many developing countries are increasingly involved in GVCs, and that this participation tends to bring about economic benefits in terms of enhanced productivity, sophistication and diversification of exports.[62]

The country in which companies prefer to outsource production is, apart from geography, largely determined by factors such as the state of the transport and telecommunication infrastructure, the level of technical and professional skills of the workforce, the effective protection of intellectual property, the ease of customs formalities, the prevalence of the rule of law and the absence of endemic corruption. Due to the abundance of cheap, unskilled labour, developing countries typically complete the low value-added, unskilled labour-intensive tasks while developed countries complete the high value-added, skill- and capital-intensive tasks.[63] To move up the global value chain from low value-added tasks to high value-added tasks, countries must pursue policies aimed at upgrading the factors referred to above.[64]

In 2013, the WTO and the OECD jointly launched the Trade in Value-Added (TiVA) database, which takes into account value added by each country in the production of goods and services consumed worldwide.[65] The trade data available through the TiVA database give us three important insights into today's international trade.[66] First, these trade data clearly show the importance of trade in services. While trade in services represents about 20 per cent of total trade, its share doubles when one considers its contribution to the value-added that is traded internationally. Second, the TiVA data highlight the importance of trade in intermediate products and the significance of such trade in improving the competitiveness of the exports. Today, trade in intermediate products accounts for more than half of global merchandise exports; and the average

61 R. Azevêdo 'The importance of the WTO in value-chain development for countries like Colombia' delivered at the Universidad Sergio Arboleda Colombia, 19 May 2016, at www.wto.org/english/news_e/spra_e/spra123_e.htm.
62 OECD, *Participation of Developing Countries in Global Value Chains*, Summary Paper, 2015, 1.
63 World Trade Organization, *World Trade Report 2013*, 144 and 234.
64 See UNCTAD, *Tracing the Value Added in Global Value Chains: Product-Level Case Studies in China*, 2015, 14.
65 The 2015 edition of the TiVA database included sixty-one economies covering OECD, EU28, G20, most East and South-East Asian economies and a selection of South American countries.
66 See Pascal Lamy, Round Table Discussion 'New Steps in Measuring Trade in Value Added' at the OECD, Paris, 16 January 2013, at www.wto.org/english/news_e/sppl_e/sppl261_e.htm.

import content of exported goods is 40 per cent. Therefore, in order for exported goods to be competitive on the world market, manufacturers need access to the cheap imported inputs. Third, the TiVA data, which reflect imports and exports measured according to their true national content, permit, and indeed require, a redefinition of bilateral trade balances. Such a redefinition results, for example, in a significant reduction of the politically sensitive trade deficit that many countries have with China.

The changing nature of international trade cannot but affect – certainly in the longer term – the way in which governments think about trade and trade policy.[67] The acute realisation that cheap imports are the lifeblood of competitive exports is perhaps one of the reasons – next to the strength of the multilateral trading system – why countries did not, as history would expect them to do, react to the 2008–9 global economic crisis with a barrage of restrictions on trade.[68] Participation in global value chains is also closely linked with unilateral tariff reductions.[69] Further, global value chains have resulted in negotiated tariff reductions in the WTO,[70] and also at the regional/bilateral level.[71] In order to facilitate smooth operation of value chains, there has been an increased demand for deep forms of integration covering more than just preferential tariffs.[72] As noted in the *World Trade Report, 2013*:

> Countries intensively involved in supply chain trade may find it increasingly difficult to rely on broad GATT/WTO principles alone to address their trade-related problems, and may turn to more narrowly focused PTAs to achieve the deep and customized bargains they need ... With parts and components crossing multiple borders and the cost of imports increasingly determining export competitiveness – anti-protectionist tendencies have dominated. Regulatory cooperation has intensified, leading to deeper integration at the regional level.[73]

2.2 A Blessing or a Curse?

All around the world people feel the effects of economic globalisation and international trade, but these effects are not felt by all in an even or equitable way. In the 1990s and early 2000s, the large and often violent street demonstrations that rocked Seattle, Prague, Montreal, Cancún, Washington, Hong Kong, Geneva, Genoa, Zurich and other cities around the world gave expression to many people's dissatisfaction with, and rejection of, economic globalisation and international trade. While such demonstrations seem to be – at least for now – a thing

67 See e.g. Global Agenda Council on the Global Trade System, *The Shifting Geography of Global Value Chains: Implications for Developing Countries and Trade Policy* (World Economic Forum, 2012).
68 See also below, pp. 104–5. 69 World Trade Organization, *World Trade Report 2013*, 269 and 271.
70 See e.g. Ministerial Conference, *Ministerial Declaration of 16 December 2015 on the Expansion of Trade in Information Technology Products*, WT/MIN(15)/25, dated 16 December 2015, wherein certain WTO Members agreed on the elimination of customs duties on 201 information technology products valued at over US$1.3 trillion per year. See below p. 430.
71 World Trade Organization, *World Trade Report 2013*, 272. 72 *Ibid.* 73 *Ibid.*, 270 and 292.

of the past, the debate on the benefits and dangers of economic globalisation and international trade is, in these times of global crises (economic, financial, environmental and food), more relevant than ever. In recent years, there has been in many countries a notable rise in anti-globalisation and anti-trade rhetoric by populist, as well as some mainstream, politicians. In the 2016 US presidential elections, the candidates of the Democratic as well as the Republican Party took anti-trade positions in an obvious attempt to appeal to the working-class voters. The Republican presidential candidate, Donald Trump, proposed *inter alia* to terminate the North American Free Trade Agreement (NAFTA) with Canada and Mexico and to impose a 45 per cent customs duty on imports from China in the United States. As noted by Kenneth Rogoff, Professor of Economics and Public Policy at Harvard University, the latter proposal 'appeals to many Americans who believe that China is getting rich from unfair trade practices'.[74] In what was labelled as a major economic policy speech in Detroit on 8 August 2016, Donald Trump argued that the United States must fight globalisation and trade deals which he believes have led to the demise of manufacturing and blue-collar jobs. In terms which make one wonder whether autarchy is at the core of his proposed economic policy, he stated:

> American cars will travel the roads, American planes will connect our cities, and American ships will patrol the seas. American steel will send new skyscrapers soaring. We will put new American metal into the spine of this nation. It will be American hands that rebuild this country, and it will be American energy – mined from American sources – that powers this country. It will be American workers who are hired to do the job. Americanism, not globalism, will be our new credo.[75]

In the same speech, and seemingly unconcerned by what might be seen as a contradictory statement, Trump stated:

> Trade has big benefits, and I am in favor of trade. But I want great trade deals for our country that create more jobs and higher wages for American workers. Isolation is not an option, only great and well-crafted trade deals are.[76]

While electoral campaign speeches must not be given more importance than they deserve, such statements by the presidential candidate of one of the two main political parties of the United States is a clear sign of the times.

74 K. Rogoff, 'Anti-Trade America?', *Project Syndicate*, 7 April 2016, at www.project-syndicate.org/commentary/us-presidential-campaign-protectionist-rhetoric-by-kenneth-rogoff-2016-04?barrier=true. Rogoff observed that 'for all its extraordinary success in recent decades, China remains a developing country where a significant share of the population live at a level of poverty that would be unimaginable by Western standards'. See *ibid.* Also, according to the McKinsey Global Institute, only around 700,000 of the 6 million manufacturing jobs lost in the United States between 2000 and 2010 went to China. Most manufacturing jobs were lost because of technological innovation (and in particular the introduction of high-tech robots) and the decrease in consumer demand during the 2008–9 global economic crisis. See R. Foroohar, 'Is China Stealing U.S. Jobs?', *Time*, 11 April 2016, 40. However, a study by David Autor and others from the Massachusetts Institute of Technology (MIT) estimated that rising Chinese imports from 1999 to 2011 costs up to 2.4 million American jobs. See E. Porter, 'On Trade, Voters May Have a Point', *International New York Times*, 16 March 2016, 14.
75 See http://time.com/4443382/donald-trump-economic-speech-detroit-transcript. 76 *Ibid.*

According to a 2015 survey of public opinion on economic globalisation in the European Union, 57 per cent of Europeans agreed that globalisation is an opportunity for economic growth, while 28 per cent disagreed with this statement.[77] Not surprisingly, the better educated, high-skilled respondents agreed more often with the statement than did the lower educated, low-skilled respondents. Equally unsurprising, northern Europeans (and in particular the Danes, Swedes and Dutch) significantly more often agreed with the statement than southern Europeans (and in particular the French and Greeks).[78] While in the European Union and most other countries, the majority of people are not *opposed* to economic globalisation and international trade, there is widespread concern and considerable anxiety about the harmful effect that economic globalisation and international trade may have: (1) on jobs and wages (affected by delocalisation and outsourcing, or the threat thereof); (2) on the global ecosystem as well as the local environment (by promoting unsustainable patterns of production and consumption); (3) on world poverty and hunger (in the face of growing income disparity between the rich and the poor); (4) on the economic development of developing countries (by obliging these countries to open their markets too far too fast, and not protecting or promoting their export opportunities); (5) on social, labour, health and safety regulation (as a result of regulatory competition resulting in a 'race to the bottom'); (6) on the livelihood of hundreds of millions of small farmers (endangered by the importation of cheap agricultural produce); (7) on cultural identity and diversity (threatened by the rise of a global Anglo-Saxon popular monoculture); and (8) on national sovereignty and the democratic process (under threat from international organisations promulgating rules for the global economy beyond the control of individual States).

Radical proponents of economic globalisation and international trade tend to present globalisation and trade as a panacea for many of the world's problems. These cheerleaders of globalisation usually show little sympathy for, or understanding of, the concerns referred to above.[79] On the contrary, opponents often see economic globalisation and international trade as malignant forces that destroy the livelihood of millions of workers and exacerbate income inequality, social injustice, environmental degradation and cultural homogenisation. They campaign for the replacement of the current 'unfair and oppressive trade system' with a 'new, socially just and sustainable trading framework'. It is unfortunate that the debate on economic globalisation and international trade

77 European Commission, Standard Eurobarometer 83, *Public Opinion in the European Union*, Report, spring 2015, 149, at http://ec.europa.eu/public_opinion/archives/eb/eb83/eb83_publ_en.pdf. Of the 56 per cent agreeing with this statement, 12 per cent totally agreed and 44 per cent tended to agree. Of the 27 per cent disagreeing, 7 per cent totally disagreed and 20 per cent tended to disagree. Note that 17 per cent expressed no opinion.

78 See *ibid.*, 149 and 150.

79 The term 'globalisation's cheerleaders' was used by Dani Rodrik in a 2007 contribution to the *Financial Times*, in which he argued that not the 'protesters on the streets', but these 'cheerleaders' in government or at elite universities in North America and Europe presented the greater menace to globalisation. See D. Rodrik, 'The Cheerleaders' Threat to Global Trade', *Financial Times*, 26 March 2007.

is often emotionally charged and thus not constructive. Oxfam noted in its 2002 study, *Rigged Rules and Double Standards: Trade, Globalization, and the Fight Against Poverty*, the following:

> Current debates about trade are dominated by ritualistic exchanges between two camps: the 'globaphiles' and the 'globaphobes'. 'Globaphiles' argue that trade is already making globalisation work for the poor. Their prescription for the future is 'more of the same'. 'Globaphobes' turn this world-view on its head. They argue that trade is inherently bad for the poor. Participation in trade, so the argument runs, inevitably leads to more poverty and inequality. The corollary of this view is 'the less trade the better'. The anti-globalisation movement deserves credit. It has raised profoundly important questions about social justice – and it has forced the failures of globalisation on to the political agenda. However, the war of words between trade optimists and trade pessimists that accompanies virtually every international meeting is counter-productive. Both world views fly in the face of the evidence – and neither offers any hope for the future.[80]

Oxfam's characterisation of the debate on economic globalisation and international trade in 2002 – unfortunately – still rings true today. While not sharing the extreme positions of anti-globalists and being careful 'not to make the mistake of attributing to globalisation the blemishes of other faces',[81] many observers and scholars recognise both the benefits *and* the dangers of economic globalisation and international trade. In his 2002 book, *Globalization and Its Discontents*, Joseph Stiglitz wrote:

> Opening up to international trade has helped many countries grow far more quickly than they would otherwise have done. International trade helps economic development when a country's exports drive its economic growth. Export-led growth was the centrepiece of the industrial policy that enriched much of Asia and left millions of people there far better off. Because of globalization many people in the world now live longer than before and their standard of living is far better. People in the West may regard low-paying jobs at Nike as exploitation, but for many people in the developing world, working in a factory is a far better option than staying down on the farm and growing rice. Globalization has reduced the sense of isolation felt in much of the developing world and has given many people in the developing countries access to knowledge well beyond the reach of even the wealthiest in any country a century ago ... Even when there are negative sides to globalization, there are often benefits. Opening up the Jamaican milk market to US imports in 1992 may have hurt local dairy farmers but it also meant poor children could get milk more cheaply. New foreign firms may hurt protected state-owned enterprises but they can also lead to the introduction of new technologies, access to new markets, and the creation of new industries.[82]

Stiglitz commented that those who vilify globalisation too often overlook its benefits.[83] However, Stiglitz also pointed out:

> [T]he proponents of globalization have been, if anything, even more unbalanced. To them, globalization (which typically is associated with accepting triumphant capitalism, American style) *is* progress; developing countries must accept it, if they are to grow and to fight

80 Oxfam, *Rigged Rules and Double Standards: Trade, Globalization, and the Fight Against Poverty* (2002), Summary of Chapter 1, at www.maketradefair.org.

81 J. Bhagwati, 'Globalization in Your Face', *Foreign Affairs*, July/August 2000, 137.

82 Stiglitz, *Globalization and Its Discontents*, 4–5.

83 *Ibid.*, 5.

poverty effectively. But to many in the developing world, globalization has not brought the promised economic benefits.[84]

Elsewhere, Stiglitz wrote about the problems and dangers of economic globalisation and international trade:

We should be frank. Trade liberalization, conducted in the wrong way, too fast, in the absence of adequate safety nets, with insufficient reciprocity and assistance on the part of developed countries, can contribute to an increase in poverty ... Complete openness can expose a country to greater risk from external shocks. Poor countries may find it particularly hard to buffer these shocks and to bear the costs they incur, and they typically have weak safety nets, or none at all, to protect the poor. These shocks, resulting essentially from contagion associated with globalization, integration and interdependence can affect workers and employers in the developed world. It must be said, however, that highly industrialized countries are able to deal with these shocks a lot better through re-employment and through other safety nets.[85]

In 2006, Stiglitz further reflected on the dark side of globalisation as follows:

There were once hopes that globalisation would benefit all, both in advanced industrial countries and the developing world. Today, the downside of globalisation is increasingly apparent. Not only do good things go more easily across borders, so do bad; including terrorism ... What is remarkable about globalisation is the disparity between the promise and the reality. Globalisation seems to have unified so much of the world against it, perhaps because there appear to be so many losers and so few winners ... Growing inequality in the advanced industrial countries was a long predicted but seldom advertised consequence: full economic integration implies the equalisation of unskilled wages throughout the world. Although this has not (yet) happened, the downward pressure on those at the bottom is evident. Unfettered globalisation actually has the potential to make many people in advanced industrial countries worse off, even if economic growth increases.[86]

On the positive *and* negative aspects of economic globalisation, Pascal Lamy, the then WTO Director-General, made the following remarks in August 2007:

Globalization has enabled individuals, corporations and nation-states to influence actions and events around the world – faster, deeper and cheaper than ever before – and equally to derive benefits for them. Trade opening and the vanishing of many walls have the potential for expanding freedom, empowerment, democracy, innovation, social and cultural exchanges, while offering outstanding opportunities for dialogue and understanding. This is the good side of globalization. But the global nature of an increasing number of worrisome phenomena – the scarcity of energy resources, the deterioration of the environment, the migratory movements provoked by insecurity, poverty and political instability or even financial markets volatility, as we have seen in recent weeks – are also by-products of globalization. Indeed, it can be argued that in some instances, globalization has reinforced the strong economies and weakened those that were already weak.[87]

84 *Ibid.*

85 J. Stiglitz, 'Addressing Developing Country Priorities and Needs in the Millennium Round', in R. Porter and P. Sauvé (eds.), *Seattle, the WTO and the Future of the Multilateral Trading System* (Harvard University Press, 2000), 53–5.

86 J. Stiglitz, 'We Have Become Rich Countries of Poor People', *Financial Times*, 7 September 2006.

87 P. Lamy, 'Trends and Issues Facing Global Trade', speech delivered in Kuala Lumpur, Malaysia, 17 August 2007, at www.wto.org/english/news_e/sppl_e/sppl65_e.htm. On the positive and negative effects of economic globalisation and international trade on growth, employment and (in)equality in developing countries as well as developed countries, see also the 2011 study by the International Labour Office (ILO) and the WTO, *Making Globalization Socially Sustainable*, edited by Marc Bacchetta and Marion Jansen (ILO/WTO, 2011).

As UN Secretary-General Ban Ki-moon said at the 2014 WTO Public Forum *Why Trade Matters to Everyone*:

The question is not whether trade matters, but how we can make trade a better driver of equitable, sustainable development. How can we make trade the foundation of a life of dignity for all? ... International trade is an essential component of an integrated effort to end poverty, ensure food security and promote economic growth. An ounce of trade can be worth a pound of aid ... Trade can – and should – benefit everyone. That is why the international community needs to avoid protectionism ... If managed well, international trade can be a key driver of sustainable development.[88]

WTO Director-General Roberto Azevêdo, at his keynote address delivered at the 2016 World Trade Symposium in London stated:

We have to acknowledge that, in many constituencies, trade is not perceived so positively. First, we must rectify the perception that imports make jobs disappear. Actually, the vast majority of jobs are lost because of new technologies and increased productivity. Second, we must recognize that while the benefits of trade are spread across the economy, the effects of increased competition can hit specific communities hard. We need to put more focus on how governments can mitigate those impacts. Third, trade is sometimes seen as only favouring the big companies. This is obviously not true – however, it is true that trading internationally is much more costly and difficult for small enterprises. We need to respond to that, particularly as SMEs are huge job creators – around 90% of the workforce in many countries.[89] All these points indicate that we need to promote a well-informed debate, not one based on rhetoric and unsubstantiated assertion ... If we allow this uncritical approach to prosper, trade will indeed become the culprit of all economic afflictions.

2.3 Free Trade versus Restricted Trade

For as long as people have traded across borders, the benefits and drawbacks of trade have been debated. This subsection discusses in turn: (1) the arguments for free trade; and (2) the arguments for restrictions on trade.

2.3.1 Arguments for Free Trade

Most economists agree that countries can benefit from international trade. In 1776, Adam Smith wrote in his classic book, *The Wealth of Nations*:

It is the maxim of every prudent master of a family, never to attempt to make at home what it will cost him more to make than to buy. The tailor does not attempt to make own shoes, but he buys them from the shoemaker. The shoemaker does not attempt to make his own clothes, but employs a tailor. The farmer attempts to make neither the one nor the other, but employs those different artificers. All of them find it for their interest to employ their whole industry in a way in which they have some advantage over their neighbours, and to purchase with a part of its produce, or what is the same thing, with the price of a part of it, whatever else they have occasion for.

88 Secretary-General's remarks at the WTO Public Forum, 1 October 2014, at www.un.org/sg/statements/index.asp?nid=8076.

89 Azevêdo, 'Trade and Globalisation in the 21st Century'.

> What is prudence in the conduct of every private family, can scarce be folly in that of a great kingdom. If a foreign country can supply us with a commodity cheaper than we ourselves can make it, better buy it of them with some part of the produce of our own industry, employed in a way in which we have some advantage. The general industry of the country ... will not thereby be diminished, no more than the above-mentioned artificers; but only left to find out the way in which it can be employed with the greatest advantage. It is certainly not employed to the greatest advantage, when it is thus directed towards an object which it can buy cheaper than it can make.[90]

Adam Smith's lucid and compelling argument for specialisation and international trade was further built upon by David Ricardo, who, in his 1817 book, *The Principles of Political Economy and Taxation*, developed the theory of 'comparative advantage'. This theory is still the predominant explanation for why countries, even the poorest, can and do benefit from international trade.

> What did the classical economist David Ricardo (1772–1823) mean when he coined the term *comparative advantage*? Suppose country A is better than country B at making automobiles, and country B is better than country A at making bread. It is obvious (the academics would say 'trivial') that both would benefit if A specialized in automobiles, B specialized in bread and they traded their products. That is a case of *absolute* advantage. But what if a country is bad at making everything? Will trade drive all producers out of business? The answer, according to Ricardo, is no. The reason is the principle of comparative advantage, arguably the single most powerful insight in economics. According to the principle of comparative advantage, countries A and B still stand to benefit from trading with each other even if A is better than B at making everything, both automobiles and bread. If A is much more superior at making automobiles and only slightly superior at making bread, then A should still invest resources in what it does best – producing automobiles – and export the product to B. B should still invest in what it does best – making bread – and export that product to A, even if it is not as efficient as A. Both would still benefit from the trade. A country does not have to be best at anything to gain from trade. That is *comparative* advantage. The theory is one of the most widely accepted among economists. It is also one of the most misunderstood among non-economists because it is confused with *absolute* advantage. It is often claimed, for example, that some countries have no comparative advantage in anything. That is virtually impossible. Think about it ...[91]

The Ricardo model is of course a vast simplification, in that it is built on two products and two countries only and assumes constant costs and constant prices. Many of the complexities of the modern economy are not taken into account in this model. Economists in the twentieth century have endeavoured to refine and build on the classic Ricardo model. While pushing the analysis further, the refined models, such as the Heckscher–Ohlin model,[92] have confirmed the basic

90 A. Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations* (1776), edited by E. Cannan (University of Chicago Press, 1976), Volume 1, 478–9.
91 WTO Secretariat, *Trading into the Future*, 2nd revised edn (WTO, 2001), 9.
92 The Heckscher–Ohlin model is a general equilibrium mathematical model of international trade. It builds on David Ricardo's theory of comparative advantage by predicting patterns of commerce and production based on the factor endowments of a trading region. The model essentially says that countries will export products that use their abundant and cheap factor(s) of production and import products that use the countries' scarce factor(s). See M. Blaug, *The Methodology of Economics, or, How Economists Explain* (Cambridge University Press, 1992), 286.

conclusions drawn from the Ricardo model concerning the theory of comparative advantage and the gains from trade via specialisation.[93]

While the theory of comparative advantage has won approval from most economists since the early nineteenth century and continues to win approval,[94] Jagdish Bhagwati, professor of economics and law at Columbia University, observed in *Free Trade Today* that it has only infrequently carried credibility with the populace at large. In search of an explanation, he noted that, when asked which proposition in the social science was the most counterintuitive yet compelling, Paul Samuelson, the 1970 winner of the Nobel Prize for Economics, chose the theory of comparative advantage.[95] According to Samuelson, there is essentially only one – but one very powerful – argument for free trade:

> Free trade promotes a mutually profitable division of labor, greatly enhances the potential real national product for all nations, and makes possible higher standards of living all over the globe.[96]

In a 2015 report on *The Economic Benefits of U.S. Trade*, the Executive Office of the President of United States noted that expansion in trade has allowed efficient use of production units such as labour and capital, raising overall productivity, promoting economic growth and development.[97] The report, summing up the classic gains from trade as 'enhanced productivity, increased innovative activity, and lower prices on and greater variety of goods and services for consumers and producers', states in particular that:

> Evidence for the United States suggests that, in manufacturing, average wages in exporting firms and industries are up to 18 percent higher than average wages in non-exporting firms and industries.
>
> In addition, international trade helps U.S. households' budgets go further ... Trade also offers a much greater diversity of consumption opportunities, from year-round fresh fruit to affordable clothing. This increase in variety provides U.S. consumers with value equivalent to 2.6 percent of gross domestic product (GDP). According to other estimates, the reduction in U.S. tariffs since World War II contributed an additional 7.3 percent to U.S. GDP, or approximately $1.3 trillion in 2014. Distributed equally, that translates into an additional over $10,000 in income per American household.[98]

93 Note, however, as Jagdish Bhagwati does, that: 'The case of free trade rests on the extension to an open economy of the case for market-determined allocation of resources. If market prices reflect "true" or social costs, then clearly Adam Smith's invisible hand can be trusted to guide us to efficiency; and free trade can correspondingly be shown to be the optimal way to choose trade (and associated domestic production). But if markets do not work well, or are absent or incomplete, then the invisible hand may point in the wrong direction: free trade cannot then be asserted to be the best policy.' See J. Bhagwati, *Free Trade Today* (Princeton University Press, 2002), 12.
94 For a dissenting, neo-Marxist view from legal scholars, see M. H. Davis and D. Neacsu, 'Legitimacy, Globally: The Incoherence of Free Trade Practice, Global Economics and Their Governing Principles of Political Economy', *Kansas City Law Review*, 2001, 733–90.
95 See Bhagwati, *Free Trade Today*, 5. 96 P. Samuelson, *Economics*, 10th edn (McGraw-Hill, 1976), 692.
97 Report by the Executive Office of the President of United States, *The Economic Benefits of U.S. Trade*, May 2015, 5 at www.whitehouse.gov/sites/default/files/docs/cea_trade_report_final_non-embargoed_v2.pdf.
98 *Ibid.*, 5.

Michael Froman, the then US Trade Representative, wrote in 2015:

> According to one recent study, American consumers in the lowest decile of income distribution owe more than half of their purchasing power to international trade. By contrast, Americans in the top decile gain only 3 percent in purchasing power through the benefits of trade.
>
> Remaining barriers also disproportionately harm America's poorest. For example, tariffs on luxury leather shoes are 8.5 percent, while tariffs on basic sneakers can reach 48 percent. Likewise, tariffs on acrylic sweaters are twice as high as those on wool sweaters and eight times the tariff on cashmere sweaters. Eliminating tariffs like these helps all consumers, but helps low-income consumers the most.[99]

Also, in the context of the European Union, a study published in 2014 by the European Commission noted with regard to benefits from free trade:

> Trade liberalisation creates additional opportunities for innovation and stronger productivity growth. Trade and investment flows spread new ideas and innovation, new technologies and the best research, leading to improvements in the products and services that people and companies use. Experience in EU countries shows that a 1% increase in the openness of the economy results in a 0.6% rise in labour productivity the following year.
>
> Benefits from trade include lower prices and greater choice for consumers, as imported food, consumer goods and components for products manufactured in Europe become cheaper.[100]

On the question of whether free trade indeed leads to greater economic growth, Jagdish Bhagwati observed that:

> those who assert that free trade will also lead necessarily to greater growth *either* are ignorant of the finer nuances of theory and the vast literature to the contrary on the subject at hand *or* are nonetheless basing their argument on a different premise: that is, that the preponderant evidence on the issue (in the postwar period) suggests that freer trade tends to lead to greater growth after all.[101]

A 2001 study by the World Bank showed that the developing countries that increased their integration into the world economy in the 1980s and 1990s achieved higher growth in incomes, longer life expectancy and better schooling. Many of these countries, including China and India, have adopted domestic policies and institutions that have enabled people to take advantage of global markets and have thus sharply increased the share of trade in their GDP.[102] These countries have been catching up with the rich ones – their annual growth rates increased from 1 per cent in the 1960s to 5 per cent in the 1990s. In 2015, China and India achieved an economic growth of 6.9 and 7.6 per cent respectively.[103] However, not all developing countries have integrated successfully into the global economy, and not all sections of the population in both developed

99 Michael Froman, 'Getting Trade Right', *Democracy*, issue 38, Fall 2015.
100 European Commission, *The European Union Explained: Trade*, 2014, 5.
101 Bhagwati, *Free Trade Today*, 42. 102 See above, pp. 9–10.
103 See http://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG. Even in 2009, at the height of the global economic crisis, China and India still had an economic growth of 7.2 and 9.2 per cent respectively, while the OECD countries had a negative growth of 3.5 per cent. See *ibid.*

and developing countries have benefited from international trade. As a 2000 WTO study, *Trade, Income Disparity and Poverty*, on the relationship between international trade and poverty concluded, the evidence seems to indicate that trade liberalisation is *generally* a positive contributor to poverty alleviation. It allows people to exploit their productive potential, assists economic growth, curtails arbitrary policy interventions and helps to insulate against shocks in the domestic economy. The study warned, however, that most trade reforms will create some losers (some even in the long run). Poverty may be exacerbated temporarily, but the appropriate policy response in those cases is to alleviate the hardship and facilitate adjustments rather than abandon the reform process.[104] A 2003 WTO study, *Adjusting to Trade Liberalization*, concluded that adjustment costs are typically smaller, and sometimes much smaller, than the gains from trade.[105] Also, governments can identify individuals and groups that are likely to suffer from the adjustment process, and they can develop policies to alleviate the burden on those adversely affected.[106]

In its 2002 study, *Rigged Rules and Double Standards: Trade, Globalization, and the Fight Against Poverty*, Oxfam stated:

> History makes a mockery of the claim that trade cannot work for the poor. Participation in world trade has figured prominently in many of the most successful cases of poverty reduction – and, compared with aid, it has far more potential to benefit the poor.[107]

Recognising and elaborating on the significant role played by trade in reducing poverty, the joint WTO–World Bank study published in 2015 notes:

> Opening up to trade increases a country's GDP because it allows each country to use its resources more efficiently by specializing in the production of the goods and services that it can produce more cheaply, while importing the others. Trade also affects long-term growth since it gives access to more advanced technological inputs available in the global market and because it enhances the incentives to innovate. Trade contributes directly to poverty reduction by opening up new employment opportunities, for example for agricultural producers, with the expansion of export sectors, and by bringing about structural changes in the economy that increase employment of low-skilled, poor workers in the informal sector. Trade also provides better access to external markets for the goods that the poor produce.[108]

Few will question that international trade has the *potential* to make a significant contribution to economic growth and poverty reduction. However, it is definitely not a 'magic bullet for achieving development'.[109] As discussed below, more is needed to achieve sustained economic growth and widespread poverty reduction.[110]

104 See D. Ben-David, H. Nordström and A. Winters, *Trade, Income Disparity and Poverty*, Special Studies Series (WTO, 2000), 6.
105 See M. Bacchetta and M. Jansen, *Adjusting to Trade Liberalization: The Role of Policy, Institutions and WTO Disciplines*, Special Studies Series (WTO, 2003), 6.
106 *Ibid.* 107 Oxfam, *Rigged Rules and Double Standards*, Summary of Chapter 2.
108 World Trade Organization and the World Bank Group, *The Role of Trade in Ending Poverty*, 2015, 7.
109 See Justice C. Nwobike, 'The Emerging Trade Regime under the Cotonou Partnership Agreement: Its Human Rights Implications', *Journal of World Trade*, 2006, 292.
110 See below, pp. 29–33.

International trade not only has the potential to bring economic benefits, but may also bring considerable non-economic gains. International trade intensifies cross-border contacts and exchange of ideas, which may contribute to better mutual understanding. In a free-trading world, other countries and their people are more readily seen as business partners, less as enemies. As Baron de Montesquieu wrote in 1748 in *De l'Esprit des Lois*:

> Peace is the natural effect of trade. Two nations who traffic with each other become reciprocally dependent; for if one has an interest in buying, the other has an interest in selling; and thus their union is founded on their mutual necessities.[111]

A country restricting trade directly inflicts economic hardship upon exporting countries. Therefore, trade protectionism is a festering source of conflict. It is often stated that, 'if goods do not cross frontiers, soldiers will'.[112] International trade can make an important contribution to peaceful and constructive international relations. Just two weeks after the terrorist attacks of 11 September 2001 on the World Trade Center in New York and on the Pentagon in Washington, DC, Robert Zoellick, the then US Trade Representative, made the following simple but profound statement about the importance of continued openness in trade:

> Let me be clear where I stand: Erecting new barriers and closing old borders will not help the impoverished. It will not feed hundreds of millions struggling for subsistence. It will not liberate the persecuted. It will not improve the environment in developing countries or reverse the spread of AIDS. It will not help the railway orphans I visited in India. It will not improve the livelihoods of the union members I met in Latin America. It will not aid the committed Indonesians I visited who are trying to build a functioning, tolerant democracy in the largest Muslim nation in the world.[113]

Two months after the attacks of 11 September 2001, the WTO Members agreed to start the Doha Round, a new round of negotiations on the further liberalisation of international trade.[114] According to former WTO Director-General Pascal Lamy, the rationale behind this decision was simple: '[T]errorism is about increasing instability; global trade rules are about promoting stability.'[115]

Apart from peaceful relations between nations, open international trade may also promote democracy. In *Free Trade Today*, Jagdish Bhagwati observed:

> One could argue this proposition by a syllogism: openness to the benefits of trade brings prosperity that, in turn, creates or expands the middle class that then seeks the end of

111 C. de Montesquieu, *De l'Esprit des Lois*, original version available online at http://classiques.uqac.ca/classiques/montesquieu/de_esprit_des_lois/de_esprit_des_lois_tdm.html. An English translation by Thomas Nugent is available at www.constitution.org/cm/sol.htm.
112 P. Lamy, 'Managing Global Security: The Strategic Importance of Global Trade', speech to the International Institute for Strategic Studies, in Geneva on 8 September 2007, at www.wto.org/english/news_e/sppl_e/sppl66_e.htm.
113 As reported by the then WTO Director-General Mike Moore in a speech to the Foreign Affairs Commission of the French Assemblée Nationale in October 2001, available at www.wto.org.
114 On the Doha Round, see below, pp. 93–100.
115 P. Lamy, 'Managing Global Security: The Strategic Importance of Global Trade', Speech to the International Institute for Strategic Studies, in Geneva on 8 September 2007, at www.wto.org/english/news_e/sppl_e/sppl66_e.htm.

> authoritarianism. This would fit well with the experience in South Korea, for instance. It was also the argument that changed a lot of minds when the issue of China's entry into the WTO came up in the US Congress recently.[116]

2.3.2 Arguments for Restrictions on Trade

While most economists advise that governments should – in the interest of their country as a whole and that of the world at large – pursue policies aimed at promoting international trade and exchange goods and services on the basis of their comparative advantage, political decision-makers do not necessarily heed this advice. In fact, governments frequently intervene in international trade by adopting trade-restrictive measures. Why do governments restrict international trade? In light of the economic and other benefits of free trade, discussed above, what are the arguments for restrictions on trade?

Governments have multiple, often overlapping, reasons for restricting trade. Governments take trade-restrictive measures for example: (1) to protect a domestic industry and jobs threatened by import competition; (2) to assist the establishment of a new industry; (3) to support a domestic industry to establish itself on the world market; (4) to generate government revenue in the form of customs duties; (5) to protect national security and ensure self-sufficiency; and (6) to protect and promote non-economic societal values and interests, such as public morals, public health, a sustainable environment, human rights, minimum labour standards, consumer safety, and cultural identity and diversity.

An often-cited reason for governments to restrict trade is the *protection of a domestic industry*, and employment in that industry, from competition arising from imported products, foreign services or service suppliers. As noted in the 2003 WTO study *Adjusting to Trade Liberalization*:

> In the United States, for instance, 45,000 steelworkers have lost their jobs since 1997 and 30 per cent of the country's steel making capacity has filed for bankruptcy since 1998, while steel imports were on the rise. In Mozambique liberalization of trade in cashew nuts resulted in 8,500 of 10,000 cashew processing workers losing their jobs.[117]

When a domestic industry is in crisis and jobs are lost, the political decision-makers may well 'scramble for shelter' by adopting protectionist measures.[118] This may happen even when the decision-makers are well aware that such measures are by no means the best response to the crisis in the industry concerned. While the import competition would probably benefit most of their constituents (through lower prices, better quality and/or more choice), import competition is likely to hurt a small group of their constituents significantly (through lower salaries or job losses). If this small group is vocal and well organised, as it often is,

116 Bhagwati, *Free Trade Today*, 43–4.
117 M. Bacchetta and M. Jansen, *Adjusting to Trade Liberalization: The Role of Policy, Institutions and WTO Disciplines*, Special Studies Series (WTO, 2003), 6.
118 'Survey World Trade', *The Economist*, 3 October 1998, 3.

it will put a great deal of pressure on the (elected) decision-makers to take protectionist measures for the benefit of the few and to the detriment of the many. In such a situation, protectionism can constitute 'good' politics.[119] The *public choice theory* explains that, when the majority of the voters are unconcerned with the (*per capita* small) losses they suffer, the vote-maximising political decision-makers will ignore the interests of the many, and support the interests of the vocal and well-organised few.[120] The then WTO Director-General Pascal Lamy called in 2007 for recognition of the fact that the politics of trade suffer from an 'inbuilt asymmetry'. He noted:

> [T]hose who benefit from gains in purchasing power stemming from trade opening are millions, but they are little aware of the source of their gains. Those who suffer from trade opening are thousands who can easily identify the source of their pain. For politicians, such an asymmetry is difficult to cope with and too often the easy way out is to treat foreigners as scapegoats, which we know is one of the safest old tricks of domestic politics.[121]

However, as discussed above, trade protectionist measures to protect the interests of some eventually leave everyone worse off. Joseph Stiglitz, reflecting on his own experience as Chair of the Council of Economic Advisors in the Clinton Administration, observed in this respect:

> One might have thought that each country would promote liberalization in those sectors where it had most to gain from a societal perspective; and similarly, that it would be most willing to give up protectionism in those sectors where protection was costing the most. But political logic prevails over economic logic: after all, if economic logic dominated, countries would engage in trade liberalization on their own. High levels of protection are usually indicative of strong political forces, and these higher barriers may be the last to give way ... The political force behind the resistance to free trade is a simple one: Although the country as a whole may be better off under free trade, some special interests will actually be worse off. And although policy could in principle rectify this situation (by using redistribution to make everybody better off), in actuality, the required compensations are seldom paid.[122]

A second reason for governments to restrict trade is their wish to assist the establishment of a new industry, i.e. to offer *infant industry protection*. The argument for infant industry protection was made by Alexander Hamilton in 1791, Friedrich List in 1841 and John Stuart Mill in 1848, and has been invoked many times since. In the nineteenth century, the infant manufacturing industries of the United States and Germany were protected against import competition on the basis of this argument. Today, this argument may be of particular relevance to developing countries, which may find that, while they have a potential comparative advantage in certain industries, new producers in these countries

119 B. Hoekman and M. Kostecki, *The Political Economy of the World Trading System: The WTO and Beyond*, 2nd edn (Oxford University Press, 2001), 22.
120 On the role of international trade law in 'helping' national decision-makers to make the 'right' decision, i.e. a decision in the best interest of the country as a whole, see below, p. 28. On measures taken to protect an industry (and jobs) threatened by import competition, see also below, p. 27.
121 Lamy, 'Trends and Issues Facing Global Trade'.
122 Stiglitz, 'Addressing Developing Country Priorities and Needs in the Millennium Round', 51–3.

cannot yet compete with established producers in the developed countries. By means of a customs duty or import restriction, temporary protection is then given to the national producers to allow them to become strong enough to compete with well-established producers.[123] The infant industry argument for protectionist measures has some appeal and validity. However, protecting the new producers from import competition does not necessarily remedy the problems that caused the new producers to be uncompetitive. Furthermore, the success of an infant industry policy crucially depends on a correct diagnosis of which industries could over time become competitive. It is often very difficult for governments to identify, in an objective manner and free from pressure from special interest groups, the new industries that merit protection. Moreover, in practice, the protection, which is by nature intended to be temporary, frequently becomes permanent. When it becomes clear that the protected national industry will never 'grow up' and will always be unable to face import competition, it is often politically difficult to remove the protection in place.[124]

A third reason for governments to take trade-restrictive measures is to support a domestic industry to establish itself on the world market. This *strategic trade policy* argument for restrictions on trade is relatively new. In an industry with economies of scale, a country may, by imposing a tariff or quantitative restriction and thus reserving the domestic market for a domestic firm, allow that firm to cut its costs and undercut foreign competitors in other markets. This may work in an industry where economies of scale are sufficiently large that there is only room for very few profitable companies in the world market. Economists reckon that this might be the case for civil aircraft, semiconductors and cars.[125] The aim of government intervention is to ensure that the domestic rather than a foreign company establishes itself on the world market and thus contributes to the national economic welfare. However, as Paul Krugman noted:

> Strategic trade policy aimed at securing excess returns for domestic firms and support for industries that are believed to yield national benefits are both beggar-thy-neighbour policies and raise income at the expense of other countries. A country that attempts to use such policies will probably provoke retaliation. In many (though not all) cases, a trade war between two interventionist governments will leave both countries worse off than if a hands-off approach were adopted by both.[126]

This does not mean that such policies will not be pursued, because, as Krugman also pointed out:

> [g]overnments do not necessarily act in the national interest, especially when making detailed microeconomic interventions. Instead, they are influenced by interest group pressures. The kinds of interventions that new trade theory suggests can raise national income will typically

123 See below, p. 423 (with regard to customs duties) and pp. 480–1 (with regard to import restrictions).
124 A. Deardorff and R. Stern, 'Current Issues in US Trade Policies: An Overview', in R. Stern (ed.), *US Trade Policies in a Changing World Economy* (Massachusetts Institute of Technology Press, 1987), 39–40.
125 'Survey World Trade', *The Economist*, 3 October 1998, 6.
126 P. Krugman, 'Is Free Trade Passé?', *Journal of Economic Perspectives*, 1987, 141.

raise the welfare of small, fortunate groups by large amounts, while imposing costs on larger, more diffuse groups. The result, as with any microeconomic policy, can easily be that excessive or misguided intervention takes place because the beneficiaries have more knowledge and influence than the losers.[127]

A fourth reason for governments to adopt trade-restrictive measures, and, in particular, customs duties, has always been, and still is, to *generate revenue for government*.[128] Taxing trade is an easy way to collect revenue. While taxation of trade for revenue is no longer significant for developed countries, for many developing-country governments customs duties remain a significant source of revenue.[129]

A fifth reason for governments to restrict trade is to protect *national security* and/or ensure *self-sufficiency*. The steel industry, as well as farmers, can, for example, be heard to argue that their presence and prosperity is essential to the national security of the country. The basic argument is that a country should be able to rely on its domestic industries and farmers to meet its basic needs for vital material and food, because it will be impossible to rely – in times of crisis and conflict – on imports from other countries. Alan Sykes noted in this respect that the probability of this type of crisis seems small, and that, if such crisis nevertheless were to arise, it may well be possible to reopen or rebuild productive facilities quickly enough to satisfy essential needs.[130] For Sykes, arguments for trade-restrictive measures to protect national security and ensure self-sufficiency rarely hold up to careful scrutiny.[131] Sykes argued that:

stockpiling during peacetime may well be a superior alternative to the protection of domestic capacity. Where the item in question is not perishable, a nation might be better off by buying up a supply of vital material at low prices in an open trading system than to burden itself over time with the high prices attendant on protectionism as a hedge against armed conflict. The funds tied up in a stockpile have some opportunity cost to be sure, but this cost can easily be smaller than the costs of excluding efficient foreign suppliers from the domestic market.[132]

A sixth and ever more prevalent reason for governments to restrict trade is the *protection and promotion of non-economic societal values and interests*, such as public morals, public health, a sustainable environment, human rights, minimum labour standards, consumer safety, and cultural identity and diversity. Measures taken to protect and/or promote these societal values and interests may, intentionally or not, restrict trade in products or services. However, the protection and promotion of these values and interests are core tasks of government, and, in many instances, trade-restrictive measures may

127 *Ibid.* 128 See below, pp. 422–3. 129 *Ibid.*
130 See J. Jackson, W. Davey and A. Sykes, *Legal Problems of International Economic Relations*, 4th edn (Westgroup, 2002), 20–1.
131 *Ibid.* 132 *Ibid.*

not only be legitimate, but also necessary. In other instances, such measures are, however, mere fronts for protectionist measures intended to shield domestic producers from import competition. Domestic producers adversely affected by import competition are generally well aware that trade-restrictive measures are more likely to get adopted if justifications other than protection from import competition are invoked. Protectionism can take on very sophisticated guises.[133]

Note that in 2016 the world is confronted with a rising tide of protectionism. In its June 2016 *Report on G20 Trade Measures*, the WTO found that in the period from October 2015 to May 2016, the G20 economies imposed an average of twenty-one new trade-restrictive measures per month, which was the highest monthly average registered since the 2008–9 global economic crisis when the WTO began its monitoring exercise.[134] WTO Director-General Roberto Azevêdo, expressing concerns over these findings, commented:

These trade-restrictive measures, combined with a notable rise in anti-trade rhetoric, could have a further chilling effect on trade flows, with knock-on effects for economic growth and job creation. If we are serious about addressing slow economic growth then we need to get trade moving again, not put up barriers between economies. The G20 economies have made a commitment to lead in this endeavour as the world's largest traders. I urge them to act on this commitment.[135]

2.4 International Trade to the Benefit of All?

As discussed in the previous section, governments may in certain situations have good reasons to restrict trade. This will be the case, in particular, when trade-restrictive measures are necessary to protect and/or promote important societal values and interests. However, there is a broad consensus that governments are well advised to adopt free trade policies. As explained above, international trade has the potential of contributing to economic development and lifting people out of poverty.[136] It has realised this potential – albeit to varying degrees – in many countries; over the past two decades, this has been the case, in particular, in Asia. However, at the same time, it is undisputed that not all countries, and within countries not all sections of the population, have benefited from international trade. In fact, many people have been left behind or are now – because of international trade – worse off than they were before. At the WTO Ministerial

133 See below, p. 885.
134 World Trade Organization, *Report on G20 Trade Measures (Mid-October 2015 to Mid-May 2016)*, 21 June 2016, 2, at www.wto.org/english/news_e/news16_e/g20_wto_report_june16_e.pdf. Since 2009, G20 countries imposed a total of 1,583 trade-restrictive measures, and only a quarter of these measures have been removed. See *ibid.* The G20 economies comprise Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Republic of Korea, Japan, Mexico, the Russian Federation, Saudi Arabia, South Africa, Turkey, the United Kingdom and the United States, as well as the European Union.
135 See www.wto.org/english/news_e/news16_e/trdev_21jun16_e.htm. 136 See above, pp. 2 and 23.

Conference in Cancún in September 2003, the then UN Secretary-General Kofi Annan noted, not without a measure of frustration:

> The reality of the international trading system today does not match the rhetoric (of improving the quality of life). Instead of open markets, there are too many barriers that stunt, stifle and starve. Instead of fair competition, there are subsidies by rich countries that tilt the playing field against the poor. And instead of global rules negotiated by all, in the interest of all, and adhered to by all, there is too much closed-door decision-making, too much protection of special interests, and too many broken promises.[137]

In its 2002 study, *Rigged Rules and Double Standards: Trade, Globalization, and the Fight Against Poverty*, Oxfam noted that, just as in any national economy, economic integration in the global economy can be a source of shared prosperity and poverty reduction, or a source of increasing inequality and exclusion. Oxfam stated:

> Managed well, the international trading system can lift millions out of poverty. Managed badly, it will leave whole economies even more marginalised. The same is true at a national level. Good governance can make trade work in the interests of the poor. Bad governance can make it work against them.[138]

In a speech to the G-20 Finance Ministers and Central Bank Governors in November 2001, James Wolfensohn, then President of the World Bank, analysed the challenge to make economic globalisation and international trade to work to the benefit of all. This analysis still holds true today. Wolfensohn first observed:

> In my view, with the improvements in both technology and policies that we have seen over recent decades, some form of globalization is with us to stay. But the kind of globalization is not yet certain: it can be either a *globalization of development and poverty reduction* – such as we have begun to see in recent decades, although this trend still cannot be taken for granted – or a *globalization of conflict, poverty, disease, and inequality*. What can we do to tip the scales decisively toward the right kind of globalization?[139]

To ensure that economic globalisation and international trade contribute to economic development, equity and the well-being of all people, Wolfensohn advocated the following four-point agenda for action: (1) good governance at the national level; (2) a further reduction of trade barriers; (3) more development aid; and (4) better international cooperation and global governance of economic globalisation and international trade. First, with regard to *good governance* at the national level, Wolfensohn stated:

> [D]eveloping countries must continue the move toward *better policies, investment climate, and governance*. Despite progress in macroeconomic management and openness, there

137 See www.wto.mvs.com/mino3_webcast_e.htm/archives. 138 *Ibid.*
139 'Responding to the Challenges of Globalization', Remarks to the G-20 Finance Ministers and Central Bank Governors by James D. Wolfensohn, President, World Bank Group, Ottawa, 17 November 2001, at www.worldbank.org/html/extdr/extme/jdwsp111701.htm.

> remain many domestic barriers to integration. Many countries have fallen short in creating an investment climate for productivity, growth, entrepreneurship, and jobs. These domestic barriers include inadequate transport infrastructure, poor governance, bureaucratic harassment of small businesses, a lack of electric power, an unskilled workforce ... And countries also need to make possible the participation of poor people in growth, through support for targeted education, health, social protection, and their involvement in key decisions that shape their lives. Poor people need much greater voice.[140]

Second, with regard to the *further reduction of trade barriers*, Wolfensohn noted that:

> all countries – developed and developing – must *reduce trade barriers* and give developing countries a better chance in world markets ... Rich countries must increase market access for the exports of developing countries, through both multilateral negotiations and unilateral action, to increase the payoffs to developing-country policy and institutional reforms.[141]

Third, with regard to the *increase in development aid*, Wolfensohn recommended that:

> developed countries must *increase development aid*, but allocate it better and cut down the burden its implementation can impose ... The evidence from the Bank's research is that well-directed aid, combined with strong reform efforts, can greatly reduce poverty. If we are serious about ensuring a beneficial globalization and meeting multilateral development goals we have all signed up to, we must double ODA [overseas development aid] from its current level of about $50 billion a year.[142]

Fourth, with regard to *better international cooperation* and *global governance* of economic globalisation and international trade, Wolfensohn stated that:

> we must *act as a global community* where it really matters. Effective globalization requires institutions of global governance, and multilateral action to confront global problems and provide global public goods. This means confronting terrorism, internationalized crime, and money laundering, as we are doing in response to September 11th. But it also means that as a community, we need to address longer-term needs, by: combating communicable diseases like AIDS and malaria; *building an equitable global trading system*; promoting financial stability to prevent deep and sudden crises; and safeguarding the natural resources and environment on which so many poor people depend for their livelihoods. As we do all this, we must bring poor countries into the decision-making of this global community.[143]

In the same vein, the then WTO Director-General Pascal Lamy noted in 2007 when addressing the question of how to ensure that economic globalisation and international trade benefits all, that this question has two sides:

> A first one is how to ensure trade benefits are shared more fairly among nations. The second side is how to ensure a better distribution of the benefits stemming from trade within a nation.

140 *Ibid.* 141 *Ibid.* 142 *Ibid.* 143 *Ibid.* Emphasis added.

On the action that needs to be taken at the *international level* (the 'first side' of the question), Lamy stated:

> I believe two elements are fundamental: fairer multilateral trade rules and building of trade capacity in developing countries. One primary objective of the ongoing WTO negotiations under the Doha Development Agenda is precisely to address the remaining imbalances in the WTO rules against developing countries, whether in agriculture or in areas such as textiles or footwear ... But negotiating a fairer playing field, difficult as it is, will not be enough. New trade opportunities do not automatically convert into growth and development. The international community also has a responsibility to make sure poorer countries have the capacity to trade and make full use of the market access opportunities provided to them, through more and better focused Aid for Trade.

On the action that needs to be taken at the *national level* (the 'second side' of the question), Lamy observed that:

> [t]rade opening can and does translate into greater growth and poverty alleviation, but this is neither automatic [nor] immediate. Trade opening must be accompanied by a solid domestic agenda to spur on growth and cushion adjustment costs. Appropriate tax policies, competition policy, investment in quality education, social safety nets and innovation fostering healthy environments must all be part of the mix needed for trade to translate into real benefits for the people. In this respect, trade policy cannot be isolated from domestic macroeconomic, social or structural policies. The same trade policy will result in different outcomes depending on the quality of economic policies, and this is true across the board, whether you look at the US, Europe, Japan, or at Vietnam, Cambodia, Kenya or Paraguay.[144]

On the action, both at the national and international level, that needs to be taken to ensure that international trade promotes, rather than hurts, economic growth, employment and equality in developing countries as well as developed countries, refer also to the 2011 study by the International Labour Office and the WTO, *Making Globalization Socially Sustainable*.[145]

Just as Wolfensohn and Lamy have done, Peter Sutherland, former GATT and WTO Director-General and later Chair of BP Amoco and Goldman Sachs International, has also emphasised that more is needed than international trade and economic openness to eradicate poverty and inequality. He already noted in a 1997 contribution to the *International Herald Tribune* that:

> There are those who oppose redistribution policies in principle, whether in the domestic or the international context. This is wrong. It is morally wrong, it is pragmatically wrong, and we ought not be ashamed to say so. I have been personally and deeply committed to promoting the market system through my entire career. Yet it is quite obvious to me that the market will never provide all of the answers to the problems of poverty and inequality. The fact is that there are those who will not be able to develop their economies simply because market access has been provided. I do not believe that we in the global community will

144 Lamy, 'Trends and Issues Facing Global Trade'.
145 *Making Globalization Socially Sustainable*, co-publication by the International Labour Office and the Secretariat of the World Trade Organization, edited by Mac Bacchetta and Marion Jansen (ILO/WTO, 2011).

> adequately live up to our responsibility if we have done no more than provide the poorest people and the poorest countries with an opportunity to succeed. We must also provide them with a foundation from which they have a reasonable chance of seizing that opportunity – decent health care, primary education, basic infrastructure.[146]

It is clear that international trade and economic openness are necessary but not sufficient conditions for economic development and prosperity. The simple spread of markets will not eliminate poverty. A global economy and more international trade will not automatically lead to rising prosperity for all countries and for all people. In fact, without the international and national action referred to above, international trade will not bring prosperity to all, but, on the contrary, is likely to result in more income inequality, social injustice, environmental degradation and cultural homogenisation.

3 THE LAW OF THE WTO

As discussed above, international trade can make a significant contribution to economic development and prosperity in developed as well as developing countries. However, for this potential to be realised, there must be: good governance at the national level; a further reduction of trade barriers; more development aid; and better international cooperation and global governance of economic globalisation and international trade. This book on the law and the policy of the World Trade Organization (WTO) touches upon the national and international action required in each of these four areas, but deals primarily with the requirement of global governance of international trade. Nobel Peace Prize winner, Muhammad Yunus, founder of the Grameen Bank for the Poor, stated the following in his Nobel Lecture in December 2006:

> I support globalization and believe it can bring more benefits to the poor than its alternative. But it must be the right kind of globalization. To me, globalization is like a hundred-lane highway criss-crossing the world. If it is a free-for-all highway, its lanes will be taken over by the giant trucks from powerful economies. Bangladeshi rickshaw will be thrown off the highway. In order to have a win–win globalization we must have traffic rules, traffic police, and traffic authority for this global highway. Rule of 'strongest takes it all' must be replaced by rules that ensure that the poorest have a place and piece of the action, without being elbowed out by the strong.[147]

This section deals with: (1) the international rules on international trade; and (2) the basic rules of WTO law.

146 P. Sutherland, 'Beyond the Market, a Different Kind of Equity', *International Herald Tribune*, 20 February 1997.
147 Muhammad Yunus, Nobel Lecture, Oslo, 10 December 2006, available at http://nobelprize.org/nobel_prizes/peace/laureates/2006/yunus-lecture-en.html.

6 Tariff Barriers

CONTENTS

1 INTRODUCTION

There can be no international trade without access to the domestic markets of other countries, and it is essential for traders in goods and services that this access is secure and predictable. Therefore, rules on market access are at the core of WTO law. Market access for goods and services from other countries may be

impeded or restricted in many different ways, but two main categories of barriers to market access can be distinguished: (1) tariff barriers; and (2) non-tariff barriers. The category of tariff barriers primarily includes customs duties, but also other duties and charges on imports (and exports). Tariff barriers are particularly relevant for trade in goods; they are of marginal importance for trade in services. The category of non-tariff barriers is a residual category that includes quantitative restrictions (such as quotas) and 'other non-tariff barriers' (such as lack of transparency of trade regulation, unfair and arbitrary application of trade regulation, customs formalities, technical barriers to trade, sanitary and phytosanitary measures, and government procurement practices). These 'other non-tariff barriers' undoubtedly constitute the largest and most diverse subcategory of non-tariff barriers. Unlike tariff barriers, non-tariff barriers significantly affect both trade in goods and trade in services.

As set out in the Preamble to the *WTO Agreement*, WTO Members pursue the objectives of higher standards of living, full employment, growth and economic development by:

> entering into reciprocal and mutually advantageous arrangements directed to the substantial reduction of tariffs and other barriers to trade.

The substantial reduction of tariff and non-tariff barriers to trade is, together with the elimination of discrimination, the key instrument of the WTO to achieve its overall objectives.[1] As discussed in Chapter 1, few economists and trade policy-makers dispute that further trade liberalisation *can* make a significant contribution to the economic development of countries.[2] The possible annual increase in global GDP resulting from the ongoing Doha Round negotiations on the reduction of customs duties is conservatively estimated to be US$63 billion.[3] Significantly, developing-country Members are expected to benefit more than developed-country Members from a successful conclusion of these tariff negotiations.[4]

As already noted in Chapter 1, some barriers to market access, such as quantitative restrictions on trade in goods, are prohibited, while other barriers, such as customs duties, are allowed in principle and are only limited to the extent of a Member's specific agreement. Thus, different rules apply to different forms of barriers. This difference in rules reflects a difference in the negative effects they have on trade and on the economy.[5] The rules on non-tariff barriers will

1 See above, pp. 88–90. 2 See above, p. 24.
3 See Gary Clyde Hufbauer, Jeffrey J. Schott and Woan Foong Wong, 'Figuring out the Doha Round', *Policy Analysis in International Economics*, No. 91 (Peterson Institute for International Economics, 2010), 35. On the Doha Round negotiations on the reduction of customs duties on non-agricultural products (the NAMA negotiations), see below, pp. 428–36.
4 See *ibid.*, 640 According to this study, the overall Doha Round package would result for the developing-country Members in a 1.3 per cent gain in GDP, while for developed-country Members the package would result in a 0.3 per cent gain.
5 See below, p. 419.

be examined in the next chapter. The rules on tariff barriers are discussed in this chapter, which, first, deals with rules on customs duties on imports, second, with rules on other duties and charges on imports, and, third, with customs duties and other duties and charges on exports. Since tariff barriers are not imposed on trade in services, this chapter only addresses tariff barriers on trade in goods.[6]

2 CUSTOMS DUTIES ON IMPORTS

A very common and widely used barrier to market access for goods are customs duties, also referred to as tariffs, on imports. This section discusses: (1) the definition and types of customs duties on imports; (2) the purpose of customs duties on imports; (3) customs duties as a lawful instrument of protection; (4) negotiations on the reduction of customs duties; (5) tariff concessions and Schedules of Concessions; (6) protection of tariff concessions; (7) modification or withdrawal of tariff concessions; and (8) the imposition of customs duties on imports.

2.1 Definition and Types

The term 'customs duty' is not defined in the GATT 1994 or in any of the other multilateral agreements on trade in goods. Moreover, these agreements use not only the term 'customs duty' but also the term 'tariff' (equally undefined), and they use these terms as synonyms. The GATT 1994 and the other multilateral agreements on trade in goods also do not set out the different types of customs duties. However, for the reasons explained below, it is important to define what a customs duty is, as well as to distinguish between the various types of customs duties. This subsection addresses the definition and types of customs duties on imports in turn.

2.1.1 Definition of a Customs Duty on Imports

Generally speaking, a customs duty or tariff on imports is a financial charge or tax on imported goods, due because of their importation. Market access for the

6 Note, however, that tariff barriers imposed on trade in goods may relate to goods which contain services outputs, embedded in digital form, for example a DVD containing audiovisual material or software, professional advice, *or* embedded in a non-digital form, for example in a book containing professional advice. The notion of a 'tariff barrier' on trade in services has also arisen in cases where there is *no embedding* of a service output in a good. The prime example is the so-called 'bit tax', which could theoretically be imposed 'at the border' on electronic communications containing services outputs, or 'digital products'. In 1998, Members agreed to maintain the practice not to impose customs duties on electronic transmissions. This and later 'moratorium' decisions reflect the concern of Members regarding such tariff barriers. For the currently applicable 'moratorium' decision, see Ministerial Conference, Decision of 19 December 2015, *Work Programme on Electronic Commerce*, WT/MIN(15)/42 – WT/L/977, dated 21 December 2015.

goods concerned is conditional upon the payment of the customs duty. In *EC – Poultry (1998)*, the Appellate Body held that:

> it is upon entry of a product into the customs territory, but before the product enters the domestic market, that the *obligation* to pay customs duties ... accrues.[7]

As discussed in Chapter 5, the panel in *China – Auto Parts (2009)* had to determine whether the charges at issue in that case were 'internal charges' (as argued by the complainants) or 'customs duties' (as argued by China).[8] With the exception of one particular charge, the panel found that the charges were not 'customs duties' but 'internal charges'.[9] In addressing this issue, the Appellate Body noted that 'the time at which a charge is collected or paid is not decisive' in determining whether a charge is a customs duty or an internal charge.[10] Customs duties may be collected after the moment of importation, and internal charges may be collected at the moment of importation.[11] What is important in determining whether a charge is a border charge (such as a customs duty) or an internal charge is whether the *obligation* to pay that charge accrues due to the importation or to an internal event (such as the distribution, sale, use or transportation of the imported product).[12] For a charge to constitute a customs duty, the *obligation* to pay it must accrue at the moment and by virtue of or on importation.[13] A determination of whether a particular charge is a customs duty or an internal charge must be made in light of the characteristics of the measure and the circumstances of the case. As noted in Chapter 5, the Appellate Body observed that in many cases this is 'a straightforward exercise', but that in other cases a panel may face a 'more complex' challenge.[14] However, neither the way in which a measure is characterised in a Member's domestic law nor the intent of a Member's legislator is dispositive of the characterisation of such measure under WTO law as a customs duty or internal charge.[15]

7 Appellate Body Report, *EC – Poultry (1998)*, para. 145. Emphasis added.
8 See above, p. 352.
9 See Panel Reports, *China – Auto Parts (2009)*, para. 7.212. Since they were internal charges, they were subject to the national treatment obligation of Article III:2, first sentence. See above, p. 352.
10 See Appellate Body Reports, *China – Auto Parts (2009)*, para. 162.
11 See Note *Ad* Article III of the GATT 1994, as discussed in Chapter 5. See above, p. 346.
12 See Appellate Body Reports, *China – Auto Parts (2009)*, para. 162. See also Panel Reports, *China – Auto Parts (2009)*, paras. 7.128–7.129.
13 See Appellate Body Reports, *China – Auto Parts (2009)*, para. 158. With regard to the difference between a 'customs duty' and 'other duties and charges on imports', see below, p. 462.
14 See Appellate Body Reports, *China – Auto Parts (2009)*, para. 171. See in this context also *India – Additional Import Duties (2008)*, in which the panel agreed with the parties that the measures at issue were border charges within the meaning of Article II, and not internal charges within the meaning of Article III:2. See Appellate Body Report, *India – Additional Import Duties (2008)*, fn. 304 to para. 153.
15 See Appellate Body Reports, *China – Auto Parts (2009)*, para. 178. Note that the 1973 *Kyoto International Convention on the Simplification and Harmonization of Customs Procedures*, to which many WTO Members are a party, defines 'customs duties' as 'the duties laid down in the Customs tariff to which goods are liable on entering ... the Customs territory'. Therefore, according to the *Kyoto Convention*, but contrary to the ruling of the Appellate Body in *China – Auto Parts (2009)*, a duty is a customs duty because a country characterises it as such by including it in its national customs tariff. See *International Convention on the Simplification and Harmonization of Customs Procedures* (as amended), done at Kyoto, 18 May 1973, General Annex, Chapter 2, EB./F11.

2.1.2 Types of Customs Duties

Customs duties are either *ad valorem* or non-*ad valorem*. An *ad valorem* customs duty on a good is an amount based on the value of that good. It is a percentage of the value of the imported good, for example a 15 per cent *ad valorem* duty on computers. In that case, the duty on a computer worth €1,000 will be €150. Non-*ad valorem* customs duties (or NAV duties) can be specific, compound, mixed or 'other' customs duties.[16] A specific customs duty on a good is an amount based on a unit of quantity such as weight (kg), length (m), area (m^2), volume (m^3 or l) or numbers (pieces, pairs, dozens, or packs) of that good, for example a duty of €100 per hectolitre of vegetable oil or a duty of €3,000 on each car. A compound customs duty is a duty comprising an *ad valorem* duty to which a specific duty is added or, less frequently, subtracted, for example a customs duty on wool of 10 per cent *ad valorem* and €50 per tonne.[17] In that case, the duty on three tonnes of wool worth €1,000 per tonne will be €450. A mixed customs duty is a duty that can be either an *ad valorem* duty or a specific duty, subject to an upper and/or a lower limit, for example a customs duty on shirts of 10 per cent *ad valorem* or €4 per shirt, whichever duty is the higher. Finally, 'other' non-*ad valorem* customs duties, also referred to as technical customs duties, are duties determined by technical factors often related to the content, composition or nature of the goods concerned.[18]

Ad valorem customs duties are by far the most common type of customs duties.[19] They are preferable to non-*ad valorem* duties for several reasons. First, *ad valorem* duties are more transparent than non-*ad valorem* duties. The protectionist impact and the negative effect on prices for consumers are easier to assess for *ad valorem* duties than for non-*ad valorem* duties. The lack of transparency of non-*ad valorem* duties makes it easier for special interest groups to obtain government support for high levels of protection.[20] Second, by definition, *ad valorem* customs duties are index-linked. In times of inflation, the government's tariff revenue will keep up with price increases and the level of protection will remain the same. By contrast, non-*ad valorem* duties will constantly have to be changed to maintain the same real tariff revenue or maintain the same level of protection. Third, non-*ad valorem* duties 'punish' efficiency, because the cheaper like products are subject to a higher duty in *ad valorem* terms. Overall, with respect to industrial products, non-*ad valorem* duties

16 See Negotiating Group on Market Access, Note by the Secretariat, *Incidence of Non-Ad Valorem Tariffs in Members' Tariff Schedules and Possible Approaches to the Estimation of Ad Valorem Equivalents*, TN/MA/S/10/Rev.1, dated 18 July 2005, para. 3.
17 e.g. the measure at issue in *Colombia – Textiles (2016)* was a compound tariff, with an *ad valorem* component of 10 per cent and a specific component of US$1.75/pair, US$3/kg, US$5/kg or US$5/pair depending on the product concerned and its declared f.o.b. price, Appellate Body Reports, *Colombia – Textiles (2016)*, para. 1.3.
18 See Negotiating Group on Market Access, Note by the Secretariat, *Incidence of Non-Ad Valorem Tariffs in Members' Tariff Schedules and Possible Approaches to the Estimation of Ad Valorem Equivalents*, para. 3.
19 See *ibid.*, paras. 5–6.
20 See WTO Secretariat, Market Access: Unfinished Business, Special Studies Series 6 (WTO, 2001), 9.

are unusual.[21] With respect to agricultural products, however, non-*ad valorem* duties, and in particular compound duties, are still common.[22]

Ad valorem or non-*ad valorem* duties can be MFN duties, preferential duties or neither of the two. *MFN duties* are the 'standard' customs duties applicable to all other WTO Members in compliance with the non-discrimination MFN treatment obligation of Article I:1 of the GATT 1994.[23] *Preferential duties* are customs duties applied to specific countries pursuant to conventional or autonomous arrangements under which products from these countries are subject to duties lower than MFN duties.[24] For example, the customs duties applied by the European Union and sixteen Caribbean countries on each other's products under the terms of the *CARIFORUM–EC Economic Partnership Agreement* are conventional preferential duties.[25] The customs duties applied by the European Union on products from developing countries under the EU's Generalised System of Preferences (GSP) are autonomous preferential duties.[26] Finally, there are customs duties that are neither MFN duties nor preferential duties. These are the duties applicable to goods from countries which are not WTO Members and do not benefit from MFN treatment.[27] However, since the number of countries that are not Members of the WTO is now very small and their share in world trade is negligible, the latter category of customs duties is therefore of limited importance.

2.1.3 National Customs Tariff

As stated above, the terms 'customs duty' and 'tariff' are used as synonyms in the multilateral agreements on trade in goods. However, the term 'tariff' has a second meaning, different from 'customs duty'. A 'tariff', or 'customs tariff', is also a structured list of product descriptions and their corresponding customs duty. The customs duties or tariffs, which are due on importation, are set out in a country's customs tariff.[28] Most national customs tariffs now follow or reflect

21 For only five Members, more than 5 per cent of their tariff lines for industrial products are bound in non-*ad valorem* terms. Only Switzerland uses non-*ad valorem* terms for all its non-zero duties. See TN/MA/S/10/Rev.1, dated 18 July 2005, para. 5. Note that the General Council, in its Decision of 1 August 2004 on the Doha Work Programme, decided that 'all non-*ad valorem* duties [on non-agricultural products] shall be converted to *ad valorem* equivalents on the basis of a methodology to be determined' (WT/L/579, dated 2 August 2004, Annex B, para. 5).

22 WTO Secretariat, *Market Access: Unfinished Business*, Special Studies Series 6 (WTO, 2001), 46 and 47. That is the case, for example, for the European Union and the United States.

23 See above, p. 321.

24 The existence of preferential duties makes it important to determine the country of origin of products. On rules of origin, see below, pp. 457–61.

25 See *CARIFORUM–EC Economic Partnership Agreement*, signed on 15 October 2008. Under this Agreement, goods from the CARIFORUM countries may be imported into the European Union free of customs duties.

26 See above, p. 322.

27 Note that non-WTO Members may benefit from MFN treatment under the terms of bilateral or regional trade agreements.

28 The 'national' customs tariff of the European Union is referred to as the Common Customs Tariff. See Council Regulation (EEC) No. 2658/87 of 23 July 1987 on the tariff and statistical nomenclature and on the Common Customs Tariff, OJ 1987, L256, 7 September 1987. Every year, the European Commission adopts a Regulation reproducing a complete version of the Common Customs Tariff, taking into account Council and Commission amendments of that year. The Regulation is published in the *Official Journal of the European Communities* no later than 31 October. It applies from 1 January of the following year.

Tariff item	Description of goods	Unit	Rate of duty: Standard	Rate of duty: Preferential areas
1801 00 00	COCOA BEANS, WHOLE OR BROKEN, RAW OR ROASTED	kg.	30%	–
1802 00 00	COCOA SHELLS, HUSKS, SKINS AND OTHER COCOA WASTE	kg.	30%	–
1803	COCOA PASTE, WHETHER OR NOT DEFATTED			
1803 10 00	– Not defatted	kg.	30%	–
1803 20 00	– Wholly or partly defatted	kg.	30%	–
1804 00 00	COCOA BUTTER, FAT AND OIL	kg.	30%	–
1805 00 00	COCOA POWDER, NOT CONTAINING ADDED SUGAR OR OTHER SWEETENING MATTER	kg.	30%	–
1806	CHOCOLATE AND OTHER FOOD PREPARATIONS CONTAINING COCOA			
1806 10 00	Cocoa powder, containing added sugar or other sweetening matter	kg.	30%	–
1806 20 00	Other preparations in blocks, slabs or bars weighing more than 2 kg. or in liquid, paste, powder, granular or other bulk form in containers or immediate packings, of a content exceeding 2 kg.	kg.	30%	–
	– Other, in blocks, slabs or bars:			
1806 31 00	– Filled	kg.	30%	–
1806 32 00	– Not Filled	kg.	30%	–
1806 90	– Other:			
1806 90 10	– Chocolate and chocolate products	kg.	30%	–
1806 90 20	– Sugar confectionery containing cocoa	kg.	30%	–
1806 90 30	– Spreads containing cocoa	kg.	30%	–
1806 90 40	– Preparations containing cocoa for making beverages	kg.	30%	–
1806 90 90	– Other	kg.	30%	–

Figure 6.1 Excerpt from the customs tariff of India, 2015–16

the structure set out in the Harmonized Commodity Description and Coding System, usually referred to as the 'Harmonized System' or 'HS' discussed in detail later in this chapter.[29]

Figure 6.1, an excerpt from the customs tariff of India, shows that the MFN customs duties on cocoa are 30 per cent *ad valorem*. India's customs duties on some goods are even higher than 30 per cent, while on other goods they are lower. The customs duty on, for example, tariff item 1704 10 00 ('Chewing gum ...') is 45 per cent *ad valorem* and the customs duty on tariff item 8703 21 10 ('Vehicles principally designed for the transport of more than seven persons,

29 See below, pp. 451–3.

including the driver') is 125 per cent *ad valorem*. The customs duty on tariff item 2501 00 10 ('Common salt ...') is 10 per cent *ad valorem*. As discussed below, average customs duties imposed by developing-country Members are, generally speaking, considerably higher than those of developed-country Members.[30]

Many WTO Members have an online database of the customs duties they apply. The website of the World Customs Organization gives easy access to many of these databases, including the TARIC database of the European Union.[31] However, information on customs duties is perhaps most conveniently obtained via the WTO's Tariff Analysis Online (for registered users only) or, for less sophisticated searches, via the Tariff Download Facility (for all users).[32] Also quite useful and presenting data in an easily accessible and graphic way is the International Trade and Market Access interactive tool, launched by the WTO Secretariat in November 2012.[33]

2.2 Purpose of Customs Duties on Imports

Customs duties or tariffs on imports serve two main purposes. First, customs duties are a source of revenue for governments. In fact, it is one of the oldest ways for a government to collect revenue.[34] This purpose is now less important for industrialised countries with a well-developed system of direct and indirect taxation. For many developing countries, however, customs duties are an important source of government revenue. In comparison with income taxes and sales taxes, customs duties are easy to collect. Imports are relatively easy to monitor and the collection of customs duties can be concentrated in a few points of entry. Second, customs duties are used to protect and/or promote domestic industries. The customs duties imposed on imported products make the 'like' domestic products relatively cheaper, giving them a price advantage and thus some degree of protection from import competition. Developing countries are likely to use customs duties to protect infant industries (and thus as an instrument of economic development policy), while developed countries use them more often to protect industries in decline.[35]

30 See below, pp. 423–4. However, note also that while India reduced its overall applied rate between 2001/2 and 2006/7 from 32.3 per cent to 15.8 per cent, and between 2006/7 and 2010/11 from 15.1 per cent to 12 per cent, there was a marginal increase from 12 per cent in 2010–11 to 13 per cent in 2014–15. See WTO Secretariat, *Trade Policy Review Report – India, Revision*, WT/TPR/S/182/Rev.1, dated 24 July 2007, vii, para. 2; WTO Secretariat, *Trade Policy Review Report – India, Revision*, WT/TPR/S/249/Rev.1 dated 20 October 2011, para. 12; and WTO Secretariat, *Trade Policy Review Report – India, Revision*, WT/TPR/S/313/Rev.1, dated 14 September 2015, para. 13.

31 See www.wcoomd.org. For the TARIC database, see http://ec.europa.eu/taxation_customs/dds2/taric/taric_consultation.jsp.

32 See www.wto.org/english/tratop_e/tariffs_e/tariff_data_e.htm. The information on customs duties in Tariff Analysis Online (http://tariffanalysis.wto.org) and the Tariff Download Facility (http://tariffdata.wto.org) is drawn from the WTO's Integrated Database (IDB), which is fed with the information that Members annually supply on the customs duties they apply. Anybody can register as a user of Tariff Analysis Online, but only WTO Members have access to import statistics beyond six digits.

33 See www.wto.org/english/res_e/statis_e/statis_e.htm.

34 There is historical evidence of the imposition of customs duties in the ancient Egyptian, Indian and Chinese civilisations. See H. Asakura, *World History of the Customs and Tariffs* (World Customs Organization, 2003), 19–105.

2.3 Customs Duties as a Lawful Instrument of Protection

In principle, WTO Members are free to impose customs duties on imported products. WTO law, and in particular the GATT 1994, does not prohibit the imposition of customs duties on imports.[36] This is in sharp contrast to the general prohibition on quantitative restrictions, discussed in Chapter 7.[37] In *India – Additional Import Duties (2008)*, the Appellate Body stated:

> Tariffs are legitimate instruments to accomplish certain trade policy or other objectives such as to generate fiscal revenue. Indeed, under the GATT 1994, they are the preferred trade policy instrument, whereas quantitative restrictions are in principle prohibited. Irrespective of the underlying objective, tariffs are permissible.[38]

Customs duties, unlike quantitative restrictions, represent an instrument of protection against imports generally allowed by the GATT 1994.[39]

2.4 Negotiations on the Reduction of Customs Duties

While WTO law does not prohibit customs duties, it does recognise that customs duties constitute an obstacle to trade. Article XXVIII *bis* of the GATT 1994, therefore, calls upon WTO Members to negotiate the reduction of customs duties. This article provides, in relevant part:

> [T]hus negotiations on a reciprocal and mutually advantageous basis, directed to the substantial reduction of the general level of tariffs and other charges on imports and exports and in particular to the reduction of such high tariffs as discourage the importation even of minimum quantities, and conducted with due regard to the objectives of this Agreement and the varying needs of individual [Members], are of great importance to the expansion of international trade. The [Members] may therefore sponsor such negotiations from time to time.

Note that Article XXXVII:1 of the GATT 1994 calls upon developed-country Members to accord, in the interest of the economic development of developing-country Members:

> high priority to the reduction and elimination of barriers to products currently or potentially of particular export interest to [developing-country Members].[40]

35 Note in addition that customs duties can also be used to promote a *rational* allocation of scarce foreign exchange (by imposing low duties on capital goods (e.g. industrial machinery) and high duties on luxury goods (e.g. SUVs or perfumes)).

36 Note, however, that Article V:3 of the GATT 1994 does prohibit customs duties on goods *in transit*.

37 See below, pp. 478–540.

38 Appellate Body Report, *India – Additional Import Duties (2008)*, para. 159.

39 The reasons behind the GATT's preference for customs duties are discussed below, p. 488.

40 Note, however, that Article XXXVII qualifies its call to give high priority to the reduction and elimination of barriers with the words 'except when compelling reasons ... make it impossible'.

Implementation period	Round covered	Weighted tariff reduction
1948	Geneva (1947)	–26
1949	Annecy (1949)	–3
1952	Torquay (1950–1)	–4
1956–8	Geneva (1955–6)	–3
1962–4	Dillon Round (1961–2)	–4
1968–72	Kennedy Round (1964–7)	–38
1980–7	Tokyo Round (1973–9)	–33
1995–9	Uruguay Round (1986–94)	–38

Figure 6.2 Sixty years of GATT/WTO tariff reductions

2.4.1 Success of Past Tariff Negotiations

Under the GATT 1947, negotiations on the reduction of customs duties, commonly and in short referred to as tariff negotiations, took place primarily in the context of eight successive 'Rounds' of trade negotiations. In fact, the first five of these Rounds (Geneva, Annecy, Torquay, Geneva and Dillon) were exclusively dedicated to the negotiation on the reduction of tariffs. The sixth, seventh and eighth Rounds (Kennedy, Tokyo and Uruguay) had an increasingly broader agenda, although the negotiation of tariff reductions remained an important element on the agenda of these Rounds. The eight GATT Rounds of trade negotiations were very successful in reducing customs duties. In the late 1940s, the average duty on industrial products imposed by developed countries was about 40 per cent *ad valorem*.[41] As a result of the eight GATT Rounds, the average duty of developed-country Members on industrial products is now below 3.8 per cent *ad valorem*.[42] Figure 6.2 sets out the tariff reductions achieved by the GATT/WTO over the past sixty years.

2.4.2 Importance of Customs Duties as Trade Barriers

Economists often consider a customs duty below 5 per cent *ad valorem* to be a nuisance rather than a barrier to trade. Nevertheless, customs duties remain a significant barrier in international trade for several reasons. First, most developing-country Members still impose relatively high customs duties. Many of them have a simple average duty ranging between 10 and 15 per cent *ad valorem*.[43]

41 See World Bank, *World Development Report 1987*, 134–5. Note that in a December 2015 VOX column, entitled 'The Urban Legend: Pre-GATT Tariffs of 40%', Chad Bown and Douglas Irwin suggested that the average tariffs in 1947 were around 22 per cent, rather than 40 per cent. See http://voxeu.org/article/myth-40-pre-gatt-tariffs.

42 See 'Tariffs: More Bindings and Closer to Zero' in *Understanding the WTO: The Agreements*, at www.wto.org/english/thewto_e/whatis_e/tif_e/agrm2_e.htm.

43 The simple average duties referred to in this paragraph are simple average applied MFN duties on all products (agricultural and non-agricultural). See WTO/ITC/UNCTAD, *World Tariff Profiles 2015*, available at www.wto.org/english/res_e/booksp_e/tariff_profiles15_e.pdf.

The simple average duty of Argentina is 13.6 per cent, of Bangladesh 13.9 per cent, of Brazil 13.5 per cent, China 9.6 per cent, India 13.5 per cent, Mexico 7.5 per cent, Nigeria 11.9 per cent and Pakistan 13.4 per cent.[44] In comparison, the simple average applied MFN duty of Japan is 4.2 per cent, the European Union 5.3 per cent, Canada 4.2 per cent, United States 3.5 per cent, and Hong Kong, China 0 per cent.[45] Second, developed-country Members as well as developing-country Members still have high, to very high, duties on specific groups of 'sensitive' industrial and agricultural products.[46] With respect to industrial products, these so-called 'tariff peaks' are quite common for textiles and clothing, leather and, to a lesser extent, transport equipment.[47] With respect to agricultural products, under the *WTO Agreement on Agriculture*, all non-tariff barriers to trade have been eliminated and substituted by customs duties at often very high levels.[48] Third, in very competitive markets and in trade between neighbouring countries, a very low duty may still constitute a barrier.

In addition, customs duties may also impede the economic development of developing-country Members to the extent that duties increase with the level of processing that products have undergone. The duties on processed and semi-processed products are often higher than the duties on non-processed products and raw materials. This phenomenon is referred to as 'tariff escalation'. Tariff escalation discourages manufacturing or processing in countries where those non-processed products or raw materials are produced, often developing countries.[49] The customs duties of Canada and Australia increase at each production stage. US customs duties increase significantly only between raw materials and semi-processed products. The same holds true for the customs duties of Japan. On average, the customs duties of the European Union appear to de-escalate, i.e. they are higher on raw materials than on semi-processed or processed products.[50] However, this is not always the case. As a clear example

44 See *ibid.* 45 See *ibid.*

46 See *ibid.* For example, the average duty imposed by the European Union on products in the product group 'dairy products' is 42.1 per cent; on products in the product group 'sugars and confectionary' 25.2 per cent; and on products in the product group 'clothing' 11.4 per cent. The average duty imposed by India on products in the product group 'tea and coffee' is 56.3 per cent; on products in the product group 'beverages and tobacco' 69.1 per cent; on products in the product group 'sugars and confectionery' 35.9 per cent; and on products in the product group 'fish and fish products' 29.9 per cent. The average duty imposed by Brazil on products in the product group 'clothing' is 34.9 per cent; on products in the product group 'textiles' 23.3 per cent; and on products in the product group 'transport equipment' 18.6 per cent.

47 Tariff peaks are tariffs that exceed a selected reference level. The OECD distinguishes between 'national peaks' and 'international peaks'. 'National peaks' are tariffs which are three times or more than the national mean tariff. 'International peaks' are tariffs of 15 per cent or more. See WTO Secretariat, *Market Access: Unfinished Business*, Special Studies Series 6 (WTO, 2001), 12.

48 See below, p. 489.

49 Note that Article XXXVII:1 of the GATT 1994 calls upon developed-country Members to accord 'high priority to the reduction and elimination of barriers to products currently or potentially of particular export interest to [developing-country Members], including customs duties and other restrictions *which differentiate unreasonably between such products in their primary and in their processed forms*' (emphasis added). See, in this respect, however, also p. 423, fn. 40.

50 See WTO Secretariat, *Market Access: Unfinished Business*, Special Studies Series 6 (WTO, 2001), 12 and 13, and Table II.3.

of tariff escalation, consider that the MFN duty applied by the European Union on cotton is zero per cent; on cotton yarn between 4 and 5 per cent; on woven fabric of cotton 8 per cent; and on men's or boy's shirts of cotton 12 per cent.[51]

2.4.3 Basic Rules Governing Tariff Negotiations

As noted above, Article XXVIII *bis* of the GATT 1994 calls for negotiations on the reduction of customs duties, in short tariff negotiations, on a 'reciprocal and mutually advantageous basis'. Furthermore, as discussed in Chapter 4, Article I:1 of the GATT 1994 requires that with respect to customs duties any advantage granted by any Member to any product originating in any other country shall be accorded immediately and unconditionally to the like product originating in all other Members.[52] The basic principles and rules governing tariff negotiations are thus: (1) the principle of reciprocity and mutual advantage; and (2) the most-favoured-nation (MFN) treatment obligation.

The principle of reciprocity and mutual advantage, as applied in tariff negotiations, entails that, when a Member requests another Member to reduce its customs duties on certain products, it must be ready to reduce its own customs duties on products which the other Member exports, or wishes to export. For tariff negotiations to succeed, the tariff reductions requested must be considered to be of equivalent value to the tariff reductions offered. There is no agreed method to establish or measure reciprocity. Each Member determines for itself whether the economic value of the tariff reductions received is equal to the value of the tariff reductions granted. Although some Members apply rather sophisticated economic methods to measure reciprocity, in general the methods applied are basic. The final assessment of the 'acceptability' of the outcome of tariff negotiations is primarily political in nature.[53]

The principle of reciprocity does not apply, at least not to its full extent, to tariff negotiations between developed- and developing-country Members. Article XXXVI:8 of Part IV ('Trade and Development') of the GATT 1994 provides:

> [Developed-country Members] do not expect reciprocity for commitments made by them in trade negotiations to reduce or remove tariffs and other barriers to the trade of [developing-country Members].

This provision is further elaborated in the 1979 Tokyo Round Decision on Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries, commonly referred to as the Enabling Clause, which provides, in paragraph 5:

> [Developed-country Members] shall ... not seek, neither shall [developing-country Members] be required to make, concessions that are inconsistent with the latter's development, financial and trade needs.

51 See http://web.ita.doc.gov/tacgi/OverSeasNew.nsf/alldata/Italy#Tariffs.
52 See above, p. 311.
53 Note that the principle of reciprocity applies not only to tariff negotiations adopting a product-by-product approach but also to tariff negotiations adopting a formula approach (be it a linear reduction approach or a non-linear reduction approach) or a sectoral approach. See below, p. 428.

In tariff negotiations between developed- and developing-country Members, the principle of *relative* reciprocity applies. In tariff negotiations with developed-country Members, developing-country Members are expected to 'reciprocate' only to the extent consistent with their development, financial and trade needs. With respect to least-developed-country Members, paragraph 6 of the Enabling Clause furthermore instructs developed-country Members to exercise the 'utmost restraint' in seeking any concessions for commitments made by them to reduce or remove tariffs.

Note, however, that paragraph 7 of the Enabling Clause states, in pertinent part:

> [Developing-country Members] expect that their capacity to make contributions or negotiated concessions ... would improve with the progressive development of their economies and improvement in their trade situation and they would accordingly expect to participate more fully in the framework of rights and obligations under the General Agreement.

Because of the principle of relative reciprocity, few developing-country Members agreed to any reductions of their customs duties up to and including the Tokyo Round. Before the Uruguay Round, tariff negotiations were, in practice, primarily conducted between developed-country Members. This changed in the Uruguay Round when almost all developing-country Members got involved in the tariff reduction negotiations, albeit that the reductions agreed to were – in accordance with the principle of relative reciprocity – smaller than the reductions agreed to by developed-country Members. The increased willingness of developing-country Members to participate actively in tariff reduction negotiations during the Uruguay Round can be attributed to two factors. First, a number of developing-country Members had made significant progress in their economic development. Second, a fundamental change had occurred in the trade policy of many developing-country Members. In the 1980s, many developing-country Members moved away from protectionist trade policies to more open and liberal trade policies.[54]

As noted above, tariff negotiations are governed not only by the principle of reciprocity (full or relative) but also by the MFN treatment obligation set out in Article I:1 of the GATT 1994. Any tariff reduction a Member grants to any country as the result of tariff negotiations with that country must be granted to all other Members, immediately and unconditionally. This considerably complicates tariff negotiations. Member A, interested in exporting product *a* to Member B, will request Member B to reduce its customs duties on product *a*. In return for such a reduction, Member A will offer Member B, interested in exporting product *b* to Member A, a reduction of its customs duties on product *b*. As a result of the MFN treatment obligation, the tariff reductions to which Members A and B agree would also benefit all other Members. However, Members A and B will be hesitant to give other Members the benefit of the tariff reductions 'without

54 See *Business Guide to the World Trading System*, 2nd edn (International Trade Centre/Commonwealth Secretariat, 1999), 59.

getting something in return'. Member A is therefore likely to put a hold on the agreement to reduce the customs duty on product *b* until it has been able 'to get something in return' from, for example, Member C which also exports product *b* to Member A and would thus also benefit from the reduction of the customs duty on product *b*. Likewise, Member B will be hesitant to reduce the customs duty on product *a* as long as Member D, which also has an interest in exporting product *a* to Member B, has not given Member B 'something in return' for this reduction. In tariff negotiations, Members may try to benefit from tariff reductions agreed between other Members without giving anything in return. If their export interests are small, they are likely to succeed and will therefore be 'free-riders'. The free-rider problem can be mitigated by opting for an approach to tariff negotiations other than the product-by-product approach described above. Other approaches to tariff negotiations include the formula approach (be it the linear reduction approach or the non-linear reduction approach) and the sectoral approach, all discussed below.[55]

2.4.4 Organisation of Tariff Negotiations

Tariff negotiations can be organised in different ways. As Article XXVIII *bis* of the GATT 1994 provides, tariff negotiations may be carried out: (1) on a selective product-by-product basis; or (2) by the application of such multilateral procedures as may be accepted by the Members concerned. Negotiators may thus opt for different tariff reduction approaches or methodologies, also referred to in WTO-speak as 'modalities'.[56]

During the first GATT Rounds (up to and including the 1961–2 Dillon Round), negotiators opted for a *product-by-product approach* to tariff negotiations. Under this approach, each of the participants in the tariff negotiations submits first its request list and then its offer list, identifying respectively the products with regard to which it is seeking and is willing to make tariff reductions. The negotiations take place between the principal suppliers and importers of each product. However, the product-by-product approach has one major disadvantage. For practical reasons, the number of products that can be subject to this kind of tariff negotiation is necessarily limited, and the product coverage of the tariff reductions that can be achieved is thus 'restricted'.

The product-by-product approach to tariff negotiations is still used, in bilateral or plurilateral negotiations outside a Round, both for Article XXVIII renegotiations and for tariff negotiations in the context of the accession of new Members to the WTO. However, since the 1963–7 Kennedy Round, the product-by-product

55 In fact, as discussed in the next section of this chapter, the increasing complexity of multilateral (as opposed to bilateral) tariff negotiations has led to the abandonment of the product-by-product approach to multilateral tariff negotiations. Note, however, that the principle of reciprocity (full or relative) and the MFN treatment obligation continue to be the underlying principles governing the negotiations.

56 For a detailed discussion of the different approaches to tariff negotiations, see Patrick Low and Roy Santana, 'Trade Liberalization in Manufactures: What Is Left After the Doha Round?', *Journal of International Trade and Diplomacy*, November 2008.

approach has no longer been used as the main approach in multilateral tariff negotiations. Multilateral tariff negotiations have been primarily conducted on the basis of a *formula approach*. Under the formula approach, tariff reductions that are derived from the application of a mathematical formula, result in either a linear reduction (linear reduction approach) or a non-linear reduction (non-linear reduction approach). These 'formula approach' negotiations always involve: (1) the selection of an appropriate formula; and (2) the identification of products to which the formula will not apply. With respect to the latter products, the tariff negotiations may be conducted on a product-by-product basis. For the Kennedy Round tariff negotiations, a *linear reduction approach* to tariff negotiations was adopted. While successful, this linear reduction approach also presented problems. Contracting Parties with low average customs duties argued that it was not reasonable to expect them to cut these duties by the same percentage as Contracting Parties with high customs duties. It is clear that a 50 per cent reduction of a customs duty of 40 per cent still leaves a 20 per cent customs duty in place, i.e. a significant degree of protection from import competition. However, a 50 per cent reduction of a customs duty of 10 per cent leaves only a 5 per cent customs duty. To mitigate this problem, the negotiators in the Tokyo Round (1973–9) applied a *non-linear reduction approach*, often referred to as the 'Swiss formula', which requires larger cuts of higher customs duties than of lower customs duties.

In the Uruguay Round tariff negotiations (1986–94), the negotiators applied different approaches, or modalities, to reduce agricultural and non-agricultural customs duties. Customs duties on agricultural products were reduced using the 'Uruguay Round formula', whereby developed-country Members eventually had to reduce customs duties on a simple average basis by 36 per cent, with a minimum reduction of 15 per cent for each tariff line.[57] Developing-country Members were required to do two-thirds of that effort.[58] With regard to the reduction of customs duties on non-agricultural products, the negotiators were never able to agree on the specific approach to apply to the tariff negotiations. In 1990, they did agree, however, on the result to be achieved, namely, an overall tariff reduction of at least 33 per cent. Each participant in the negotiations was free to determine the manner in which it would reach that reduction target.[59] Different participants applied different approaches. While some participants, and in particular Canada, the European Union and Japan, applied a formula to produce their initial offers, others, and in particular the United States, engaged in

57 These modalities for the tariff negotiations on non-agricultural products, which were set out in the so-called 'Dunkel text' of 1991, were never accepted by the Uruguay Round participants (see GATT document MTN. GNG/MA/W/24). However, in 1992, the participants proceeded to table comprehensive draft schedules which were in line with these modalities.

58 I.e. reduce customs duties on a simple average by 24 per cent, with a minimum reduction of 10 per cent for each tariff line.

59 See Negotiating Group on Market Access, Note by the Secretariat, *Sector Specific Discussions and Negotiations on Goods in the GATT and WTO*, TN/MA/S/13, dated 24 January 2005.

product-by-product negotiations. Subsequently, in 1993, Canada, the European Union, Japan and the United States announced they had reached an agreement on a number of elements they considered necessary for a final agreement on a global and balanced package, which included the large-scale use of the *sectoral approach* to tariff negotiations. The sectoral approach is an approach in which negotiators aim at reducing or eliminating tariffs in a specific sector (such as the chemical products, pharmaceuticals, construction equipment, medical equipment and beer sectors).[60]

Between the end of the Uruguay Round and the start of the current Doha Round, a group of WTO Members agreed to eliminate all customs duties on information technology products (i.e. computers, telecommunications equipment, semiconductors, etc.). At the Singapore Ministerial Conference in 1996, twenty-nine Members adopted the *Ministerial Declaration on Trade in Information Technology Products* and thus agreed to the *Agreement on Trade in Information Technology Products* (ITA) attached to the Ministerial Declaration.[61] The ITA provided for participants to eliminate duties completely on information technology products by 1 January 2000. The ITA entered into force in 1997 when forty Members, accounting for more than 90 per cent of world trade in information technology products covered by the ITA, had adopted the Agreement. At present, eighty-two Members, accounting for approximately 97 per cent of world trade in the information technology products covered by the ITA, have adopted the Agreement.[62] In 2013 the trade in information technology products covered by the ITA was valued at an estimated US$1.6 trillion and accounts today for approximately 10 per cent of global merchandise exports.[63] In June 2012, 33 WTO Members (which eventually increased to 54) initiated an informal process towards negotiations for expansion of product coverage under the ITA. At the Nairobi Ministerial Conference in December 2015, over 50 Members representing major exporters of IT products, adopted the *Ministerial Declaration on the Expansion in Trade in Information Technology Products* (ITA II) and agreed on the timetable for eliminating tariffs on 201 IT products, previously not covered and valued at over US$1.3 trillion per year.[64] All 164 WTO Members will benefit from ITA II as they will all enjoy, as a result of the MFN treatment obligation under Article I:1 of GATT 1994, duty-free market access to the markets of the Members eliminating tariffs on these products.[65]

60 See *ibid.*
61 Ministerial Conference, *Singapore Ministerial Declaration on Trade in Information Technology Products*, WT/MIN(96)/16, dated 13 December 1996.
62 See www.wto.org/english/tratop_e/inftec_e/inftec_e.htm.
63 See www.wto.org/english/tratop_e/inftec_e/itaintro_e.htm.
64 See Ministerial Conference, *Nairobi Ministerial Declaration on the Expansion of Trade in Information Technology Products*, WT/MIN(15)/25, dated 16 December 2015. The declaration established that the first set of tariff cuts are to be implemented by 1 July 2016 and the second set no later than 1 July 2017, with successive reductions taking place by 1 July 2018 and effective elimination no later than 1 July 2019.
65 On the MFN treatment obligation under Article I:1 of the GATT 1994, see above, pp. 307–25.

The Doha Ministerial Declaration of November 2001, in which the WTO Members agreed to start the Doha Round, provided little guidance with respect to the approach to be taken to the Doha Round tariff negotiations on non-agricultural products. However, the level of ambition of these tariff negotiations was clearly high. The Doha Ministerial Declaration states, in relevant part:

> We agree to negotiations which shall aim, *by modalities to be agreed*, to reduce or as appropriate eliminate tariffs, including the reduction or elimination of tariff peaks, high tariffs, and tariff escalation, as well as non-tariff barriers, in particular on products of export interest to developing countries. Product coverage shall be comprehensive and without *a priori* exclusions. The negotiations shall take fully into account the special needs and interests of developing and least-developed country participants, including through less than full reciprocity in reduction commitments.[66]

The approach to be taken to these tariff negotiations – negotiations commonly referred to as negotiations on non-agricultural market access or NAMA negotiations – was further 'clarified' by the General Council in its Decision of 1 August 2004. In this Decision, the General Council stated:

> We recognize that a *formula approach* is key to reducing tariffs, and reducing or eliminating tariff peaks, high tariffs, and tariff escalation. We agree that the Negotiating Group should continue its work on a non-linear formula applied on a line-by-line basis which shall take fully into account the special needs and interests of developing and least-developed country participants, including through less than full reciprocity in reduction commitments.
>
> We recognize that a *sectoral tariff component*, aiming at elimination or harmonization is another key element to achieving the objectives of paragraph 16 of the Doha Ministerial Declaration with regard to the reduction or elimination of tariffs, in particular on products of export interest to developing countries.[67]

At the subsequent Ministerial Conference in Hong Kong in December 2005, Members were unable to agree on the specific approach to (or, in WTO-speak, the modalities of) the NAMA negotiations.[68] After the Hong Kong Ministerial Conference, the positions of developed-country and developing-country Members in the NAMA negotiations became increasingly polarised. Developed-country Members wanted developing-country Members, and in particular emerging economies, to agree to a much greater reduction of tariff bindings than the latter were willing to accept.[69] Against this background, Ambassador Don Stephenson, the Chair of the Negotiating Group on Non-Agricultural Market Access (NAMA),

66 Ministerial Conference, *Doha Ministerial Declaration*, WT/MIN(1)/DEC/1, dated 20 November 2001, para. 16. Emphasis added.
67 See General Council, *Doha Work Programme, Framework for Establishing Modalities in Market Access for Non-Agricultural Products*, WT/L/579, dated 2 August 2004, Annex B, paras. 4 and 7. Emphasis added. See paras. 5–6 and 8–13 for further details on the 'initial elements' for future work on the modalities for the Doha Round tariff negotiations.
68 Ministerial Conference, *Hong Kong Ministerial Declaration*, WT/MIN(05)/DEC, dated 22 December 2005, 4–5. However, Members were able – four years after the start of the Doha Round – to frame better the agenda of the NAMA negotiations.
69 The European Union and the United States needed more market access for non-agricultural goods to balance the liberalisation of trade in agricultural goods requested by developing-country Members.

proposed in July 2007 the first 'NAMA Draft Modalities' with regard to the tariff negotiations on non-agricultural products.[70] The Chair proposed to conduct the tariff reduction negotiations primarily on the basis of a *non-linear reduction approach*, commonly referred to as the 'Swiss formula'. As explained above, the 'Swiss formula' requires larger cuts of higher customs duties than of lower customs duties. According to the 'Swiss formula', which applies on a line-by-line basis, the tariff reductions will be calculated as follows:

$$t_1 = \frac{(a \text{ or } b) \times t_0}{(a \text{ or } b) + t_0}$$

where:

t_1 is the final bound rate of duty

t_0 is the base rate of duty

a is the coefficient for developed Members, and is in the range 8–9

b is the coefficient for developing Members, and is in the range 19–23.[71] Note that the 'Swiss formula' provides for different coefficients for developed- and developing-country Members.[72] Least-developed-country Members would not be required to undertake tariff reduction commitments.

The Chair's July 2007 proposals for tariff negotiations on non-agricultural products were not received with much enthusiasm. Many developing-country Members had grave concerns regarding the 'Swiss formula' as well as other issues, which they considered were not satisfactorily addressed, such as the issue of preference erosion and the issue of sectoral tariff elimination. They considered that the specific interests of developing countries were not sufficiently taken into account. The *Financial Times* reported on the reaction of developing-country Members to the Chair's proposals, as follows:

> Serious opposition emerged ... to new proposals to cut manufacturing tariffs in the troubled Doha round of trade talks, with a group of developing countries saying the draft agreement was unacceptable. The group, led by South Africa and including Argentina and Venezuela, wants to continue protecting its industry against imports ... Mr Stephenson's [Canadian Ambassador] paper, released this week ... suggested a ceiling of 19–23 per cent for developing country industrial tariffs. The group wanted a ceiling of more than 30 per cent.[73]

70 Negotiating Group on Market Access, *Draft NAMA Modalities*, JOB(07)/126, dated 17 July 2007. This draft was revised by the Chair in February 2008. See Negotiating Group on Market Access, *Draft Modalities for Non-Agricultural Market Access*, TN/MA/W/103, dated 8 February 2008.

71 Negotiating Group on Market Access, *Draft NAMA Modalities*, JOB(07)/126, dated 17 July 2007, para. 5.

72 As an exception, the Chair proposed that developing-country Members with a binding coverage of non-agricultural tariff lines of less than 35 per cent would be exempted from making tariff reductions through the formula. Instead, they would be expected to bind 90 per cent of non-agricultural tariff lines at an average level that does not exceed the overall average of bound tariffs for all developing countries after full implementation of current concessions (28.5 per cent). The developing countries concerned are Cameroon, Congo, Côte d'Ivoire, Cuba, Ghana, Kenya, Macao, Mauritius, Nigeria, Sri Lanka, Suriname and Zimbabwe. See *ibid.*, para. 8.

73 See A. Beattie, 'Attack on Doha Talks Plan to Cut Tariffs', *Financial Times*, 25 July 2007.

Developed-country Members were also dissatisfied with the Chair's proposals, as the proposals were not, in their opinion, sufficiently ambitious in reducing customs duties.[74] The Chair's proposals triggered intense negotiations, which made meaningful progress by providing, for example, for more flexible modalities for certain categories of developing-country Members.[75] However, these negotiations eventually ended in failure at the mini-ministerial meeting in Geneva in July 2008.[76]

As discussed in Chapter 2, in April 2011, the then WTO Director-General Pascal Lamy presented to the Members the so-called 'Easter Package', a document reflecting the work done in the Doha Round negotiations so far.[77] This document showed that in many areas progress had been made, but it also made clear that Members had still to come to an agreement on many core issues, in particular on NAMA. The issue of market access for industrial products, a 'classic mercantilist issue' which had been 'the bread and butter' of the negotiations since the start, divided Members as no other issue.[78] Developed-country Members demanded, in particular from emerging economies, a substantial and meaningful 'Swiss-formula' cut in tariff bindings, combined with tariff elimination in important sectors. Emerging economies considered that these demands would: (1) lower their tariff bindings to a point where their policy space would be greatly reduced; and (2) have huge adverse impacts – especially as a result of sectoral tariff elimination – on their industrial development prospects. The Members subsequently made an effort to agree by the next Ministerial Conference in December 2011, on a smaller 'package' of issues relating primarily to issues of particular interest to the least-developed-country Members (an LDC package), including duty-free and quota-free market access and associated rules of origin. However, such narrow focus was not acceptable to all Members and agreement was subsequently sought on a somewhat extended package of issues, including for example trade facilitation and export competition (an 'LDC plus' package).[79]

Ambassador Servansing from Mauritius, the Coordinator and Chief Negotiator of the ACP Group in Geneva, noted in 2012:

> It could be said that the NAMA negotiations ultimately floundered on the conflict between market access mercantilism on the one hand and development concerns on the other. But,

74 This was so, in particular, because developing-country Members would in fact only be required to cut 'water' (i.e. the difference between the bound and the applied duties) and would, therefore, fail to create new market access opportunities. On 'water', see below, p. 446. Moreover, developed-country Members considered that emerging economies should join a number of sectoral tariff elimination initiatives.

75 A 'sliding scale' with five options was established for developing-country Members applying the formula. Moreover, separate and more flexible modalities were established for 'small, vulnerable economies' (SVEs), 'Members with low binding coverage', and 'recently acceded Members' (RAMs).

76 See above, p. 95. 77 See above, p. 96.

78 See Opening Remarks of Director-General Pascal Lamy at the informal TNC meeting of 29 April 2011, www.wto.org/english/news_e/news11_e/tnc_dg_infstat_29apr11_e.htm. As Lamy noted, trade negotiators have haggled over market access for industrial products for more than sixty years and they were eventually always able to find a compromise, 'using a mix of imagination, determination and spirit of compromise'. It was, therefore 'deeply disappointing that no ground for compromise has been found on the issue of industrial tariffs yet'. See *ibid.*

79 See above, p. 97.

this failure in large measure also shows the complexity of finding a new balance in global economic governance in today's globalised world.[80]

At the Bali Ministerial Conference in December 2013, there was hardly any progress in the negotiations on the NAMA front, and in 2014, the disagreement on the Bali decision on public stockholding for food security purposes virtually paralysed work in almost all aspects of the Doha Round, including NAMA.[81] Despite regular meetings in 2015, with the aim of drawing up a work programme and achieve progress in the negotiations before the Nairobi Ministerial Conference in December 2015, not much could be achieved.[82] The stalemate partly stemmed from the difficulty some WTO members had with the 2008 draft modalities of NAMA (commonly referred to as 'Rev. 3'), and in particular the Swiss Formula.[83] In his July 2015 report to the Trade Negotiations Committee, Ambassador Remigi Winzap, the Chair of the Negotiating Group on Market Access, observed:

> In my view, Members should further engage in a more numbers-based discussion on a non-prejudicial basis. It is hard to define ambition in abstract terms, and difficult to make an honest assessment of what one can do when one does not know what one can get. Possibly the best way forward is to work backwards from acceptable results.[84]

Further, in May 2016 at a meeting with the heads of delegations, Ambassador Winzap described the main challenge in NAMA as follows:

> How to build convergence in a situation where, on the one hand, Members' appetite to pursue NAMA negotiations in the WTO varies greatly and, on the other hand, no negotiated outcome may probably be reached in other areas without a result in NAMA?[85]

In the context of the Doha Round, Members are, in addition to tariff negotiations on non-agricultural products, also engaged in tariff negotiations on agricultural products. Reflecting the dissatisfaction of some countries with the result reached in the Uruguay Round regarding agricultural trade, Article 20 of the *Agreement on Agriculture* provided, as part of the so-called 'built-in agenda', for the restart of negotiations on agricultural trade, including tariff negotiations on agricultural products, by the end of 1999. The need for further negotiations on agricultural tariff reductions was particularly 'acute' since the Uruguay Round 'tariffication exercise' (discussed in Chapter 7) resulted in many (prohibitively) high tariff

80 See Shree B. C. Servansing, 'Non-Agricultural Market Access (NAMA) – Balancing Development and Ambition', in Mehta, Kaushik and Kaukab (eds.), *Reflections from the Frontline*, 94.
81 See *WTO Annual Report 2015*, 33.
82 See *WTO Annual Report 2016*, 36.
83 See *ibid.* The NAMA draft modalities Rev.3 (TN/MA/W/103/Rev.3) foresee the Swiss Formula to reduce tariffs of developed and more advanced developing Members ('formula-applying Members'). The discussion is affected by the fact that some formula-applying Members do not have a mandate to move away from the Swiss Formula, while for others using a Swiss Formula is not doable.
84 Negotiating Group on Market Access, *Report by the Chairman, Ambassador Remigi Winzap to the Trade Negotiations Committee*, TN/MA/27, dated 30 July 2015, para 3.1.
85 Meeting of 9 May 2016, Negotiating Group on Market Access, *Oral Report by the Chairman, Ambassador Remigi Winzap, to the Heads of Delegations*, TN/MA/30, dated 10 May 2016.

bindings.[86] Pursuant to paragraph 13 of the Doha Ministerial Declaration of November 2001, these negotiations were made a core part of the agenda of the Doha Round negotiations. As in the NAMA negotiations, discussed above, in the agricultural tariff negotiations the major challenge is to agree on the approach to be taken to the tariff reduction. Since the early years of the Doha Round negotiations, Members are discussing a tiered formula approach to the agricultural tariff negotiations. Under this approach, developed countries would reduce their customs duties on agricultural products in equal annual instalments over a number of years in accordance with a formula that provides for larger reductions in the higher tiers of customs duties. For example, duties in the tier from 21 to 50 per cent would be reduced by x per cent, while duties in the tier from 51 to 75 per cent would be reduced by $x + y$ per cent. In addition, developed-country Members would have to achieve a minimum average cut of their customs duties on agricultural products. Developing-country Members would also have to reduce their customs duties on agricultural products but would have to do so over a longer period in accordance with a tiered formula similar to the formula for developed-country Members but which provides for relatively smaller reductions in each tier. Also, developing-country Members would have to achieve a minimum average cut of their customs duties on agricultural products but this minimum average cut would be smaller than for developed-country Members. Small, vulnerable economies (SVEs) and recently acceded Members (RAMs) would be allowed to reduce their customs duties on agricultural products by a smaller amount than other developing-country Members. While various proposals have been worked out in excruciating technical detail,[87] final agreement on the tiered formula to be applied in the agricultural tariff negotiations has not been reached to date.

Recent discussions have also focused on alternative approaches to the reduction of tariffs on agricultural products.[88] The Chair of the Negotiating Group on Agriculture identified in July 2015 three types of tariff reduction approaches: the tiered formula approach (discussed above); an approach targeting a reduction in average bound tariffs – the so-called 'cut to the average' approach; and an average tariff cut approach. With regard to the two latter (alternative) approaches, the Chairman stated:

> The fundamental challenge, once again, relates to the differences of views among key participants on their respective contributions to any outcome and what they stand to get in return. The point has also been registered very strongly from a range of Members that while they may accept that the level of ambition achievable in current circumstances may

86 On the tariffication exercise, see below, p. 490.
87 See, for example, Negotiating Group on Agriculture, *Report by the Chairman, H. E. Mr David Walker, to the Trade Negotiations Committee*, TN/AG/26, dated 21 April 2011, which contains in an annex the Revised Draft Modalities for Agriculture, TN/AG/W/4/Rev.4, dated 6 December 2008.
88 See Negotiating Group on Agriculture, *Report by the Chairman, H. E. Mr John Adank, to the Trade Negotiations Committee*, TN/AG/30 dated 30 July 2015, para. 1.8.

be less than that envisaged in the 2008 draft modalities, in order for a deal to be politically viable it must be of substantive value when compared to the status quo. Finding this optimal level, and being able to present it in a balanced way that respects the interests of all Members, therefore remains the key challenge if we are to reach closure here.[89]

Before agreeing on any tariff reduction approach, Members will want to address numerous related concerns, such as the designation and treatment of 'sensitive products', the designation and treatment of 'special products', tariff escalation, tariff simplification, tariff quotas, cotton market access and the special safeguard mechanism (SSM), as well as broader issues such as domestic support.[90]

2.5 Tariff Concessions and Schedules of Concessions

The results of tariff negotiations are referred to as 'tariff concessions' or 'tariff bindings'. This subsection discusses the concept of 'tariff concessions' or 'tariff bindings', and explains where they can be found and how they are to be interpreted.

2.5.1 Tariff Concessions or Tariff Bindings

A tariff concession, or a tariff binding, is a commitment not to raise the customs duty on a certain product above an agreed level. As a result of the Uruguay Round tariff negotiations, almost all customs duties imposed by developed-country Members are now 'bound', i.e. are subject to a maximum level.[91] Most Latin American developing-country Members have bound all customs duties.[92] However, for Asian and African developing-country Members the situation is more varied. While Members such as Indonesia and South Africa have bound more than 95 per cent of their customs duties, India and Thailand have bound about 75 per cent; Hong Kong, China, 45.9 per cent; Zimbabwe, 22.2 per cent; Bangladesh, 15.5 per cent; and Cameroon, 13.3 per cent.[93]

2.5.2 Schedules of Concessions

The tariff concessions or bindings of a Member are set out in that Member's Schedule of Concessions (also referred to as a Goods Schedule). Each Member of the WTO has a schedule, except when the Member is part of a customs union, in which case the Member has a common schedule with the other members of the customs union.[94] The Schedules of Concessions resulting from the Uruguay Round negotiations are all annexed to the *Marrakesh Protocol* to the GATT 1994.

89 *Ibid.*, para 1.10. 90 On agricultural domestic support, see below, p. 874.
91 For both the European Union and the United States, the binding coverage is 100 per cent. See WTO/ITC/UNCTAD, *World Tariff Profiles 2015*, available at www.wto.org/english/res_e/booksp_e/tariff_profiles15_e.pdf.
92 Note that many Latin American Members apply a 'uniform ceiling binding', i.e. they have bound their customs duties to a single maximum level. For Chile, for example, this uniform maximum level is 25 per cent.
93 See WTO/ITC/UNCTAD, *World Tariff Profiles 2015*. Note that these percentages are not weighted according to trade volume or value. With regard to Hong Kong, China, note also that, while a high percentage of customs duties is unbound, the applied duties are zero.
94 e.g. the twenty-eight Member States of the European Union do not have their 'own' individual schedule. Their common schedule is the Schedule of the European Communities, now the European Union.

Pursuant to Article II:7 of the GATT 1994, the Schedules of Members are an integral part of the GATT 1994. The Schedules are available on the WTO website.[95] Information on tariff bindings can also be obtained via Tariff Analysis Online or, for less sophisticated searches, via the Tariff Download Facility.[96] Also the International Trade and Market Access interactive tool is quite useful.[97]

Each Schedule of Concessions contains four parts. The most important part, Part I, sets out the MFN concessions with respect to agricultural products and non-agricultural products. Furthermore, a Schedule sets out preferential concessions (Part II), concessions on non-tariff measures (Part III) and specific commitments on domestic support and export subsidies on agricultural products (Part IV). Figure 6.3 sets out an excerpt from Chapter 18 of the Schedule of Concessions of the European Union.

It is not possible for Members to agree in their Schedules to treatment that is inconsistent with the basic GATT obligations. In *EC – Bananas III (1997)*, the Appellate Body addressed the question of whether the allocation of tariff quotas agreed to and inscribed in the EC's Schedule was inconsistent with Article XIII of the GATT 1994. The Appellate Body referred first to the report of the panel in *US – Sugar (1989)*, which stated, *inter alia*:

> Article II permits contracting parties to incorporate into their Schedules acts yielding rights under the General Agreement but not acts diminishing obligations under that Agreement.[98]

Subsequently, the Appellate Body ruled in *EC – Bananas III (1997)*:

> This principle is equally valid for the market access concessions and commitments for agricultural products contained in the Schedules annexed to the GATT 1994. The ordinary meaning of the term 'concessions' suggests that a Member may yield rights and grant benefits, but it cannot diminish its obligations.[99]

Most Schedules are structured according to the Harmonized Commodity Description and Coding System ('Harmonized System' (or HS)), discussed below. Although the format is not identical in all cases, they generally contain the following information for each product subject to tariff concessions: (1) HS tariff item number; (2) description of the product; (3) base rate of duty; (4) bound rate of duty; (5) initial negotiating rights (INR);[100] (6) other duties and charges;[101] and (7) for agricultural products only, special safeguards.[102]

95 See www.wto.org/english/tratop_e/schedules_e/goods_schedules_table_e.htm.
96 See www.wto.org/english/tratop_e/tariffs_e/tariff_data_e.htm. The information on tariff bindings in Tariff Analysis Online and the Tariff Download Facility is based on the WTO's Consolidated Tariff Schedules (CTS) database. As discussed above, Tariff Analysis Online and the Tariff Download Facility also contain information on the applied duties. That information is drawn from the WTO's Integrated Database (IDB), which is fed with the information that Members annually supply on the duties they apply.
97 See www.wto.org/english/res_e/statis_e/statis_e.htm.
98 GATT Panel Report, *US – Sugar (1989)*, para. 5.2.
99 Appellate Body Report, *EC – Bananas III (1997)*, para. 154. The Appellate Body confirmed this ruling in Appellate Body Report, *EC – Poultry (1998)*, para. 98.
100 See below, p. 447. 101 See below, p. 461.
102 See below, p. 655. Since the Schedules are structured according to the Harmonized System, the periodic amendments to the Harmonized System to take account of changes in technology and patterns in international trade will give rise to changes in the Schedules.

SCHEDULE LXXX – EUROPEAN COMMUNITIES

PART I – MOST-FAVOURED-NATION TARIFF

SECTION I – Agricultural Products

SECTION I – A Tariffs

Tariff item number	Description of products	Base rate of duty			Bound rate of duty		Implementation period from/to	Special safeguard	Initial negotiating right	Other duties and charges	Comments
		Ad valorem (%)	Other	U/B/C	Ad valorem (%)	Other					
1	2	3			4		5	6	7	8	9
1802.00.00	Cocoa shells, husks, skins and other cocoa waste	3.0			0.0						
1803	Cocoa pastes, whether or not defatted:										
1803.10.00	– Not defatted	15.0			9.6						
1803.20.00	– Wholly or partly defatted	15.0			9.6						
1804.00.00	Cocoa butter, fat and oil	12.0			7.7						
1805.00.00	Cocoa powder, not containing added sugar or other sweetening matter	16.0			8.0						
1806	Chocolate and other food preparations containing cocoa:										
1806.10	– Cocoa powder, containing added sugar or other sweetening matter:										
1806.10.10	– Containing no more or less than 5% by weight of sucrose (including invert sugar expressed as sucrose) or isoglucose expressed as sucrose	10.0			8.0						
	– Containing 5% or more but less than 65% by weight of sucrose (including invert sugar expressed as sucrose) or isoglucose expressed as sucrose	10.0	+ 315 ECU/T		8.0	+ 252 ECU/T					
1806.10.30	– Containing 65 % or more but less than 80 % by weight of sucrose (including invert sugar expressed as sucrose) or isoglucose expressed as sucrose	10.0	+ 393 ECU/T		8.0	+ 314 ECU/T					
1806.10.90	– Containing 80 % or more by weight of sucrose (including invert sugar expressed as sucrose) or isoglucose expressed as sucrose	10.0	+ 524 ECU/T		8.0	+ 419 ECU/T					
1806.20	– Other preparations in block slabs or bars weighing more than 2 kg or in liquid, paste, powder, granular or other bulk form in containers or immediate packings, of a content exceeding 2 kg:										
1806.20.70	– Chocolate milk crumb, containing a combined weight of less than 25% of cocoa butter and milkfat and containing less than 18% by weight of cocoa butter	22.3	*		15.4	*					* see annex 1
1806.20.80	– Other	12.0	* MAX 27% + AD S/Z		8.3	* MAX 18.7% + AD S/Z					* see annex 1
	– Other, in blocks, slabs or bars:										
1806.31.00	– Filled	12.0	* MAX 27% + AD S/Z		8.3	* MAX 18.7% + AD S/Z					* see annex 1
1806.32.50	– Not filled	12.0	* MAX 27% + AD S/Z		8.3	* MAX 18.7% + AD S/Z					* see annex 1
1806.90.49	– Other	12.0	* MAX 27% + AD S/Z		8.3	* MAX 18.7% + AD S/Z					* see annex 1

Figure 6.3 Excerpt from the EU Goods Schedule

Note that the Schedules of the major trading entities such as the European Union and the United States, which have made tariff concessions on virtually all products, are lengthy and detailed. The file containing the Schedule of the European Union on the WTO's website is 759KB in size. By contrast, the Schedules of many developing-country Members are general and short. The files containing the Schedules of Botswana and the Dominican Republic are only 12 and 13KB respectively.[103]

2.5.3 Interpretation of Tariff Schedules and Concessions

Since the tariff schedules are an integral part of the GATT 1994 pursuant to Article II:7 thereof, they are part of a 'covered agreement' under the DSU.[104] Article 3.2 of the DSU therefore applies to the interpretation of tariff schedules and the concessions set out therein. As discussed in Chapter 3, Article 3.2 of the DSU provides that the provisions of the covered agreements are to be clarified in accordance with customary rules of interpretation of public international law, which have been codified in Articles 31 and 32 of the *Vienna Convention on the Law of Treaties*.[105] In *EC – Computer Equipment (1998)*, at issue was a dispute between the United States and the European Communities on whether the EC's tariff concessions regarding automatic data-processing equipment applied to local area network (LAN) computer equipment.[106] The panel based its interpretation of the EC's tariff concessions on the 'legitimate expectations' of the exporting Member, *in casu*, the United States. On appeal, the Appellate Body rejected this approach to the interpretation of tariff concessions, ruling as follows:

> The purpose of treaty interpretation under Article 31 of the *Vienna Convention* is to ascertain the *common* intentions of the parties. These *common* intentions cannot be ascertained on the basis of the subjective and unilaterally determined 'expectations' of *one* of the parties to a treaty. Tariff concessions provided for in a Member's Schedule – the interpretation of which is at issue here – are reciprocal and result from a mutually advantageous negotiation between importing and exporting Members. A Schedule is made an integral part of the GATT 1994 by Article II:7 of the GATT 1994. Therefore, the concessions provided for in that Schedule are part of the terms of the treaty. As such, the only rules which may be applied in interpreting the meaning of a concession are the general rules of treaty interpretation set out in the Vienna Convention.[107]

103 See www.wto.org/english/tratop_e/schedules_e/goods_schedules_e.htm.
104 On the concept of 'covered agreement', see above, p. 297. 105 See above, pp. 193–8.
106 In the context of the Uruguay Round tariff negotiations, the European Communities agreed to a tariff binding for automatic data processing equipment of 4.9 per cent (to be reduced to 2.5 per cent for some products or duty-free for others). According to the United States, during and shortly after the Uruguay Round, the European Communities classified LAN computer equipment as automatic data processing equipment. Later, however, it started classifying LAN computer equipment as telecommunications equipment, a product category subject to generally higher duties, in the range of 4.6–7.5 per cent (to be reduced to 3–3.6 per cent).
107 Appellate Body Report, *EC – Computer Equipment (1998)*, para. 84.

The Appellate Body furthermore noted with respect to the lack of clarity of tariff concessions and tariff schedules:

> Tariff negotiations are a process of reciprocal demands and concessions, of 'give and take'. It is only normal that importing Members define their offers (and their ensuing obligations) in terms which suit their needs. On the other hand, exporting Members have to ensure that their corresponding rights are described in such a manner in the Schedules of importing Members that their export interests, as agreed in the negotiations, are guaranteed ... [T]he fact that Members' Schedules are an integral part of the GATT 1994 indicates that, while each Schedule represents the tariff commitments made by *one* Member, they represent a common agreement among *all* Members.
>
> For the reasons stated above, we conclude that the Panel erred in finding that 'the United States was not required to clarify the scope of the European Communities' tariff concessions on LAN equipment'. We consider that any clarification of the scope of tariff concessions that may be required during the negotiations is a task for *all* interested parties.[108]

Note that, at the very end of the Uruguay Round, a special arrangement was made to allow the negotiators to check and control, through consultations with their negotiating partners, the scope of tariff concessions agreed to. This 'process of verification' took place from 15 February to 25 March 1994.[109]

As discussed above, most schedules are structured according to the Harmonized System. The Uruguay Round tariff negotiations were held on the basis of the Harmonized System's nomenclature; requests for, and offers of, concessions were normally made in terms of this nomenclature. In *EC – Chicken Cuts (2005)*, the Appellate Body stated that:

> [these] circumstances confirm that, prior to, during, as well as after the Uruguay Round negotiations, there was broad consensus among the GATT Contracting Parties *to use* the Harmonized System as the basis for their WTO Schedules, notably with respect to agricultural products. In our view, this consensus constitutes an 'agreement' between WTO Members 'relating to' the WTO Agreement that was 'made in connection with the conclusion of' that Agreement, within the meaning of Article 31(2)(a) of the Vienna Convention. As such, this agreement is 'context' under Article 31(2)(a) for the purpose of interpreting the WTO agreements, of which the EC Schedule is an integral part.[110]

The Appellate Body thus considered that the Harmonized System is relevant for purposes of interpreting tariff commitments in the Members' Schedules.[111] The Appellate Body also considered that Chapter Notes and Explanatory Notes to the Harmonized System could also be relevant for interpretation purposes.[112]

108 *Ibid.*, paras. 109 and 110. 109 See MTN.TNC/W/131, dated 21 January 1994.
110 Appellate Body Report, *EC – Chicken Cuts (2005)*, para. 199. See also Appellate Body Reports, *China – Auto Parts (2009)*, para. 149. Already in *EC – Computer Equipment (1998)*, the Appellate Body expressed surprise that in that case neither the European Communities nor the United States argued before the panel that the Harmonized System and its Explanatory Notes were relevant in the interpretation of the EC's Goods Schedule. See Appellate Body Report, *EC – Computer Equipment (1998)*, para. 89.
111 See Appellate Body Report, *EC – Chicken Cuts (2005)*, para. 199. Note that the panel in *EC – IT Products (2010)* stated that it does not follow from the Appellate Body's case law that the Harmonized System will necessarily be relevant in interpreting *all* tariff concessions, including tariff concessions that are not based on the Harmonized System. See Panel Reports, *EC – IT Products (2010)*, para. 7.443.
112 See Appellate Body Report, *EC – Chicken Cuts (2005)*, paras. 219–29.

Finally, note that the consistent classification practice at the time of the tariff negotiations is also relevant to the interpretation of tariff concessions.[113] As the Appellate Body noted in *EC – Computer Equipment (1998)*, the classification practice during the Uruguay Round is part of 'the circumstances of [the] conclusion' of the *WTO Agreement*. Therefore, this practice may be used as a supplementary means of interpretation within the meaning of Article 32 of the *Vienna Convention*.[114]

2.6 Protection of Tariff Concessions

As noted above, under WTO law customs duties are not prohibited. It was envisaged, however, that customs duties would be 'bound' and then progressively reduced through rounds of negotiations. WTO rules on customs duties relate primarily to the protection of tariff concessions agreed to in the context of tariff negotiations. The basic rules are set out in Article II:1 of the GATT 1994.

2.6.1 Articles II:1(a) and II:1(b), First Sentence, of the GATT 1994

Article II:1 of the GATT 1994 states:

> a. Each [Member] shall accord to the commerce of the other [Members] treatment no less favourable than that provided for in the appropriate Part of the appropriate Schedule annexed to this Agreement.
>
> b. The products described in Part I of the Schedule relating to any [Member], which are the products of territories of other [Members], shall, on their importation into the territory to which the Schedule relates, and subject to the terms, conditions or qualifications set forth in that Schedule, be exempt from ordinary customs duties in excess of those set forth and provided therein.

Article II:1(a) provides that Members shall accord to the commerce of other Members, that is, in any case the products imported from other Members, *treatment no less favourable* than that provided for in their Schedule.[115] Article II:1(b), first sentence, provides that products described in Part I of the Schedule of any Member shall, on importation, be *exempt from ordinary customs duties in excess of* those set out in the Schedule. This means that products may not be subjected to customs duties above the tariff concessions or bindings.[116] With respect to the relationship between Article II:1(a) and Article II:1(b), first sentence, the Appellate Body noted in *Argentina – Textiles and Apparel (1998)*:

> Paragraph (a) of Article II:1 contains a general prohibition against according treatment less favourable to imports than that provided for in a Member's Schedule. Paragraph

113 On tariff classification, see above, p. 384.

114 See above, pp. 197–8. See also Appellate Body Report, *EC – Computer Equipment (1998)*, paras. 92 and 95. Note that, while the prior classification practice of only *one* of the parties may be relevant, it is clearly of more limited value than the practice of all parties. See *ibid.*, para. 93.

115 The question whether the concept of the 'commerce of other [Members]' refers not only to the imports from other Members but also to the exports to other Members, has not yet been addressed in WTO dispute settlement.

116 For the most recent application of, and findings of inconsistency with, Article II:1(b), first sentence, of the GATT 1994, see Panel Report, *Russia – Tariff Treatment (2016)*, para. 8.1.

> (b) prohibits a specific kind of practice that will always be inconsistent with paragraph (a): that is, the application of ordinary customs duties in excess of those provided for in the Schedule.[117]

The requirement of Article II:1(b), first sentence, that a Member may not impose customs duties *in excess of* the duties set out in its Schedule was at issue in *Argentina – Textiles and Apparel (1998)*. In its Schedule, Argentina has bound its customs duties on textiles and apparel to 35 per cent *ad valorem*. In practice, however, these products were subject to the higher of *either* a 35 per cent *ad valorem* duty *or* a minimum specific import duty (the so-called 'DIEM'). The panel found the DIEM to be inconsistent with Argentina's obligations under Article II:1(b) of the GATT 1994 for two reasons: (1) because Argentina applied a different *type* of import duty (a specific duty) than that set out in its Schedule (an *ad valorem* duty); and (2) because the DIEM would, in certain cases, be in excess of the binding of 35 per cent *ad valorem*. On appeal, the Appellate Body agreed with the panel that the DIEM was inconsistent with Argentina's obligations under Article II:1(b), but it modified the panel's reasoning. The Appellate Body first noted:

> The principal obligation in the first sentence of Article II:1(b) ... requires a Member to refrain from imposing ordinary customs duties *in excess of* those provided for in that Member's Schedule. However, the text of Article II:1(b), first sentence, does not address whether applying a *type* of duty different from the *type* provided for in a Member's Schedule is inconsistent, in itself, with that provision.[118]

According to the Appellate Body, the application of a type of duty different from the type provided for in a Member's Schedule is only inconsistent with Article II:1(b) *to the extent that* it results in customs duties being imposed in excess of those set forth in that Member's Schedule.[119]

As Article II:1(b), first sentence, explicitly states, the obligation to exempt products from customs duties in excess of those set forth in the Schedule is

117 Appellate Body Report, *Argentina – Textiles and Apparel (1998)*, para. 45. See also Panel Report, *Colombia – Textiles (2016)*, para. 7.84. A finding of inconsistency with Article II:1(b), first sentence, of the GATT 1994, may therefore lead a panel to conclude, without the need for further analysis, that the measure at issue is also inconsistent with Article II:1(a) of the GATT 1994.

118 Appellate Body Report, *Argentina – Textiles and Apparel (1998)*, para. 46.

119 See *ibid.*, para. 55. On this basis, the Appellate Body found the DIEM regime inconsistent with Article II:1(b), first sentence, of the GATT 1994. In *Colombia – Textiles (2016)*, the panel found, as upheld by the Appellate Body, that the compound duty at issue exceeded the bound level (expressed in *ad valorem* terms) established in its Schedule and was therefore inconsistent with Article II:1(b), first sentence, of the GATT 1994. See Panel Report, *Colombia – Textiles (2016)*, paras. 7.189 and 7.193–7.194; and Appellate Body Report, *Colombia – Textiles (2016)*, para. 5.44. On how to assess whether a specific or compound duty exceeds the level bound expressed in *ad valorem* terms, see Appellate Body Report, *Argentina – Textiles and Apparel (1998)*, paras. 50ff.; and Panel Report, *Colombia – Textiles (2016)*, paras. 7.145ff. Note also that the Appellate Body indicated in *Argentina – Textiles and Apparel (1998)* that it is possible for a Member to provide for a legislative ceiling or cap on the level of specific or compound duties applied which would ensure that the duties applied do not exceed the bound level. See Appellate Body, *Argentina – Textiles and Apparel (1998)*, para. 54. See also Panel Report, *Colombia – Textiles (2016)*, paras. 7.182–7.186. In neither *Argentina – Textiles and Apparel (1998)* nor *Colombia – Textiles (2016)* the measure at issue was considered to provide for such legislative ceiling or cap.

'subject to the terms, conditions or qualifications set forth in that Schedule'. In *Canada – Dairy (1999)*, the Appellate Body ruled in this respect:

> In our view, the ordinary meaning of the phrase 'subject to' is that such concessions are without prejudice to and are *subordinated to*, and are, therefore, *qualified by*, any 'terms, conditions or qualifications' inscribed in a Member's Schedule ... A strong presumption arises that the language which is inscribed in a Member's Schedule under the heading, 'Other Terms and Conditions', has some *qualifying* or *limiting* effect on the substantive content or scope of the concession or commitment.[120]

Some of the disputes under Article II:1(a) and (b), first sentence, of the GATT 1994 do not directly stem from duties or charges imposed in excess of those contained in the Schedules of Concessions. In *EC – Chicken Cuts (2005)*, the European Communities did not deviate from the customs duties as contained in its Schedule of Concessions. It did, however, reclassify a certain type of chicken meat, namely, frozen boneless chicken cuts impregnated with salt, under a different tariff heading (heading 02.07 'Meat and edible offal, of the poultry of heading No. 0105, fresh, chilled or frozen').[121] Under that particular tariff heading, the customs duty imposed was higher than under the heading that applied according to the complainants in the case (heading 02.10 'Meat and edible meat offal, salted, in brine, dried, smoked; edible flours and meals of meat or meat offal'). As in *EC – Computer Equipment (1998)*, discussed above, the outcome of the *EC – Chicken Cuts (2005)* dispute depended on the interpretation of the tariff headings, and, in this case more specifically, on the interpretation of the term 'salted'. According to the European Communities, the key element under heading 02.10 was preservation and therefore the term 'salted' implied that the meat should be impregnated with salt sufficient to ensure long-term preservation. The complainants, Thailand and Brazil, contended that 'salted' did not imply long-term preservation and that the salted chicken cuts at issue thus fell within heading 02.10. Both the panel and the Appellate Body came to the conclusion that 'salted' did not imply long-term preservation in any way and that therefore the chicken cuts did fall under the

120 Appellate Body Report, *Canada – Dairy (1999)*, para. 134. At issue in *Canada – Dairy (1999)* was a tariff quota for fluid milk of 64,500 tonnes included in Canada's Schedule. In the column 'Other Terms and Conditions' of Canada's Schedule, it states that 'this quantity [64,500 tonnes] represents the estimated annual cross-border purchases imported by Canadian consumers'. In practice, Canada restricted imports under the 64,500 tonnes tariff quota to dairy products for the personal use of the importer and his household not exceeding C$20 in value for each importation. The United States contested that the restriction of access to imports for personal use not exceeding C$20 in value constituted a violation of Article II:1(b) of the GATT 1994. The panel agreed with the United States. The panel found that the 'condition' in Canada's Schedule is *descriptive* and does not establish restrictions on access to the tariff quota for fluid milk. The Appellate Body disagreed with the panel that the 'condition' was merely descriptive, and concluded that the limitation of cross-border purchases to 'Canadian consumers' referred to in Canada's Schedule justifies Canada's effective limitation of access to the tariff quota to imports for 'personal use'. However, the Appellate Body found that the C$20 value limitation was not contained in Canada's Schedule. See *ibid.*, para. 143.

121 See Panel Report, *EC – Chicken Cuts (2005)*, paras. 7.46–7.47.

more favourable tariff heading 02.10.[122] The European Communities had thus acted inconsistently with Article II:1(a) and (b) by wrongly classifying the chicken cuts, which resulted in treatment less favourable than that provided for in its Schedule.[123] To date, WTO Members have been found to have acted inconsistently with the obligations under Articles II:1(a) and II:1(b), first sentence, of the GATT 1994 in ten disputes[124]

In *Colombia – Textiles (2016)*, the respondent, Colombia, considered imports of textiles, apparel and footwear at a price below certain thresholds to be 'illicit trade' because there is a very high chance that such imports at below-threshold prices are being used to launder money. Colombia argued before the panel that the obligations of Articles II:1(a) and II:1(b), first sentence, are not applicable to 'illicit trade'. For Colombia, the term 'commerce' in Article II:1(a) and the term 'importation' in Article II:1(b) do not cover 'illicit trade'. The panel in *Colombia – Textiles (2016)* did not pronounce on whether 'illicit trade' is covered by the obligations under Article II:1.[125] On appeal, however, the Appellate Body found that the scope of the term 'commerce' in Article II:1(a) and the term 'importation' in Article II:1(b) is not qualified in respect of the nature or type of 'commerce' or 'imports' in a manner that excludes what Colombia considers to be illicit trade.[126] The Appellate Body concluded:

> we do not see that the text of Article II:1(a) and (b) of the GATT 1994 excludes what Colombia classifies as illicit trade. Moreover, the context provided in Articles II:2 and VII:2 of the GATT 1994 and the Customs Valuation Agreement supports our view that the scope of Article II:1(a) and (b) of the GATT 1994 is not limited in the manner suggested by Colombia.[127]

122 This conclusion was reached by applying the customary rules of interpretation of public international law, as codified in Articles 31 and 32 of the *Vienna Convention on the Law on Treaties*. Note, however, that the Appellate Body reversed the panel's conclusion that: 'the European Communities' practice of classifying, between 1996 and 2002, the products at issue under heading 02.10 of the EC Schedule "amounts to subsequent practice" within the meaning of Article 31.3(b) of the Vienna Convention'. See Appellate Body Report, *EC – Chicken Cuts (2005)*, para. 276.

123 See *ibid.*, paras. 346, 347(b)(i)–(iii) and 347 (c)(i)–(iii).

124 See *Argentina – Textiles and Apparel (1998); Canada – Dairy (1999); Korea – Various Measures on Beef (2001); EC – Chicken Cuts (2005); EC – Bananas III (Article 21.5 – Ecuador II)/EC – Bananas III (Article 21.5 – US) (2008); China – Auto Parts (2009); US – Zeroing (Japan – Article 21.5 – Japan) (2009); EC – IT Products (2010); Colombia – Textiles (2016)*; and *Russia – Tariff Treatment (2016)*. Note that, in *EC – Computer Equipment (1998)*, the Appellate Body reversed the panel's finding of inconsistency for the reasons discussed above, and did not complete the legal analysis.

125 The Panel considered it was not necessary for it to interpret Article II:1 of the GATT 1994 and determine whether 'illicit trade' fell within the scope of application of this provision, because the compound tariff was not structured or designed to apply 'solely to operations which have been classified as "illicit trade"'. See Panel Report, *Colombia – Textiles (2016)*, para. 7.106. On appeal, the Appellate Body noted that the compound tariff applies, or could apply, to some illicit trade, and that therefore the panel was required to address the interpretative issue pertaining to the scope of Article II:1 of the GATT 1994. See Appellate Body Report, *Colombia – Textiles (2016)*, para. 5.27. The Panel's failure to do so constituted a violation of its obligation under Article 11 of the DSU to make an objective assessment of the matter, including an objective assessment of the applicability of the relevant covered agreements. See *ibid.*, para. 5.28.

126 See Appellate Body Report, *Colombia – Textiles (2016)*, paras. 5.34–5.35.

127 *Ibid.*, para. 5.45.

128 *Ibid.*, para. 5.45.

Note that, having reached this conclusion, the Appellate Body stated:

> we wish to remark that our analysis set out above should not be understood to suggest that Members cannot adopt measures seeking to combat money laundering. This, however, cannot be achieved through interpreting Article II:1 of the GATT 1994 in a manner excluding from the scope of that provision what a Member considers to be illicit trade. A Member's right to adopt and pursue measures seeking to address concerns relating to money laundering can be appropriately preserved when justified, for example, in accordance with the general exceptions contained in Article XX of the GATT 1994.[128]

2.6.2 Tariff Concessions and Customs Duties Actually Applied

Note the difference between tariff concessions or bindings and the customs duties actually applied. As the Appellate Body observed in *Argentina – Textiles and Apparel (1998)*:

> A tariff binding in a Member's Schedule provides an upper limit on the amount of duty that may be imposed, and a Member is permitted to impose a duty that is less than that provided for in its Schedule.[129]

For many Members, tariff bindings for industrial products are considerably higher than the customs duties actually applied to these products. This means that the customs duties applied are significantly lower than the maximum levels agreed upon. This is in particular the case for developing-country Members. Figure 6.4 shows simple average tariff bindings and applied duties of selected Members. For example, the simple average tariff binding of India is 48.5 per cent, while its simple average applied duty is 13.5 per cent. Likewise, the simple average tariff binding of Brazil is 31.4 per cent, while its simple average applied duty is 13.5 per cent. In WTO-speak, the difference between the tariff binding and the applied duty is referred to as 'water' or 'binding overhang'. The presence of 'water' reflects a unilateral lowering of tariff barriers and thus allows for better market access. In this respect, 'water' is very welcome. However, 'water' also gives the importing Members concerned ample opportunity to increase the applied duties. Importing Members have the discretion to increase the applied duty to the level of the tariff binding. Therefore, when there is a lot of 'water', i.e. when the difference between the tariff bindings and the applied duties is large, exporting Members and traders have much less security and predictability with respect to the level of duties that will actually be applied on their products. However, as is clear in the Doha Round tariff negotiations,[130] Members, and in particular developing-country Members, are often hesitant to agree to lower bindings and to give up their 'water', even when their applied duties have for years been much lower than their bindings. Agreeing to lower bindings means giving up economic and fiscal policy space.

129 Appellate Body Report, *Argentina – Textiles and Apparel (1998)*, para. 46.
130 See above, pp. 93–9.

	Bound rate	MFN applied rate
Argentina	31.8	13.6
Brazil	31.4	13.5
Burundi	67.1	12.8
China	10	9.6
European Union	5.0	5.3
India	48.5	13.5
Japan	4.6	4.2
Kuwait	97.8	4.7
Malaysia	22.2	6.1
Nigeria	118.3	11.9
United States	3.5	3.5

Figure 6.4 Tariff rates: bound and applied[131]

2.7 Modification or Withdrawal of Tariff Concessions

As discussed above, Members may not apply customs duties above the tariff concessions or bindings agreed to in tariff negotiations and reflected in their Schedules. However, the GATT 1994 provides a procedure for the modification or withdrawal of agreed tariff concessions. Article XXVIII:1 of the GATT 1994 states, in pertinent part:

> [A Member] ... may, by negotiation and agreement ... modify or withdraw a concession included in the appropriate schedule annexed to this Agreement.

The negotiations on the modification or withdrawal of tariff concessions are to be conducted with: (1) the Members that hold so-called 'Initial Negotiating Rights' (INRs); and (2) any other Member that has a 'principal supplying interest'. In addition, consultations should be held with Members having a 'substantial interest'. The Members holding INRs are those Members with which the concession was bilaterally negotiated, initially. As mentioned above, INRs are commonly, though not always, specified in the Schedule of the Member granting the concession, but can also be determined on the basis of the negotiation records. Due to the approach to tariff negotiations adopted during the Uruguay Round,[132] many tariff concessions did not result from bilateral negotiations and thus INRs are much less common in respect of concessions agreed during the

131 See *World Tariff Profiles 2015*, available at www.wto.org/english/res_e/booksp_e/tariff_profiles15_e.pdf.
132 See above, pp. 428–36.

Uruguay Round. It was therefore agreed in the *Understanding on Article XXVIII* that:

> Any Member having a principal supplying interest ... in a concession which is modified or withdrawn shall be accorded an initial negotiating right.[133]

A Member has a 'principal supplying interest' if, as provided in Note *Ad* Article XXVIII, paragraph 1.4:

> that [Member] has had, over a reasonable period of time prior to the negotiations, a larger share in the market of the applicant [Member] than a Member with which the concession was initially negotiated or would ... have had such a share in the absence of discriminatory quantitative restrictions maintained by the applicant [Member].

The *Understanding on Article XXVIII*, paragraph 1, further elaborates on the concept of 'principal supplying interest' as follows:

> [T]he Member which has the highest ratio of exports affected by the concession (i.e. exports of the product to the market of the Member modifying or withdrawing the concession) to its total exports shall be deemed to have a principal supplying interest if it does not already have an initial negotiating right or a principal supplying interest as provided for in paragraph 1 of Article XXVIII.

Pursuant to Article XXVIII, the *negotiations* on the modification or withdrawal of a tariff concession are to be conducted only with the Members holding INRs or those having a principal supplying interest. However, the Member wishing to modify or withdraw a tariff concession must *consult* any other Member that has a substantial interest in such concession.[134] The Note *Ad* Article XXVIII, paragraph 1.7, states:

> The expression 'substantial interest' is not capable of a precise definition and accordingly may present difficulties ... It is, however, intended to be construed to cover only those [Members] which have, or in the absence of discriminatory quantitative restrictions affecting their exports could reasonably be expected to have, a significant share in the market of the [Member] seeking to modify or withdraw the concession.

A 'significant share', required to claim a 'substantial interest', has generally been considered to be 10 per cent of the market of the Member seeking to modify or withdraw a tariff concession.

With respect to the objective of the negotiations and agreement on the modification or withdrawal of tariff concessions, Article XXVIII:2 provides:

> In such negotiations and agreement ... the [Members] concerned shall endeavour to maintain a general level of reciprocal and mutually advantageous concessions not less favourable to trade than that provided for in this Agreement prior to such negotiations.

When a tariff concession is modified or withdrawn, compensation in the form of new concessions needs to be granted to maintain a general level of concessions not less favourable to trade.[135]

133 *Understanding on the Interpretation of Article XXVIII of the GATT 1994*, para. 7.
134 See Article XXVIII:1 of the GATT 1994. The Ministerial Conference determines which Members have a 'substantial interest'. See *ibid.*
135 See Award of the Arbitrator, *EC–ACP Partnership Agreement – Recourse to Arbitration Pursuant to the Decision of 14 November 2001*.

It follows from the above that the modification or withdrawal of a tariff binding is based on the principle of renegotiation and compensation. However, if the negotiations fail to lead to an agreement, Article XXVIII:3(a) provides, in relevant part, that:

> [T]he [Member] which proposes to modify or withdraw the concession shall, nevertheless, be free to do so.

In that case, any Member holding an INR, any Member having a principal supplying interest *and* any Member having a substantial interest shall be free to withdraw substantially equivalent concessions.[136]

In 2012, Ukraine requested – less than four years after its accession to the WTO – the renegotiation of its tariff bindings on 371 tariff lines. Both the size and the timing of this request for renegotiation alarmed many Members. In support of its request for renegotiation, Ukraine argued that, on joining the WTO in 2008, it agreed on very low tariff bindings 'with the expectation that the ongoing Doha Round talks would lead to additional liberalisation among other WTO members with more protected economies'.[137] As such additional liberalisation has clearly not been realised, Ukraine argued that 'today's reality [now] makes the adjustment necessary'.[138] However, in light of the negative reaction of many WTO Members to its request for renegotiation, Ukraine announced at the General Council meeting of 21 October 2014 that it no longer sought to renegotiate its tariff bindings.

Finally, note that Article XVIII:7 of the GATT 1994 allows developing-country Members to *modify or withdraw a tariff concession* in order to promote the establishment of a particular industry.[139] However, the developing-country Member concerned must enter into negotiations with the Members primarily affected by the modification or withdrawal of the tariff concession in order to come to an agreement on compensatory adjustment.[140] If no agreement is reached, it is for the General Council to decide whether the compensatory adjustment offered is adequate. Where the General Council considers the compensation to be adequate, the developing-country Member is then free to modify or withdraw the tariff concession provided that, at the same time, it gives effect to the compensatory adjustment. Should the General Council find the compensation offered to be inadequate, but also that every reasonable effort was made to offer adequate compensation, the developing-country Member may proceed with the modification or withdrawal of the tariff concession.[141] Any other Member affected by the modification or withdrawal is then free to modify or withdraw substantially equivalent concessions with regard to the developing-country Member concerned.[142] Under the GATT 1947, the GATT Council was generous in allowing developing-country Members to modify or withdraw tariff concessions without

136 See Article XXVIII:3 of the GATT 1994.
137 See *Bridges Weekly Trade News Digest*, 17 October 2012. 138 See *ibid.*
139 For a discussion of the 'infant industry' argument for trade-restrictive measures, see above, p. 27.
140 See Article XVIII:7(a) of the GATT 1994. 141 See Article XVIII:7(b) of the GATT 1994.
142 See *ibid.*

requiring any compensatory adjustment. The contribution of the exception under Article XVIII:7 to the economic development of developing countries has been limited. In fact, the infant-industry-protection exception under Article XVIII:7 has not been invoked by any developing-country Member since the entry into force of the *WTO Agreement* in 1995.[143]

2.8 Imposition of Customs Duties on Imports

In addition to rules for the protection of tariff concessions, WTO law also provides for rules on the manner in which customs duties must be imposed. The imposition of customs duties may require three determinations to be made: (1) the determination of the proper classification of the imported good, which allows customs authorities to determine which duty to levy; (2) the determination of the customs value of the imported good; and (3) the determination of the origin of the imported good.

The need for these determinations follows from the fact that customs duties differ from good to good (customs classification); are usually *ad valorem* duties and thus calculated on the basis of the value of the products concerned (customs valuation); and may differ depending on the exporting country (determination of origin).

2.8.1 Customs Classification

As illustrated above when discussing *EC – Computer Equipment (1998)* and *EC – Chicken Cuts (2005)*, the imposition of customs duties requires the determination of the proper customs classification of the imported good.[144] WTO law does not *specifically* address the issue of customs classification. In *Spain – Unroasted Coffee (1981)*, the panel ruled that:

> there was no obligation under the GATT to follow any particular system for classifying goods, and that a contracting party had the right to introduce in its customs tariff new positions or sub-positions as appropriate.[145]

However, in classifying products for customs purposes, Members have of course to consider their general obligations under the WTO agreements, such as the MFN treatment obligation. As discussed in Chapter 4, the panel in *Spain – Unroasted Coffee (1981)* ruled that:

> whatever the classification adopted, Article I:1 required that the same tariff treatment be applied to 'like products'.[146]

143 Committee on Trade and Development, *Implementation of Special and Differential Treatment Provisions in WTO Agreements and Decisions*, Note by the WTO Secretariat, WT/COMTD/W/196, dated 14 June 2013, 7.
144 See above, pp. 444 and 445.
145 Panel Report, *Spain – Unroasted Coffee (1981)*, para. 4.4.
146 *Ibid.*; and Panel Report, *Japan – SPF Dimension Lumber (1989)*, para. 5.9.

Specific rules on classification can be found in the *International Convention on the Harmonized Commodity Description and Coding System* (the '*HS Convention*'), which entered into force on 1 January 1988 and to which most WTO Members are a party.[147] The Harmonized Commodity Description and Coding System, commonly referred to as the 'Harmonized System' or 'HS', is an *international commodity classification system*, developed under the auspices of the Brussels-based Customs Cooperation Council (CCC), known today as the World Customs Organization (WCO).[148] As of 1 January 2016, 207 countries, territories or customs or economic unions are applying the Harmonized System.[149]

The Harmonized System consists of 21 sections covering 97 chapters, 1,241 headings and over 5,000 commodity groups. The sections and chapters are:

- Section I (Chapters 1–5, live animals and animal products);
- Section II (Chapters 6–14, vegetable products);
- Section III (Chapter 15, animal or vegetable fats and oils);
- Section IV (Chapters 16–24, prepared foodstuffs, beverages and spirits, tobacco);
- Section V (Chapters 25–7, mineral products);
- Section VI (Chapters 28–38, chemical products);
- Section VII (Chapters 39–40, plastics and rubber);
- Section VIII (Chapters 41–3, leather and travel goods);
- Section IX (Chapters 44–6, wood, charcoal, cork);
- Section X (Chapters 47–9, wood pulp, paper and paperboard articles);
- Section XI (Chapters 50–63, textiles and textile products);
- Section XII (Chapters 64–7, footwear, umbrellas, artificial flowers);
- Section XIII (Chapters 68–70, stone, cement, ceramic, glass);
- Section XIV (Chapter 71, pearls, precious metals);
- Section XV (Chapters 72–83, base metals);
- Section XVI (Chapters 84–5, electrical machinery);
- Section XVII (Chapters 86–9, vehicles, aircraft, vessels);
- Section XVIII (Chapters 90–2, optical instruments, clocks and watches, musical instruments);
- Section XIX (Chapter 93, arms and ammunition);
- Section XX (Chapters 94–6, furniture, toys, miscellaneous manufactured articles); and
- Section XXI (Chapter 97, works of art, antiques).[150]

147 *International Convention on the Harmonized Commodity Description and Coding System*, Brussels, 14 June 1983, as amended by the Protocol of Amendment of 24 June 1986, available at www.wcoomd.org/home_wco_topics_hsoverviewboxes_hsconvention.htm.
148 The Harmonized System was developed not only for customs classification purposes, but also for the collection of trade statistics and for use in the context of various types of transactions in international trade (such as insurance and transport).
149 See www.wco.org. The *HS Convention* has 154 Contracting Parties (including the European Union and all EU Member States).
150 Chapters 98 and 99 are reserved for special use by Contracting Parties. Most Members do not use these chapters.

In the Harmonized System, each commodity group has a six-digit HS code.[151] For example, the HS Code for 'Electric trains, including tracks, signals and other accessories therefor; reduced-size (scale) model assembly kits' is 9503 30. Of this code, the first two digits refer to the Chapter, in this case Chapter 95 ('Toys, games and sport requisites; parts and accessories thereof'), while the first four digits refer to the heading, in this case Heading 95.03 ('Tricycles, scooters, pedal cars and similar wheeled toys; dolls' carriages; dolls; other toys; reduced-size (scale) models and similar recreational models working or not; puzzles of all kinds').

To keep the Harmonized System up to date, to include new products (resulting from new technologies) and to take account of new developments in international trade, the Harmonized System is revised every four to six years.[152]

To allow for a systematic and uniform classification of goods, the Harmonized System not only provides for a structured list of commodity descriptions and related numerical codes, but also compromises: (1) Chapter, Heading and Subheading Notes; and (2) General Rules for the Interpretation of the Harmonized System. The Chapter, Heading and Subheading Notes, which precede the chapters of the Harmonized System are the most important source for determining classification in case of doubt. The General Rules for the Interpretation of the Harmonized System, set out in an annex to the *HS Convention*, provide that the classification of goods shall be governed, *inter alia*, by the following principles: (1) incomplete or unfinished goods are classified as finished goods (in the event that they do not have their own line) when the goods already have the essential character of the complete or finished goods;[153] (2) when goods are, *prima facie*, classifiable under two or more headings, classification shall be effected as follows: (a) the heading which provides the most specific description shall be preferred to headings providing a more general description;[154] (b) when goods cannot be classified as provided under (a), mixtures, composite goods consisting of different materials or made up of different components, and goods put up in sets for retail sale, shall be classified as if they consisted of the material or component which gives them their essential character;[155] and (c) when goods cannot be classified as provided under (a) or (b), they shall be classified under the heading which occurs last in numerical order among those which equally merit consideration;[156] and (3) goods which cannot be classified in accordance with the above rules shall be classified under the heading appropriate to the goods to which they are most akin, i.e. with which they bear most likeness.[157]

151 Note, however, that, pursuant to Article 3.3 of the *HS Convention*, parties to the Convention can, and do, use more than six-digit codes. Article 3.3 of the *HS Convention*. See, for example, Figures 6.1 and 6.3, at p. 421 and pp. 438–9, respectively.
152 See Article 16 of the *HS Convention*. To date, there have been revisions in 1992, 1996, 2002, 2007 and 2012. The next revision is to take place in 2017.
153 See General Rules for the Interpretation of the Harmonized System, para. 2(a).
154 *Ibid.*, para. 3(a). 155 *Ibid.*, para. 3(b).
156 *Ibid.*, para. 3(c). 157 *Ibid.*, para. 4.

In addition to the Chapter, Heading and Subheading Notes and the General Rules for the Interpretation of the Harmonized System, the Explanatory Notes and Classification Opinions are also of importance. As stated in Article 8.2 of the *HS Convention*, the Explanatory Notes and Classification Opinions serve to secure uniformity in the interpretation and application of the Harmonized System. The Explanatory Notes are commentaries on the Harmonized System finalised by the WCO Harmonized System Committee (HSC) and adopted by the WCO Council, while the Classification Opinions are decisions taken by the WCO's HSC on the classification of specific products.[158]

WTO Members are not obliged under the GATT 1994 to adopt the Harmonized System.[159] However, as already noted, most WTO Members are a party to the *HS Convention*. Article 3.1(a) of this Convention provides, in relevant part, that a party to the *HS Convention*:

> undertakes that, in respect of its customs tariff and statistical nomenclatures:
> i. it shall use all the headings and subheadings of the Harmonized System without addition or modification, together with their related numerical codes;
> ii. it shall apply the General Rules for the Interpretation of the Harmonized System and all the Section, Chapter and Subheading Notes, and shall not modify the scope of the Sections, Chapters, headings or subheadings of the Harmonized System; and
> iii. it shall follow the numerical sequence of the Harmonized System.

Consequently, most WTO Members use the Harmonized System, its Section, Chapter and Subheading Notes and its General Rules for the Interpretation in their national customs tariffs and for the customs classification of goods. Although the Harmonized System is not a WTO agreement, as discussed above, the Appellate Body ruled in *EC – Chicken Cuts (2005)* and confirmed in *China – Auto Parts (2009)* that the Harmonized System is relevant for the interpretation of WTO Schedules and the tariff bindings contained therein.[160]

Disputes between the importer and the relevant customs authorities on proper classification are resolved by national courts or tribunals.[161] Parties to the *HS Convention* may bring a dispute to the WCO for settlement under Article 10 thereof.[162]

158 They are published in four volumes in English and French but are also available on CD-ROM and online, as part of a database giving the HS classification of more than 200,000 goods. Information about all HS publications can be found at www.publications.wcoomd.org.
159 Note, however, that the WTO *Agreement on Agriculture*, when defining its product scope, does refer to the Harmonized System, and in particular to HS Chapters 1 to 24. See Article 2 of and Annex 1 to the *Agreement on Agriculture*.
160 See above, p. 441.
161 Article X of the GATT 1994 concerns the access to national courts and tribunals. See below, p. 499.
162 Pursuant to Article 10 of the *HS Convention*, any dispute between Contracting Parties concerning the interpretation or application of the Convention shall, so far as possible, be settled by negotiation. Any dispute, which is not so settled shall be referred to the HS Committee. If the HS Committee is unable to settle the dispute, it shall refer the matter to the WCO Council. The parties to the dispute may agree in advance to accept the recommendations of the HS Committee or the WCO Council as binding.

2.8.2 Valuation for Customs Purposes

As previously explained, most customs duties are *ad valorem*. The customs administrations must therefore determine the value of the imported goods in order to be able to calculate the customs duty due. Unlike for customs classification, the WTO agreements provide for rules on customs valuation. These rules, which are crucial to ensure that the value of the tariff concessions is not nullified or undermined, are set out in: (1) Article VII of the GATT 1994, entitled 'Valuation for Customs Purposes'; (2) the Note *Ad* Article VII; and (3) the WTO *Agreement on the Implementation of Article VII of the GATT 1994*.[163] The latter agreement, commonly referred to as the *Customs Valuation Agreement*, elaborates the provisions of Article VII in order to provide greater uniformity and certainty in their implementation.

The core provision of Article VII on customs valuation is found in paragraph 2(a), which states:

> The value for customs purposes of imported merchandise should be based on the *actual value* of the imported merchandise on which duty is assessed, or of like merchandise, and should *not* be based on the value of merchandise of national origin or on arbitrary or fictitious values.[164]

Paragraph 2(b) of Article VII defines the concept of the 'actual value' of goods as the price at which such or like goods are sold or offered for sale in the ordinary course of trade under fully competitive conditions. Elaborating on and elucidating Article VII:2 of the GATT 1994, Article 1.1 of the *Customs Valuation Agreement* provides:

> The customs value of imported goods shall be the *transaction value*, that is the price actually paid or payable for the goods when sold for export to the country of importation adjusted in accordance with the provisions of Article 8.[165]

The primary basis for the customs value is thus the 'transaction value' of the imported goods, i.e. the price actually paid or payable for the goods. This price is normally shown in the invoice, contract or purchase order.[166] Article 1.1 is to be

163 The WTO *Agreement on the Implementation of Article VII of the GATT 1994* replaced the 1979 Tokyo Round *Agreement on the Implementation of Article VII of the GATT*, but is not significantly different from this 1979 Agreement.

164 Emphasis added.

165 Emphasis added. Note that, in the proviso to Article 1.1, a number of situations are identified in which the transaction value cannot be used to determine the customs value. This is, for example, the case when there are certain restrictions on the use or disposition of the goods. Furthermore, as a rule, the buyer and seller should not be related (within the meaning of Article 15) but, if they are, the use of the transaction value is still acceptable if this relationship did not influence the price (see Article 1.2(a)) or the transaction value closely approximates a test value (see Article 1.2(b)). See also Panel Report, *Thailand – Cigarettes (Philippines) (2011)*, paras. 7.143–7.173.

166 Pursuant to Article 17 of the *Customs Valuation Agreement*, customs authorities have the right to 'satisfy themselves as to the truth or accuracy of any statement, document or declaration'. In cases of doubt as to the truth or accuracy, customs authorities will first request the importer to provide further information and clarification. If reasonable doubt persists, the customs authorities will not determine the customs value on the basis of the transaction value but will apply a different method of valuation (see below, pp. 474–6).

read together with Article 8, which provides for *adjustments* to be made to the price actually paid or payable, as discussed below.[167]

Articles 2–7 of the *Customs Valuation Agreement* provide methods for determining the customs value whenever it cannot be determined under the provisions of Article 1. These methods to determine the customs value, other than the 'transaction value' method of Article 1, are, first, the 'transaction value of identical or similar goods' method set out in Articles 2 and 3; second, the deductive value method set out in Article 5; third, the computed value method set out in Article 6; and, fourth, the fallback method set out in Article 7. These methods to determine the customs value of imported goods are to be applied in the above order.[168]

Under the *deductive value method*, the customs authorities try to determine the customs value based on information provided by the importer concerning the price at which the imported goods are subsequently sold. This is done by determining the unit price at which the imported goods, or identical or similar imported goods, are sold at the greatest aggregate quantity to an unrelated buyer in the country of importation.[169] The greatest aggregate quantity is the greatest number of units sold at one price.[170] A number of elements are then 'deducted' (i.e. subtracted) from this price, including commissions paid to distributors in the importing country, the costs of transport and insurance in the country of importation, and customs duties and other internal taxes paid.

Under the *computed value method*, customs authorities try to 'compute' (i.e. reconstruct) the value of the good at the time of exportation based on information provided by the manufacturer, who is often located in the exporting country. The computed value is the sum of the production cost (i.e. the cost of materials and fabrication), profit and general expenses and other expenses (e.g. transport costs to the place or port of importation).[171]

167 Subparagraphs (a)–(d) of Article 1.1 of the *Customs Valuation Agreement* specify circumstances in which customs value need not be based on transaction value. This is the case when: (1) there are certain restrictions on the disposition or use of the goods by the buyer; (2) the sale or price is subject to some condition or consideration for which a value cannot be determined with respect to the goods being valued; (3) some part of the proceeds accrue to the seller; or (4) under certain circumstances, the buyer and seller are related.

168 See Article 4 and the General Note in Annex I to the *Customs Valuation Agreement*. Note, however, that, at the request of the importer, the order of application of the deductive method (Article 5) and the computed method (Article 6) may be reversed (*ibid.*).

169 Goods are 'identical' if they are the same in all respects, including physical characteristics, quality and reputation. 'Similar goods' means goods which, although not alike in all respects, have like characteristics and like component materials which enable them to perform the same functions and to be commercially interchangeable. In addition, goods shall not be regarded as 'similar' or 'identical' unless they are produced in the same country as the goods being valued. See Article 15.2 of the *Customs Valuation Agreement*.

170 See Article 5 and the Note to Article 5 in Annex I to the *Customs Valuation Agreement*. Since the deductive value method uses the sale price in the country of importation as a basis for the calculation of the customs value, a number of deductions (for profits, general expenses, transport, etc.) are necessary to reduce the sale price to the relevant customs value. See also Panel Report, *Thailand – Cigarettes (Philippines) (2011)*, paras. 7.345–7.362.

171 See Article 6 and the Note to Article 6 in Annex I to the *Customs Valuation Agreement*.

The *fallback method*, set out in Article 7.1, applies when the customs value cannot be determined under any of the other four methods. Under this method, the customs value shall be:

> determined using reasonable means consistent with the principles and general provisions of this Agreement and of Article VII of the GATT 1994 and on the basis of the data available in the country of importation.[172]

However, as explicitly stated in Article 7.2(a)–(g), the customs value of imported goods may never be determined on the basis of, for example: the selling price in the country of importation of goods produced in that country; the price of goods on the domestic market of the country of exportation; minimum customs values; or arbitrary or fictitious values.

In *Colombia – Ports of Entry (2009)*, one of the measures at issue was a Colombian regulation requiring customs authorities to use indicative prices for the customs valuation of imported products, unless the transaction value was higher than the indicative price. The panel found this regulation to be inconsistent with the obligation to conduct customs valuations of imported goods based on the sequential application of the methods established by Articles 1, 2, 3, 5 and 6 of the *Customs Valuation Agreement*.[173] Moreover, the panel found that Colombia's use of indicative prices did not constitute a 'reasonable means' of customs valuation within the meaning of Article 7.1 of the *Customs Valuation Agreement*, as it was inconsistent with Article 7.2(b) and (f) thereof.[174]

In *Colombia – Textiles (2016)*, the Appellate Body found that the existence of the alternative methods set out in Articles 2–7 of the *Customs Valuation Agreement* for determining the customs value when a declared value of a transaction is rejected because it is unduly low, confirms – as discussed above – that the underlying transaction remains subject to Article II:1 of the GATT 1994 and:

> further supports our understanding that the scope of Article II:1(a) and (b) of the GATT 1994 does not exclude what Colombia considers to be illicit trade.[175]

As mentioned above, the customs value of imported goods is – if possible (and, usually, this *is* possible) – determined on the basis of the transaction value of these goods. This transaction value must, however, be adjusted as provided for in Article 8 of the *Customs Valuation Agreement*. Pursuant to Article 8.1, the following costs and values, for example, must be added to the price actually paid or payable for the imported products: (1) commissions and brokerage;[176] (2) the cost of packing;[177] (3) royalties and licence fees related to the goods being valued

172 Paragraph 2 of the Note to Article 7 in Annex 1 to the *Customs Valuation Agreement* states: 'The methods of valuation to be employed under Article 7 should be those laid down in Articles 1 through 6 but a reasonable flexibility in the application of such methods would be in conformity with the aims and provisions of Article 7.'
173 See Panel Report, *Colombia – Ports of Entry (2009)*, para. 7.152.
174 See *ibid.*, para. 7.153.
175 Appellate Body Report, *Colombia – Textiles (2016)*, para. 5.39.
176 See Article 8.1(a)(i) of the *Customs Valuation Agreement*. 177 See *ibid.*, Article 8.1(a)(iii).

that the buyer must pay;[178] and (4) the value of any part of the proceeds of any subsequent resale that accrues to the seller.[179]

Pursuant to Article 8.2, each Member is free either to include or to exclude from the customs value of imported goods: (1) the cost of transport to the port or place of importation; (2) loading, unloading and handling charges associated with the transport to the port or place of importation; and (3) the cost of insurance. Note in this respect that most Members take the CIF price as the basis for determining the customs value, while Members such as the United States, Japan and Canada take the (lower) FOB price.[180]

To date, WTO Members have been found to have acted inconsistently with the obligations under Article VII of the GATT 1994 and the *Customs Valuation Agreement* in two disputes.[181]

2.8.3 Determination of Origin

In spite of the MFN treatment obligation, discussed in Chapter 4, the customs duties applied to imported goods may differ depending on the country from which the goods originate. For example, goods *from* developing-country Members commonly benefit from lower import duties in developed-country Members than do goods from other developed-country Members;[182] and no customs duties apply to goods *from* Members that are a party to the same free-trade agreement.[183] Moreover, only the goods *from* WTO Members benefit under WTO law from MFN treatment with respect to customs duties.[184] It is, therefore, important to determine the origin of imported goods, and this is not always an easy determination to make. As noted in Chapter 1, when discussing the global value chain, many industrial products, available on the market today, are produced with inputs and raw materials from more than one country.[185] For example, in the case of cotton shirts, it is possible that the cotton used in their production is manufactured in country A, the textile woven, dyed and printed in country B, the cloth cut and stitched in country C and the shirts packed for retail in country D before being exported to country E.[186]

The rules to determine the origin of imported goods differ from Member to Member, and many Members use different rules of origin depending on the

178 See *ibid.*, Article 8.1(c). 179 See *ibid.*, Article 8.1(d).
180 CIF (cost, insurance and freight) and FOB (free on board) are International Commercial terms (INCO terms). CIF means that the seller must pay the costs, insurance and freight involved in bringing the goods to the named port of destination. FOB means that the buyer has to bear all costs and risks of loss of, or damage to, the goods from the point that the goods pass the ship's rail at the named port of shipment.
181 See *Colombia – Ports of Entry (2009)*; and *Thailand – Cigarettes (Philippines) (2011)*.
182 On preferential customs duties for developing-country Members under the Enabling Clause of the GATT 1994, see above, pp. 321–5.
183 On customs duties in the context of customs unions and free-trade agreements pursuant to Article XXIV of the GATT 1994, see below, pp. 679–88.
184 Note that the determination of origin is also necessary for the imposition of antidumping duties and countervailing duties. See below, p. 709.
185 See below, pp. 11–14.
186 See *Business Guide to the World Trading System*, 2nd edn (International Trade Centre/Commonwealth Secretariat, 1999), 155.

purpose for which the origin is determined.[187] Generally speaking, the national rules of origin currently applied by Members use one or more of three methods to determine origin: (1) the method of 'value added'; (2) the method of 'change in tariff classification'; and (3) the method of 'qualifying processes'. Under national rules of origin using the method of 'value added', a good will be considered to have originated in country X if in that country a specified percentage (for example, 50 per cent) of the value of the good was added. Under national rules of origin using the method of 'change in tariff classification', a good will be considered to have originated in country X if, as a result of processing in that country, the tariff classification of the product changes. Finally, under national rules of origin using the method of 'qualifying processes', a good will be considered to have originated in country X if a particular technical manufacturing or processing operation relating to the good took place in that country.[188]

The GATT 1947 had no specific rules on the determination of the origin of imported goods, and the GATT 1994 still provides no specific rules on this matter. However, the negotiators during the Uruguay Round recognised the need for multilateral disciplines on rules of origin in order to prevent these rules from being a source of uncertainty and unpredictability in international trade. The consensus on the need for such disciplines resulted in the *Agreement on Rules of Origin*, which is part of Annex 1A to the WTO Agreement.

The *Agreement on Rules of Origin* makes a distinction between: (1) non-preferential rules of origin; and (2) preferential rules of origin. Non-preferential rules of origin are rules of origin used in non-preferential trade policy instruments (relating to, *inter alia*, MFN treatment, anti-dumping and countervailing duties, safeguard measures, origin marking or tariff quotas).[189] Most of the disciplines set out in the *Agreement on Rules of Origin* concern *non-preferential* rules of origin.[190] However, Annex II to the *Agreement on Rules of Origin* sets out some disciplines for *preferential* rules of origin. Preferential rules of origin are rules of origin applied by Members to determine whether goods qualify for preferential treatment under contractual or autonomous trade regimes (leading to the granting of tariff preferences going beyond the application of the MFN treatment obligation).[191] Note that 19 per cent of world trade is conducted on a preferential basis.[192]

With respect to *non-preferential* rules of origin, the *Agreement on Rules of Origin* provides for a work programme on the harmonisation of these rules.[193]

187 e.g. whether the origin of imported products is determined for the imposition of ordinary customs duties, anti-dumping or countervailing duties or the administration of country-specific tariff quota shares.
188 Members may also have a list of processes and operations, such as packaging, simple painting or dilution with water, that are considered insufficient to confer origin.
189 See Article 1.2 of the *Agreement on Rules of Origin*.
190 See *ibid.*, Article 1.1. 191 See *ibid.*, Article 1.1 and Annex II.2.
192 See below, p. 673.
193 See Article 9.1 of the *Agreement on Rules of Origin*. This work programme is to be undertaken in conjunction with the World Customs Organization.

Pursuant to Article 9.2 of the *Agreement on Rules of Origin*, this Harmonization Work Programme should have been completed by July 1998. However, the WTO Members failed to meet this deadline. In fact, work on the harmonisation of non-preferential rules of origin is still ongoing.[194]

The failure of WTO Members to agree, to date, on harmonised rules of origin does not, however, mean that no WTO disciplines apply to non-preferential rules of origin. Article 2 of the *Agreement on Rules of Origin* contains a rather extensive list of multilateral disciplines for rules of origin already applicable during the 'transition period', i.e. the period until the Harmonization Work Programme is completed. These multilateral disciplines applicable during the transitional period include: (1) a transparency requirement, namely, the rules of origin must clearly and precisely define the criteria they apply; (2) a prohibition on using rules of origin as instruments to pursue trade objectives; (3) a requirement that rules of origin shall not themselves create restrictive, distorting or disruptive effects on international trade; (4) a national treatment requirement, namely, that the rules of origin applied to imported products shall not be more stringent than the rules of origin applied to determine whether or not a good is domestic; (5) an MFN requirement, namely, that rules of origin shall not discriminate between other Members, irrespective of the affiliation of the manufacturers of the good concerned; (6) a requirement that rules of origin shall be administered in a consistent, uniform, impartial and reasonable manner; (7) a requirement that rules of origin state what confers origin (a positive standard) rather than state what does *not* confer origin (a negative standard); (8) a requirement to publish laws, regulations, judicial decisions, etc., relating to rules of origin; (9) requirements regarding the issuance of assessments of origin (no later than 150 days after the request) and the validity of the assessments (in principle, three years); (10) a prohibition on the retroactive application of new or amended rules of origin; (11) a requirement that any administrative action relating to the determination of origin is reviewable promptly by independent tribunals; and (12) a requirement to respect the confidentiality of information provided on a confidential basis.[195] Note that many of these disciplines are in fact the specific application of general GATT obligations (such as Articles I, III and X of the GATT 1994) to national non-preferential rules on the determination of origin.

To date, there has only been one dispute before a panel dealing with rules of origin. In *US – Textiles Rules of Origin (2003)*, India claimed that the United States applied rules of origin on textiles and certain other products that were inconsistent with several obligations under Article 2 of the *Agreement on Rules*

194 See WTO Secretariat, *Report (2015) of the Committee on Rules of Origin to the Council for Trade in Goods*, G/L/1127, dated 21 October 2015. The report refers to the issues discussed in detail in the earlier report of 2013 (G/L/1047) as the reason for little or no progress in harmonisation of the non-preferential rules of origin. Members hold divergent views with regard to the need to finalise the harmonisation work programme with some stating that conclusion of negotiations is no longer a political priority.
195 See Articles 2(a)–(k) of the *Agreement on Rules of Origin*.

of Origin. The panel in *US – Textiles Rules of Origin (2003)* noted that Article 2 does not provide what WTO Members must do, but rather what they should not do,[196] and that:

> [b]y setting out what Members cannot do, these provisions leave for Members themselves discretion to decide what, within those bounds, they can do. In this regard, it is common ground between the parties that Article 2 does not prevent Members from determining the criteria which confer origin, changing those criteria over time, or applying different criteria to different goods.[197]

Once the Harmonization Work Programme is completed, all Members will apply only one set of non-preferential rules of origin for all purposes.[198] As provided for in Article 3 of the *Agreement on Rules of Origin*, the disciplines set out in Article 2, already applicable, will continue to apply.[199] Moreover, Article 3 makes clear that, under the harmonised rules (still to be agreed on), Members will be required to determine as the country of origin of imported goods: (1) the country where the goods have been wholly obtained; or (2) the country where the last substantial transformation to the goods has been carried out.[200] However, to date, Members have been unsuccessful in reaching consensus either on detailed rules regarding the requirements for a good to be 'wholly obtained' in one country,[201] or on the criteria for a 'substantial transformation' (a change in tariff classification and/or a specific percentage of value added).[202]

The disciplines on rules of origin discussed above concern only non-preferential rules of origin. However, as already noted, Annex II to the *Agreement on Rules of Origin* provides – in the form of a 'Common Declaration' – for some disciplines applicable to preferential rules of conduct. Pursuant to Annex II, the general principles and requirements set out in the *Agreement on Rules of Origin* in respect of transparency, positive standards, administrative assessments, judicial review, non-retroactivity of changes and confidentiality apply also to *preferential* rules of origin. While, as discussed above, the Harmonization Work Programme has not yet resulted in an agreement on specific multilateral disciplines on non-preferential rules of origin, more progress has been achieved with respect to preferential rules of origin, at least with respect to preferential rules of origin applying to least-developed countries. Building on the *Decision on Measures in Favour of Least Developed Countries (LDCs)*, taken at the Hong Kong Ministerial

196 See Panel Report, *US – Textiles Rules of Origin (2003)*, para. 6.23.
197 *Ibid.*, para. 6.24. India argued that rules of origin applied by the United States on its textile imports were inconsistent with Articles 2(b)–(d) of the *Agreement on Rules of Origin*. The panel found with regard to all claims that India did not adduce sufficient evidence to make a *prima facie* case of inconsistency. See Panel Report, *US – Textiles Rules of Origin (2003)*, paras. 6.118; 6.190–6.191, 6.221 and 6.231; and 6.271–6.272.
198 See Article 3(a) of the *Agreement on Rules of Origin*.
199 See *ibid.*, Article 3(c)–(i) and Article 9(c)–(g). 200 See *ibid.*, Article 3(b).
201 The question of, for example, which minimal operations or processes can and cannot, by themselves, confer origin on a good is a matter of current debate.
202 Note, however, the agreement reached by the Nairobi Ministerial Conference in December 2016 on the requirements to be considered by developed- and developing-country Members to assess 'sufficient or substantial transformation' in the context of *preferential* rules of origin. See below, p. 461.

Conference in December 2005,[203] whereby developed- and developing-country Members committed to ensure transparent and simple application of preferential rules of origin to imports from least-developed countries, the Bali Ministerial Conference in December 2013 took a step further in this direction and agreed on guidelines providing elements to be considered by Members to determine the criteria to confer 'origin'.[204] Clarifying furthermore as to whether or not a product has originated from a least-developed country, the Nairobi Ministerial Conference in December 2015 set forth in detail the requirements to be considered by developed- and developing-country Members to assess '*sufficient or substantial transformation*'.[205] In order to ensure timely implementation, the Ministerial Decision mandates Members to inform the Committee on Rules of Origin on the efforts taken to implement the decision.[206]

Note that the United Nations 2030 Agenda for Sustainable Development expressly recognises the realisation of timely implementation of duty-free and quota-free access for all least-developed countries, including by ensuring transparency and simplicity of the preferential rules of origin applicable to imports from least-developed countries, as one of the goals to strengthen the means of implementation and revitalisation of the global partnership for sustainable development.[207]

To date, no WTO Member has been found in dispute settlement proceedings to have acted inconsistently with the obligations under the *Agreement on Rules of Origin*.[208]

3 OTHER DUTIES AND CHARGES ON IMPORTS

In addition to customs duties on imports, tariff barriers on imports can also take the form of 'other duties and charges'. This section deals in turn with: the definition and types of 'other duties and charges on imports'; the rule applicable to such measures; and the measures exempted from the scope of application of this rule.

203 See Hong Kong Ministerial Conference, *Ministerial Declaration of 18 December* (Annex F), WT/MIN(05)/DEC, dated 22 December 2005.
204 See Bali Ministerial Conference, *Decision of 7 December on Preferential Rules of Origin for Least Developed Countries*, WT/MIN(13)/42, dated 11 December 2013. The elements include other than for wholly obtained products, substantial or sufficient transformation, which can be defined in a number of ways including through: (a) *ad valorem* percentage criterion; (b) change of tariff classification; and (c) specific manufacturing or processing operation or a combination of any of the above.
205 See Nairobi Ministerial Conference, *Decision of 19 December 2015 on Preferential Rules of Origin for Least Developed Countries*, WT/MIN(15)/47, dated 21 December 2015.
206 See *ibid.*, para. 4.1.
207 See Goal 17.12, *Res 70/1* adopted by the General Assembly on 25 September 2015.
208 With regard to *US – Textiles Rules of Origin (2003)*, see above, p. 460, fn. 198.

3.1 Definition and Types

'Other duties and charges on imports' are financial charges or taxes, *other than* ordinary customs duties,[209] which are levied on imported products and are due because of their importation. In *India – Additional Import Duties (2008)*, the Appellate Body held that 'other duties and charges on imports', also referred to as 'ODC' on imports:

> are defined in relation to duties covered by the first sentence of Article II:1(b), such that ODCs encompass only duties and charges that are not [ordinary customs duties].[210]

'Other duties and charges on imports' form a *residual* category encompassing financial charges on imports that are not ordinary customs duties or customs duties *sensu stricto*.[211] The difference between ordinary customs duties and other duties and charges was at issue in *Chile – Price Band System (2002)*.[212] The panel in this case distinguished ordinary customs duties from other duties and charges by considering that customs duties:

> always relate to either the value of the imported goods, in the case of *ad valorem* duties, or the volume of the imported goods, in the case of specific duties. Such ordinary customs duties, however, do not appear to involve the consideration of any other, exogenous, factors, such as, for instance, fluctuating world market prices. We therefore consider that ... an 'ordinary' customs duty, that is, a customs duty *sensu stricto*, is to be understood as referring to a customs duty which is not applied on the basis of factors of an exogenous nature.[213]

On appeal, the Appellate Body disagreed with the panel that what distinguishes ordinary customs duties from other duties and charges is that the former are applied on the basis of the value or volume of the imported products, and not on the basis of factors of an exogenous nature.[214] The Appellate Body thus reversed the panel's finding but did not offer much further guidance on the distinction

209 The term '*ordinary* customs duties' (emphasis added) is used in Article II:1(b), first sentence, of the GATT 1994. The panel in *Chile – Price Band System (2002)* used the term 'customs duties *sensu stricto*'.
210 Appellate Body Report, *India – Additional Import Duties (2008)*, para. 151. The Appellate Body also noted that while both 'ordinary customs duties' and 'other duties and charges' relate to duties and charges applied 'on the importation', 'other duties and charges' also relate to duties and charges 'in connection with the importation'. See *ibid.*, para. 157.
211 See also Panel Report, *Peru – Agricultural Products (2015)*, para. 7.408; Panel Report, *Dominican Republic – Safeguard Measures (2012)*, paras. 7.79 and 7.85; and Panel Report, *Dominican Republic – Import and Sale of Cigarettes (2005)*, para. 7.113. The panel in the latter case also referred to the *travaux préparatoires* concerning the *Understanding on the Interpretation of Article II:1 (b) of the GATT 1994*, where it is stated that it would be impossible to draw up an exhaustive list of ODCs since it is always possible for governments to invent new charges. See *ibid.*, para. 7.114.
212 As discussed above, the Appellate Body in *China – Auto Parts (2009)* addressed the question whether the charges at issue in that dispute were a customs duty or an internal charge. The Appellate Body ruled in this respect that what is important in determining whether a charge is a border charge (such as a customs duty) or an internal charge is whether the obligation to pay that charge accrues due to the importation or to an internal event (such as the distribution, sale, use or transportation of the imported product). This usefully distinguishes border charges from internal charges, but is of little help in distinguishing, within the category of border charges, between customs duties *and* other duties and charges.
213 Panel Report, *Chile – Price Band System (2002)*, para. 7.52. See also *ibid.*, para. 7.104.
214 See Appellate Body Report, *Chile – Price Band System (2002)*, para. 278.

between ordinary customs duties and other duties and charges, except that an essential feature of ordinary customs duties is that 'any change in them is discontinuous and unrelated to an underlying scheme or formula'.[215]

In *Dominican Republic – Safeguard Measures (2012)*, the panel concluded that the safeguard measures imposed by Dominican Republic on imports of polypropylene bags and tubular fabric were 'other duties or charges' as they were neither 'ordinary customs duties',[216] nor any of the measures provided for in Article II: 2 of GATT. With regard to what is covered by an ordinary customs duty, the panel noted:

> All in all, using a meaning that seeks to reconcile the texts of the GATT 1994 in the various official languages, we could conclude that the expression 'ordinary customs duties' in Article II:1(b) of the GATT 1994 refers to duties collected at the border which constitute 'customs duties' in the strict sense of the term (stricto sensu) and that this expression does not cover possible extraordinary or exceptional duties collected in customs.[217]

Further, summarising the decision of the Appellate Body in *Chile – Price Band System* (2002), the panel noted:

> In its report in *Chile – Price Band System*, the Appellate Body made it clear that what determines whether 'a duty imposed on an import at the border' constitutes an ordinary customs duty is not the form which that duty takes. Nor is the fact that the duty is calculated on the basis of exogenous factors, such as the interests of consumers or of domestic producers ... a Member may periodically change the rate at which it applies an 'ordinary customs duty', provided it remains below the rate bound in the Member's schedule. This change in the applied rate of duty could be made, for example, through an act of the Member's legislature or executive at any time. However, one essential feature of 'ordinary customs duties' is that any change in them is discontinuous and unrelated to an underlying scheme or formula.[218]

In *Peru – Agricultural Products (2015)*, the panel concluded that 'a Member's measure which corresponds or is similar to any of the measures listed in footnote 1 to Article 4.2 of the Agreement on Agriculture may not correspond to the ordinary customs duty of the Member in question'.[219] Accordingly, it held that the additional duties resulting from Peru's price range system (PRS) being in the nature of variable import levies, or similar to variable import levies fell within the meaning of Article 4.2 of the Agreement on Agriculture, and were therefore not ordinary customs duties.[220]

The panel in *Colombia – Textiles (2016)* found that the compound tariff at issue was an ordinary customs duty, and not an 'other duty or charge' because the compound tariff was similar in nature to the tariff provided for in Colombia's Customs Tariff, and that there was 'no evidence whatsoever that the compound tariff forms part of possible extraordinary or exceptional duties collected in

215 *Ibid.*, para. 233.
216 The panel considered the design and structure of the impugned measures and concluded that the measures are 'extraordinary' or 'exceptional' and not 'ordinary' since they replace the ordinary tariff temporarily and only for imports originating in certain Members. See Panel Report, *Dominican Republic – Safeguard Measures (2012)*, para. 7.86.
217 *Ibid.*, para 7.85. 218 See *ibid.*, para. 7.84.
219 Panel Report, *Peru – Agricultural Products (2015)*, para. 7.423. 220 See *ibid.*

customs or that the compound tariff lacks the essential attributes or qualities of duties collected in customs'.[221]

Examples of 'other duties and charges on imports' identified in GATT/WTO case law are: (1) an import surcharge, i.e. a duty imposed on an imported product in addition to the ordinary customs duty;[222] (2) a security deposit to be made on the importation of goods;[223] (3) a statistical tax imposed to finance the collection of statistical information, with no maximum limit;[224] (4) a customs fee with no maximum limit;[225] (5) a transitional surcharge for economic stabilisation imposed on imported goods;[226] and (6) a foreign exchange fee imposed on imported goods.[227]

3.2 Rule Regarding Other Duties or Charges on Imports

To protect the tariff bindings set forth in the Schedules and to prevent 'circumvention' of the prohibition of Article II:1(b), first sentence, of the GATT 1994, to impose ordinary customs duties in excess of the bindings, WTO law provides for a rule on other duties and charges on imports. With regard to products subject to a tariff binding, Article II:1(b), second sentence, of the GATT 1994 requires that *no* other duties or charges be imposed *in excess of* those: (1) already imposed at the 'date of this Agreement'; or (2) provided for in mandatory legislation in force on that date. However, under the GATT 1947, there was considerable uncertainty and confusion regarding the 'date of this Agreement' and thus regarding the maximum level of other duties or charges on imports that could be imposed.[228] Therefore, the Uruguay Round negotiators agreed on the *Understanding on the Interpretation of Article II:1(b) of the GATT 1994*, commonly referred to as the *Understanding on Article II:1(b)*. This Understanding states, in relevant part:

> In order to ensure transparency of the legal rights and obligations deriving from paragraph 1(b) of Article II, the nature and level of any 'other duties or charges' levied on bound tariff items, as referred to in that provision, shall be recorded in the Schedules of Concessions annexed to GATT 1994 against the tariff item to which they apply.[229]

The Understanding thus requires Members to record in their Schedules all other duties or charges on imports imposed on products subject to a tariff binding.[230]

221 Panel Report, *Colombia – Textiles (2016)*, para. 7.141. See also Panel Report, *Dominican Republic – Safeguard Measures (2012)*, para. 7.85.
222 See e.g. *Korea – Beef (Australia) (1989)*.
223 See e.g. *EEC – Minimum Import Prices (1978)*; and *EEC – Animal Feed Proteins (1978)*.
224 See e.g. *Argentina – Textiles and Apparel (1998)*.
225 See e.g. *United States – Customs User Fee (1988)*. A customs fee is a financial charge imposed for the processing of imported goods by the customs authorities.
226 See e.g. *Dominican Republic – Import and Sale of Cigarettes (2005)*. 227 *Ibid.*
228 See *Analytical Index: Guide to GATT Law and Practice* (WTO, 1995), 84–5.
229 *Understanding on the Interpretation of Article II:1(b) of the GATT 1994* (hereinafter '*Understanding on Article II:1(b)*'), para. 1.
230 Members had to record other duties and charges in their Goods Schedule within six months of the date of the deposition of their Schedule. After six months, the right to record other duties and charges expired.

As noted above, the Uruguay Round Schedules have a special column for 'other duties or charges'.[231] The other duties or charges on imports must be recorded in the Schedules at the levels applying on 15 April 1994 or, for Members which acceded to the WTO, on the date of their accession.[232] The other duties or charges on imports are 'bound' at these levels.[233]

It follows from Article II:1(b), second sentence, and from the Understanding, that Members may: (1) impose only other duties and charges on imports that have been properly recorded in their Schedules; and (2) impose other duties and charges on imports only at a level that does not exceed the level recorded in their Schedules. Other duties and charges not recorded, or in excess of the recorded levels, are prohibited. Note, however, that the inclusion of an other duty or charge in a Member's Goods Schedule does not give rise to a presumption of consistency with other GATT provisions. Such duty or charge is not exempted from an examination of its consistency with other GATT provisions, such as e.g. Article VIII.[234]

In *Chile – Price Band System (2002)*, the panel, having found that the Chilean Price Band System (PBS) duties were not 'ordinary customs duties' but were 'other duties or charges', examined whether these duties were inconsistent with Article II:1(b), second sentence. The panel ruled:

> Pursuant to the Uruguay Round Understanding on the Interpretation of Article II:1(b), such other duties or charges had to be recorded in a newly created column 'other duties and charges' in the Members' Schedules ... Other duties or charges must not exceed the binding in this 'other duties and charges' column of the Schedule. If other duties or charges were not recorded but are nevertheless levied, they are inconsistent with the second sentence of Article II:1(b), in light of the Understanding on the Interpretation of Article II:1(b). We note that Chile did not record its PBS in the 'other duties and charges' column of its Schedule. We therefore find that the Chilean PBS duties are inconsistent with Article II:1(b) of GATT 1994.[235]

In *Dominican Republic – Import and Sale of Cigarettes (2005)*, the panel found that the two 'other duties or charges' at issue in this case, namely the transitional surcharge for economic stabilisation and the foreign exchange fee imposed on imported products, had not been recorded in a legally valid manner in the

231 See above, pp. 437–9.
232 See *Understanding on Article II:1(b)*, para. 2. Note, however, that paragraph 4 of the *Understanding on Article II:1(b)* states: 'Where a tariff item has previously been the subject of a concession, the level of "other duties or charges" recorded in the appropriate Schedule shall not be higher than the level obtaining at the time of the first incorporation of the concession in that Schedule.'
233 Note that paragraph 1 of the *Understanding on Article II:1(b)* states that the recording in the Schedules does not change the legal character of the 'other duties or charges' and that paragraphs 4 and 5 provide that – with certain restrictions in time – the Members can challenge the GATT consistency of recorded 'other duties or charges'. See Panel Report, *Argentina – Textiles and Apparel (1998)*, para. 6.81.
234 See *ibid.*, paras. 6.81–6.83.
235 Panel Report, *Chile – Price Band System (2002)*, paras. 7.105 and 7.107–7.108. On appeal, the Appellate Body found that the panel's finding on Article II:1(b), second sentence, related to a claim that had not been made, and this finding was therefore in violation of Article 11 of the DSU. As a result, the Appellate Body reversed the finding.

Schedule of Concessions of the Dominican Republic.[236] With regard to the transitional surcharge for economic stabilisation, the panel came to the following conclusion:

> For all legal and practical purposes, what was notified by the Dominican Republic in document G/SP/3 is equivalent to 'zero' in the Schedule. The Panel finds that the surcharge as an 'other duty or charge' measure is applied in excess of the level 'zero' pursuant to the Schedule. Therefore, the surcharge measure is inconsistent with Article II:1(b) of the GATT 1994.[237]

With regard to the foreign exchange fee, the panel came to the same conclusion.[238]

On the legal effects of the scheduling of other duties or charges on imports, note that, in *Argentina – Textiles and Apparel (1998)*, Argentina argued that, since its 3 per cent statistical tax was included in its Schedule of Concessions (Schedule LXIV), there was no violation of Article II:1(b) of the GATT 1994. The panel disagreed with Argentina, and noted that:

> [t]he provisions of the WTO Understanding on the Interpretation of Article II:1(b) of GATT 1994, dealing with 'other duties and charges', make clear that including a charge in a schedule of concessions in no way immunizes that charge from challenge as a violation of an applicable GATT rule.[239]

In *Peru – Agricultural Products (2015)*, the panel found that Peru did not record in its Schedule of Concessions any duty corresponding to 'other duties or charges' within the six months following the date on which the instrument was deposited. Having concluded that the additional duties resulting from Peru's price range system were 'other duties or charges ... imposed on or in connection with the importation' and based on evidence of application of such duties by Peru, the panel found that Peru acted inconsistently with its obligations under the second sentence of Article II:1(b) of the GATT 1994.[240]

To date, WTO Members have been found to have acted inconsistently with the obligations under Article II:1(b), second sentence of the GATT 1994 in three disputes.[241]

3.3 Measures Exempted from the Rule

There are a number of 'other duties and charges on imports' that are exempted from the rule that Members may not impose such duties or charges unless recorded and not in excess of the recorded level. Pursuant to Article II:2 of the

236 The panel ruled that the recording of the Selective Consumption Tax, i.e. an internal tax, could not be used as legal basis to justify the current transitional surcharge or the foreign exchange fee. See Panel Report, *Dominican Republic – Import and Sale of Cigarettes (2005)*, para. 7.86.
237 *Ibid.*, para. 7.89. 238 See *ibid.*, para. 7.121.
239 Panel Report, *Argentina – Textiles and Apparel (1998)*, para. 6.81. See also above, p. 446.
240 Panel Report, *Peru – Agricultural Products (2015)*, para. 7.432. On appeal, the finding of the panel that Peru acted inconsistently with its obligations under Article II:1(b), second sentence were upheld by the Appellate Body. See Appellate Body Report, *Peru – Agricultural Products (2015)*, para. 5.121.
241 See *Argentina – Textiles and Apparel (1998)*; *Dominican Republic – Import and Sale of Cigarettes (2005)*; and *Peru – Agricultural Products (2015)*. With regard to *Chile – Price Band System (2002)*. With regard to *India – Additional Import Duties (2008)*, the Appellate Body found that the panel erred in its interpretation of Article II:1 (b), second sentence, and was unable to complete the legal analysis.

GATT 1994, Members may – despite their obligation under Article II:1(b), second sentence – impose on an imported product: (1) a financial charge equivalent to an internal tax on the like domestic product imposed consistently with Article III:2 of the GATT 1994 (border tax adjustment) (see Article II:2(a));[242] (2) WTO-consistent anti-dumping or countervailing duties (see Article II:2(b)); or (3) fees or other charges 'commensurate' with, i.e. matching, the cost of the services rendered (see Article II:2(c)).[243] In *India – Additional Import Duties (2008)*, the Appellate Body ruled with regard to Article II:2(a) that:

> Article II:2(a), subject to the conditions stated therein, *exempts* a charge from the coverage of Article II:1(b).[244]

In the same vein, but with regard to Article II:2(b), in *US – Zeroing (Japan) – (Article 21.5 – Japan) (2009)*, the Appellate Body upheld the panel's approach to Article II:2(b) as providing a *safe harbour* to Article II:1 to the extent that the anti-dumping duties concerned were applied in a WTO-consistent manner.[245]

Most case law on Article II:2 relates to Article II:2(c). The requirement set out in this provision, namely that the fees or other charges concerned must be commensurate with the cost of the services, is also reflected in Article VIII:1(a) of the GATT 1994. The latter provision requires that:

> All fees and charges of whatever character (other than import or export duties and other than taxes within the purview of Article III) imposed by [Members] on or in connection with importation or exportation shall be limited in amount to the approximate cost of services rendered and shall not represent an indirect protection to domestic products or a taxation of imports or exports for fiscal purposes.[246]

The fees and charges for services rendered within the meaning of Article II:2(c) and Article VIII:1(a) include, pursuant to Article VIII:4, fees and charges relating to: (1) consular transactions, such as consular invoices and certificates; (2) quantitative restrictions; (3) licensing; (4) exchange control; (5) statistical services; (6) documents, documentation and certification; (7) analysis and inspection; and (8) quarantine, sanitation and fumigation. With respect to the concept of 'services'

242 See Appellate Body Report, *India – Additional Import Duties (2008)*, paras. 170, 172 and 180. On the concept of 'border tax adjustment', see above, p. 384. On the requirements of Article III:2 of the GATT 1994, see above, pp. 351–76.
243 The three instances identified in Article II:2, in which the obligations set out in Article II:1 do
244 Appellate Body Report, *India – Additional Import Duties (2008)*, para. 153. Emphasis added. Note that the Appellate Body found that, where there is a reasonable basis to understand that the challenged measure may not result in a violation of Article II:1(b) because it satisfies the requirements of Article II:2(a), then the complaining party bears some burden of establishing that the conditions of Article II:2(a) are not met. See *ibid.*, para. 192.
245 See Appellate Body Report, *US – Zeroing (Japan) – (Article 21.5 – Japan) (2009)*, para. 209.
246 Note that there is a slight difference in wording between the two 'cost of services' limitations stated in Articles II:2(c) and VIII:1(a), i.e. 'commensurate with the cost of services rendered' and 'limited in amount to the approximate cost of services rendered'. However, the panel in *US – Customs User Fee (1988)*, after reviewing both the drafting history and the subsequent application of these provisions, concluded that no difference of meaning had been intended.

not apply, constitute a closed, i.e. exhaustive, list. See Appellate Body Report, *Colombia – Textiles (2016)*, para. 5.36.

used in this context, the panel in *US – Customs User Fee (1988)* stated, not without wit:

> Granted that some government regulatory activities can be considered as 'services' in an economic sense when they endow goods with safety or quality characteristics deemed necessary for commerce, most of the activities that governments perform in connection with the importation process do not meet that definition. They are not desired by the importers who are subject to them. Nor do they add value to the goods in any commercial sense. Whatever governments may choose to call them, fees for such government regulatory activities are, in the Panel's view, simply taxes on imports. It must be presumed, therefore, that the drafters meant the term 'services' to be used in a more artful political sense, i.e. government activities closely enough connected to the processes of customs entry that they might, with no more than the customary artistic licence accorded to taxing authorities, be called a 'service' to the importer in question.[247]

In *US – Customs User Fee (1988)*, the financial charge at issue was a merchandise-processing fee, in the form of an *ad valorem* charge without upper limits. The complainants, the European Communities and Canada, challenged the GATT consistency of an *ad valorem* charge without upper limit. The panel in this case noted that the requirement of Article VIII:1(a) that a fee or charge be 'limited in amount to the approximate cost of services rendered' is in fact a dual requirement: (1) the fee or charge in question must first involve a 'service' rendered; and (2) the level of the charge must not exceed the approximate cost of that service.[248] With respect to the first element of this dual requirement, the panel in *Argentina – Textiles and Apparel (1998)* further clarified that the fee or charge in question must involve a 'service' rendered to the *individual* importer in question.[249] Services rendered to foreign trade operators in general and foreign trade as an activity *per se* would fail to meet this first element of the dual requirement.[250] With respect to the second element of the dual requirement, the panel in *US – Customs User Fee (1988)* stated that:

> the term 'cost of services rendered' in Articles II:2(c) and VIII:1(a) must be interpreted to refer to the cost of the customs processing for the individual entry in question and accordingly that the *ad valorem* structure of the United States merchandise processing fee was inconsistent with the obligations of Articles II:2(c) and VIII:1(a) to the extent that it caused fees to be levied in excess of such costs.[251]

In *Argentina – Textiles and Apparel (1998)*, the panel found that Argentina's 3 per cent *ad valorem* statistical tax on imports was inconsistent with Article VIII:1(a) of the GATT 1994 'to the extent it results in charges being levied in excess of the approximate costs of the services rendered'.[252] As the panel explained, an *ad valorem* charge with no maximum limit, as was the case with Argentina's statistical tax, by its very nature, is not 'limited in amount to the approximate

247 Panel Report, *US – Customs User Fee (1988)*, para. 77.
248 See *ibid.*, para. 69. See also Panel Report, *Argentina – Textiles and Apparel (1998)*, para. 6.74; and Panel Report, *US – Certain EC Products (2001)*, para. 6.69.
249 See Panel Report, *US – Customs User Fee (1988)*, para. 80.
250 See Panel Report, *Argentina – Textiles and Apparel (1998)*, para. 6.74.
251 Panel Report, *US – Customs User Fee (1988)*, para. 86. Underlining in the original deleted.
252 Panel Report, *Argentina – Textiles and Apparel (1998)*, para. 6.80.

cost of services rendered'. For example, high-price items necessarily will bear a much higher tax burden than low-price goods, yet the service accorded to both is essentially the same. An unlimited *ad valorem* charge on imported goods violates the provisions of Article VIII because such a charge cannot be related to the cost of the service rendered.[253]

Note that the panel in *Argentina – Textiles and Apparel (1998)* also found that the statistical tax was inconsistent with Article VIII:1(a) because this tax – according to Argentina's own admission – was imposed for 'fiscal purposes', which is explicitly prohibited under Article VIII:1(a).

In Article VIII:1(b) of the GATT 1994 Members explicitly 'recognize the need for reducing the number and diversity' of Article VIII:1(a) fees and charges.

Article 6 of the *Agreement on Trade Facilitation*, entitled 'Disciplines on Fees and Charges imposed on or in Connection with Importation and Exportation' also provides rules on other charges and duties. However, these rules add little, if anything, to the rules that already existed under the GATT 1994. Note that Article 6.1(2) of the *Agreement on Trade Facilitation* requires Members to publish information on fees and charges, including information on the amount of the fees and charges, the reason for such fees and charges, the responsible authority and when and how payment is to be made.[254] Also note that Article 6.2(ii) states that fees and charges for customs processing are not required to be linked to a specific import or export operation provided they are levied for services that are closely connected to the customs processing of goods. Article 6.3 provides for a few 'new' rules regarding 'penalties' for breach of a Member's customs rules. Most notable are: (1) the requirement to avoid conflicts of interest in the assessment and collection of penalties; and (2) the requirement to explain in writing the nature of the breach and the legal basis for the penalty imposed.

4 CUSTOMS DUTIES AND OTHER DUTIES AND CHARGES ON EXPORTS

As noted above, tariff barriers to trade in goods apply not only to imports. While much less common than customs duties and other duties and charges on imports, Members also impose customs duties and other duties and charges on exports, often in brief referred to as 'export duties'.[255] This section discusses in turn: (1) the definition and purpose of export duties; and (2) WTO rules applicable to export duties.

253 *Ibid.*, para. 6.75.
254 It could be argued that this obligation already exists under Article X:1 of the GATT 1994.
255 Unlike for customs duties and other duties and charges on imports, there is no need to distinguish between customs duties and other duties and charges on exports, since there is no difference in the rules that apply to customs duties on exports on the one hand and other duties and charges on exports on the other hand.

4.1 Definition and Purpose

Generally speaking, an export duty, be it a customs duty or another duty or charge on exports, is a financial charge or tax on exported products, due because of their exportation. Market exit of the products concerned is conditional upon the payment of the export duty. Like import duties, export duties have a long history, but, unlike the former, the latter largely fell into disuse in the mid-nineteenth century.[256] While there have always been some countries that applied export duties on some products, these 'sporadic' export duties were considered to be much less problematic to international trade than the 'omnipresent' import duties. As noted below, this was, and still is, clearly reflected in the GATT/WTO rules on export duties, or rather the paucity of these rules. Possibly because of this paucity of rules, there has, however, been a proliferation of the use of export duties in recent years. At present, export duties are most commonly imposed on raw materials and agricultural products, which are in short supply on the world market.

Like customs duties and other duties and charges on imports, export duties serve two main purposes. First, export duties are a source of revenue for governments. Some mineral-rich developing-country Members depend on export duties for much of their revenue. Second, export duties are used to protect and/or promote domestic industries. Some Members consider export duties to act as 'indirect subsidies' to domestic downstream industries.[257] By imposing export duties, exportation is commercially less attractive and goods are less likely to be exported, thus reserving them for use by domestic downstream industries. For example, by imposing an export duty on forest products, a Member will protect and/or promote the domestic milling, furniture and paper industries. An export duty will stem the exportation of forest products and ensure the availability of forest products for domestic downstream industries, often at prices lower than they would be if exportation were not impeded. In other words, export duties may give the domestic downstream industries a cost advantage in comparison with foreign downstream industries.[258] In some cases, export duties on agricultural products, in particular, may also be used to safeguard, in times of international scarcity, domestic supply of food products at affordable prices. In the context of its WTO accession negotiations, with regard to the purpose pursued by its export duties, Russia explained as follows:

> [I]n 1998 export duties had been imposed on raw materials and semi-finished goods, mainly for fiscal purposes, and now ranged from 3 to 50 per cent, with a few exceptions where

256 In the seventeenth century, England imposed export duty on more than 200 goods, but in 1842 all export duties were abolished. France abolished export duties in 1857 and Prussia in 1865. See www.britannica.com/EBchecked/topic/583535/tariff#ref592273.

257 *Report of the Working Party on the Accession of Russia*, WT/ACC/RUS/70, dated 17 November 2011, para. 629.

258 In situations in which a country produces a substantial share of the world output of a good (for example, a rare mineral), that country can, by imposing an export duty, push up the world price of that good. This would disadvantage foreign downstream industries in comparison to the domestic downstream industries, which would have access to this good at a lower price.

> higher export duties were applied. In very few cases (oil seeds, raw hides and skins), export duties had been imposed to ensure greater availability of raw materials for the domestic industry. Export duties on non-ferrous and ferrous metals waste and scrap (and those in the guise of other products, e.g. used axle-boxes) had been imposed to address problems of environmental protection.[259]

4.2 Rules Applicable on Export Duties

Neither the GATT 1994 nor any of the other multilateral agreements on trade in goods prohibit or specifically regulate export duties, be it customs duties or other duties and charges on exports. While the WTO agreements do not *specifically* regulate export duties, there are some general GATT obligations which also apply to export duties. This is the case, for example, for Article I:1 of the GATT 1994, which sets out the MFN treatment obligation.[260] In short, if a Member imposes an export duty on a product exported to another Member, it must impose the same export duty on all like products exported to all other Members.

As discussed above, the GATT 1994 does not prohibit customs duties on imports but encourages negotiations on the lowering of these duties and protects the results of these negotiations. Pursuant to Articles II:1(a) and II:1(b), first sentence, of the GATT 1994, a Member is not allowed to impose customs duties on imports of a product above the relevant binding, i.e. the maximum level it has agreed on.[261] Some Members have agreed to bindings with regard to their export duties and have included these bindings in their Goods Schedule.[262] It is the subject of debate whether Article II:1(a) also applies to, and thus provides protection for, bindings regarding customs duties on exports. It has been observed that Article II:1(a) states:

> Each [Member] shall accord *to the commerce* of the other [Members] treatment no less favourable than that provided for in the appropriate Part of the appropriate Schedule annexed to this Agreement.[263]

It has been argued that the term 'commerce' in Article II:1(a) refers to both imports and exports. What is clear is that the obligation set out in Article II:1(b), first sentence, does not apply to customs duties on exports as it explicitly refers to the 'importation' of products. For the same reason, Article II:1(b), second sentence, which concerns other duties and charges, also does not apply to export duties.

259 *Report of the Working Party on the Accession of Russia*, WT/ACC/RUS/70, dated 17 November 2011, para. 626. See also *ibid.*, paras. 631–3. Russia also indicated that, over the last few years, the overall number of products subject to export duties had been reduced from 1,200 to 310 tariff lines. See *ibid.*, para. 627.

260 See above, p. 307. See also Articles VII, VIII and XVII of the GATT 1994.

261 See above, p. 443.

262 Part I, Section 2, of the Goods Schedule of Australia, for example, provides in the 'Notes' column with regard to eleven tariff lines that 'there shall be no export duty on this product'. See Schedule I, annexed to the *Marrakesh Protocol* of the GATT 1994, www.wto.org/english/tratop_e/schedules_e/goods_schedules_table_e.htm.

263 Emphasis added. Note also that Article XXVIII *bis* of the GATT 1994, which calls for negotiations on the reduction of customs duties, expressly refers to customs duties on imports *and* exports.

While the GATT 1994 or the other multilateral agreements on trade in goods do not prohibit or specifically regulate export duties, some WTO accession protocols do. The best-known example of such accession protocol is the 2001 *Protocol on the Accession of the People's Republic of China*.[264] Paragraph 11.3 of China's Accession Protocol contains specific obligations with respect to export duties, and provides that:

> 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.[265]

Annex 6 to China's Accession Protocol, entitled 'Products Subject to Export Duty', lists eighty-four different products, such as live eels fry, bones and horn-cores, yellow phosphorus, alloy pig iron, copper alloys and unwrought aluminium. The Note to Annex 6 states that:

> China confirmed that the tariff levels included in this Annex are *maximum levels* which will not be exceeded.[266]

In *China – Raw Materials (2012)*, the question arose whether China's export duties on bauxite, coke, fluorspar, magnesium, manganese, silicon metal, zinc and yellow phosphorus were inconsistent with paragraph 11.3 of China's Accession Protocol. The panel found that, with the exception of yellow phosphorus, none of these raw materials is listed in Annex 6 to China's Accession Protocol and that China therefore acted inconsistently with paragraph 11.3 of the Accession Protocol when it imposed export duties on these raw materials.[267] With regard to yellow phosphorus, which is included in the list of Annex 6, the complainants contended that China imposed a 'special' export duty of 50 per cent *ad valorem* on yellow phosphorus pursuant to the 2009 Tariff Implementation Program, while it had committed, pursuant to paragraph 11.3 of and Annex 6 to its Accession Protocol, not to exceed a maximum export duty of 20 per cent on yellow phosphorus. The panel, however, agreed with China that China had removed the 'special' export duty rate as of 1 July 2009, before the date of the panel's establishment and therefore did not make any finding on the WTO consistency of this measure.[268]

264 See WT/L/432, dated 23 November 2001.
265 Emphasis added.
266 Emphasis added. The Note to Annex 6 also states: 'China confirmed furthermore that it would not increase the presently applied rates, except under exceptional circumstances. If such circumstances occurred, China would consult with affected members prior to increasing applied tariffs with a view to finding a mutually acceptable solution.'
267 See Panel Reports, *China – Raw Materials (2012)*, para. 7.77 (for bauxite), para. 7.81 (for coke), para. 7.85 (for fluorspar), para. 7.89 (for magnesium), para. 7.93 (for manganese), para. 7.98 (for silicon metal) and para. 7.101 (for zinc). Note that China did not invoke Article VIII of the GATT 1994 in justification of the export duties at issue. However, with regard to most of the export duties, China did invoke Articles XX(b) or XX(g) of the GATT 1994 in justification of the inconsistency with paragraph 11.3 of its Accession Protocol. As discussed in Chapter 8, the panel found – as upheld by the Appellate Body – that Article XX did not apply in the case at hand.
268 See Panel Reports, *China – Raw Materials (2012)*, para. 7.71.

The issue whether export duties imposed by China were inconsistent with paragraph 11.3 of China's Accession Protocol, arose again in *China – Rare Earths (2014)*. This dispute concerned *inter alia* export duties on various forms of rare earths, tungsten and molybdenum. These metals are used in devices such as computer memory, mobile phones and rechargeable batteries, and global demand for them has grown exponentially in the last twenty years. In line with the ruling of the panel in *China – Raw Materials (2012)*, the panel in *China – Rare Earths (2014)* found that the China export duties at issue were inconsistent with paragraph 11.3 of China's Accession Protocol.[269]

China's Accession Protocol is not the only accession protocol, which provides for 'WTO-plus' obligations with regard to export duties.[270] As already noted, Russia imposed export duties on a significant number of goods, including minerals, petrochemicals, natural gas, raw hides and skins, wood, ferrous and non-ferrous metals and scrap.[271] The 2011 *Protocol on the Accession of the Russian Federation* and, in particular, the Schedule of Concessions and Commitments on Goods of the Russian Federation annexed to the Protocol, provides that the goods described in 'Part V' of that Schedule are, subject to the relevant terms, conditions or qualifications, *exempt from export duties in excess* of those set forth therein.[272] During its accession negotiations, Russia emphasised that export duties were permitted under WTO rules, and that many Members applied export duties as an instrument of trade policy.[273] However, as part of the deal on its accession to the WTO, Russia was required to agree on maximum levels for its export duties. Note that the obligation with regard to export duties undertaken by Russia is less far-reaching than the obligation undertaken by China.

In the context of the Doha Round negotiations, the European Union has advocated for specific WTO rules on export duties confirming and operationalising the basic GATT disciplines (and exceptions), while allowing flexibility to small developing-country Members and least-developed-country Members.[274] However, to date, it has been unsuccessful in garnering sufficient support for such rules on export duties.

269 See Panel Report, *China – Rare Earths (2014)*, para. 7.48. As in *China – Raw Materials (2012)*, China invoked Article XX(b) of the GATT 1994 in justification of the inconsistency with paragraph 11.3 of its Accession Protocol. As discussed in Chapter 8, the panel found – as upheld by the Appellate Body – that Article XX did not apply in the case at hand.
270 See with regard to Ukraine, Report of the Working Party on the Accession of Ukraine, WT/ACC/UKR/152, 25 January 2008, para. 240; with regard to Montenegro, Report of the Working Party on the Accession of Montenegro, WT/ACC/CGR/38, WT/MIN(11)/7, 5 December 2011, para. 132; with regard to Tajikistan, Report of the Working Party on the Accession of Tajikistan, WT/ACC/TJK/30, 6 November 2012, para. 169; with regard to Kazakhstan, Report of the Working Party on the Accession of Kazakhstan, WT/ACC/KAZ/93, 23 June 2015, para. 540.
271 For a complete list of the export duties applied by Russia, see *Report of the Working Party on the Accession of Russia*, WT/ACC/RUS/70, dated 17 November 2011, Table 32.
272 See Annex 1 to WT/L/839, dated 17 December 2011, which contains Russia's Goods Schedule, circulated as WT/ACC/RUS/70/Add.1.
273 *Report of the Working Party on the Accession of Russia*, WT/ACC/RUS/70, dated 17 November 2011, para. 635.
274 See Negotiating Group on Market Access, Communication from the European Communities, *Market Access for Non-Agricultural Products, Revised Submission on Export Taxes*, TN/MA/W/101, dated 17 January 2008.

5 SUMMARY

Market access for goods and services from other countries can be, and frequently is, impeded or restricted in various ways. There are two main categories of barriers to market access: (1) tariff barriers; and (2) non-tariff barriers. This chapter deals with tariff barriers. The category of tariff barriers includes: (1) customs duties on imports; (2) other duties and charges on imports; and (3) export duties (i.e. customs duties and other duties and charges on exports). Different rules apply to these different types of tariff barrier.

A customs duty or tariff on imports is a financial charge or tax on imported goods, due because of their importation. Market access for the goods concerned is conditional upon the payment of the customs duty. Customs duties are *ad valorem* specific, compound, mixed or otherwise. *Ad valorem* customs duties are by far the most common type of customs duties. The customs duties or tariffs, which are due on importation, are set out in a country's national customs tariff. Most national customs tariffs follow or reflect the structure set out in the Harmonized Commodity Description and Coding System, usually referred to as the 'Harmonized System' or 'HS'.

WTO law, and in particular the GATT 1994, does not prohibit the imposition of customs duties on imports. Customs duties, unlike quantitative restrictions discussed in Chapter 7, represent an instrument of protection against imports generally allowed by the GATT 1994. Article XXVIII *bis* of the GATT 1994 does, however, call upon WTO Members to negotiate the reduction of customs duties. The eight GATT Rounds of trade negotiations have been very successful in reducing customs duties. Nevertheless, customs duties remain a significant barrier in international trade, and further negotiations on the reduction of tariffs are therefore necessary. The basic principles and rules governing tariff negotiations are: (1) the principle of reciprocity and mutual advantage; and (2) the most-favoured-nation (MFN) treatment obligation. The principle of reciprocity does not apply in full to tariff negotiations between developed- and developing-country Members. Members can adopt different approaches, or modalities, to tariff negotiations, including the product-by-product approach, the formula approach (be it the linear reduction approach or the non-linear reduction approach), the sectoral approach, or a combination of these approaches.

The results of tariff negotiations are referred to as 'tariff concessions' or 'tariff bindings'. A tariff concession, or tariff binding, is a commitment not to raise the customs duty on a certain product above an agreed level. The tariff concessions or bindings made by a Member are set out in that Member's Schedule of Concessions (also referred to as a Goods Schedule). The Schedules of Concessions resulting from the Uruguay Round negotiations are all annexed to the *Marrakesh Protocol* to the GATT 1994 and are an integral part thereof. Therefore, the tariff schedules and tariff concessions must be interpreted in accordance with the rules

of interpretation set out in Article 31 and 32 of the *Vienna Convention on the Law of Treaties*.

Article II:1(a) of the GATT 1994 provides that Members shall accord to products imported from other Members *treatment no less favourable* than that provided for in their Schedules. Article II:1(b), first sentence, of the GATT 1994 provides that products described in Part I of the Schedule of any Member shall, on importation, be *exempt from ordinary customs duties in excess of* those set out in the Schedule. This means that products may not be subjected to customs duties above the tariff concessions or bindings. Note, however, that Article XXVIII of the GATT 1994 provides a procedure for the modification or withdrawal of the agreed tariff concessions.

In addition to the rules to protect tariff concessions, WTO law also provides for some rules on the manner in which customs duties must be imposed. The imposition of customs duties may require three determinations to be made: (1) the determination of the proper classification of the imported good; (2) the determination of the customs value of the imported good; and (3) the determination of the origin of the imported good. The WTO agreements do not specifically address the issue of customs classification. However, in classifying products for customs purposes, Members have of course to consider their general obligations under the WTO agreements, such as the MFN treatment obligation. *Specific* rules on classification can be found in the *HS Convention*, to which most WTO Members are a party.

Unlike for customs classification, the *WTO Agreement* provides for rules on customs valuation. These rules are set out in: Article VII of the GATT 1994; the Note *Ad* Article VII; and the WTO *Customs Valuation Agreement*. The primary basis for the customs value is the 'transaction value' of the imported goods, i.e. the price actually paid or payable for the goods. This price is normally shown in the invoice, contract or purchase order, albeit that a number of adjustments usually have to be made. If the customs value cannot be established in this manner, it must be established pursuant to the alternative methods set out in the *Customs Valuation Agreement*.

The GATT 1994 provides no specific disciplines on rules of origin. However, the negotiators during the Uruguay Round recognised the need for multilateral disciplines on rules of origin in order to prevent these rules from being a source of uncertainty and unpredictability in international trade. The consensus on the need for such disciplines resulted in the WTO *Agreement on Rules of Origin*. With respect to *non-preferential* rules of origin, the *Agreement on Rules of Origin* provides for a work programme on the harmonisation of these rules. While the completion of the work programme is long overdue, Members have not yet been able to reach agreement on harmonised rules of origin. Until the successful completion of this work programme, Article 2 of the *Agreement on Rules of Origin* contains a list of multilateral disciplines on the application and administration

of rules of origin applicable during the current 'transition period'. After harmonised rules of origin have been agreed on, these disciplines will continue to apply. With respect to *preferential* rules of origin, Annex 2 to the *Agreement on Rules of Origin* provides for a more modest list of multilateral disciplines on the application and administration of rules of origin.

In addition to 'ordinary' customs duties on imports, tariff barriers on imports can also take the form of other duties and charges on imports. 'Other duties and charges on imports' are financial charges or taxes, *other than* ordinary customs duties, which are levied on imported products and are due because of their importation. Pursuant to Article II:1(b), second sentence, of the GATT 1994 and the *Understanding on Article II:1(b)*, Members may: (1) impose only other duties and charges on imports that have been properly recorded in their Schedules; and (2) impose other duties and charges on imports only at a level that does not exceed the level recorded in their Schedules. There are, however, a number of 'other duties and charges on imports' that are e*xempted* from the rule that Members may not impose such duties or charges unless recorded and not in excess of the recorded level. Pursuant to Article II:2 of the GATT 1994, Members may – in spite of their obligation under Article II:1(b), second sentence – impose on imported products: (1) a financial charge equivalent to an internal tax on the like domestic product imposed consistently with Article III:2 of the GATT 1994 (border tax adjustment); (2) WTO-consistent anti-dumping or countervailing duties; or (3) fees or other charges 'commensurate' with, i.e. matching, the cost of the services rendered.

Tariff barriers to trade in goods apply not only to imports. While much less common than customs duties and other duties and charges on imports, Members also impose export duties. An export duty, be it a customs duty or another duty or charge on exports, is a financial charge or tax on exported products, due because of their exportation. Market exit of the products concerned is conditional upon the payment of the export duty. Neither the GATT 1994 nor any of the other multilateral agreements on trade in goods prohibits or specifically regulates export duties. Note that some WTO accession protocols, including China's Accession Protocol (2001) and Russia's Accession Protocol (2011) do prohibit or specifically regulate export duties.

FURTHER READINGS

A. Tesafayesus, 'Liberalization Agreements in the GATT/WTO and the Terms-of-Trade Externality Theory: Evidence from Three Developing Countries', USPTO Economic Working Paper No. 2016-3, June 2016.

M. Daly, 'Is the WTO a World Tax Organization? A Primer on WTO Rules for Tax Policymakers', Fiscal Affairs Department, International Monetary Fund, March 2016.

7

Non-Tariff Barriers

CONTENTS

1 INTRODUCTION

As mentioned in Chapter 6, not only tariff barriers but also a wide range of non-tariff barriers restrict trade.[1] While tariff barriers were systematically reduced since the late 1940s as a result of successive rounds of tariff negotiations, non-tariff barriers have in recent decades gradually become an ever more prominent instrument of protection. The term 'non-tariff barrier' is not defined in WTO law, but this important residual category of barriers to trade can be understood to include all government imposed and sponsored actions or omissions that act as prohibitions or restrictions on trade, other than ordinary customs duties and other duties and charges on imports and exports.[2]

Unlike tariff barriers, non-tariff barriers not only affect trade in goods but also trade in services.[3]

This chapter deals in turn with: (1) quantitative restrictions on trade in goods; (2) 'other non-tariff barriers' on trade in goods; (3) market access barriers to trade in services; and (4) other barriers to trade in services. Note, however, that this chapter does not deal with two specific types of 'other non-tariff barriers' to trade in goods, namely, technical barriers to trade and sanitary and phytosanitary measures. Due to their importance and detailed nature, the rules on these 'other non-tariff barriers' are discussed, separately, in Chapters 13 and 14 respectively.[4] While non-tariff barriers have become a prominent instrument of protection, they often also serve important public policy objectives, such as public health, consumer safety and environmental protection. To the extent that they do so, their elimination or liberalisation may not be desirable at all. That is the case in particular, but not only, for the 'other non-tariff barriers' discussed in Chapters 13 and 14. WTO law regulates these other non-tariff barriers with a view to allowing their use but minimising discrimination and their adverse impact on trade.

1 In this book, the term 'non-tariff barrier' (NTB) encompasses the term 'non-tariff measure' (NTM), a term in vogue and referred to in the title of the WTO's World Trade Report 2012, *Trade and Public Policies: A Closer Look at Non-Tariff Measures in the 21st Century* (WTO, 2012). However, the term 'non-tariff barrier' is broader than the term 'non-tariff measure' as it also includes barriers to trade other than measures, such as the lack of transparency. See below, pp. 499–503.

2 See also Roy Santana and Lee Ann Jackson, 'Identifying Non-Tariff Barriers: Evolution of Multilateral Instruments and Evidence from the Disputes (1948–2011)', *World Trade Review*, 2012, 465.

3 On tariff barriers to trade in services, see above, p. 416. As discussed, tariff barriers to trade in services do not currently exist, but the debate, and the current WTO moratorium, on the 'bit tax', i.e. a tax imposed 'at the border' on electronic communications containing services outputs, shows that tariff barriers *can* exist for trade in services.

4 See below, pp. 893, 894 and 935–7. Note also that this chapter does not deal with non-tariff barriers to trade resulting from the lack of effective protection of intellectual property rights. The WTO rules addressing these barriers, i.e. the WTO rules ensuring a minimum level of protection and enforcement of intellectual property rights, are dealt with in Chapter 15. See below, p. 1042.

2 QUANTITATIVE RESTRICTIONS ON TRADE IN GOODS

The archetypical non-tariff barrier to trade is a quantitative restriction on trade in goods. This section discusses: (1) the definition and types of quantitative restriction on trade in goods; (2) the rules on quantitative restrictions; and (3) the administration of quantitative restrictions.[5]

2.1 Definition and Types

A quantitative restriction on trade in goods, also referred to as a 'QR', is a measure that *limits the quantity* of a product that may be imported or exported. A typical example of a quantitative restriction is a measure allowing the importation of a maximum of 1,000 tonnes of cocoa powder a year or a measure allowing the importation of a maximum of 450 tractors a year. While usually based on the number of units, weight or volume, quantitative restrictions may also be based on value, for example a limit on the importation of flowers to the value of €12 million per year.

There are different types of quantitative restriction: (1) a *prohibition*, or ban, on the importation or exportation of a product; such a prohibition may be absolute or conditional, i.e. only applicable when certain defined conditions are *not* fulfilled; (2) an import or export *quota*, i.e. a measure, as the examples given above, indicating the quantity that may be imported or exported; a quota can be a global quota, a global quota allocated among countries or a bilateral quota; (3) import or export *licensing*, as further discussed below;[6] and (4) *other* quantitative restrictions.[7] For an illustrative list of quantitative restrictions, refer to the 2012 WTO *Decision on Notification Procedures for Quantitative Restrictions*, also referred to as the 'QR Decision'.[8]

Confusingly perhaps, a tariff (rate) quota, or 'TRQ', is *not* a quota in the strict sense of the term; it is *not* a quantitative restriction.[9] A tariff quota is a quantity, which can be imported at a certain duty. The panel in *US – Line Pipe (2002)* stated that a tariff quota involves the 'application of a higher tariff rate to imported goods after a specific quantity of the item has entered the country at a lower prevailing rate'.[10] Any quantity above the quota is subject to a higher duty.[11]

5 This section concludes with a short note on special and differential treatment regarding quantitative restrictions on trade in goods.
6 See below, pp. 496–8.
7 On the scope of the subcategory of 'other quantitative restrictions', see below, pp. 498–517.
8 See Council for Trade in Goods, *Decision on Notification Procedures for Quantitative Restrictions*, adopted on 22 June 2012, G/L/59/Rev.1, dated 3 July 2012, Annex 2.
9 See Panel Report, *EEC – Bananas II (1994)*, paras. 138–9. Note that this GATT panel report was not adopted.
10 Panel Report, *US – Line Pipe (2002)*, para. 7.18.
11 To imports within the quota, the 'in quota duty' applies; to imports over and above the quota, the higher 'out of quota duty' applies.

For example, a Member may allow the importation of 5,000 tractors at 10 per cent *ad valorem* and any tractor imported above this quantity at 30 per cent *ad valorem*. Tariff quotas are not quantitative restrictions because rather than prohibit or restrict the quantity of imports, they subject the imports to varying duties. As discussed below, customs duties and other charges and duties are explicitly excluded from the scope of quantitative restrictions. Tariff quotas are widely used with regard to agricultural products, but are also used for non-agricultural products.[12]

The European Union's intricate import regime for bananas, at issue in *EC – Bananas III (1997)* and subsequent *EC – Bananas III* disputes, provided for tariff quotas. Under this regime, the European Union initially granted, for example, duty-free access to 90,000 tonnes of non-traditional ACP bananas; the out-of-quota tariff rate for these same bananas was 693 ECU per tonne. In *EC– Bananas III (Article 21.5– Ecuador II) / EC – Bananas III (Article 21.5 – US) (2008)*, the Appellate Body stated:

> In contrast to quantitative restrictions, tariff quotas do not fall under the prohibition in Article XI:1 and are in principle lawful under the GATT 1994, provided that quota tariff rates are applied consistently with Article I.[13]

WTO Members are required to notify the WTO Secretariat of any quantitative restrictions which they maintain, and of any changes to these restrictions, as and when they occur.[14] Such notifications must contain and/indicate: (1) a general description of the restriction; (2) the type of restriction; (3) the relevant tariff line code; (4) a detailed product description; (5) the WTO justification for the measure concerned; (6) the national legal basis for the restriction; and (7) information on the administration of the restriction and, where relevant, an explanation of the modification of a previously notified restriction.[15] With this information, the WTO Secretariat maintains a QR database, which its Members and the general public may consult.[16] As of 19 May 2015, only twenty-seven WTO Members had submitted notifications of all their quantitative restrictions in force. In total, 731 quantitative restrictions were notified.[17]

12 The frequent use of tariff quotas with regard to agricultural products is a result of the 'tariffication' exercise under which quantitative restrictions on trade in agricultural products were 'translated' into tariffs and in particular 'tariff quotas'. See below, p. 490.
13 Appellate Body Reports, *EC– Bananas III (Article 21.5 – Ecuador II) / EC – Bananas III (Article 21.5 – US) (2008)*, para. 335.
14 See Council for Trade in Goods, *Decision on Notification Procedures for Quantitative Restrictions*, G/L/59/Rev.1, dated 3 July 2012, para. 1.
15 See *ibid.*, para. 2. For an example of such notification, see a notification by Australia, G/MA/QR/N/AUS/2, dated 6 February 2015.
16 See www.wto.org/english/res_e/statis_e/statis_e.htm.
17 See Report by the Secretariat, *Quantitative Restrictions: Factual Information on Notifications Received*, Committee on Market Access, G/MA/W/114, dated 22 May 2015, paras. 3.2–3.3.

2.2 Rules on Quantitative Restrictions

The GATT 1994 and other multilateral agreements on trade in goods set out specific rules on quantitative restrictions. This subsection discusses in turn: (1) the general prohibition on quantitative restrictions set out in Article XI of the GATT 1994; (2) the rationale behind the marked difference in the GATT rules on customs duties and quantitative restrictions; (3) the rules on quantitative restrictions on specific products, in particular agricultural products and textiles; and (4) the rules on voluntary export restraints (VERs).

2.2.1 General Prohibition on Quantitative Restrictions

Article XI:1 of the GATT 1994, entitled 'General Elimination of Quantitative Restrictions', sets out a general prohibition on quantitative restrictions, whether on imports or exports. As the panel in *Turkey – Textiles (1999)* stated:

> The prohibition on the use of quantitative restrictions forms one of the cornerstones of the GATT system.[18]

Article XI:1 provides, in relevant part:

> No prohibitions or restrictions other than duties, taxes or other charges, whether made effective through quotas, import or export licences or other measures, shall be instituted or maintained by any [Member] on the importation of any product of the territory of any other [Member] or on the exportation or sale for export of any product destined for the territory of any other [Member].

The panel in *Japan – Semi-Conductors (1988)* noted that the wording of Article XI:1 is *comprehensive* as:

> it applied to *all measures* instituted or maintained by a contracting party *prohibiting or restricting* the importation, exportation or sale for export of products *other than* measures that take the form of duties, taxes or other charges.[19]

The broad scope of the prohibition on quantitative restrictions set out in Article XI:1 is clear from the text of Article XI:1 itself, which refers in addition to quotas and import licences, also to the undefined residual category of 'other measures'. As an illustration of the broad scope of the prohibition on quantitative restrictions, consider that Article XI was found to apply to: export quotas;[20] minimum import price requirements;[21] minimum export price requirements;[22] a discretionary and non-automatic licensing system;[23] trade balancing

18 Panel Report, *Turkey – Textiles (1999)*, para. 9.63.
19 Panel Report, *Japan – Semi-Conductors (1988)*, para. 104. Emphasis added. See also Panel Report, *India – Quantitative Restrictions (1999)*, para. 5.129. The panel in this case further noted that: 'the scope of the term "restriction" is also broad, as seen in its ordinary meaning, which is "a limitation on actions, a limiting condition or regulation"'.
20 See *China – Raw Materials (2012)*.
21 See *EEC – Minimum Import Prices (1978)*. Note that, in this case, the minimum import price requirement was enforced with an import certificate and a security lodgement measure.
22 See *Japan – Semi-Conductors (1988)*; and *China – Raw Materials (2012)*.
23 See *India – Quantitative Restrictions (1999)*; and *China – Raw Materials (2012)*.

requirements;[24] and restrictions on ports of entry.[25] However, note that the Appellate Body stated in *Argentina – Import Measures (2015)*, that the scope of the provision is 'not unfettered' and that the provision itself explicitly excludes 'duties, taxes and other charges' and 'does not extend to areas listed in Article XI:2, and other GATT provisions, such as Articles XII, XIV, XV, XVIII, XX, and XXI, which permit a Member, in certain specified circumstances, to be excused from its Article XI:1 obligations'.[26] Also measures that created uncertainty as to whether and under which conditions importation or exportation of products is allowed;[27] and measures that make importation prohibitively costly[28] have been found to be inconsistent with Article XI:1.

As the Appellate Body ruled in *China – Raw Materials (2012)*, the term 'restriction' refers generally to something that has a limiting effect, and the use of the term 'quantitative' in the title of Article XI suggests that the restriction within the meaning of Article XI:1 is a measure that has a limiting effect on the quantity or amount of a product being imported or exported.[29]

Unlike other GATT provisions, Article XI refers not to laws or regulations but more broadly to *measures*. A measure instituted or maintained by a Member, which restricts imports or exports, is covered by Article XI, *irrespective* of the legal status of the measure.[30] In *Japan – Semi-Conductors (1988)*, the panel thus ruled that *non-mandatory* measures of the Japanese Government, restricting the export of certain semi-conductors at below-cost price, were nevertheless 'restrictions' within the meaning of Article XI:1.[31]

Note that, in addition, quantitative restrictions which do *not actually* restrict or impede trade, such as quotas above current levels of trade, are nevertheless prohibited under Article XI:1 of the GATT 1994.[32] The panel in *EEC – Oilseeds I (1990)* ruled in this respect:

> [T]he Contracting Parties have consistently interpreted the basic provisions of the General Agreement on restrictive trade measures as provisions establishing conditions of competition. Thus they decided that an import quota constitutes an import restriction within the meaning of Article XI:1 whether or not it actually impeded imports.[33]

24 See *India – Autos (2002)*. 25 See *Colombia – Ports of Entry (2009)*.
26 See Appellate Body Reports, *Argentina – Import Measures (2015)*, para. 5.220. Note that in *Argentina – Financial Services (2016)*, the panel concluded that since the relevant measure at issue was 'fiscal in nature', it was thereby not covered by the disciplines of Article XI:1 of the GATT 1994. See Panel Report, *Argentina – Financial Services (2016)*, paras. 7.1067–7.1069.
27 See *China – Raw Materials (2012)*. 28 See *Brazil – Retreaded Tyres (2007)*.
29 See Appellate Body Report, *China – Raw Materials (2012)*, paras. 319–20.
30 See Panel Report, *Japan – Semi-Conductors (1988)*, para. 106.
31 *Ibid.*, paras. 104–17. The panel considered that, in order to determine whether the *non-mandatory* measures were measures falling within the scope of Article XI, it needed to be satisfied on two essential criteria: (1) there were reasonable grounds to believe that sufficient incentives or disincentives existed for non-mandatory measures to take effect; and (2) the operation of the measures was essentially dependent on government action or intervention. The panel considered that, if these two criteria were met, the measures would be operating in a manner equivalent to mandatory requirements such that the difference between the measures and mandatory requirements was only one of form and not one of substance.
32 Such non-binding quotas cause increased transaction costs and create uncertainties, which could affect investment plans. See Panel Report, *Japan – Leather (US II) (1984)*, para. 55.
33 Panel Report, *EEC – Oilseeds I (1990)*, para. 150.

On the other hand, the panel in *EEC – Minimum Import Prices* (1978) found that automatic import licensing does not constitute a restriction of the type meant to fall within the scope of application of Article XI:1.[34]

Article XI:1 of the GATT 1994 does not only prohibit *de jure* quantitative restrictions; restrictions of a *de facto* nature are also prohibited under Article XI:1. The scope of quantitative restrictions within the meaning of Article XI:1 is thus not limited to measures that set an explicit numerical ceiling. Rather, measures which have in fact that effect are also quantitative restrictions within the meaning of Article XI:1. In *Argentina – Hides and Leather (2001)*, the issue arose whether Argentina violated Article XI:1 by authorising the presence of domestic tanners' representatives in the customs inspection procedures for hides destined for export operations. According to the European Union, the complainant in this case, Argentina, imposed a *de facto* restriction on the exportation of hides inconsistent with Article XI:1. The panel ruled:

> There can be no doubt, in our view, that the disciplines of Article XI:1 extend to restrictions of a *de facto* nature.[35]

However, the panel concluded with respect to the Argentinian regulation providing for the presence of the domestic tanners' representatives in the customs inspection procedures that there was insufficient evidence that this regulation actually operated as an export restriction inconsistent with Article XI:1 of the GATT 1994.[36] According to the panel, there was 'no persuasive explanation of precisely how the measure at issue causes or contributes to the low level of exports'.[37] Taking a different approach, the panel in *Colombia – Ports of Entry (2009)* stated, however, that:

> to the extent Panama were able to demonstrate a violation of Article XI:1 based on the measure's design, structure, and architecture, the Panel is of the view that it would not be necessary to consider trade volumes or a causal link between the measure and its effects on trade volumes.[38]

The panel in *Colombia – Ports of Entry (2009)* found that the restriction to two ports of entry limited the *competitive opportunities* for the products at issue, and thus had a limiting effect on imports and therefore was inconsistent with Article XI:1.[39]

The broad scope of application of Article XI:1 was also confirmed by the panels in *India – Quantitative Restrictions (1999)* and *India – Autos (2002)*. The panel in the latter dispute explicitly addressed the question whether Article XI

34 See Panel Report, *EEC – Minimum Import Prices (1978)*, para. 4.1.
35 Panel Report, *Argentina – Hides and Leather (2001)*, para. 11.17. In support of this finding, the panel referred to the Panel Report in *Japan – Semi-Conductors (1988)*, paras. 105–9. For findings on *de facto* quantitative restrictions, see also Panel Reports, *Colombia – Ports of Entry (2009)*, *US – Poultry (China) (2010)* and *China – Raw Materials (2012)*.
36 See Panel Report, *Argentina – Hides and Leather (2001)*, para. 11.55. 37 *Ibid.*, para. 11.21.
38 Panel Reports, *Colombia – Ports of Entry (2009)*, para. 7.252. 39 See *ibid.*, para. 7.275.

also covered situations where products are technically allowed into the market without an express formal quantitative restriction, but yet subject to certain conditions which create a disincentive to import.[40] The panel responded to this question as follows:

> On a plain reading, it is clear that a 'restriction' need not be a blanket prohibition or a precise numerical limit. Indeed, the term 'restriction' cannot mean merely 'prohibitions' on importation, since Article XI:1 expressly covers both 'prohibition or restriction'. Furthermore, the Panel considers that the expression 'limiting condition' used by the *India – Quantitative Restrictions* panel to define the term 'restriction' and which this Panel endorses, is helpful in identifying the scope of the notion in the context of the facts before it. That phrase suggests the need to identify not merely a condition placed on importation, but a condition that is limiting, i.e. that has a limiting effect. In the context of Article XI, that limiting effect must be on importation itself.[41]

The panel in *Dominican Republic – Import and Sale of Cigarettes (2005)* further clarified the scope of application of Article XI:1 of the GATT 1994 by stating:

> Not every measure affecting the opportunities for entering the market would be covered by Article XI, but only those measures that constitute a prohibition or a restriction on the importation of products, i.e. those measures which affect the opportunities for importation itself.[42]

In *China – Raw Materials (2012)*, the panel found that the minimum export price requirement on exporters of bauxite, coke, fluorspar, magnesium, silicon carbide, yellow phosphorus and zinc was a quantitative restriction on exports, inconsistent with Article XI:1 of the GATT 1994.[43] The Appellate Body upheld this finding of inconsistency, considering *inter alia* that:

> [t]he use of the word 'quantitative' in the title of Article XI of the GATT 1994 informs the interpretation of the words 'restriction' and 'prohibition' in Article XI:1, suggesting that the coverage of Article XI includes those prohibitions and restrictions that limit the quantity or amount of a product being imported or exported.[44]

In *Argentina – Import Measures (2015)*, the Appellate Body further clarified that Article XI does 'not cover simply *any* restriction or prohibition' but that it refers to prohibitions or restrictions 'on the importation ... or on the exportation or sale for export'.[45] The Appellate Body ruled that:

> 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.[46]

The Appellate Body also noted that the words 'made effective through' in Article XI:1, which precede the words 'quotas, import or export licences or other

40 See Panel Report, *India – Autos (2002)*, para. 7.269. 41 *Ibid.*, para. 7.270.
42 Panel Report, *Dominican Republic – Import and Sale of Cigarettes (2005)*, para. 7.261.
43 See Panel Reports, *China – Raw Materials (2012)*, para. 8.20.
44 Appellate Body Reports, *China – Raw Materials (2012)*, para. 320.
45 See Appellate Body Reports, *Argentina – Import Measures (2015)*, para. 5.217. 46 *Ibid.*

measures', indicate that 'the scope of Article XI:1 covers measures through which a prohibition or restriction is produced or becomes operative'.[47]

As to the question of how the limitation of the importation or exportation is to be demonstrated, the Appellate Body ruled in *Argentina – Import Measures (2015)* that this limitation need not be demonstrated by quantifying the effects of the measure at issue.[48] In line with the panel's ruling in *Colombia – Ports of Entry (2010)*, referred to above, the Appellate Body stated that the limiting effects 'can be demonstrated through the design, architecture, and revealing structure of the measure at issue considered in its relevant context'.[49]

Finally, with regard to the controversial issue of whether Article XI:1 of the GATT 1994 covers only border measures or also measures concerning, for example, the sale, offering for sale, transportation, distribution and use of products after they have been imported, please refer to the discussion on the respective scopes of Articles III and XI of the GATT 1994 in Chapter 5.[50] Note that in *Brazil – Retreaded Tyres (2007)*, the European Communities claimed, *inter alia*, that the imposition of fines on the importation, marketing, transportation, storage, keeping and warehousing of imported retreaded tyres was inconsistent with Article XI:1 of the GATT 1994.[51] In addressing this claim, the panel considered whether these fines, imposed by Brazil as an enforcement measure of the import prohibition, constituted a restriction on importation within the meaning of Article XI:1. The panel reached the following conclusion:

> [W]hat is important in considering whether a measure falls within the types of measures covered by Article XI:1 is the nature of the measure. In the present case, we note that the fines as a whole, including that on marketing, have the effect of penalizing the act of 'importing' retreaded tyres by subjecting retreaded tyres already imported and existing in the Brazilian internal market to the prohibitively expensive rate of fines. To that extent, we consider that the fact that the fines are not administered at the border does not alter their nature as a restriction on importation within the meaning of Article XI:1.[52]

While it is explicitly referred to as a 'general prohibition', the prohibition on quantitative restrictions set out in Article XI:1 of the GATT 1994 is not without exceptions. The many and broad exceptions discussed in Chapters 8 and 9, as well as the special and differential treatment of developing-country Members referred to later in this chapter, are most important in this respect.[53] In addition, note that Article XI *exempts* certain measures from the scope of application of the prohibition on quantitative restrictions.[54] Note in particular Article XI:2(a) which allows for export prohibitions or restrictions temporarily applied

47 See *ibid.*, para. 5.218. 48 See *ibid.*, para. 5.217.
49 *Ibid.* 50 See above, p. 484.
51 See Panel Report, *Brazil – Retreaded Tyres (2007)*, para. 7.361. This finding was not appealed.
52 *Ibid.*, para. 7.372. The panel noted in addition that: 'the level of the fines – R$ 400 per unit, which significantly exceeds the average prices of domestically produced retreaded tyres for passenger cars (R$ 100–280) – is significant enough to have a restrictive effect on importation'. See *ibid.*
53 See below, pp. 544–623 and 630–68.
54 See Appellate Body Reports, *China – Raw Materials (2012)*, para. 334.

to prevent or relieve critical shortages of foodstuffs or other products essential to the exporting Member. In *China – Raw Materials (2012)* the Appellate Body clarified the meaning of the terms 'temporarily applied', 'essential products' and 'prevent or relieve critical shortages' as used in Article XI:2(a).[55]

In *Argentina – Import Measures (2015)*, Argentina argued that Article XI:1 did not apply to import and export formalities and requirements within the meaning of Article VIII of the GATT 1994. The Appellate Body conceded that Article VIII:1(c) could be read as implying that Members recognised that import formalities and requirements can have trade-restricting effects. The Appellate Body considered, however, that the general and hortatory language of Article VIII:1(c) did not suffice to establish a carve-out or derogation from Article XI:1 for formalities and requirements referred to in Article VIII of the GATT 1994.[56] The Appellate Body found that:

> formalities or requirements under Article VIII of the GATT 1994 are not excluded *per se* from the scope of application of Article XI:1 of the GATT 1994, and that their consistency could be assessed under either Article VIII or Article XI:1, or under both provisions. Thus, we reject Argentina's argument that Articles VIII and XI:1 have mutually exclusive spheres of application.[57]

As to the question of when formalities and requirements under Article VIII of the GATT 1994 are inconsistent with Article XI thereof, the Appellate Body noted in *Argentina – Import Measures (2015)*:

> Article XI:1 covers measures through which a prohibition or restriction is produced or becomes operative. If an import formality or requirement does not itself limit the importation of products independently of the limiting effects of another restriction, then such import formality or requirement cannot be said to produce the limiting effect and, thus, it will not amount to a 'restriction' captured by the prohibition in Article XI:1.[58]

To date, Members have been found to have acted inconsistently with the prohibition on quantitative restrictions of Article XI:1 of the GATT 1994 in fourteen disputes.[59] Most recently, the panel in *China – Rare Earths (2014)* found China's export quotas on rare earths, tungsten and molybdenum to be inconsistent with Article XI:1 of the GATT 1994,[60] and the panel in *Argentina – Import Measures (2015)* found, as upheld by the Appellate Body, that the Trade Related

55 See Appellate Body Reports, *China – Raw Materials (2012)*, paras. 318–28. The Appellate Body in this case upheld the finding of the panel that refractory-grade bauxite is 'essential' to China, but that China had not demonstrated that its export quota on refractory-grade bauxite is 'temporarily applied' within the meaning of Article XI:2(a) to either prevent or relieve a 'critical shortage'. See *ibid.*, para. 344.
56 Appellate Body Report, *Argentina – Import Measures (2015)*, paras. 5.233–5.235.
57 *Ibid.*, para. 5.237. 58 *Ibid.*, para. 5.244.
59 See *Canada – Periodicals (1997)*; *US – Shrimp (1998)*; *India – Quantitative Restrictions (1999)*; *Turkey – Textiles (1999)*; *Korea – Various Measures on Beef (2001)*; *Argentina – Hides and Leather (2001)*; *US – Shrimp (Article 21.5 – Malaysia) (2001)*; *India – Autos (2002)*; *Brazil – Retreaded Tyres (2007)*; *US – Poultry (China) (2010)*; *China – Raw Materials (2012)*; *China – Rare Earths (2014)*; and *Argentina – Import Measures (2015)*.
60 See Panel Reports, *China – Rare Earths (2014)*, para. 7.200.

Requirements (TRRs) and Advance Sworn Import Declaration (DJAI) procedure were a restriction on importation inconsistent with Article XI:1.[61]

2.2.2 Quantitative Restrictions and Customs Duties

As already noted in Chapter 6, the WTO has a clear preference for customs duties over quantitative restrictions, and this preference is reflected in the relevant provisions of the GATT 1994.[62] In comparing customs duties with quantitative restrictions, the panel in *Turkey – Textiles (1999)* noted:

> A basic principle of the GATT system is that tariffs are the preferred and acceptable form of protection ... The prohibition against quantitative restrictions is a reflection that tariffs are GATT's border protection 'of choice'.[63]

The reasons for this preference are both economic and political in nature. First, customs duties are more transparent. The economic impact of customs duties on imported products, i.e. how much more expensive imported products are as a result of customs duties, is immediately clear. Quantitative restrictions also increase the price of the imported products. As supply of the imported product is limited, the price increases. However, it is not immediately clear by how much quantitative restrictions increase the price of imported products. As it is less obvious what the negative impact of quantitative restrictions is on prices (paid by consumers and companies using imports), those affected are less likely to mobilise against these measures, and special interest groups are more likely to be able to convince governments to adopt them.

Second, and related to the first reason, it is considered easier to negotiate, in successive rounds of negotiations, the gradual reduction of customs duties than it is to negotiate the elimination (or liberalisation) of quantitative restrictions.

Third, while the price increase resulting from customs duties goes to the government as revenue, the price increase resulting from quantitative restrictions ordinarily benefits the importers. The importers will be able to sell at higher prices because of the limits on the supply of the product. This 'extra profit' is commonly referred to as the 'quota rent', and, unless a quota is auctioned (which is seldom done), no part of this quota rent goes to the government.

Fourth, the administration of quantitative restrictions is more open to corruption than the administration of customs duties. This is because quantitative restrictions, and, in particular, quotas, are usually administered through an import-licensing system; import-licensing procedures are often not transparent, and decisions by government officials to award an import licence are not necessarily based on general interest.[64]

Finally, and arguably most importantly, quantitative restrictions impose absolute limits on imports, while customs duties do not. While customs duties are

61 See Panel Reports, *Argentina – Import Measures (2015)*, para. 6.265. 62 See above, p. 423.
63 Panel Report, *Turkey – Textiles (1999)*, para. 9.63.
64 On import-licensing procedures, see below, pp. 496–8.

surmountable (at least, if they are not set at prohibitively high levels), quantitative restrictions cannot be surmounted. If a foreign producer is sufficiently more efficient than a domestic producer, the customs duty will not prevent imported products from competing with domestic products. By contrast, once the limit of a quantitative restriction is reached, no more products can be imported. Even the most efficient foreign producer cannot 'overcome' the quantitative restriction. Above the quota, domestic products have no competition from imported products.[65]

2.2.3 Rules on Quantitative Restrictions on Specific Products

Under the GATT 1947, the prohibition against quantitative restrictions was often *not* respected. The panel in *Turkey – Textiles (1999)* noted:

> From early in the GATT, in sectors such as agriculture, quantitative restrictions were maintained and even increased ... In the sector of textiles and clothing, quantitative restrictions were maintained under the Multifibre Agreement [*sic*] ... Certain contracting parties were even of the view that quantitative restrictions had gradually been tolerated and accepted as negotiable and that Article XI could not be, and had never been considered to be, a provision prohibiting such restrictions irrespective of the circumstances specific to each case.[66]

However, the overall detrimental effect of these quantitative restrictions in the sectors of agriculture and textiles were generally recognised. Therefore, their elimination was high on the agenda of the Uruguay Round negotiations, and the *Agreement on Agriculture* and the *Agreement on Textiles and Clothing* (resulting from these negotiations) contain specific rules regarding the elimination of quantitative restrictions.

The *Agreement on Agriculture* provides that quantitative import restrictions and voluntary export restraints, *inter alia*, must be converted into tariffs and that no new restrictions of this kind can be adopted. Article 4.2 of the *Agreement on Agriculture* states:

> Members shall not maintain, resort to, or revert to any measures of the kind which have been required to be converted into ordinary customs duties, except as otherwise provided for in Article 5 and Annex 5.

In footnote 1 to this provision, the measures which had to be converted into tariffs (or tariff quotas) were identified as: quantitative import restrictions, variable import levies, minimum import prices, discretionary import licensing, non-tariff measures maintained through State trading enterprises, voluntary export restraints, and similar border measures other than ordinary customs duties.[67]

65 See also Panel Report, *Turkey – Textiles (1999)*, para. 9.63.
66 *Ibid.*, para. 9.64. Note that the argument of certain Contracting Parties that Article XI could not be a provision prohibiting quantitative restrictions irrespective of the circumstances in which they were imposed, in a specific case, was explicitly rejected by the panel in *EEC – Import Restrictions (1983)*.
67 Note that measures maintained under balance-of-payments provisions or under other general, non-agriculture-specific provisions of the GATT 1994 or of the other multilateral agreements on trade in goods did *not* need to be converted into tariffs.

The process of converting these non-tariff measures into tariffs is commonly referred to as the 'tariffication process'. As this process provided for the replacement of non-tariff measures with a tariff which afforded *an equivalent level of protection*, many of the tariffs resulting from the 'tariffication process' are very high.[68] However, by introducing a system of *tariff quotas*, it was possible to guarantee: (1) that the quantities imported before Article 4.2 of the *Agreement on Agriculture* took effect could continue to be imported; and (2) that some new quantities were subject to tariffs that were not prohibitive. Under this system of tariff quotas, lower tariffs applied to specified quantities (in-quota quantities), while higher (often prohibitive) tariffs applied to quantities that exceed the quota (over-quota quantities).[69]

At the Bali Ministerial Conference in December 2013, the WTO adopted an understanding on the administration of tariff quotas for agricultural products.[70] The Understanding stipulates that tariff quota administration shall be deemed to be an instance of import licensing to which the provisions of the *Agreement on Import Licensing Procedures* apply in full, subject to the *Agreement on Agriculture* and the more specific and additional obligations set out in the Understanding.[71] The Understanding addresses in particular the problem of under-filling the tariff quota.[72]

With respect to the relationship between Article 4.2 of the *Agreement on Agriculture* and Article XI of the GATT 1994, the panel in *Korea – Various Measures on Beef (2001)* stated that:

> when dealing with measures relating to agricultural products which should have been converted into tariffs or tariff-quotas, a violation of Article XI of GATT ... would necessarily constitute a violation of Article 4.2 of the *Agreement on Agriculture* and its footnote.[73]

As mentioned above, trade in textiles and clothing also largely 'escaped' from the GATT 1947 rules and disciplines, and in particular the prohibition of Article XI on quantitative restrictions. Under the *Multifibre Arrangement* (MFA), in effect from 1974, developed and developing countries, respectively importing and exporting textiles, entered into bilateral agreements requiring the exporting developing countries to limit their exports of certain categories of textiles and clothing. In 1995, the main importing countries had eighty-one such restraint agreements with exporting countries, comprising over a thousand individual quotas.[74]

68 The customs duties resulting from the 'tariffication process' concern, on average, one-fifth of the total number of agricultural tariff lines in the national customs tariffs of developed-country Members.
69 On the reduction of customs duties on agricultural products agreed on during the Uruguay Round negotiations, see above, pp. 434–5.
70 See *Understanding on Tariff Rate Quota Administration Provisions of Agricultural Products, as Defined in Article 2 of the Agreement on Agriculture*, Ministerial Decision of 7 December 2013, WT/MIN(13)/39 – WT/L/914, dated 11 December 2013.
71 See *ibid.*, para. 1. 72 See *ibid.*, paras. 6–15.
73 Panel Report, *Korea – Various Measures on Beef (2001)*, para. 7.62.
74 In addition, there were also a number of non-MFA agreements or unilateral measures restricting the imports of textiles and clothing. See *Business Guide to the World Trading System*, 2nd edn (International Trade Centre/Commonwealth Secretariat, 1999), 164.

The MFA, which was negotiated within the framework of the GATT, provided a 'legal cover' for the GATT inconsistency of these quotas.[75] The *Agreement on Textiles and Clothing* (ATC) negotiated during the Uruguay Round sought to address this situation and contained specific rules for quantitative restrictions on textiles and clothing.

The ten-year-long 'integration process', provided for in the ATC, was to be carried out in four stages, ending on 31 December 2004. At each stage, products amounting to a certain minimum percentage of the volume of a Member's 1990 imports of textiles and clothing were made fully subject to the disciplines of the GATT 1994, including the prohibition on quantitative restrictions of Article XI.[76] Moreover, the level of the remaining quantitative restrictions was to be increased annually.[77]

While the integration process of the ATC was successfully completed by the end of 2004 and quantitative restrictions on textiles terminated, the benefits of this return to GATT discipline have been unevenly spread. A number of smaller, textile-producing developing-country Members, such as Mauritius, Lesotho and Costa Rica, which before 2005 had enjoyed guaranteed quota access, encountered serious adjustment problems as their textile exports could not compete with the textile exports of the large textile-producing developing-country Members, such as Bangladesh, Brazil, India and especially China.[78] When it was suggested that the WTO should address the problems of small textile-producing developing-country Members adversely affected by the elimination of quotas, China, Brazil, India and Hong Kong objected to the inclusion of this issue on the agenda of the Council for Trade in Goods.[79]

2.2.4 Voluntary Export Restraints

Voluntary export restraints (VERs) are actions taken by exporting countries involving a *self-imposed* quantitative restriction of exports. VERs are taken either unilaterally or under the terms of an agreement or arrangement between two or more countries. As the term indicates, in theory, VERs are entered into on a *voluntary* basis, i.e. the exporting country voluntarily limits the volume of its

75 *Ibid.*, 165.
76 See Articles 2.6 and 2.7 of the ATC. Note, however, that this integration process applied to *all* textile products listed in the ATC, including products on which there were no quantitative restrictions. This allowed the United States and the European Communities, during the first stages, to 'integrate' mainly products on which there were *no* quantitative restrictions into the GATT 1994. To the discontent and disappointment of the textile-exporting Members, the two major importing Members, the European Union and the United States, could at least initially meet their obligations under the ATC without significantly removing quantitative restrictions. They removed most of their quantitative restrictions only in the fourth and last stage of the integration process, ending on 1 January 2005.
77 e.g. the quotas were increased by 25 per cent per year from 1998 to 2001. See Articles 2.13 and 2.14 of the ATC.
78 See F. Williams, 'China and India Gain from End of Quotas', *Financial Times*, 25 October 2005.
79 See *Bridges Weekly Trade News Digest*, 18 May 2005.

exports. However, in reality, the voluntary nature of VERs is usually a fiction. A 1983 GATT report observed:

> It appeared ... that exporting countries which accepted so-called 'grey-area' actions did so primarily because ... they felt that they had little choice and that the alternative was, or would have been, unilateral action in the form of quantitative restrictions, harassment by anti-dumping investigations, countervailing action ... involving greater harm to their exports in terms of quantity or price.[80]

Under the GATT 1947, the legality of voluntary export restraints was a much-debated issue. With the entry into force of the *WTO Agreement*, this issue has been definitively decided. The WTO *Agreement on Safeguards* specifically prohibits voluntary export restraints.[81] Article 11.1(b) of this Agreement provides:

> [A] Member shall not seek, take or maintain any voluntary export restraints, orderly marketing arrangements or any other similar measures on the export or the import side.[82]

Article 11.1(b) of the *Agreement on Safeguards* furthermore required that any such measure existing in 1995 had to be phased out (or brought into compliance with the *Agreement on Safeguards*) before the end of 1999.

2.3 Administration of Quantitative Restrictions

Article XI:1 of the GATT 1994 prohibits quantitative restrictions. There are, however, as noted above and discussed elsewhere in this book, many exceptions to this prohibition of Article XI:1.[83] Article XIII of the GATT 1994 bears testimony to this by setting out rules on the *administration* of quantitative restrictions. This subsection addresses: (1) the rule of non-discrimination; (2) the rules on the distribution of trade; and (3) the rules on import-licensing procedures.

While tariff quotas are not quantitative restrictions, pursuant to Article XIII:5 of the GATT 1994, the rules on the administration of quantitative restrictions set out in Article XIII, and discussed in this subsection, also apply to the administration of tariff quotas. In fact, many of the disputes on Article XIII are related to the administration of tariff quotas.[84] This subsection therefore includes some examples of tariff quotas applied by the European Union.

80 Report of the Chairman of the Safeguards Committee, BISD 30S/216, 218.
81 For a detailed discussion of the *Agreement on Safeguards*, see below, pp. 631–65. Also, Article 4.2, read together with fn. 1, of the *Agreement on Agriculture* contains a prohibition of voluntary export restraints.
82 Footnote 4 to this provision contains an illustrative list of 'similar measures', including export moderation, export-price or import-price monitoring systems, export or import surveillance, compulsory import cartels and discretionary export or import-licensing schemes, any of which afford protection.
83 See above, p. 484; and, *inter alia*, below, pp. 540–2.
84 See e.g. the controversial administration of the tariff quotas under the EC's import regime for bananas at issue in *EC – Bananas III (1997)*, or for poultry at issue in *EC – Poultry (1998)*. See also the tariff quotas at issue in *US – Line Pipe (2002)*.

2.3.1 Rule of Non-Discrimination

Article XIII:1 of the GATT 1994 provides that quantitative restrictions, when applied, should be administered in a non-discriminatory manner. Article XIII:1 states:

> No prohibition or restriction shall be applied by any [Member] on the importation of any product of the territory of any other [Member] or on the exportation of any product destined for the territory of any other [Member], unless the importation of the like product of all third countries or the exportation of the like product to all third countries is *similarly prohibited or restricted*.[85]

What Article XIII:1 requires is that, if a Member imposes a quantitative restriction on products to or from another Member, products to or from all other countries are 'similarly prohibited or restricted'. This requirement of Article XIII:1 is an MFN-like obligation. As the Appellate Body noted in *EC – Bananas III (1997)*, the essence of the non-discrimination obligations of Articles I:1 *and* XIII of the GATT 1994 is that:

> like products should be treated equally, irrespective of their origin.[86]

The GATT panel in *EEC – Apples (Chile I) (1980)* found that the European Communities had acted inconsistently with the non-discrimination obligation of Article XIII:1. The importation of apples from Argentina, Australia, New Zealand and South Africa into the European Communities had been restricted through voluntary restraint agreements negotiated and concluded with these countries. The European Communities tried to agree on a similar voluntary restraint agreement with Chile but the negotiations failed. The European Communities subsequently adopted measures restricting the importation of Chilean apples to approximately 42,000 tonnes a year. The panel in *EEC – Apples (Chile I) (1980)* found that the measure applied to apple imports from Chile were *not* a restriction *similar* to the voluntary restraint agreements negotiated with the other apple-exporting countries and therefore was inconsistent with Article XIII:1. The panel came to this conclusion primarily on the basis that: (1) there was a difference in transparency between the two types of action; (2) there was a difference in the administration of the restrictions, the one being an import restriction, the other an export restraint; and (3) the import restriction was unilateral and mandatory while the other was voluntary and negotiated.[87]

2.3.2 Rules on the Distribution of Trade

If quantitative restrictions, other than a prohibition or ban, are applied on the importation of a product, the question arises how the trade that is still allowed

85 Emphasis added.
86 Appellate Body Report, *EC – Bananas III (1997)*, para. 190.
87 See Panel Report, *EEC – Apples (Chile I) (1980)*, para. 4.11.

will be distributed among the different Members exporting that product. The chapeau of Article XIII:2 of the GATT 1994 provides in this respect:

> In applying import restrictions to any product, [Members] shall aim at a distribution of trade in such product approaching as closely as possible the shares which the various [Members] might be expected to obtain in the absence of such restrictions.[88]

In *EC – Bananas III (1997)*, the Appellate Body found the reallocation of non-utilised tariff quotas only among those countries that concluded the *Banana Framework Agreement* with the European Communities to be inconsistent with Article XIII:2, as the reallocation failed to approximate, in the administration of tariff quotas, the relative trade flows which would exist in the absence of the tariff quotas.[89] The panel in *US – Line Pipe* (2002) found:

> There is nothing in the record before the Panel to suggest that the line pipe measure was based in any way on historical trade patterns in line pipe, or that the United States otherwise 'aim[ed] at a distribution of trade ... approaching as closely as possible the shares which the various Members might be expected to obtain in the absence of' the line pipe measure. Instead, as noted by Korea, 'the in-quota import volume originating from Korea, the largest supplier historically to the US market, was reduced to the same level as the smallest – or even then non-existent – suppliers to the US market (9,000 short tons)'. For this reason, we find that the line pipe measure is inconsistent with the general rule contained in the chapeau of Article XIII:2.[90]

Furthermore, Article XIII:2 sets out a number of requirements to be met when imposing quantitative restrictions. Pursuant to Article XIII:2(a) and (b), when imposing a quantitative restriction, a quota – whether global or allocated among the supplying countries – is preferred to quantitative restrictions applied through import licences or permits without a quota. In cases in which a quota is allocated among supplying countries, Article XIII:2(d) provides:

> [T]he [Member] applying the restrictions may seek agreement with respect to the allocation of shares in the quota with all other [Members] having a substantial interest in supplying the product concerned.

However, when this method of allocating the shares in the quota 'is not reasonably practicable', i.e. when no agreement can be reached with *all* the Members having a substantial interest, the Member applying the quota:

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

In other words, if no agreement can be reached, the quota must be allocated among the Members having a substantial interest on the basis of their share of

88 Note that the panel in *US – Line Pipe (2002)* stated that the chapeau of Article XIII:2 contains 'a general rule, and not merely a statement of principle'. See Panel Report, *US – Line Pipe (2002)*, fn. 64.
89 See Appellate Body Report, *EC – Bananas III (1997)*, para. 163.
90 Panel Report, *US – Line Pipe (2002)*, para. 7.55.

the trade during a previous representative period. It is normal GATT practice to use a three-year period prior to the imposition of the quota as the 'representative period'.[91] Quotas allocated among supplying countries *must* be allocated among *all* Members having a *substantial interest* in supplying the product.[92] There is no additional obligation to allocate a part of the quota to Members *without* a substantial interest in supplying the product concerned. While the requirement of Article XIII:2(d) is not expressed as an exception to the basic non-discrimination requirement of Article XIII:1, it may be regarded, to the extent that its practical application is inconsistent with it, as a *lex specialis*.[93] It allows for the discrimination between Members with and Members without a substantial interest in supplying the product at issue.

In *EC – Bananas III (1997)*, the panel addressed the question of whether quota shares or tariff quota shares (as they were in this case) *can* also be allocated to Members that do not have a substantial interest in supplying the product at issue. According to the panel, quota shares and tariff quota shares *can* be allocated to Members with minor market shares. The panel ruled:

> [W]e note that the first sentence of Article XIII:2(d) refers to allocation of a quota 'among supplying countries'. This could be read to imply that an allocation may also be made to Members that do not have a substantial interest in supplying the product.[94]

However, if a Member wishes to allocate quota shares or tariff quota shares to some Members with minor market shares, then such shares must be allocated to *all* such Members. If not, imports from such Members would not be 'similarly restricted' as required by Article XIII:1 of the GATT 1994.[95] Moreover, the same method as was used to allocate the shares to the Members having a substantial interest in supplying the product would have to be used. Otherwise, again, the non-discrimination obligation of Article XIII:1 would not be met.[96] If a Member wishes to allocate a part of the quota or tariff quota to Members with minor market shares, then this is best done by providing – next to country-specific quota shares for Members with a substantial interest – for an 'others' category for all Members not having a substantial interest in supplying the product.[97] The use of an 'others' category is consistent with the object and purpose of Article XIII (as expressed in the chapeau of Article XIII:2) to achieve a distribution of trade as close as possible to that which would have been the distribution of trade in the

91 See Panel Report, *EEC – Apples (Chile I) (1980)*, para. 4.16; and Panel Report, *EEC – Dessert Apples (1989)*, para. 12.22.
92 As discussed above, a share of 10 per cent of the market of the Member applying the quota has generally been considered to be a 'significant share' of the market, required to claim a 'substantial interest'. See above, p. 448.
93 See Panel Reports, *EC – Bananas III (1997)*, para. 7.75. 94 *Ibid.*, para. 7.73.
95 See above, p. 307. 96 See *ibid.*
97 The alternative is to allocate to all supplying countries, including Members with minor market shares, country-specific tariff quota shares. This method, however, is more likely to lead to a long-term freezing of market shares and a less competitive market. See also Panel Reports, *EC – Bananas III (1997)*, para. 7.76.

absence of the quantitative restriction.[98] The panel in *EC – Bananas III (1997)* noted:

> When a significant share of a tariff quota is assigned to 'others', the import market will evolve with a minimum amount of distortion. Members not having a substantial supplying interest will be able, if sufficiently competitive, to gain market share in the 'others' category and possibly achieve 'substantial supplying interest' status ... New entrants will be able to compete in the market, and likewise have an opportunity to gain 'substantial supplying interest' status.[99]

2.3.3 Import-Licensing Procedures

Quotas and tariff quotas are usually administered through import-licensing procedures. Article 1.1 of the *Agreement on Import Licensing Procedures*, commonly referred to as the *Import Licensing Agreement*, defines import-licensing procedures as:

> administrative procedures ... requiring the submission of an application or other documentation (other than that required for customs purposes) to the relevant administrative body as a prior condition for importation into the customs territory of the importing Member.[100]

A trader who wishes to import a product that is subject to a quota or tariff quota must apply for an import licence, i.e. a permit to import. Whether this import licence will be granted depends on whether the quota is already filled or not, and on whether the trader meets the requirements for an import licence.[101] Economists agree that a first-come, first-served distribution rule for import licences is the most economically efficient licensing method.[102] However, import-licensing rules and procedures are often much more complex, as was illustrated by the import-licensing system for bananas at issue in *EC – Bananas III (1997)*.[103]

One of the most important rules of the *Import Licensing Agreement* is set out in Article 1.3, which reads:

> The rules for import licensing procedures shall be neutral in application and administered in a fair and equitable manner.

As emphasised by the Appellate Body in *EC – Bananas III (1997)*, the requirements of Article 1.3 do not concern the licensing rules *per se*, but concern the *application* and *administration* of these rules.[104]

98 See *ibid.*, para. 7.76. 99 *Ibid.*, para. 7.76.
100 While Article 1.1 of the *Import Licensing Agreement* does not explicitly state that import-licensing procedures for tariff quotas are import-licensing procedures within the meaning of Article 1.1, the Appellate Body in *EC – Bananas III (1997)* ruled that a careful reading of that provision 'leads inescapably to that conclusion'. As the Appellate Body noted, import-licensing procedures for tariff quotas require 'the submission of an application' for import licences as 'a prior condition for importation' of a product at the lower in-quota tariff rate. See Appellate Body Report, *EC – Bananas III (1997)*, para. 193.
101 This would be an example of non-automatic import licensing. As discussed below, there is also automatic import licensing, but this would not occur with respect to the importation of a product that is subject to a quota or tariff quota. See below, p. 497.
102 See e.g. P. Lindert and T. Pugel, *International Economics*, 10th edn (McGraw Hill, 1996).
103 See Panel Reports, *EC – Bananas III (1997)*, paras. 7.142–7.273.
104 See Appellate Body Report, *EC – Bananas III (1997)*, paras. 197–8. See also Panel Report, *Korea – Various Measures on Beef (2001)*, paras. 784–5; and Panel Report, *EC – Poultry (1998)*, para. 254.

Moreover, Article 1.4 of the *Import Licensing Agreement* requires that the rules and all information concerning procedures for the submission of applications for import licences must be published in such a manner as to enable Members and traders to become acquainted with them.[105] In no event shall such a publication be later than the date on which the licence requirement becomes effective.[106] In *EC – Poultry (1998)*, Brazil argued that frequent changes to the EC licensing rules and procedures regarding the poultry tariff quota made it difficult for Members and traders to become familiar with the rules, contrary to the provisions of Article 1.4 and other provisions of the *Import Licensing Agreement*. The panel rejected this complaint as follows:

> We note that the transparency requirement under the cited provisions is limited to publication of rules and other information. While we have sympathy for Brazil regarding the difficulties caused by the frequent changes to the rules, we find that changes in rules *per se* do not constitute a violation of Articles 1.4, 3.3, 3.5(b), 3.5(c) or 3.5(d).[107]

Articles 1.7 and 1.8 of the *Import Licensing Agreement* require that, in the administration and application of licensing rules, minor documentation errors or minor variations in value should not matter. For example, an application for an import licence shall not be refused for minor documentation errors, which do not alter basic data contained therein.[108]

The *Import Licensing Agreement* distinguishes between automatic and non-automatic import licensing. *Automatic import licensing* is defined as import licensing where approval of the application is granted *in all cases*.[109] Automatic import licensing may be maintained to collect statistical and other information on imports. Article 2.2 of the *Import Licensing Agreement* requires that automatic import-licensing procedures shall not be administered in such a manner as to have 'restricting effects on imports subject to automatic licensing'.[110] *Non-automatic import licensing* is import licensing where approval is *not* granted in all cases. Import-licensing procedures for quotas and tariff quotas are by definition non-automatic import-licensing procedures. However, non-automatic import licences are also used by countries for many other reasons. Note, for example, that Saudi Arabia requires non-automatic import licences for certain 'distillation equipment' due to the fact that the latter has been used to produce alcoholic beverages in the past. Since alcohol is generally prohibited in Saudi Arabia, it has decided therefore to establish an import-licence requirement for

105 The rules and information concerned include rules and information on the eligibility of persons, firms and institutions to make such applications and the administrative body(ies) to be approached.
106 See *ibid.* Whenever practicable, the publication shall take place twenty-one days prior to the effective date. Note that any exceptions, derogations or changes in or from the rules concerning licensing procedures or the list of products subject to import licensing shall also be published in the same manner and within the same period. See *ibid.*
107 Panel Report, *EC – Poultry (1998)*, para. 246.
108 See Article 1.7 of the *Import Licensing Agreement*. 109 See *ibid.*, Article 2.1.
110 On situations in which automatic licensing procedures shall *be deemed* to have trade-restricting effects, see Article 2.2 of the *Import Licensing Agreement*.

certain distillation equipment.[111] With regard to non-automatic import licensing, Article 3.2 of the *Import Licensing Agreement* requires that:

> Non-automatic licensing shall not have trade-restrictive or distortive effects on imports additional to those caused by the imposition of the restriction.

Other requirements relating to non-automatic import licensing concern: (1) the non-discrimination among applicants for import licences;[112] (2) the obligation to give reasons for refusing an application;[113] (3) the right of appeal or review of the decisions on applications;[114] (4) time limits for processing applications;[115] (5) the validity of import licences;[116] and (6) the desirability of issuing licences for products in economic quantities.[117]

2.4 Special and Differential Treatment

The GATT 1994 provides for special and differential treatment of developing-country Members regarding the rules on quantitative restrictions discussed above. Article XVIII of the GATT 1994 allows developing-country Members to impose quantitative restrictions for balance-of-payments reasons under less demanding conditions than apply for developed-country Members under Article XII of the GATT 1994. For a discussion of this special and differential treatment, refer to Chapter 9.[118]

3 OTHER NON-TARIFF BARRIERS ON TRADE IN GOODS

In addition to customs duties and other duties and charges (i.e. tariff barriers), and quantitative restrictions (i.e. the first subcategory of non-tariff barriers), trade in goods may also be impeded by 'other non-tariff barriers'. As the term indicates, this is a *residual* category of measures, actions or omissions, which restrict, to various degrees and in different ways, market access for goods.[119] The category of 'other non-tariff barriers' includes, *inter alia*, technical barriers to trade, sanitary and phytosanitary measures, customs formalities and procedures, and government procurement laws and practices. Also, the unfair and arbitrary application of trade measures may constitute an important barrier to trade. However, not only action but also omission, and in particular the failure

111 See Working Party Report on the Accession of the Kingdom of Saudi Arabia to the WTO, WT/ACC/SAU/61, dated 1 November 2005, para. 149.
112 See Article 3.5(e) of the *Import Licensing Agreement*. 113 See *ibid.*
114 See *ibid.* 115 See *ibid.*, Article 3.5(f).
116 See *ibid.*, Article 3.5(g). 117 See *ibid.*, Article 3.5(j).
118 See below, pp. 659–68.
119 See e.g. *Table of Contents of the Inventory of Non-Tariff Measures*, Note by the Secretariat, TN/MA/S/5/Rev.1, dated 28 November 2003.

to inform about the applicable trade laws, regulations and procedures, promptly and accurately, may constitute a formidable barrier to trade.

This section addresses in turn the following 'other non-tariff barriers' to trade in goods: (1) lack of transparency; (2) unfair and arbitrary application of trade measures; (3) customs formalities and procedures; (4) government procurement laws and practices; and (5) other measures or actions, such as preshipment inspection, marks of origin and measures relating to transit shipments. As mentioned above, and due to their importance and detailed nature, the rules on technical barriers to trade and sanitary and phytosanitary measures are discussed, separately, in Chapters 13 and 14 respectively.[120]

3.1 Lack of Transparency

As discussed above, lack of information, uncertainty or confusion with respect to the trade laws, regulations and procedures applicable in actual or potential export markets is an important barrier to trade. Therefore, WTO law provides for rules and procedures to ensure a high level of transparency of its Members' trade laws, regulations and procedures. There are four kinds of relevant WTO rules and procedures: (1) the *publication* requirement; (2) the *notification* requirement; (3) the requirement to establish *enquiry points*; and (4) the trade policy *review* process.

Article X of the GATT 1994, entitled 'Publication and Administration of Trade Regulations', requires in its first paragraph that Members *publish* their laws, regulations, judicial decisions, administrative rulings of general application and international agreements relating to trade matters.[121] Article X:1 does not prescribe in any detail how these laws, regulations, etc. have to be published, but it does state that they have to be published: (1) 'promptly'; and (2) 'in such a manner as to enable governments and traders to become acquainted with them'.[122] The panel in *EC – IT Products (2010)* noted that:

> Article X:1 addresses the due process notion of notice by requiring publication that is prompt and that ensures those who need to be aware of certain laws, regulations, judicial

120 See below, pp. 883–932 and 935–90.
121 The many and diverse trade matters to which the laws, regulations, etc. may relate to include the classification or the valuation of products for customs purposes, rates of duties, taxes or other charges, and restrictions and prohibitions on imports and exports; and are set out in detail in Article X:1. Note that the term 'of general application' qualifies not just 'administrative rulings' but all types of measures referred to in Article X:1, first sentence. See Panel Report, *US – Countervailing and Anti-Dumping Measures (China) (2014)*, paras. 7.30–7.31. According to the Appellate Body in *US – Underwear (1997)* measures of 'general application' are those affecting 'an unidentified number of economic operators'. See Appellate Body Report, *US – Underwear (1997)*, 29. Therefore, licences issued to a specific company or applied to a specific shipment are not subject to the publication requirement of Article X:1. See Appellate Body Report, *EC – Poultry (1998)*, para. 113.
122 Note that Article X:1, unlike Article X:2, discussed below, does not require that the publication is in an official publication. See Panel Reports, *EC – IT Products (2010)*, para. 7.1082. Note also that the publication requirements set out in the first sentence of Article X:1 do not explicitly apply to the publication of the international agreements, but it may be assumed that they also apply in this context. Moreover, note that Article X:1 does not require Members to disclose confidential information which would impede law enforcement or otherwise be contrary to the public interest or which would prejudice the legitimate commercial interests of particular enterprises, public or private. See Article X:1, last sentence, of the GATT 1994. See also Panel Report, *Thailand – Cigarettes (Philippines) (2011)*, para. 7.819.

decisions and administrative rulings of general application can become acquainted with them.[123]

With regard to the 'promptness' requirement, the panel in *EC – IT Products (2010)* considered that:

> the meaning of prompt is not an absolute concept, i.e. a pre-set period of time applicable in all cases. Rather, an assessment of whether a measure has been published 'promptly', that is 'quickly' and 'without undue delay', necessarily requires a case-by-case assessment.[124]

In this case, the panel found that publication in the EU's *Official Journal* eight months after the measures were made effective was not 'prompt', i.e. 'quickly' or 'without undue delay'. However, the panel noted that the measures were posted on an EU website prior to the date that they were made effective. The panel found that the latter publication was 'prompt' but that it was not 'in such a manner as to enable governments and traders to become acquainted' with the measures at issue.[125]

With regard to the concept of 'administrative ruling of general application', note that, to the extent that an administrative ruling is addressed to a specific company or applied to a specific shipment, it cannot be qualified as an administrative ruling of general application. However, to the extent that an administrative ruling affects an unidentified number of economic operators, it can be qualified as a ruling of general application. The fact that a measure is country-specific does not preclude the possibility of it being an administrative ruling of general application.[126] In *EC – IT Products (2010)*, the question arose whether a CNEN (i.e. an explanatory note to the EU's Customs Nomenclature) could be considered to be a measure to which Article X:1 applied. The panel found that:

> the instruments covered by Article X:1 range from imperative rules of conduct to the exercise of influence or an authoritative pronouncement by certain authoritative bodies. Accordingly, we consider that the coverage of Article X:1 extends to instruments with a degree of authoritativeness issued by certain legislative, administrative or judicial bodies. This does not mean, however, that they have to be 'binding' under domestic law. Hence, the fact that CNENs are not legally binding under EC law does not preclude them from being contemplated by the terms 'laws, regulations, judicial decisions [or] administrative rulings' under Article X:1.[127]

The panel did emphasise, however, that for a measure to be a law, regulation, etc. within the meaning of Article X:1, it must have a 'degree of authoritativeness'

123 Panel Reports, *EC – IT Products (2010)*, para. 7.1015.
124 *Ibid.*, para. 7.1074. See also Panel Report, *US – Countervailing and Anti-Dumping Duties (2014)*, paras. 7.79–7.87.
125 See Panel Reports, *EC – IT Products (2010)*, para. 7.1088.
126 See Appellate Body Report, *US – Underwear (1997)*, 29. See also Appellate Body Report, *EC – Poultry (1998)*, paras. 111–13. Note that the panel in *Japan – Film (1998)* stated that: 'it stands to reason that inasmuch as the Article X:1 requirement applies to all administrative rulings of general application, it also should extend to administrative rulings in individual cases where such rulings establish or revise principles or criteria applicable in future cases'. See Panel Report, *Japan – Film (1998)*, para. 10.388.
127 Panel Reports, *EC – IT Products (2010)*, para. 7.1027.

and this will need to be established on a case-by-case basis considering the particular factual features of the measure at issue.[128]

The panel in *Thailand – Cigarettes (Philippines) (2011)* found that the explanation given by the Thai Excise Department of the methodology for calculating the maximum retail sales prices (MRSPs) for imported and domestic cigarettes applied 'prospectively and generally' to all potential sales of cigarettes. Therefore, the panel considered that this methodology for determining the MRSPs to be a measure of general application to which Article X:1 applied.[129]

The panel in *US – Countervailing and Anti-Dumping Measures (China) (2014)* found that a measure is of 'general application' when the 'measure applies to a class, or a set or category, of persons, entities, situations or cases that have some attributes in common'.[130] A measure that applies to named or otherwise specifically identified persons, entities, situations or cases would not be a measure of 'general application'.[131]

In addition to Article X:1, Article X:2 of the GATT 1994 also concerns the publication of trade measures of general application. Article X:2 provides:

> No measure of general application taken by any [Member] effecting an advance in a rate of duty or other charge on imports under an established and uniform practice, or imposing a new or more burdensome requirement, restriction or prohibition on imports, or on the transfer of payments therefor, shall be enforced before such measure has been officially published.

Pursuant to Article X:2, Members may not enforce, i.e. apply,[132] measures of general application, imposing new or higher barriers to trade, *before* they are officially published.[133] Such trade measures shall only take effect *after* official publication.[134] With respect to the rationale of Article X:2, the Appellate Body noted in *US – Underwear (1997)*:

> Article X:2, *General Agreement*, may be seen to embody a principle of fundamental importance – that of promoting full disclosure of governmental acts affecting Members and private persons and enterprises, whether of domestic or foreign nationality. The relevant policy principle is widely known as the principle of transparency and has obviously due

128 See *ibid.*, para. 7.1027. Whether a measure is a law, regulation, etc. within the meaning of Article X:1 must be based primarily on the content and substance of the instrument, and not merely on its form or nomenclature. See *ibid.*, para. 7.1023.
129 Panel Report, *Thailand – Cigarettes (Philippines) (2011)*, para. 7.773. Note that the panel in *China – Raw Materials (2012)* found that China's failure to set a quota amount was a measure to which Article XI:1 applied. See Panel Reports, *China – Raw Materials (2012)*, para. 7.803.
130 Panel Report, *US – Countervailing and Anti-Dumping Measures (China) (2014)*, para. 7.32.
131 See *ibid.*, para. 7.35.
132 See Panel Reports, *EC – IT Products (2010)*, para. 7.1129. See also Panel Report, *US – Countervailing and Anti-Dumping Measures (2014)*, para. 7.105.
133 The panel in *EC – IT Products (2011)* ruled that even a *single* instance of enforcement before the official publication could amount to a violation of Article X:2. See Panel Reports, *EC – IT Products (2011)*, para. 7.1131. Note that Article X:1 refers to 'publication', while Article X:2 refers to 'official publication'.
134 Note that, with respect to the issue of the retroactive effect of trade measures, the Appellate Body ruled in *US – Underwear (1997)* that Article X:2 does not speak to, and hence does not resolve, the permissibility of giving retroactive effect to trade-restrictive measures. Where no authority exists to give retroactive effect to a trade-restrictive measure, that deficiency is not cured by publishing the measure some time before its actual application. See Appellate Body Report, *US – Underwear (1997)*, 21.

process dimensions. The essential implication is that Members and other persons affected, or likely to be affected, by governmental measures imposing restraints, requirements and other burdens, should have a reasonable opportunity to acquire authentic information about such measures and accordingly to protect and adjust their activities or alternatively to seek modification of such measures.[135]

Article X:2 of the GATT 1994 concerns only two types of measures of general application: (1) measures of general application 'effecting an advance in a rate of duty or other charge on imports under an established and uniform practice';[136] and (2) measures of general application 'imposing a new or more burdensome requirement, restriction or prohibition on imports'. For neither type of measure, does Article X:2 explicitly specify the baseline of comparison to be used in order to determine whether there is an advance in a rate of duty or a new or more burdensome requirement.[137] However, the Appellate Body found in *US – Countervailing and Anti-Dumping Measures (China) (2014)* that:

> the language in Article X:2 that refers to an *advance* in a rate of duty and a *new* or *more burdensome* requirement implies a comparison between the measure that is alleged to be increasing a rate of duty or imposing a new or more burdensome requirement and a relevant baseline, which is normally to be found in published measures of general application.[138]

The baseline of comparison for Article X:2 is thus the prior published measure of general application that was replaced or modified by the measure at issue,[139] as interpreted and applied by the relevant domestic authorities.[140] As already noted above, Article X:2 embodies the principles of transparency, due process and notice.[141] It follows therefrom that the relevant baseline of comparison should be reflected in norms that traders can rely upon and that accordingly create expectations among them, i.e. the prior published measures of general application.[142] As the Appellate Body stated:

> Published measures create expectations among traders, and changes to such measures trigger the due process and notice obligations of Article X:2, which, for this reason, preclude the enforcement of those changes before publication.[143]

The Appellate Body recognised that there may be circumstances where there is no prior published measure of general application. It may be that: (1) the prior

135 *Ibid.* See also Appellate Body Report, *US – Countervailing and Anti-Dumping Measures (China) (2014)*, paras. 4.65–4.66.
136 'Effecting an advance in a rate of duty' may be understood to mean 'bringing about an increase in a rate of duty'. See Panel Report, *US – Countervailing and Anti-Dumping Measures (China) (2014)*, para. 7.145.
137 Note that the Appellate Body reversed the panel's finding that the phrase 'under an established and uniform practice' in Article X:2 served to define the appropriate baseline of comparison. See Appellate Body Report, *US – Countervailing and Anti-Dumping Measures (China) (2014)*, para. 4.93.
138 See *ibid.*, para. 4.96.
139 See *ibid.*, para. 4.105. While the Appellate Body agreed with the panel that the practices of government agencies are relevant in identifying the baseline of comparison under Article X:2 of the GATT 1994, it disagreed with the panel's use of the practice as the baseline of comparison without regard to other elements of municipal law. See *ibid.*, para. 4.92.
140 On the determination of the meaning of municipal law by panels and the Appellate Body, see above, p. 70.
141 See Appellate Body Report, *US – Underwear (1997)*, 29. See also above, p. 501.
142 See Appellate Body Report, *US Countervailing and Anti-Dumping Measures (China) (2014)*, para. 4.105.
143 *Ibid.*

measure of general application is unpublished; or (2) there is no measure at all. If the prior measure of general application is unpublished, this unpublished measure serves as the baseline of comparison.[144] If there is no prior measure at all, the absence of any rate of duty or any requirement will be the baseline of comparison.[145]

In *US – Countervailing and Anti-Dumping Measures (China) (2014)*, China, the complainant, argued that a measure that applies on a *retroactive* basis is, by definition, a measure that has been enforced prior to its publication and therefore in violation of Article X:2 of the GATT 1994. The panel in this case ruled that Article X:2 prohibits an administrative agency or court not only from enforcing a measure prior to its official publication, but also from enforcing or applying such measure in respect of *events or circumstances that occurred before it has been officially published.*[146] This finding was not appealed.

Note that the GATT 1994 and other WTO agreements also require Members to publish, or give public notice of, certain *specific* trade measures of general application.[147]

As noted above, WTO law also provides for a *notification* requirement. Almost all WTO agreements require Members to notify the WTO of measures or actions covered by these agreements. A typical example of such a notification requirement is found in Article 12.6 of the *Agreement on Safeguards*, which states:

> Members shall notify promptly the Committee on Safeguards of their laws, regulations and administrative procedures relating to safeguard measures as well as any modifications made to them.[148]

A number of WTO agreements also provide for the possibility for a Member to notify measures or actions of other Members, which the latter failed to notify.[149] The 1993 *Decision on Notification Procedures* lists in an annex the many measures and actions Members must notify to the WTO.[150] To improve the operation of the notification requirements under almost all WTO agreements, and thereby contribute to the transparency of Members' trade policies and measures, a *central registry of notifications* has been established under the responsibility of the WTO Secretariat. This central registry records the measures notified and the information provided by Members with respect to the purpose of the measure, its

144 See *ibid.*, para. 4.106. According to the Appellate Body, the content of such unpublished measure of general application should be ascertained based on its text, as well as other available elements of municipal law, such as practices of administrative agencies, court decisions and writings of recognised scholars. See *ibid.*
145 See *ibid.*
146 See Panel Report, *US – Countervailing and Anti-Dumping Measures (2014)*, para 7.118.
147 See e.g. Article XIII:3 of the GATT 1994 (concerning quotas and tariff quotas) and Article 2.11 of the *TBT Agreement* (concerning technical regulations).
148 See also below, p. 504.
149 See e.g. Article 12.8 of the *Agreement on Safeguards*. Such notifications are often referred to as 'cross notifications' or 'reverse notifications'.
150 *Decision on Notification Procedures*, adopted by the Trade Negotiations Committee on 15 December 1993 and annexed to the Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations.

trade coverage and the requirement under which it has been notified. The central registry cross-references its records of notifications by Members and their obligations.[151] Information in the central registry regarding individual notifications is made available, on request, to any Member entitled to receive the notification concerned. The central registry informs each Member annually of the regular notification obligations to which that Member will be expected to respond in the course of the following year. It must be noted that many Members, and especially developing-country Members, fail to comply with one or more of their notification requirements. Often this failure is due to a lack of administrative capacity and WTO expertise within the relevant ministries of the Members concerned.[152]

In addition to a publication requirement and a notification requirement, some WTO agreements also require Members to establish national *enquiry points* where further information and relevant documents on certain trade laws and regulations can be obtained by other Members or interested parties. This is, for example, the case with regard to technical barriers to trade and SPS measures, as discussed in Chapters 13 and 14 respectively.[153]

Finally, the transparency of Members' trade policies, legislation and procedures is also advanced considerably by the periodic trade policy reviews under the *Trade Policy Review Mechanism*. This mechanism is discussed in detail in Chapter 2.[154]

Note that under its Accession Protocol, China is subject to a number of WTO-plus transparency obligations, such as: (a) the obligation to open its measures for pre-implementation public comments; (b) the obligation to publish its measures in the designated official journal; and (c) the obligation to make available the translation of its measures in one or more WTO languages.[155]

3.2 Unfair and Arbitrary Application of Trade Measures

It is clear that the unfair and arbitrary application of national trade measures, and the degree of uncertainty and unpredictability this generates for other Members and traders, constitutes a significant barrier to trade in the same way as the lack of transparency discussed above. To ensure minimum standards for transparency and procedural fairness in the administration of national trade measures,[156] Article X:3 of the GATT 1994 provides for: (1) a requirement of

151 See *ibid.*, 388.
152 On technical assistance in this respect to developing-country Members, see above, pp. 110–13. Note that the failure of Members to comply with their notification requirements may also be due to the lack of an incentive for doing so, or of a sanction for not doing so.
153 See below, pp. 883–932 and 935–90.
154 See above, p. 52.
155 See *Protocol on the Accession of the People's Republic of China*, WT/L/432, dated 23 November 2001.
156 See Appellate Body Report, *US – Shrimp (1998)*, para. 183.

uniform, impartial and reasonable administration of national trade measures; and (2) a requirement for procedures for the objective and impartial review of the administration of national customs rules.

The first of these two requirements is set out in Article X:3(a) of the GATT 1994, which provides:

> Each [Member] shall administer in a uniform, impartial and reasonable manner all its laws, regulations, decisions and rulings of the kind described in paragraph 1 of this Article.

The panel in *Thailand – Cigarettes (Philippines) (2011)* ruled that to establish a violation of Article X:3(a):

> a complaining party must therefore show that the responding Member *administers* the legal instruments of the kind described in Article X:1 in a manner that is *non-uniform, partial* and/or *unreasonable* ... The obligations of uniformity, impartiality and reasonableness are legally independent and the WTO Members are obliged to comply with all three requirements. This means that ... a violation of any of the three obligations will lead to a violation of the obligations under Article X:3(a).[157]

As the words of Article X:3(a) clearly indicate, the requirements of 'uniformity, impartiality and reasonableness' do not apply to the laws, regulations, decisions and rulings *themselves*, but rather to the *administration* of those laws, regulations, decisions and rulings.[158] To the extent that these measures themselves are discriminatory, they may be found inconsistent with, for example, Articles I:1, III:2 or III:4 of the GATT 1994.[159] However, as the Appellate Body clarified in *EC – Selected Customs Matters* (2006), it is possible to challenge under Article X:3(a) the substantive content of a legal instrument that regulates the administration of a law, regulation, decision or ruling falling under Article X:1.[160] The Appellate Body stated:

> Under Article X:3(a), a distinction must be made between the legal instrument being administered and the legal instrument that regulates the application or implementation of that instrument. While the substantive content of the legal instrument being administered is not challengeable under Article X:3(a), we see no reason why a legal instrument that regulates the application or implementation of that instrument cannot be examined under Article X:3(a) if it is alleged to lead to a lack of uniform, impartial, or reasonable administration of that legal instrument.[161]

Under Article X:3(a), one can thus challenge: (1) the manner in which legal instruments of the kind falling under Article X:1 are applied or implemented in particular cases; and (2) legal instruments that regulate such application or implementation. Note that also administrative processes leading to administrative

157 Panel Report, *Thailand – Cigarettes (Philippines) (2011)*, paras. 7.866–7.867.
158 See Appellate Body Report, *EC – Bananas III (1997)*, para. 200. See also Panel Report, *EC – Poultry (1998)*; and Panel Report, *US – Corrosion-Resistant Steel Sunset Review (2004)*.
159 See above, pp. 307–25, 351–76 and 376–99.
160 See Appellate Body Report, *EC – Selected Customs Matters (2006)*, para. 200. See also Panel Report, *Argentina – Hides and Leather (2001)*, paras. 11.71–11.72.
161 Appellate Body Report, *EC – Selected Customs Matters (2006)*, para. 200.

decisions have been found to fall within the scope of application of Article X:3(a).[162]

With regard to the requirement that national trade rules be applied in a uniform manner (the requirement of 'uniform administration'), the panel in *US – Stainless Steel (Korea) (2001)* stated:

> [T]he requirement of uniform administration of laws and regulations must be understood to mean uniformity of treatment in respect of persons similarly situated; it cannot be understood to require identical results where relevant facts differ.[163]

Furthermore, the Appellate Body ruled in *EC – Selected Customs Matters (2006)* that:

> Article X:3(a) of the GATT 1994 does not contemplate uniformity of administrative processes. In other words, non-uniformity or differences in administrative processes do not, by themselves, constitute a violation of Article X:3(a) ... [U]nder Article X:3(a), it is the application of a legal instrument ... that is required to be uniform, but not the processes leading to administrative decisions, or the tools that might be used in the exercise of administration.[164]

Note that, in *China – Raw Materials (2012)*, the panel found that a system under which export quotas were allocated by thirty-two local governmental entities which were not provided with any guidelines for the allocation of such export quotas, posed a very real risk to the interests of relevant parties such that this necessarily leads to 'non-uniform' administration inconsistent with Article X:3(a).[165]

The panel in *US – COOL (2012)* in considering whether the administration of the COOL measure at issue was 'non-uniform' noted:

> the interpretation of the term 'uniform' in Article X:3(a) does not necessarily entail *instantaneous* uniformity. Rather, uniformity must be attained within a period of time that is reasonable, and what is reasonable will depend on the form, nature and scale of the administration at issue, as well as on the complexity of the factual and legal issues raised by the act of administration that is being challenged.[166]

With respect to the requirement that national trade rules be applied in an impartial manner (the requirement of 'impartial administration'), the panel in *Thailand – Cigarettes (Philippines) (2011)* addressed the question whether the features of the administrative process at issue, namely, the fact that certain Thai government officials in charge of customs and tax determinations also serve on

162 See Panel Report, *Thailand – Cigarettes (Philippines) (2011)*, para. 7.873.
163 Panel Report, *US – Stainless Steel (Korea) (2001)*, para. 6.51.
164 Appellate Body Report, *EC – Selected Customs Matters (2006)*, para. 224.
165 See Panel Reports, *China – Raw Materials (2012)*, para. 7.752. Note, however, that the Appellate Body declared this finding moot and of no legal effect because the panel made this finding regarding a claim not properly identified in the panel request. See Appellate Body Reports, *China – Raw Materials (2012)*, para. 235. According to the panel in that case, 'reasonable' administration can be understood to be administration that is 'equitable', 'appropriate to the circumstances' and 'based on rationality'. See Panel Reports, *China – Raw Materials (2012)*, para. 7.696.
166 Panel Reports, *US – COOL (2012)*, para. 7.878. Emphasis added. Note that the findings of the panel in respect of Article X:3 of the GATT were not appealed.

the board of directors of the Thai Tobacco Monopoly to which these customs and tax determinations applied, leads to a lack of 'impartial administration'.[167] The panel started out by ruling that:

> [b]ased on the ordinary meaning ... *impartial* administration would appear to mean the application or implementation of the relevant laws and regulations in a fair, unbiased and unprejudiced manner.[168]

After considering in detail the evidence submitted by the complainant, the Philippines, the panel concluded that:

> unless it can be shown that these determinations are made because of the very presence of the government officials serving also as [Thai Tobacco Monopoly] directors, we are not in a position to find that the appointment of dual function officials led to a partial administration of customs and tax rules.[169]

With respect to the requirement that national trade rules be applied in a reasonable manner (the requirement of 'reasonable administration'), the panel in *Argentina – Hides and Leather (2001)* found that:

> a process aimed at assuring the proper classification of products, but which inherently contains the possibility of revealing confidential business information, is an unreasonable manner of administering the laws, regulations and rules identified in Article X:1 and therefore is inconsistent with Article X:3(a).[170]

The panel in *US – COOL (2012)* considered the term 'administer' in Article X:3(a) to refer to 'putting into practical effect or applying a legal instrument'.[171] Further, the panel considered that the act of providing guidance on the meaning of specific requirements of a measure amounts to an act of administering such measure within the meaning of Article X:3(a).[172]

Note that, in *Dominican Republic – Import and Sale of Cigarettes (2005)*, the panel found that the Dominican Republic had applied the provisions regarding

167 See Panel Report, *Thailand – Cigarettes (Philippines) (2011)*, para. 7.898. 168 *Ibid.*, para. 7.899.
169 *Ibid.*, para. 7.904. A similar situation arose in *Argentina – Hides and Leather (2001)*. At issue in that case was an Argentinian regulation providing for the participation of representatives of the domestic tanners' association, ADICMA, in the customs inspection procedures for hides destined for export operations. The representatives of ADICMA 'assisted' Argentina's customs authorities in the application and enforcement of the rules on customs classification, valuation and export duties. The panel in that case ruled that the Argentinian measure was inconsistent with the 'requirement of impartiality' of Article X:3(a). The panel noted that adequate safeguards could remedy this situation. However, such safeguards were, according to the panel, not in place. See Panel Report, *Argentina – Hides and Leather (2001)*, paras. 11.99–11.101. In *China – Raw Materials (2012)*, the panel examined the claim that the involvement of the China Chamber of Commerce of Metals, Minerals and Chemicals Importers and Exporters (CCCMC) in administering the export quotas on various raw materials constituted partial administration inconsistent with Article X:3(a). The panel concluded that, given the specific circumstances, it did not. See Panel Reports, *China – Raw Materials (2012)*, para. 7.787.
170 Panel Report, *Argentina – Hides and Leather (2001)*, para. 11.94.
171 Panel Reports, *US – COOL (2012)*, para. 7.821. The panel refers to Appellate Body Report, *EC – Selected Customs Matters (2006)*, para. 224 in this regard. The panel found that the contents of the 'Vilsack letter' and the circumstances surrounding its issuance 'indicate that the issuance ... of the letter to the US industry falls within the broad scope of administrative authority given to USDA regarding the application of the COOL measure, including any guidance on the specific requirements under the measure to be provided to the public'. See Panel Reports, *US – COOL (2012)*, para. 7.827.
172 *Ibid.*, para. 7.833.

the determination of the tax base for the imposition of tax on cigarettes in an unreasonable manner. According to the panel:

> [t]he fact that the Dominican Republic authorities did not support its decisions regarding the determination of the tax base for imported cigarettes by resorting to the rules in force at the time and that they decided to disregard retail selling prices of imported cigarettes, is not 'in accordance with reason', 'having sound judgement', 'sensible', 'within the limits of reason', nor 'articulate'.[173]

The panel in *Thailand – Cigarettes (Philippines) (2011)* examined whether the delays in appeals of customs valuation determinations constituted 'unreasonable administration' of the Thai customs laws. The panel found that, although the 'requirement of reasonable administration' of Article X:3(a) does not set a specific time limit for administrative review process, the delays at issue (the appeals process took over seven years) resulted in the administration of the Thai customs law in an unreasonable manner and were inconsistent with Article X:3(a).[174]

To conclude on Article X:3(a) of the GATT 1994, four more observations of a general nature must be made. First, the panel in *Argentina – Hides and Leather (2001)* clarified the nature of the obligation under Article X:3(a) by distinguishing between transparency between WTO Members and transparency with respect to individual traders. According to that panel, unlike for other rules under the GATT 1994, for Article X:3(a):

> the test generally will not be whether there has been discriminatory treatment in favour of exports to one Member relative to another. Indeed, the focus is on the treatment accorded by government authorities to the *traders* in question.[175]

Second, the same panel in *Argentina – Hides and Leather (2001)* ruled that, while a showing of trade damage is not required, Article X:3(a) requires an examination of the real effect that a measure might have on traders operating in the commercial world. The assessment of a violation of Article X:3(a) can therefore involve an examination of whether there is a possible impact on the competitive situation due to alleged partiality, unreasonableness or lack of uniformity in the application of a law, regulation, decision or ruling.[176]

Third, as the panel in *US – Hot-Rolled Steel (2001)* ruled, for a finding of violation of Article X:3(a), a Member's actions would have to have 'a significant impact on the overall administration of the law, and not simply on the outcome in the single case in question'.[177]

173 Panel Report, *Dominican Republic – Import and Sale of Cigarettes (2005)*, para. 7.388.
174 See Panel Report, *Thailand – Cigarettes (Philippines) (2011)*, para. 7.969.
175 See Panel Report, *Argentina – Hides and Leather (2001)*, para. 11.76. Emphasis added.
176 See *ibid.*, para. 11.77.
177 Panel Report, *US – Hot-Rolled Steel (2001)*, para. 7.268.

Fourth, the Appellate Body in *US – Oil Country Tubular Goods Sunset Reviews (2004)* cautioned WTO Members on bringing a case under Article X:3(a):

> We observe, first, that allegations that the conduct of a WTO Member is biased or unreasonable are serious under any circumstances. Such allegations should not be brought lightly, or in a subsidiary fashion.[178]

The requirements of uniform, impartial and reasonable administration of national trade measures are also reflected in WTO agreements other than the GATT 1994. Article 1.3 of the *Import Licensing Agreement*, for example, provides:

> The rules for import licensing procedures shall be neutral in application and administered in a fair and equitable manner.[179]

The Appellate Body ruled in *EC – Bananas III (1997)* that Article 1.3 of the *Import Licensing Agreement* and Article X:3(a) of the GATT 1994 have 'identical coverage'.[180] In disputes involving the administration of import-licensing procedures, Article 1.3 of the *Import Licensing Agreement* should be applied *first* since the *Import Licensing Agreement* deals specifically, and in detail, with the administration of import-licensing procedures.[181]

Apart from the requirements of Article X:3(a) that national trade measures be administered in a uniform, impartial and reasonable manner, Article X:3 contains – as noted above – a second rule to ensure transparency and procedural fairness in the administration of trade measures, namely the requirement of procedures for the *objective and impartial review*, and possible correction, of the administration of national customs rules. Article X:3(b) of the GATT 1994 provides:

> Each [Member] shall maintain, or institute as soon as practicable, judicial, arbitral or administrative tribunals or procedures for the purpose, *inter alia*, of the prompt review and correction of administrative action relating to customs matters.

In *EC – Selected Customs Matters (2006)*, the panel reflected on the function of Article X:3(b) as follows:

> [A] due process theme underlies Article X of the GATT 1994. In the Panel's view, this theme suggests that an aim of the review provided for under Article X:3(b) of the GATT 1994 is to ensure that a trader who has been adversely affected by a decision of an administrative agency has the ability to have that adverse decision reviewed by a tribunal or procedure that is independent from the agency that originally took the adverse decision.[182]

178 Appellate Body Report, *US – Oil Country Tubular Goods Sunset Reviews (2004)*, para. 217. See also Panel Report, *Thailand – Cigarettes (Philippines) (2011)*, para. 7.874.
179 See also above, pp. 496–8.
180 Appellate Body Report, *EC – Bananas III*, para. 203. The Appellate Body noted the difference in wording between Article 1.3 of the *Import Licensing Agreement* and Article X:3(a) of the GATT 1994, but considered that 'the two phrases are, for all practical purposes, interchangeable'.
181 See *ibid.*, para. 204.
182 Panel Report, *EC – Selected Customs Matters (2006)*, para. 7.536.

Article X:3(b) does not prescribe one particular type of review or correction. It refers very broadly to 'judicial, arbitral or administrative tribunals or procedures'. Members thus have a significant degree of discretion in complying with the obligation under Article X:3(b). However, Article X:3(b) does explicitly require that the 'tribunals or procedures' be *independent* of the agencies of which decisions are reviewed.[183] Furthermore, Article X:3(b) requires that the review or correction be 'prompt'. As discussed above, the panel in *Thailand – Cigarettes (Philippines) (2011)* was confronted with a situation in which there were excessive delays in the administrative appeals process; this process took over seven years and was the prerequisite step necessary to reach the Thai Tax Court. The panel ruled that Thailand had 'failed to maintain an independent tribunal for the *prompt* review of customs value determinations inconsistently with Article X:3(b)'.[184] Finally, Article X:3(b) requires that the decisions resulting from the review are implemented by, and govern the practice of, the agencies whose decisions are reviewed, unless an appeal is filed.[185]

Note that Article X:3(b) refers to 'administrative action relating to customs matters', i.e. the administration of *customs rules*, and *not* to the administration of the broader category of 'laws, regulations, decisions and rulings relating to trade matters' or, in short, the administration of *trade rules*.[186] However, in *Thailand – Cigarettes (Philippines) (2011)*, the Appellate Body agreed with the panel in that case that 'administrative action relating to customs matters' encompasses 'a *wide range of acts* applying legal instruments that have a rational relationship with customs matters'.[187]

Finally, in *US – Countervailing and Anti-Dumping Duties (2014)*, China, the complainant, argued that Article X:3(b) prevented WTO Members from changing legislation retroactively. According to China, the possibility of retroactive legislation would render judicial review under Article X:3(b) meaningless. The panel rejected China's argument.[188]

3.3 Customs Formalities and Procedures

Another important type of 'other non-tariff barrier' to trade in goods are customs formalities and procedures, i.e. administrative barriers to trade. The losses that traders suffer through delays at borders, complicated and/or unnecessary

183 Note, however, that pursuant Article X:3(c) of the GATT 1994, Members are not required to eliminate or replace procedures in place on the date of the GATT 1994 entered into force, which *in fact* provide for an objective and impartial review, even though these procedures are not fully or formally independent of the agencies of which decisions are being reviewed.
184 Panel Report, *Thailand – Cigarettes (Philippines) (2011)*, para. 7.1015.
185 This obligation does not, however, prohibit a Member from taking legislative action, which would retroactively change the law at issue. See Panel Report, *US – Countervailing and Anti-Dumping Measures (China) (2014)*, para. 7.291.
186 See in this respect the 'parallel' and broader obligation under Article VI:2 of the GATS, discussed below, p. 535.
187 Appellate Body Report, *Thailand – Cigarettes (Philippines) (2011)*, para. 202. Emphasis added.
188 See Panel Report, *US – Countervailing and Anti-Dumping Measures (China) (2014)*, para. 7.284.

documentation requirements and lack of automation of customs procedures are estimated to exceed, in many cases, the costs of customs duties. In a speech at the World Customs Organization in June 2011, the then WTO Director-General Pascal Lamy noted:

> For OECD countries it currently takes on average about four separate documents and clearing the goods in an average of ten days at an average cost of about $1,100 per container. By contrast, in sub-Saharan Africa almost double the number of documents are required and goods take from 32 days (for exports) to 38 days (for imports) to clear at an average cost per container of between $2,000 (for exports) and $2,500 (for imports). The overall world champion at trade facilitation is Singapore, where four documents are required and goods are cleared in, at most, five days at an average cost of around $456 per container. At the other end of the scale are many of the low-income developing countries, in particular the landlocked developing countries, whose trade-processing costs can mushroom as a result of the effort required to move goods in transit by road or rail through their neighbours to their nearest international port. According to recent research, every extra day required to ready goods for import or export decreases trade by around 4%.[189]

Article VIII:1(c) of the GATT 1994 states:

> The [Members] ... recognize the need for minimizing the incidence and complexity of import and export formalities and for decreasing and simplifying import and export documentation requirements.[190]

Article VIII:2 requires Members, in very general terms, to 'review' the operation of their laws and regulations in light of the acknowledged need for: (1) minimising the incidence and complexity of customs formalities; and (2) decreasing and simplifying documentation requirements. Article VIII:3 of the GATT 1994 furthermore requires penalties for breaches of customs regulations and procedural requirements to be *proportional*. Members may not impose substantial penalties for minor breaches of customs regulations or procedural requirements.

In view of the paucity of specific WTO rules with respect to customs formalities and procedures, the 1996 Singapore Ministerial Conference directed the Council for Trade in Goods 'to undertake exploratory and analytical work ... on the simplification of trade procedures in order to assess the scope for WTO rules in this area'.[191] The negotiations on simplification of trade procedures, commonly referred to as 'trade facilitation', were added to the agenda of the Doha Round negotiations in August 2004.[192] After almost a decade, it was at the Bali Ministerial Conference of December 2013, that the negotiations on rules to simplify customs formalities

189 Speech at the World Customs Organization in Brussels on 24 June 2011, www.wto.org/english/news_e/sppl_e/sppl197_e.htm.
190 The panel in *Argentina – Import Measures (2015)*, para. 6.432, considered that 'formalities' within the meaning of Article VIII:3 include 'all requirements that, although in appearance directed at mere observance of forms, must usually be observed in connection with the importation or exportation of goods'.
191 Ministerial Conference, *Singapore Ministerial Declaration*, adopted 13 December 1996, WT/MIN(96)/DEC, para. 21.
192 See Ministerial Conference, *Doha Ministerial Declaration*, adopted 14 November 2001, WT/MIN(01)/DEC/1, para. 27; and General Council, *Doha Work Programme*, Decision adopted on 1 August 2004, WT/L/579, dated 2 August 2004, para. 1(g). See also above, p. 93–9.

and procedures, were finally concluded resulting in a political agreement on an *Agreement on Trade Facilitation*.[193] In November 2014, the WTO Members adopted a *Protocol of Amendment* to insert this new Agreement into Annex 1A of the WTO Agreement. The *Agreement on Trade Facilitation* will enter into force once two-thirds of Members have completed their domestic ratification process.[194]

The *Agreement on Trade Facilitation* clarifies and improves relevant aspects of Articles V, VIII and X of the GATT 1994 with a view to further expediting the movement, release and clearance of goods, including goods in transit.[195] It further contains provisions for technical assistance and capacity building in this area. The *Agreement on Trade Facilitation* takes a unique approach towards special and differential treatment, in the form of provisions enabling developing and least-developed-country Members to self-designate the implementation periods of their commitments under the Agreement and identify their technical assistance needs.[196] It is estimated that full implementation of the *Agreement on Trade Facilitation* will bring down Members' trade costs by an average of 14.3 per cent; reduce time to import by over a day and a half (a 47 per cent reduction over the current average) and time to export by almost two days (a 91 per cent reduction over the current average); and add up to 2.7 per cent a year to world export growth and more than half a per cent a year to world GDP growth.[197]

3.4 Government Procurement Laws and Practices

National laws and/or practices relating to the procurement of goods by a government for its own use are often significant barriers to trade. Under such laws or practices, governments frequently buy domestic products rather than imported products. It is undisputed that a government can most effectively ensure 'best value for money' by purchasing goods (and services) through an open and non-discriminatory procurement process. However, governments often use public procurement to support the domestic industry or to promote employment. As discussed above, the national treatment obligation of Article III of the GATT 1994 does not apply to law, regulations and requirements governing government procurement.[198] As government procurement typically represents between 15 and 20 per cent of GDP,[199] it is clear that the absence of this and

193 See *Agreement on Trade Facilitation*, Ministerial Decision of 7 December 2013, WT/MIN(13)/36 – WT/L/911, dated 11 December 2013.
194 As of 1 October 2016, ninety-four WTO Members had submitted their instrument of ratification. See www.tfafacility.org/ratifications.
195 See Recital 3, *Agreement on Trade Facilitation*.
196 See Section II, *Agreement on Trade Facilitation*. See also above, p. 124.
197 See WTO, *World Trade Report 2015*, 7 and 8.
198 See Article III:8(a) of the GATT 1994; and above, pp. 347–50. Such measures governing government procurement must of course meet the requirements set out in Article III:8(a) of the GATT 1994.
199 The total size of the government procurement sector was estimated by the OECD to be in the range of 15–20 per cent of GDP across OECD and non-OECD economies. See R. Anderson, P. Pelletier, K. Osei-Lah and A. Müller, 'Assessing the Value of Future Accessions to the WTO Agreement on Government Procurement (GPA)', Staff Working Paper ERSD-2011-15 (WTO, 2011), 9.

other multilateral disciplines represents a significant gap in the multilateral trading system and leaves a considerable source of barriers to trade unaddressed.

The plurilateral WTO *Agreement on Government Procurement*, as revised, provides for some disciplines with respect to government procurement of goods as well as services.[200] However, it does so only for the forty-seven Members that are currently a party to this Agreement.[201] The *Agreement on Government Procurement* applies to the laws, regulations, procedures and practices regarding procurement by those government bodies which a party has listed in Appendix I to the Agreement[202] and which concern goods or services covered by the Agreement.[203] Furthermore, for the Agreement to apply, the government procurement contract must be worth more than a specified threshold value.[204] The key discipline provided for in the plurilateral *Agreement on Government Procurement* is non-discrimination. Article III:1(a) of the *Agreement on Government Procurement* sets out a national treatment obligation; Article III:1(b) sets out an MFN treatment obligation.[205] Furthermore, in order to ensure that these non-discrimination obligations are abided by, the Agreement also provides for rules to ensure that laws, regulations, procedures and practices regarding government procurement are transparent.[206] Compared to the original 1994 Agreement, the revised Agreement, which entered into force in 2014, makes the provisions of the Agreement more user-friendly and adapts them to recent developments in government procurement practices (such as the use of electronic tools in the procurement process). The revised Agreement also includes more explicit special and differential treatment provisions, so as to facilitate developing-country Members to become a party to the Agreement. Most importantly, however, the revised Agreement provides for a significantly extended coverage. The WTO Secretariat has estimated the gains in market access as a result of the extended coverage of the Agreement between US$80 and 100 billion annually.[207] These gains result from lower thresholds and additions of new entities and sectors to the parties' lists in Appendix I to the Agreement.

200 See Annex 4 of the *WTO Agreement* and the *Protocol Amending the Agreement on Government Procurement*, GPA/113, dated 2 April 2012. The revised *Agreement on Government Procurement* came into force on 6 April 2014.
201 See www.wto.org/english/tratop_e/gproc_e/memobs_e.htm. Note that these forty-seven Members include both the European Union and its twenty-eight Member States. The Agreement thus has only nineteen parties. Note also that another twenty-eight WTO Members participate in the GPA committee as observers, out of which eight are in the process of acceding to the Agreement.
202 See, in this respect, Panel Report, *Korea – Procurement (2000)*, in which the question arose whether the Korean Airport Construction Authority, the Korean Airports Authority and the Inchon International Airport Corporation were within the scope of Korea's list of 'central government entities' as specified in Korea's Schedule in Appendix I to the *Agreement on Government Procurement*.
203 The Agreement applies in principle to the procurement of all goods except those goods which a Member has explicitly excluded from the scope of application in its schedule (see annex 4 to a Member's schedule). For services, the Agreement only applies to those services Members have explicitly listed in their schedules (see annex 5 to a Member's schedule).
204 See Article I:4 of the *Agreement on Government Procurement*. In Appendix I to the Agreement, each party specifies relevant thresholds.
205 Note that these non-discrimination obligations *only apply* between the parties to the Agreement.
206 See Articles VII to XVI of the *Agreement on Government Procurement*.
207 See www.wto.org/english/tratop_e/gproc_e/negotiations_e.htm.

In the 2001 Doha Ministerial Declaration, Members expressly recognised the case for a *multilateral* agreement on transparency in government procurement.[208] However, in the years that followed, they failed to agree on the modalities of the negotiations on such a multilateral agreement, and transparency on government procurement was thus never included in the Doha Round agenda.[209] Many developing-country Members were concerned about their ability to engage 'successfully' in such negotiations and to implement the new international commitments resulting from these negotiations.

3.5 Other Measures and Actions

In addition to technical barriers to trade and SPS measures, the lack of transparency, unfair and arbitrary application of trade rules, customs formalities and procedures, and government procurement laws and practices, the category of 'other non-tariff barriers' to trade in goods also includes many other measures or actions, or the lack thereof. This section briefly addresses the following 'other non-tariff barriers': (1) preshipment inspection; (2) marks of origin; (3) measures relating to transit shipments; (4) operations of State trading enterprises; (5) trade-related investment measures; and (6) exchange controls or exchange restrictions.

Preshipment inspection is the practice of employing private companies to check the price, quantity, quality and/or the customs classification of goods *before* their shipment to the importing country.[210] Preshipment inspection is primarily used by developing-country Members to prevent commercial fraud and evasion of customs duties. Preshipment inspection is used to compensate for inadequacies in national customs administrations. While certainly beneficial, the problem with preshipment inspection is that it may give rise to unnecessary delays or unequal treatment, and thus constitute a barrier to trade. The WTO *Agreement on Preshipment Inspection* sets out obligations for both importing Members using preshipment inspection and the exporting Members on whose territory the inspection is carried out.

The importing Members using preshipment inspection must ensure, *inter alia*, that: (1) preshipment inspection activities are carried out in a non-discriminatory manner;[211] (2) preshipment inspection activities are carried out in a transparent manner;[212] (3) the companies carrying out the inspection respect the confidentiality of business information received in the course of the preshipment

208 Ministerial Conference, *Doha Ministerial Declaration*, adopted 14 November 2001, WT/MIN(01)/DEC/1, para. 26. A first step in this direction was taken at the 1996 Singapore Ministerial Conference. See Ministerial Conference, *Singapore Ministerial Declaration*, adopted 13 December 1996, WT/MIN(96)/DEC, para. 21.
209 See General Council, *Doha Work Programme*, Decision adopted on 1 August 2004, WT/L/579, dated 2 August 2004, para. 1(g).
210 See Article 1 of the *Agreement on Preshipment Inspection*.
211 See *ibid.*, Articles 2.1–2.2. 212 See *ibid.*, Articles 2.5–2.8.

inspection;[213] and (4) the companies carrying out the inspection avoid unreasonable delays in the inspection of shipments.[214]

The exporting Members on whose territory the preshipment inspection is carried out must ensure non-discrimination and transparency with regard to their laws and regulations relating to preshipment inspection activities.[215] The *Agreement on Preshipment Inspection* also provides for rules on procedures for independent review of disputes between the companies carrying out the inspection and the exporters.[216]

With respect to *marks of origin* 'attached' to imported goods, Article IX:2 of the GATT 1994 states:

> The [Members] recognize that, in adopting and enforcing laws and regulations relating to marks of origin, the difficulties and inconveniences which such measures may cause to the commerce and industry of exporting countries should be *reduced to a minimum*, due regard being had to the necessity of protecting consumers against fraudulent or misleading indications.[217]

Note that marking requirements are, of course, subject to all relevant WTO rules and disciplines, such as the MFN treatment obligation.[218]

With respect to measures concerning *traffic in transit*, Article V of the GATT 1994, entitled 'Freedom of Transit', sets out a number of obligations on Members not to impede this traffic. Traffic in transit is the traffic of goods from country A to country C, through the territory of country B. It is clear that any restriction or impediment that country B would impose on the transit of the goods concerned would constitute a barrier to trade. Article V:2 of the GATT 1994 provides:

> There shall be freedom of transit through the territory of each [Member], via the routes most convenient for international transit, for traffic in transit to or from the territory of other [Members]. No distinction shall be made which is based on the 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.
>
> Traffic in transit shall not be subject to any unnecessary delays or restrictions and shall be exempt from customs duties and from all transit duties or other charges imposed in respect of transit, except charges for transportation or those commensurate with administrative expenses entailed by transit or with the cost of services rendered.[219] All charges, regulations and formalities in connection with transit shall be reasonable and be subject to the MFN treatment obligation.[220] The provisions of the recently concluded *Agreement on Trade Facilitation* are also pertinent in this regard.[221]

213 See *ibid.*, Articles 2.9–2.13. 214 See *ibid.*, Articles 2.15–2.19.
215 See *ibid.*, Articles 3.1–3.2. These Members must also provide to user Members, if requested, technical assistance directed towards the achievement of the objectives of this Agreement on mutually agreed terms. See *ibid.*, Article 3.3.
216 See *ibid.*, Article 4. 217 Emphasis added.
218 See Article IX:1 of the GATT 1994. 219 See Article V:3 of the GATT 1994.
220 See Article V:4 and 5 of the GATT 1994.
221 See Article 11 of the *Agreement on Trade Facilitation*.

Furthermore, the *operations of State trading enterprises* can be a significant barrier to trade in goods. State trading enterprises are:

> [g]overnmental and non-governmental enterprises, including marketing boards, which have been granted exclusive or special rights or privileges, including statutory or constitutional powers, in the exercise of which they influence through their purchases or sales the level or direction of imports or exports.[222]

The WTO does not prohibit the establishment or maintenance of State trading enterprises. However, Article XVII of the GATT 1994 requires that: (1) State trading enterprises act in accordance with the MFN treatment obligation and other basic obligations under the GATT 1994;[223] and (2) only commercial considerations should guide their decisions on purchases and sales for import and export.[224] To increase transparency regarding the use of State trading, Members must notify their State trading enterprises to the WTO annually. Article XVII of the GATT 1994 is an anti-circumvention provision: a WTO Member may not, through state trading enterprises, 'engage in or facilitate conduct that would be condemned as discriminatory under the GATT 1994 if such conduct were undertaken directly by the Member itself'.[225]

Trade-related investment measures can also be barriers to trade when these measures take the form of direct or indirect quantitative restrictions on imports or exports. For example, a foreign car manufacturer may be allowed to establish a production plant in a country but only if it uses in the production of the cars steel produced in that country.[226] Article 2.1 of the *TRIMS Agreement* states in relevant part:

> Without prejudice to other rights and obligations under GATT 1994, no Member shall apply any TRIM that is inconsistent with the provisions of ... Article XI of GATT 1994.

Finally, *exchange controls* or *exchange restrictions* may make it difficult, if not impossible, for an importer to pay for imports or for an exporter to be paid for exports. If so, these measures constitute a significant impediment to trade. Article XV:9 of the GATT 1994 stipulates in this regard that the GATT 1994 does not preclude Members to use exchange controls or exchange restrictions that are in accordance with: (1) the *Articles of Agreement* of the IMF; or (2) a Member's special exchange arrangement with the WTO. Nothing in the GATT 1994 precludes restrictions or controls on imports or exports the sole effect of which is to make effective such exchange controls or exchange restrictions.

222 *WTO Understanding on the Interpretation of Article XVII*, para. 1.
223 See Articles II:1 and XI of the GATT 1994, as discussed above, pp. 325 and 482.
224 See Appellate Body Report, *Canada – Wheat Exports and Grain Imports (2004)*, paras. 100–1 and 145.
225 *Ibid.*, para. 85.
226 For an illustrative list of trade-related investment measures in the form of quantitative restrictions, see *TRIMS Agreement*, Annex, para. 2.

4 MARKET ACCESS BARRIERS TO TRADE IN SERVICES

This chapter on non-tariff barriers to trade has dealt thus far with non-tariff barriers to trade in goods. The remainder of the chapter discusses non-tariff barriers to trade in services. As already discussed, the production and consumption of services are a principal economic activity in virtually all countries, developed and developing, alike. Financial, telecommunication and transport services are the backbone of a modern economy, and economic development and prosperity are dependent on the availability and efficiency of these and other services.[227] Services play a central role in the world economy. They represent 68.5 per cent of world GDP.[228] However, the importance of services in the world economy is *not* reflected (yet) in their share of world trade. In 2015, trade in services amounted to US$4.75 trillion, while trade in goods amounted to US$16.5 trillion.[229]

As discussed in Chapter 6 and in the introduction to this chapter, trade in services is, unlike trade in goods, not subject to tariff barriers.[230] Trade in services, however, faces many non-tariff barriers. The production and consumption of services are subject to a vast range of internal regulations. Barriers to trade in services are primarily the result of these internal regulations. Examples of such internal regulations that may constitute barriers to trade in services are: (1) a restriction on the number of drugstores allowed within a geographical area; (2) an obligation for all practising lawyers to be a member of the local bar association; (3) sanitation standards for restaurants; (4) technical safety requirements for oil-drilling companies; (5) a requirement that all professional services be offered in the national language; (6) professional qualification requirements for accountants; and (7) a prohibition for banks to sell life insurance.

WTO law, and the GATS in particular, provides for rules and disciplines on barriers to trade in services. Note, however, that, as explained below, most internal regulation of services does not constitute a GATS-inconsistent barrier to trade in services.[231] The production and consumption of services are often subject to internal regulation for good reason, including the protection of consumers and the protection of public health and safety. The Preamble to the GATS explicitly recognises:

> the right of Members to regulate, and to introduce new regulations on, the supply of services within their territories in order to meet national policy objectives.

It is important to stress that the objective of the GATS is *not* the *deregulation* of services. In fact, the liberalisation of some services sectors, such as

227 See WTO Secretariat, 'Market Access: Unfinished Business', Special Studies Series 6 (WTO, 2001), 98.
228 See World Bank, *Services, Etc., Value Added (% of GDP)*, http://data.worldbank.org/indicator/NV.SRV.TETC.ZS.
229 See above, p. 5.
230 See above, pp. 423 and 480. As discussed, tariff barriers to trade in services *currently* do not exist. However, such barriers *can* exist. See, for example, the 'bit tax'.
231 See below, pp. 518–20.

telecommunications, may require *increased* regulation in order to ensure quality of service or competition in the market.

With regard to non-tariff barriers to trade in services, the GATS distinguishes between, on the one hand, market access barriers, and, on the other hand, other barriers to trade in services. This section addresses the GATS rules on market access barriers and discusses in turn: (1) the definition and types of market access barriers; (2) rules on market access barriers; (3) negotiations on market access; (4) Schedules of Specific Commitments; and (5) modification and withdrawal of commitments. The next section in this chapter deals with the GATS rules on other barriers to trade in services.[232]

4.1 Definition and Types of Market Access Barriers

The GATS does not explicitly define the concept of 'market access barriers'. However, Article XVI:2(a)–(f) of the GATS provide an *exhaustive* list of such measures.[233] This list comprises six types of market access barriers. Five of the six types are quantitative restrictions on: (1) the number of service suppliers; (2) the value of the service transactions; (3) the number of service operations; (4) the number of natural persons employed by a service supplier; and (5) the amount of foreign capital invested in service suppliers.[234] One type of market access barrier is of a different nature. It is a limitation on the kind of legal entity or joint venture through which services may be supplied.[235]

These market access barriers can be discriminatory *or* non-discriminatory with respect to foreign services or service suppliers. For example, a restriction on the broadcasting time available for foreign movies is obviously a *discriminatory* market access barrier, while a licence for a fast food restaurant subject to an economic needs test based on population density is a *non-discriminatory* market access barrier.[236] Article XVI:2 of the GATS covers both discriminatory *and* non-discriminatory market access barriers.

232 Recall that Chapter 4 discusses the scope of application of the GATS. See above, pp. 325–7.

233 The panel in *US – Gambling (2005)* confirmed that the list of Article XVI:2 is exhaustive. It came to this conclusion based on the text of the provision, its context and the 1993 Scheduling Guidelines. See Panel Report, *US – Gambling (2005)*, paras. 6.293–6.298. Antigua appealed this finding. The Appellate Body, however, chose not to deal with this issue. See Appellate Body Report, *US – Gambling (2005)*, para. 256. The panel in *China – Publications and Audiovisual Products (2010)* reiterated that the list of Article XVI:2 is exhaustive. See also Panel Report, *China – Publications and Audiovisual Products (2010)*, para. 7.1353.

234 See Article XVI:2(a)–(d) and (f) of the GATS. As the Appellate Body noted in *US – Gambling (2005)*, the focus of Article XVI:2 is on quantitative restrictions. See Appellate Body Report, *US – Gambling (2005)*, para. 225.

235 See Article XVI:2(e) of the GATS.

236 See *Guidelines for the Scheduling of Specific Commitments under the General Agreement on Trade in Services (GATS)*, adopted by the Council for Trade in Services on 23 March 2001, S/L/92, dated 28 March 2001, para. 12. As stated in an explanatory note, these Guidelines were based on two documents which were produced and circulated during the Uruguay Round negotiations: MTN.GNS/W/164, *Scheduling of Initial Commitments in Trade in Services: Explanatory Note*, dated 3 September 1993; and MTN.GNS/W/164/Add.1, *Scheduling of Initial Commitments in Trade in Services: Explanatory Note, Addendum*, dated 30 November 1993. See *ibid.*, fn. 1.

Note that, when a market access barrier takes the form of a quantitative restriction referred to in subparagraphs (a)–(d), this restriction can be expressed numerically, *or* through the criteria specified in these provisions, such as an economic needs test. It is important to note, however, that these criteria do *not* relate to: (1) the quality of the service supplied; or (2) the ability of the supplier to supply the service (i.e. technical standards or qualification of the supplier).[237] A requirement, for example, that services be offered in the national language or a requirement for engineers to have specific professional qualifications may impede trade in services but is *not* a market access barrier within the meaning of Article XVI:2 of the GATS.

Note also that the quantitative restrictions specified in subparagraphs (a)–(d) refer to *maximum* limitations. Minimum requirements such as those common to licensing criteria (for example, minimum capital requirements for the establishment of a corporate entity) do not fall within the scope of Article XVI of the GATS.[238]

In *US – Gambling (2005)*, the panel found that, by maintaining measures that *prohibit* the supply of certain services, the United States effectively limited to zero the service suppliers and service operations relating to that service. According to the panel, such a zero quota constituted a limitation 'on the number of service suppliers ... in the form of numerical quotas' within the meaning of Article XVI:2(a) and a limitation 'on the total number of service operations ... in the form of quotas' within the meaning of Article XVI:2(c).[239] On appeal, the United States argued that the panel had ignored the fact that Article XVI:2(a) and (c) refer to measures in the *form* of numerical quotas and not to measures having the *effect* of numerical quotas. According to the United States, the measures concerned were not market access barriers within the meaning of Article XVI:2. The Appellate Body disagreed with the United States and upheld the relevant findings of the panel.[240] The Appellate Body noted that the words 'in the form of' must not be interpreted as 'prescribing a rigid mechanical formula'.[241] According to the Appellate Body, a measure equivalent to a zero quota is a market access barrier within the meaning of Article XVI:2.[242] An example of such limitation would be a nationality requirement for suppliers of services.[243]

The panel in *Mexico – Telecoms* (2004) noted that none of the six types of market access barrier of Article XVI:2 relates to *temporal* limitations on the supply of

237 *Guidelines for the Scheduling of Specific Commitments under the General Agreement on Trade in Services (GATS)*, S/L/92, dated 28 March 2001, para. 8.

238 See *ibid.*, para. 11.

239 See Panel Report, *US – Gambling (2005)*, paras. 6.330 and 6.347.

240 See Appellate Body Report, *US – Gambling (2005)*, paras. 239 and 252.

241 *Ibid.*, para. 231. It is the numerical or quantitative nature of the limitation that matters, not the form of the limitation.

242 See *ibid.*, paras. 238 and 251.

243 Note that the Appellate Body ruled in *US – Gambling (2005)* that 'it is neither necessary nor appropriate for us to draw, in the abstract, the line between quantitative and qualitative measures'. See Appellate Body Report, *US – Gambling (2005)*, para. 250.

a service. According to the panel, this suggests that temporal limitations cannot constitute market access barriers within the meaning of Article XVI:2.[244]

The panel in *Argentina – Financial Services (2016)* concluded that for a measure to be covered by Article XVI:2(a) of the GATS, the measure must regulate 'service suppliers' as such, that is, 'when the measure is aimed at persons in their capacity as service suppliers'.[245] Further, based on a combined reading of Article XXVIII(g) and Article XXVIII(j) of the GATS, it noted that 'Article XVI:2(a) covers measures whose purpose is to limit the number of persons, natural or legal, supplying a service'.[246]

4.2 Rules on Market Access Barriers

The GATS does not provide for a general prohibition on the market access barriers discussed in the above paragraphs. Whether a Member may maintain or adopt these market access barriers with regard to a specific service depends on whether, and if so to what extent, that Member has, in its Services Schedule, made market access commitments with regard to that service or the relevant services sector and the relevant mode of supply. This is commonly referred to as the 'positive list' or 'bottom-up' approach to the liberalisation of trade in services. Article XVI of the GATS, entitled 'Market Access', provides, in paragraph 1:

> With respect to market access through the modes of supply identified in Article I, each Member shall accord services and service suppliers of any other Member *treatment no less favourable* than that provided for under the terms, limitations and conditions agreed and specified in its Schedule.[247]

Furthermore, the chapeau of Article XVI:2 of the GATS states:

> In sectors where market-access commitments are undertaken, the measures which a Member shall not maintain or adopt either on the basis of a regional subdivision or on the basis of its entire territory, unless otherwise specified in its Schedule, are defined as ...

Paragraphs (a)–(f) of Article XVI:2 then provide for the list of market access barriers discussed above. In other words, when a Member has undertaken a market access commitment in respect of a services sector and a mode of supply, it

244 See Panel Report, *Mexico – Telecoms (2004)*, para. 7.358. For example, a measure that makes the supply of a service subject to a permit which would not be granted until the corresponding regulations are issued would not be a market access barrier within the meaning of Article XVI:2.

245 See Panel Report, *Argentina – Financial Services (2016)*, para. 7.424. The panel in this case found that the measure at issue regulated 'reinsurance operations' or 'individual risks', but did not specifically regulate any natural or legal person supplying reinsurance service. It therefore concluded that the measure is not covered by Article XVI(2)(a) of GATS because it does not regulate service suppliers within the meaning of that provision. Note that the panel's conclusion on this issue was not appealed.

246 See *ibid.*, para. 7.425.

247 Emphasis added. The panel in *China – Publications and Audiovisual Products (2010)* stated that, under Article XVI, a Member is free to maintain a market access regime less restrictive than that set out in its Schedule. See Panel Reports, *China – Publications and Audiovisual Products (2010)*, para. 7.1353.

may not maintain or adopt any of the listed market access barriers with regard to trade in services in that sector and that mode of supply, unless otherwise specified in its Services Schedule. A Member can specify in its Schedule that it maintains, or reserves the right to adopt, certain market access barriers.

When a Member makes a market access commitment, it *binds* the level of market access specified in its Schedule (see Article XVI:1) and agrees not to impose any market access barrier that would restrict access to the market beyond the level specified (see Article XVI:2).[248] In *US – Gambling (2005)*, the United States had inscribed the term 'none' in its Schedule with respect to market access limitations for 'other recreational services (excluding sporting)', which was interpreted to include gambling and betting services.[249] Both the panel and the Appellate Body confirmed that this means that the United States has committed itself to providing *full* market access in that services sector.[250]

To date, Members have been found to have acted inconsistently with the prohibition on market access barriers of Article XVI of the GATS in three disputes.[251]

4.3 Negotiations on Market Access for Services

Article XIX of the GATS, entitled 'Negotiation of Specific Commitments', states, in its first paragraph:

> In pursuance of the objectives of this Agreement, Members shall enter into successive rounds of negotiations ... with a view to achieving a progressively higher level of liberalization.

The GATS thus aims at achieving *progressively* higher levels of liberalisation of trade in services through *successive* rounds of negotiations. The Uruguay Round negotiations on the liberalisation of trade in services were only a first step in what will definitely be a long process of progressive liberalisation. The negotiations on 'specific commitments' under Article XIX concern not only market access commitments but also national treatment commitments, discussed in Chapter 6.[252] While the focus in this subsection is on the negotiations on market access, it must be kept in mind that the rules discussed in this subsection equally apply to the negotiations on national treatment. This subsection addresses in turn: (1) the basic rules governing Article XIX negotiations; and (2) the organisation of Article XIX negotiations.

248 On the relationship between Article XVI:1 and XVI:2, the panel in *China – Publications and Audiovisual Products (2010)* stated that Article XVI:2 was 'more specific' as it describes the measures that a Member must not adopt. See Panel Report, *China – Publications and Audiovisual Products (2010)*, para. 7.1353.

249 See below, pp. 527–8.

250 See Panel Report, *US – Gambling (2005)*, paras. 6.267–6.279; and Appellate Body Report, *US – Gambling (2005)*, paras. 214–15.

251 See *US – Gambling (2005)*; *China – Publications and Audiovisual Products (2009)*; and *China – Electronic Payment Services (2012)*.

252 See above, p. 400.

4.3.1 Basic Rules Governing Article XIX Negotiations

With regard to the negotiations on the progressive liberalisation of trade in services, Article XIX:1 of the GATS provides:

> Such negotiations shall be directed to the reduction or elimination of the adverse effects on trade in services of measures as a means of providing effective market access. This process shall take place with a view to promoting the interests of all participants on a mutually advantageous basis and to securing an overall balance of rights and obligations.

The objective of the negotiations is thus to provide effective *market access* for services. In Article XIX negotiations, Members strive for a 'mutually advantageous' outcome, i.e. 'reciprocity'. The main approach to negotiations on the liberalisation of services is a request-and-offer approach.[253] At the initial stage of negotiations, Members first make requests for the liberalisation of trade in specific services.[254] The exchange of requests, as a process, is mainly bilateral, but may also be plurilateral.[255] It is simply a process of letters being addressed from the requesting participants to their negotiating partners.[256] After Members participating in the negotiations have made requests, they submit offers.[257] A Member submits an offer in response to all the requests that it has received, but does not necessarily have to address each element contained in those requests in its offer.[258] Unlike a request, which is usually presented in the form of a letter, an offer is normally presented in the form of a draft schedule of commitments.[259] While requests are addressed bilaterally (or plurilaterally) to negotiating partners, offers are circulated multilaterally.[260] Offers are to be open to consultations and negotiation by all negotiating partners; not only to those who have made requests to the Member concerned but also any other participant in the negotiations.[261] In fact, offers are a signal of the real start of the advanced stage of bilateral negotiations, i.e. when negotiators come to Geneva to hold many

253 See *Guidelines and Procedures for the Negotiations on Trade in Services*, adopted by the Special Session of the Council for Trade in Services on 28 March 2001, S/L/93, dated 29 March 2001, para. 11. On approaches to tariff negotiations, see above, pp. 428–36.

254 There are possibly four types of content in a request, which are not mutually exclusive: (i) the addition of new services sectors; (ii) the removal of existing limitations or the introduction of bindings in modes which have so far been unbound; (iii) the undertaking of additional commitments under Article XVIII; and (iv) the termination of MFN exemptions. See *Technical Aspects of Requests and Offers*, Summary of Presentation by the WTO Secretariat at the WTO Seminar on the GATS, 20 February 2002, 1, www.wto.org/english/tratop_e/serv_e/requests_offers_approach_e.doc.

255 See *Guidelines and Procedures for the Negotiations on Trade in Services*, adopted by the Special Session of the Council for Trade in Services on 28 March 2001, S/L/93, dated 29 March 2001, para. 11; and Ministerial Conference, *Ministerial Declaration*, adopted on 18 December 2005, WT/MIN(05)/DEC, dated 22 December 2005, Annex C, para. 7.

256 See *ibid.*

257 In terms of content, offers normally address the same four types referred to in fn. 254 above.

258 See *Technical Aspects of Requests and Offers*, Summary of Presentation by the WTO Secretariat at the WTO Seminar on the GATS, 20 February 2002, 3, www.wto.org/english/tratop_e/serv_e/requests_offers_approach_e.doc.

259 See *ibid.*

260 See *ibid.* The multilateral circulation is useful not only from a transparency point of view but also from a functional point of view since, in an offer, a participant is actually responding to *all* the requests that it has received.

261 See *ibid.*

bilateral talks with various different delegations. The submission of offers may also trigger the submission of further requests and then the process continues and becomes a succession of requests and offers.[262]

Article XIX:2 of the GATS explicitly requires that the process of liberalisation of trade in services take place with due respect for: (1) national policy objectives; and (2) the level of development of individual Members, both overall and in individual sectors. Article XIX:2 further provides specifically with respect to the position of developing-country Members in the negotiations on the liberalisation of trade in services that:

> [t]here shall be appropriate flexibility for individual developing-country Members for opening fewer sectors, liberalizing fewer types of transactions, progressively extending market access in line with their development situation and, when making access to their markets available to foreign service suppliers, attaching to such access conditions aimed at achieving the objectives referred to in Article IV.

It is thus accepted that developing-country Members undertake fewer and more limited market access commitments than developed-country Members. 'Full reciprocity' is not required from developing-country Members. These Members are only expected to undertake market access commitments commensurate with their level of development.

4.3.2 Organisation of Article XIX Negotiations

As provided in Article XIX:3 of the GATS, for each round of multilateral negotiations on the liberalisation of trade in services, negotiating guidelines and procedures shall be established. For the current negotiations, initiated pursuant to Article XIX:1 of the GATS in January 2000 and now conducted in the context of the Doha Round negotiations,[263] the *Guidelines and Procedures for the Negotiations on Trade in Services* were adopted on 28 March 2001 by the Council for Trade in Services.[264]

Members have been exchanging bilateral initial requests since June 2002, and, as of the end of April 2011, WTO Members had submitted seventy-one initial offers and thirty-one revised offers.[265] However, from early on, there was – and there currently still is – widespread disappointment regarding the progress made in the negotiations. In its Decision of 1 August 2004 on the *Doha Work Programme*, the General Council reaffirmed the Members' commitment to make progress in the services negotiations;[266] and, in December 2005, the Ministerial

262 See *ibid.*

263 Ministerial Conference, *Doha Ministerial Declaration*, adopted 14 November 2001, WT/MIN(01)/DEC/1, dated 20 November 2001, para. 15.

264 Council for Trade in Services, *Guidelines and Procedures for the Negotiations on Trade in Services*, S/L/93, dated 29 March 2001. Note that, while the negotiations focus on market access, they also cover three other major areas, namely, internal regulation, GATS rules and the implementation of LDC modalities.

265 See www.wto.org/english/tratop_e/serv_e/market_access_negs_e.htm. On the request-and-offer approach to the negotiations on trade in services, see above, p. 522.

266 See General Council, *Doha Work Programme*, Decision adopted on 1 August 2004, WT/L/579, dated 2 August 2004, para. 1(e).

Conference, at its meeting in Hong Kong, called on Members to intensify the negotiations with a view to expanding coverage of commitments and improving their quality. The Ministerial Conference provided in Annex C to the Hong Kong Ministerial Declaration more detailed negotiating objectives to guide Members.[267] The Ministerial Conference also agreed that least-developed-country Members were not expected to undertake new services commitments. As provided for in Annex C to the Hong Kong Ministerial Declaration, Members tried out, as from March 2006, a new approach to the negotiations, namely, the plurilateral request approach. Under this approach, a group of Members requesting market access started negotiations with targeted Members on the basis of a *collective* request. However, this and other efforts to produce a breakthrough in the market access negotiations were to little avail. In short, the negotiations on market access for services are, as the Doha Round negotiations in general, deadlocked. On the one hand, there are Members, mainly developed-country Members, for which the market access offers currently on the table are insufficient. On the other hand, there are Members, primarily developing-country Members, for which the requests for market access go too far.[268] In its 2015 report to the Trade Negotiation Committee, the Chair of the Special Session of the Council for Trade in Services stated as follows:

> It is with considerable disappointment therefore that I must report that, despite our best efforts, it has not proved possible to agree on a work program in services. Although various interesting ideas have been put forward by Members in the course of our discussions, ultimately there has been no convergence toward any text containing a clearly-defined work program in services.[269]

Most recently, at an informal meeting of the Services Council in July 2016, WTO Members reportedly expressed strong interest in reviving service negotiations.[270]

As noted in Chapter 2, there are at present – outside the WTO – negotiations ongoing on an ambitious liberalisation of trade in services, building upon but going beyond the existing GATS.[271] These negotiations on a Trade in Services Agreement (TiSA), currently involve twenty-three developed- and developing-country Members, including the European Union and the United States, but not Brazil, China or India.[272] The latter Members have warned of the consequences for the multilateral trading system of adopting a plurilateral approach to negotiations on the liberalisation of trade in services.[273]

267 Ministerial Conference, *Ministerial Declaration*, adopted on 18 December 2005, WT/MIN(05)/DEC, dated 22 December 2005.
268 Note that some of these developing-country Members, and in particular Brazil, linked their willingness to accept far-reaching requests for market access to a successful conclusion of the negotiations on the liberalisation of trade in agricultural products.
269 Council for Trade in Services, Special Session, *Negotiations on Trade in Services*, Report by the Chairman, Ambassador Gabriel Duque, to the Trade Negotiations Committee, TN/S/39, dated 30 July 2015, 1.
270 See www.wto.org/english/news_e/news16_e/serv_04jul16_e.htm.
271 See above, p. 101.
272 See http://ec.europa.eu/trade/policy/in-focus/tisa/. Together, the WTO Members participating in the TiSA negotiations account for 70 per cent of world trade in services. See *ibid.*
273 See *Bridges Weekly Trade News Digest*, 4 April 2012, 11 July 2012 and 26 September 2012.

4.4 Schedules of Specific Commitments

The results of negotiations on market access for services are set out in Schedules of Specific Commitments, commonly referred to as 'Services Schedules'. This is what was done in 1994 with the results of the Uruguay Round negotiations on market access for services. This subsection discusses: (1) the contents and structure of Services Schedules; (2) the interpretation of Services Schedules; and (3) the market access commitments agreed to in the Uruguay Round Services Schedules.

4.4.1 Contents and Structure of Services Schedules

The Services Schedules set out the terms of market access for services agreed to in the context of market access negotiations. In addition to the terms of market access, Services Schedules also set out the terms of national treatment, discussed in Chapter 5, and the terms of additional commitments, discussed later in this chapter.[274] Each Member has a Services Schedule. In fact, each Member *must* have a Services Schedule, albeit that there is no minimum requirement as to the scope or depth of the commitments set out in that Schedule. All Services Schedules are annexed to the GATS and form an integral part thereof.[275] All Services Schedules are available on the WTO website.[276] The online WTO Services Database gives information on all commitments undertaken by all Members, and can be used to establish the commitments of a particular Member with regard to a specific services sector or subsector, or to compare services commitments across Members.[277]

Services Schedules have two parts: (1) a part containing the ***horizontal commitments***; and (2) a part containing the ***sectoral commitments***. Horizontal commitments apply to all sectors included in the Schedule. Schedules include horizontal commitments to *avoid repeating* in relation to each sector contained in the Schedule the same information regarding limitations, conditions or qualifications of commitments.[278] Horizontal commitment often concern two modes of supply in particular, namely, supply through commercial presence (mode 3) and supply through the presence of natural persons (mode 4).[279] For example,

274 See above, p. 400, and below, p. 536.
275 Article XX:3 of the GATS.
276 See www.wto.org/english/tratop_e/serv_e/serv_commitments_e.htm.
277 See http://tsdb.wto.org/wto/WTOHomepublic.htm. Be aware that the Consolidated Services Schedule of the European Union and its Member States (S/C/W/273, dated 9 October 2006), resulting from the enlargement of the European Union, is not included in the searchable database of commitments (as it had not yet entered into force at the time of establishing this database).
278 Horizontal commitments are found at the beginning of a schedule. The concept of 'horizontal commitments' may be misleading since 'horizontal commitments' are often, in fact, horizontal limitations, i.e. limitations applicable to all commitments. Only with regard to mode 4 supply of services, horizontal commitments are frequently positive undertakings.
279 On the four modes of supply of services (cross-border supply, consumption abroad, supply through commercial presence and supply through the presence of natural persons), see above, pp. 329–30.

with regard to mode 4 supply of all services scheduled, the Services Schedule of the European Union and its Member States stipulates:

> Unbound except for measures concerning the entry into and temporary stay within a Member State, without requiring compliance with an economic needs test, of the following categories of natural persons providing services ...[280]

Unlike horizontal commitments, sectoral commitments (or sector-specific commitments) are, as the term indicates, commitments made regarding specific services sectors or subsectors. For scheduling commitments, WTO Members distinguish twelve broad services sectors: business services; communication services; construction and related engineering services; distribution services; educational services; environmental services; financial services; health-related and social services; tourism and travel-related services; recreational, cultural and sporting services; transport services; and other services not included elsewhere. These twelve broad services sectors are further divided into more than 150 subsectors.[281] For example, the 'business services' sector includes: professional services (including, for example, legal services, accounting, architectural services, engineering services, and medical and dental services); computer and related services; research and development services; real estate services; rental/leasing services without operators; and other business services (including, for example, building cleaning services and publishing). The 'communication services' sector includes: postal services; courier services; telecommunications services (including, for example, voice telephone services, electronic mail, voice mail and electronic data interchange); and audiovisual services (including, for example, motion picture and video tape production and distribution services, radio and television services and sound recording). This WTO classification of services sectors, set out in the Services Sectoral Classification List of the WTO Secretariat, also referred to as 'document W/120',[282] is based on the provisional Central Product Classification (CPC) of the United Nations. In the Secretariat's List, each sector is identified by the corresponding CPC number. The CPC gives a detailed explanation of the services covered by each of the sectors and subsectors.[283] Note that a specific service cannot fall within two different sectors or subsectors. The sectors and subsectors are mutually exclusive.[284]

280 GATS/SC/31, dated 15 April 1994, 7–10.

281 Note that, if a market access commitment is given in a particular sector, that commitment applies to the whole of that sector, including all of its subsectors (unless of course a subsector is specifically excluded or a different regime is specified for it). See Panel Report, *US – Gambling (2005)*, para. 6.290.

282 See MTN.GNS/W/120, dated 10 July 1991.

283 A breakdown of the CPC, including explanatory notes for each subsector, is contained in the UN Provisional Central Product Classification, http://unstats.un.org/unsd/cr/registry/regcst.asp?Cl=16&Lg=1. To determine the coverage of the services sectors and subsectors of the WTO Services Sectoral Classification List, the detailed explanation of the CPC system can be used. Entries in Schedules often include CPC numbers.

284 See Appellate Body Report, *US – Gambling (2005)*, para. 180. See also Panel Report, *China – Electronic Payment Services (2012)*, para. 7.531.

In scheduling their commitments, most Members follow the WTO's Services Sectoral Classification List (W/120).[285] Thus, most Schedules have the same structure. A services sector or subsector is of course only included in a Member's Services Schedule if that Member undertakes commitments in that sector or subsector.

Services Schedules have four columns: (1) a first column identifying the services sector or subsector which is the subject of the commitment; (2) a second column containing the terms, limitations and conditions on market access; (3) a third column containing the conditions and qualifications on national treatment; and (4) a fourth column for undertakings relating to additional commitments. With regard to market access commitments, Members indicate, in the second column of their Schedule, the presence or absence of limitations on market access. They do so for each services sector scheduled and with regard to each of the four modes of supply: cross-border supply (mode 1); consumption abroad (mode 2); supply through commercial presence (mode 3); and supply through presence of natural persons (mode 4).

As set out in the 2001 Scheduling Guidelines,[286] for each market access commitment with respect to each mode of supply, four different situations can occur:

> (1) First situation: *full commitment*, i.e. the situation in which a Member does not seek in any way to limit market access in a given sector and mode of supply through market access barriers within the meaning of Article XVI:2. A Member in this situation records in the second column of its Schedule the word 'none'.[287]
>
> (2) Second situation: *commitment with limitations*, i.e. the situation in which a Member wants to limit market access in a given sector and mode of supply through market access barriers within the meaning of Article XVI:2. A Member in this situation describes in the second column of its Schedule the market access barrier(s) that is/are maintained.[288]
>
> (3) Third situation: *no commitment*, i.e. the situation in which a Member wants to remain free in a given sector and mode of supply to introduce or maintain market access barriers within the meaning of Article XVI:2. A Member in this situation records in the second column of its Schedule the word 'unbound'.[289]

285 W/120 is therefore an important document for the interpretation of service commitments made by Members. The Appellate Body has considered and used W/120 as preparatory work within the meaning of Article 32 of the *Vienna Convention*. See Appellate Body Report, *US – Gambling (2005)*, paras. 196ff.

286 See Council for Trade in Services, *Guidelines for the Scheduling of Specific Commitments under the General Agreement on Trade in Services* (GATS), adopted on 23 March 2001, S/L/92, dated 28 March 2001, paras. 41–7.

287 Note, however, that any relevant limitation listed in the 'horizontal commitments' part of the Schedule also applies. See above, p. 526.

288 Two main possibilities can be envisaged in such a situation: the first is the binding of an existing situation ('standstill'); the second is the binding of a more liberal situation where some, but not all, of the access barriers inconsistent with Article XVI:2 will be removed ('rollback'). The Scheduling Guidelines state that: '[t]he entry should describe each measure concisely, indicating the elements which make it inconsistent with Articles XVI or XVII'. See Scheduling Guidelines 1993, para 25; and Scheduling Guidelines 2001, para. 44.

289 Note that this situation will only occur when a Member made a commitment in a sector with respect to at least one mode of supply. Where all modes of supply are 'unbound', and no additional commitments have been undertaken in the sector, the sector should not appear in the Schedule.

(4) Fourth situation: *no commitment technically feasible*, i.e. the situation in which a particular mode of supply is not technically possible, such as the cross-border supply of hair-dressing services. A Member in this situation records in the second column of its Schedule 'unbound*'.[290]

As discussed in Chapter 5, and as is evident from the excerpt from the Services Schedule of Brazil shown in Figure 7.1, national treatment commitments and limitations thereof are inscribed in the third column of the Schedules in the same way as market access commitments and limitations thereof are inscribed. It is possible that a measure is both a market access barrier prohibited under Article XVI:2 and a measure inconsistent with the national treatment obligation of Article XVII. For this type of situation, Article XX:2 of the GATS provides that:

[m]easures inconsistent with both Articles XVI and XVII shall be inscribed in the column relating to Article XVI. In this case the inscription will be considered to provide a condition or qualification to Article XVII as well.

In other words, any limitation to a market access commitment inscribed in the second column will also apply to the national treatment commitment made, even if that limitation is not inscribed in the third column (which deals with the national treatment commitments).

As the panel in *China – Publications and Audiovisual Products (2010)* stated:

If a limitation affects *both* market access and national treatment then, by a convention set out in Article XX:2 of the GATS (avoiding the need to repeat an inscription), it is to be inscribed *only* in the market access column.[291]

In *China – Electronic Payment Services (2012)*, China had with regard to mode 1 of the subsector at issue inscribed in the national treatment column of its Schedule 'None', while in the market access column it had inscribed 'Unbound'. The United States contended that China had made a full national treatment commitment with regard to mode 1 of the subsector at issue. China contested this, arguing that measures described in Article XVI:2 cannot simultaneously be subject to Article XVII. The panel in this case ruled:

By inscribing 'Unbound' under market access, China reserves the right to maintain any type of measure within the six categories falling under Article XVI:2, regardless of its inscription in the national treatment column.[292]

The panel added that its interpretation, however, also gave meaning to the term 'None' in the national treatment column, because:

[d]ue to the inscription of 'None', China must grant national treatment with respect to any of the measures at issue that are not inconsistent with Article XVI:2. China's national treatment commitment could thus have practical application should China, for example, choose

290 The asterisk refers to a footnote which states: 'Unbound due to lack of technical feasibility'.
291 Panel Report, *China – Publications and Audiovisual Products (2010)*, para. 7.921.
292 Panel Report, *China – Electronic Payment Services (2012)*, para. 7.663.

Modes of supply: 1) Cross-border supply 2) Consumption abroad 3) Commercial presence 4) Presence of natural persons

Sector or subsector	Limitations on market access	Limitations on national treatment	Additional commitments
e) Engineering Services			
Advisory and consultative engineering services (CPC 86721)	1) Unbound	1) Unbound	
	2) Unbound	2) Unbound	
	3) Same conditions as in Architectural services	3) None	
	4) Unbound except as indicated in the horizontal section	4) Unbound except as indicated in the horizontal section	
Industrial engineering (CPC 86725)	1) Unbound	1) Unbound	
	2) Unbound	2) Unbound	
	3) Same conditions as in Architectural services	3) None	
	4) Unbound except as indicated in the horizontal section	4) Unbound except as indicated in the horizontal section	
Engineering design (CPC 86722, CPC 86723, CPC 86724)	1) Unbound	1) Unbound	
	2) Unbound	2) Unbound	
	3) Same conditions as in Architectural services	3) None	
	4) Unbound except as indicated in the horizontal section	4) Unbound except as indicated in the horizontal section	
Other engineering services (CPC 86729)	1) Unbound	1) Unbound	
	2) Unbound	2) Unbound	
	3) Same conditions as in Architectural services	3) None	
	4) Unbound except as indicated in the horizontal section	4) Unbound except as indicated in the horizontal section	

Figure 7.1 Excerpt from the Schedule of Specific Commitments of Brazil

to allow in practice the supply of services from the territory of other WTO Members into its market, despite the fact that it has not undertaken any market access commitments in subsectors (a) to (f) of its Schedule.[293]

The panel in *China – Electronic Payment Services (2012)* emphasised that it did *not* find that either Article XVI or Article XVII is substantively subordinate to the other.[294] The panel stated:

We find simply that Article XX:2 establishes a certain scheduling primacy for entries in the market access column, in that a WTO Member not wishing to make any commitment under Article XVI, discriminatory or non-discriminatory, may do so by inscribing the term 'Unbound' in the market access column of its schedule.[295]

4.4.2 Interpretation of Services Schedules

Just as Goods Schedules are an integral part of the GATT 1994, Services Schedules are an integral part of the GATS.[296] Article XX:3 of the GATS states:

Schedules of specific commitments shall be annexed to this Agreement and shall form an integral part thereof.

293 *Ibid.*
294 See *ibid.*, para. 7.664. 295 *Ibid.*
296 On the interpretation of Goods Schedules, see above, pp. 440–2.

The issue of interpretation of Services Schedules arose in *US – Gambling (2005)*. In this case, the panel had to interpret the Services Schedule of the United States. The question was:

> whether the US Schedule includes specific commitments on gambling and betting services notwithstanding the fact that the words 'gambling and betting services' do not appear in the US Schedule.[297]

The United States had inscribed 'other recreational services (except sporting)' in its Schedule, and had recorded *no* limitations on market access in mode 1 (cross-border supply of services). It argued, however, that the term 'sporting' includes gambling and betting and that gambling and betting services were therefore excluded from its specific commitments. The panel in this case, however, first noted – referring to the Appellate Body's finding regarding tariff concessions in *EC – Computer Equipment (1998)* – that scheduled commitments 'are reciprocal and result from mutually advantageous negotiations between importing and exporting Members'.[298] The panel then noted:

> The United States has repeated several times in these proceedings that it did not intend to schedule a commitment for gambling and betting services. This may well be true, given that the legislation at issue in this dispute predates by decades, not only the GATS itself, but even the notion of 'trade in services' as embodied therein. We have, therefore, some sympathy with the United States' point in this regard. However, the scope of a specific commitment cannot depend upon what a Member intended or did not intend to do at the time of the negotiations.[299]

What matters, according to the panel, is the *common* intent of all negotiating parties. To determine this common intent with regard to the specific commitment at issue in this case, the panel applied – as did the Appellate Body in *EC – Computer Equipment (1998)* – the rules of interpretation set out in Articles 31 and 32 of the *Vienna Convention on the Law of Treaties*.[300] On appeal, the Appellate Body agreed with the panel's reliance on the rules of interpretation of the *Vienna Convention* to ascertain the meaning of the Services Schedule of the United States.[301] As the panel, the Appellate Body found that the United States' Services Schedule includes specific commitments on gambling and betting services.[302]

As the Appellate Body held in *US – Gambling (2005)*, other Members' Schedules could be relevant context for the interpretation of a particular Schedule, since all Schedules are an integral part of the GATS.[303] Furthermore, there are three specific

297 Panel Report, *US – Gambling (2005)*, para. 6.41.
298 Appellate Body Report, *EC – Computer Equipment (1998)*, para. 84.
299 Panel Report, *US – Gambling (2005)*, para. 6.136.
300 See Appellate Body Report, *EC – Computer Equipment (1998)*, para. 84.
301 See Appellate Body Report, *US – Gambling (2005)*, para. 160. See also Panel Report, *China – Publications and Audiovisual Products (2010)*, para. 7.922.
302 See Appellate Body Report, *US – Gambling (2005)*, para. 213. Although coming to the same conclusion as the panel, the Appellate Body applied the *Vienna Convention* rules of interpretation differently than the panel did. See Appellate Body Report, *US – Gambling (2005)*, para. 197.
303 See Appellate Body Report, *US – Gambling (2005)*, para. 182. As the Appellate Body noted, each Schedule has, however, 'its own intrinsic logic'. See *ibid.*

documents dealing with the classification of services that may be useful in assisting the interpretation of a Services Schedule, namely: (1) the 1991 UN *Provisional Central Product Classification* (CPC); (2) the GATT Secretariat's Services Sectoral Classification List (document W/120); and (3) the 1993 Guidelines for the Scheduling of Specific Commitments under the GATS.[304]

Finally, note that, in *China – Publication and Audiovisual Products (2009)*, China contended on appeal that the panel had erred in interpreting its Services Schedule entry 'Sound recording distribution services' according to the contemporary meaning of the words it contains, i.e. also covering the *electronic* distribution of sound recordings. According to China, the principle of progressive liberalisation does not allow for the expansion of the scope of the commitments of a WTO Member by interpreting the terms used in the Schedule based on the meaning of those terms at the time of interpretation.[305] Disagreeing with China, the Appellate Body ruled:

> we consider that the terms used in China's GATS Schedule ('sound recording' and 'distribution') are sufficiently generic that what they apply to may change over time.[306]

4.4.3 Market Access Commitments Agreed to in the Uruguay Round Services Schedules

The market access commitments agreed to during the Uruguay Round negotiations on the liberalisation of trade in services are, in general, modest. On average, WTO Members have only undertaken market access commitments on about twenty-five subsectors, i.e. 15 per cent of the total.[307] Only one-third of the Members have undertaken commitments on more than sixty-one subsectors.[308] Furthermore, the market access commitments rarely go beyond the *status quo*, i.e. they bind the degree of market access already existing. The value of these bindings, also referred to as 'standstill bindings', is that they give traders and investors a degree of security and predictability with respect to market access in the services sectors of interest to them.

In a number of important sectors, such as financial services, telecommunications and maritime transport, and with respect to the movement of natural persons, the Uruguay Round negotiators were unable to complete the market access negotiations, and the GATS made provision for further negotiations. These further negotiations led in 1997 to agreements providing for significant market

304 See Panel Report, *China – Publications and Audiovisual Products (2010)*, para. 7.923; and Appellate Body Report, *US – Gambling (2005)*, paras. 196–7. With regard to the 1993 Guidelines for the Scheduling and document W/120, the Appellate Body ruled in *US – Gambling (2005)*, that these instruments constituted 'supplementary means of interpretation' under Article 32 of the *Vienna Convention*. See *ibid.* On this point, the Appellate Body reversed the panel, which considered these instruments to be 'context' under Article 31.2 of the *Vienna Convention*. See also above, p. 194, fn. 166, and p. 198.
305 See Appellate Body Report, *China – Publications and Audiovisual Products (2009)*, para. 390.
306 *Ibid.*, para. 396.
307 See WTO Secretariat, *Market Access: Unfinished Business*, Special Studies Series 6 (WTO, 2001), 104.
308 See *ibid.*

access commitments in the sectors of basic telecommunications and financial services.[309] Further negotiations on market access for maritime transport failed, while further negotiations on the movement of natural persons were completed in July 1995 with very modest results. To the dissatisfaction of developing-country Members, the agreement reached on the movement of natural persons was largely confined to business visitors (to establish business contacts or negotiate contracts) and intra-corporate transfers of managers and technical staff.

Thus far, tourism has been the services sector in which most market access commitments have been made, followed by financial and business services. In the health and education sectors, Members have made the fewest market access commitments, but few commitments were also made in the sector of distribution services. On the whole, developed-country Members have made market access commitments with regard to nearly all sectors, except health and education. Note, however, that, for example, the European Union, Canada and Switzerland made no commitments with regard to audiovisual services.[310]

Market access commitments with respect to 'consumption abroad' (mode 2) are much less subject to limitations than market access commitments with respect to other modes of supply of services. Presumably, governments feel less of a need to restrict their nationals' consumption of services abroad or consider it impracticable to enforce such restrictions.[311] Market access commitments with respect to 'supply through the presence of natural persons' (mode 4), however, are usually subject to broad limitations.[312] Members, developed and developing alike, are clearly hesitant to undertake any commitments involving the entry of natural persons onto their territory. They are unwilling to expose their labour markets to competition from foreign workers.[313]

4.5 Modification or Withdrawal of Commitments

As is the case with tariff concessions for goods, market access commitments for services can also be modified or withdrawn.[314] According to Article XXI of the

309 See above, pp. 91–2.
310 See WTO Secretariat, *Market Access*, 104.
311 See WTO Secretariat, *Market Access*, 105.
312 Note also that the Annex on Movement of Natural Persons excludes from the scope of the GATS measures regarding citizenship and permanent residency, and visas.
313 In March 2016, India notified the WTO Secretariat of the initiation of dispute proceedings against the United States with respect to measures imposing increased fees on certain applicants for two categories of non-immigrant temporary working visas into the US, and measures relating to numerical commitments for some visas. See www.wto.org/english/news_e/news16_e/ds503rfc_04mar16_e.htm.
314 For the details of the relevant procedure, see *Procedures for the Implementation of Article XXI of the General Agreement on Trade in Services (GATS) (Modification of Schedules)*, adopted on 19 July 1999, S/L/80, dated 29 October 1999. On the modification or withdrawal of tariff concessions, see above, pp. 447–50. See also the 2000 *Procedures for the Certification of Rectifications or Improvements to Schedules of Specific Commitments*, regarding changes (changes through certification by the WTO Secretariat) that do not require the Article XXI procedure to be followed, unless another Member objects. Council for Trade in Services, *Procedures for the Certification of Rectifications or Improvements to Schedules of Specific Commitments*, S/L/84 (18 April 2000).

GATS, a Member may modify or withdraw any commitment in its Schedule, at any time after three years have elapsed from the date on which that commitment entered into force.[315] A Member wishing to 'unbind' a commitment must first notify its intention to do so to the Council for Trade in Services. Subsequently, it must – if so requested – enter into negotiations with a view to reaching agreement on any necessary compensatory adjustment. The purpose of these negotiations on compensatory adjustment is to maintain a general level of mutually advantageous commitments not less favourable to trade than that provided for in the Schedule. If no agreement on compensatory adjustment can be reached between the modifying Member and any affected Member, the affected Member(s) may refer the matter to arbitration.[316] Recall that this possibility to refer to arbitration is not specifically provided for in the context of the modification or withdrawal of tariff concessions.[317] If no arbitration is requested, the modifying Member is free to implement the intended modification or withdrawal.[318] If arbitration is requested, however, the modifying Member may not modify or withdraw its commitment until it has made compensatory adjustments in conformity with the findings of the arbitration.[319] In case the modifying Member does not comply with the findings of the arbitration, any affected Member that participated in the arbitration may modify or withdraw *substantially equivalent benefits* in conformity with those findings.[320] Note that any compensatory adjustment made by the Member 'unbinding' a commitment must be made on an MFN basis. However, the modification or withdrawal of substantially equivalent benefits by the affected Member(s) in case of non-compliance with the arbitration findings may be implemented solely with respect to the modifying Member.[321]

After an Article 21.5 panel had established in March 2007 that the United States had failed to comply with the recommendations and rulings of the DSB in *US – Gambling (2005)*,[322] the United States announced in May 2007 that it would not comply with these recommendations and rulings, but was modifying its market access commitments in the subsector of 'recreational services', the services subsector at issue in *US – Gambling (2005)*. Reportedly, seven other WTO

315 In certain exceptional circumstances, the period of three years is reduced to one year. See Article X of the GATS.
316 See Article XXI:3(a) of the GATS. Any affected Member that wishes to enforce a right that it may have to compensation must participate in the arbitration. See *ibid.*
317 See above, pp. 447–50. 318 See Article XXI:3(b) of the GATS.
319 See Article XXI:4(a) of the GATS. 320 See Article XXI:4(b) of the GATS.
321 See Article XXI:2(b) of the GATS (for the compensatory adjustment) and Article XXI:4(b) of the GATS (for the modification or withdrawal of substantially equivalent benefits).
322 See Panel Report, *US – Gambling (Article 21.5) (2007)*. Subsequently, in June 2007, Antigua requested the DSB to authorise the taking of retaliatory measures up to an amount of US$3.443 billion. See WT/DS285/22, dated 22 June 2007. On 21 December 2007, the Arbitrator under Article 22.6 of the DSU determined that the annual level of nullification or impairment of benefits accruing to Antigua is US$21 million. The Arbitrator also found that suspension of commitments or other obligations under the GATS was not practicable and effective for Antigua and that circumstances were serious enough to permit 'cross-retaliation' under various sections of the *TRIPS Agreement*. See WT/DS285/ARB, dated 21 December 2007. On 24 April 2012, Antigua informed the DSB that the United States was still not in compliance with the recommendations and rulings of the DSB, and that it had notified the United States of its wish to seek recourse to the good offices of the WTO Director-General in finding a mediated solution to this dispute. On 28 January 2013, the DSB granted Antigua authorisation to suspend commitments and other obligations including under the *TRIPS Agreement*.

Members joined Antigua in notifying their intent to seek compensation from the United States. The United States reached agreement on compensatory adjustment with Australia, Canada, the European Union and Japan, by making additional market access commitments in the subsectors of postal services, research and development services, technical testing services, and warehousing. However, with Antigua, no agreement on compensatory adjustment was reached. In early 2008, Antigua referred this matter to arbitration pursuant to Article XXI:3(a).

5 OTHER BARRIERS TO TRADE IN SERVICES

In addition to the market access barriers, discussed above, trade in services can also be impeded by a wide array of other barriers. With regard to a number of these other barriers, WTO law, and in particular the GATS, provides for specific rules. Some of these rules have general application.[323] Other rules apply only in services sectors with regard to which specific market access commitments were made.[324] This section discusses in turn the following other barriers to trade in services: (1) lack of transparency; (2) unfair or arbitrary application of measures affecting trade in services; (3) licensing and qualification requirements and technical standards; (4) lack of recognition of diplomas and professional certificates; (5) government procurement; and (6) other measures and actions.

Note that while the rules discussed below are rules that apply to measures that are not market access barriers within the meaning of Article XVI of the GATS, these rules, such as the rules on transparency, also apply to measures that are market access barriers.

5.1 Lack of Transparency

For trade in services, as much as for trade in goods discussed above, lack of information, uncertainty and confusion with respect to the relevant laws and regulations applicable in actual or potential foreign markets are formidable barriers to trade. Effective market access for services is impossible without transparency regarding the laws and regulations affecting the services concerned. Service suppliers must have accurate information concerning the rules with which they must comply.

As Article X of the GATT 1994 does with regard to trade in goods, Article III of the GATS requires with regard to trade in services that Members *publish* all

323 For example, the requirement that Members maintain or institute as soon as practicable judicial, arbitral or administrative tribunals for the prompt review of decisions affecting trade in services. See Article VI:2(a) of the GATS, and below, p. 535.
324 For example, the requirement to administer measures affecting trade in services in a reasonable, objective and impartial manner. See Article VI:1 of the GATS, and below, p. 535.

measures of general application affecting trade in services.[325] Publication must take place promptly, and at the latest by the time the measure enters into force.[326] Since the end of 1997, each Member has been required to establish one or more *enquiry points* to provide information on laws and regulations affecting trade in services.[327] Members have an obligation to respond promptly to all requests by any other Member for specific information on any of its measures of general application.[328] For the benefit of developing-country Members, developed-country Members have a special obligation to establish 'contact points' to facilitate the access of service suppliers from developing-country Members to information of special interest to them.[329] Article III of the GATS also requires a Member to *notify* the Council for Trade in Services of any new, or any changes to, laws, regulations or administrative guidelines which significantly affect trade in sectors where that Member has made specific commitments. Members must do so at least once a year.[330] Note that the transparency of Members' measures affecting trade in services is also advanced by the trade policy reviews under the *Trade Policy Review Mechanism*.[331]

5.2 Unfair and Arbitrary Application of Trade Measures

In sectors where specific commitments are undertaken, Article VI:1 of the GATS requires a Member to ensure:

> that all measures of general application affecting trade in services are administered in a reasonable, objective and impartial manner.

This obligation is the counterpart to Article X:3(a) of the GATT 1994, discussed above, for trade in services.[332]

In all services sectors, including those in which no specific commitments are undertaken, Article VI:2(a) of the GATS requires Members to maintain judicial, arbitral or administrative tribunals or procedures which allow service suppliers to challenge administrative decisions affecting them. The relevant procedures must not necessarily be independent of the agency entrusted with the administrative decision concerned, but must be objective and impartial.[333] Moreover, they must provide for prompt review and, where necessary, appropriate remedies.[334]

325 Where publication is not practicable, the information must be made otherwise publicly available (see Article III:2 of the GATS). The publication requirement exists also for measures affecting trade in services with regard to which a Member has not made specific commitments.
326 See Article III:1 of the GATS. This obligation can be waived in emergency situations. This publication obligation also applies to international agreements pertaining to or affecting trade in services to which a Member is a signatory.
327 See Article III:4 of the GATS. 328 See *ibid.*
329 See Article IV:2 of the GATS. Such information includes information on registration, recognition and obtaining of professional qualifications; and the availability of services technologies.
330 See Article III:3 of the GATS. Members are not required, however, to supply confidential information. See Article III *bis* of the GATS.
331 See above, pp. 102–4. 332 See above, p. 505.
333 See Article VI:2(a), second sentence of the GATS. 334 See Article VI:2(a), first sentence of the GATS.

Where authorisation is required for the supply of a service on which a commitment has been made, the competent authorities of a Member must, within a reasonable period of time, inform the applicant of the decision concerning the application.[335]

5.3 Licensing and Qualification Requirements and Technical Standards

As discussed above, trade in services is primarily impeded or restricted by internal regulations. For scheduled services, certain internal regulations may constitute market access barriers within the meaning of Article XVI:2 of the GATS and, as discussed above, are prohibited when, and, if so, to the extent, a market access commitment is made.[336] However, most internal regulations do not constitute market access barriers within the meaning of Article XVI:2.[337] Apart from the rules concerning transparency and the rules on unfair and arbitrary application, discussed above, the GATS currently only provides for a few other disciplines applicable to internal regulations which do not constitute market access barriers. The most important of these disciplines concerns licensing requirements, qualification requirements, and technical standards.[338] Article VI:5(a) of the GATS states:

> In sectors in which a Member has undertaken specific commitments ... the Member shall not apply licensing and qualification requirements and technical standards that nullify or impair such specific commitments in a manner which:
> i. does not comply with the criteria outlined in sub-paragraphs 4(a), (b) or (c); and
> ii. could not reasonably have been expected of that Member at the time the specific commitments in those sectors were made.

According to the criteria of Article VI:4(a)–(c) to which the above provision refers, licensing requirements, qualification requirements and technical standards relating to services sectors in which specific commitments are undertaken must: (1) be based on objective and transparent criteria such as competence and the ability to supply the service; (2) not be more burdensome than necessary to ensure the quality of the service; and (3) in the case of licensing procedures, not be, in themselves, a restriction on the supply of the service. If licensing requirements, qualification requirements or technical standards relating to services

335 See Article VI:3 of the GATS. 336 See above, pp. 520–1.
337 The panel in *US – Gambling (2005)* stated: 'Under Article VI and Article XVI, measures are either of the type covered by the disciplines of Article XVI or are internal regulations relating to qualification requirements and procedures, technical standards and licensing requirements subject to the specific provisions of Article VI. Thus, Articles VI:4 and VI:5 on the one hand and XVI on the other hand are mutually exclusive.' Panel Report, *US – Gambling (2005)*, para. 6.305.
338 Note that the scope of application of the different provisions of Article VI of the GATS, entitled 'Domestic regulation', differs. Articles VI:1–VI:3, discussed above, have a broad scope of application (e.g. 'measures of general application affecting trade in services' (Article VI:1) or 'administrative decisions affecting trade in services' (Article VI:2)), while the scope of application of Articles VI:4 and VI:5 is limited to technical standards and licensing and qualification requirements. See Panel Report, *Argentina – Financial Services (2016)*, paras. 7.837–7.838.

sectors, in which specific commitments are undertaken, do not meet these criteria *and*, furthermore, nullify or impair the specific commitments undertaken in a manner which could not reasonably have been expected at the time the commitments were made, the Member acts inconsistently with its obligations under Article VI:5(a) of the GATS.[339] The Member must then amend the licensing requirement, qualification requirement or technical standard at issue.

Note that Article VI:4 of the GATS gives the Council for Trade in Services a broad and ambitious mandate to develop the multilateral disciplines necessary to ensure that licensing requirements, qualification requirements and procedures and technical standards do not constitute *unnecessary barriers* to trade in services. However, rather than 'de-regulation', the aim of Article VI:4 is to promote *better regulation* based on objective and transparent criteria. To date, such disciplines have only been successfully developed with regard to accountancy.[340]

Note also that Article XVIII, entitled 'Additional Commitments', provides:

> Members may negotiate commitments with respect to measures affecting trade in services not subject to scheduling under Articles XVI or XVII, including those regarding qualifications, standards or licensing matters. Such commitments shall be inscribed in a Member's Schedule.

Members may therefore make commitments with respect to measures which are neither market access barriers (Article XVI) nor inconsistent with the national treatment obligation (Article XVII). These additional commitments are recorded in the fourth column of a Member's Schedule.[341] In practice, such commitments are uncommon in most services sectors. However, with regard to basic telecommunication services, many Members took additional commitments regarding transparency, licensing, competition and universal service in the telecommunication sector. They did so by inserting in the fourth column of their Schedule any or all of the provisions of the *Reference Paper on Basic Telecommunications* containing pro-competitive regulatory principles.[342]

5.4 Government Procurement Laws and Practices

As discussed above in the context of trade in goods, government procurement laws and practices often constitute significant barriers to trade as governments give preferences to domestic services or service suppliers over foreign services or

339 In determining whether a Member is in conformity with the obligation under Article VI:5(a), account shall be taken of international standards of relevant international organisations applied by that Member. See Article VII:5(b) of the GATS.
340 See Council for Trade in Services, *Disciplines on Domestic Regulation in the Accountancy Sector*, adopted on 14 December 1998, S/L/64, dated 17 December 1998. While adopted in 1998, these disciplines are not yet in force. There have been proposals for sector-specific domestic regulations disciplines for legal services, engineering and telecommunications sectors.
341 See above, p. 527.
342 Such additional commitments were at issue in *Mexico – Telecoms (2004)*.

service suppliers. The GATS, like the GATT 1994 with regard to government procurement of goods, does not set forth any multilateral disciplines on the procurement of services for governmental purposes. Article XIII:1 of the GATS provides:

> Articles II, XVI and XVII shall not apply to laws, regulations or requirements governing the procurement by governmental agencies of services purchased for governmental purposes and not with a view to commercial resale or with a view to use in the supply of services for commercial sale.

The general MFN treatment obligation (of Article II) and specific commitments on market access and national treatment (of Articles XVI and XVII respectively) do not, generally speaking, apply to laws, regulations or requirements governing government procurement of services. However, Article XIII:2 provides for multilateral negotiations on government procurement of services, which are currently taking place as part of the Doha Round of negotiations.[343]

Note that the plurilateral WTO *Agreement on Government Procurement*, discussed above, applies not only to government procurement of goods but also to government procurement of services. The plurilateral disciplines set forth in that Agreement also apply to laws and regulations on the government procurement of services.[344]

5.5 Other Measures and Actions

In addition to lack of transparency, unfair or arbitrary application of measures affecting trade in services, licensing and qualification requirements, technical standards and government procurement laws and practices, trade in services is impeded by a number of other measures and actions. This section briefly addresses the following: (1) lack of recognition of foreign diplomas and professional certificates; (2) monopolies and exclusive service providers; and (3) international payments and transfers.

Foreign service suppliers, such as doctors, engineers, nurses, lawyers or accountants, will usually have obtained their *diplomas and professional certificates* in their country of origin and will not have diplomas or professional certificates of other countries in which they may wish to be active. Members are required to provide for adequate procedures, in sectors where specific commitments regarding professional services are undertaken, to verify the competence of professionals from any other Member.[345] However, it is clear that, even with these procedures, having only a foreign diploma or professional certificate may constitute an important impediment for persons to supply services in other Members. While WTO law does not require that Members recognise foreign diplomas or professional certificates, it encourages and facilitates their recognition. As discussed in Chapter 4, the GATS does so by allowing Members

343 For an overview of the pace of negotiations, see WTO Working Paper, 'The Relationship between Services Trade and Government Procurement Commitments: Insights from Relevant WTO Agreements and Recent RTAs', ERSD-2014-21, Economics Research and Statistics Division, World Trade Organization, November 2014, para. 2.2.2.

344 See above, p. 513. 345 See Article VI:6 of the GATS.

to deviate, under certain conditions, from the basic MFN treatment obligation of Article II of the GATS.[346] Article VII:1 of the GATS provides in relevant part:

> [A] Member may recognize the education or experience obtained, requirements met, or licences or certifications granted in *a particular country*.[347]

Pursuant to Article VII:1, such recognition: (1) may be achieved through harmonisation *or* otherwise; and (2) may be based upon an agreement with the country concerned *or* may be accorded autonomously. However, the recognition must be based on objective criteria, and may not discriminate among Members where similar conditions prevail. As discussed in Chapter 4, Members who are parties to recognition agreements are required to afford adequate opportunity for other interested Members to negotiate their accession to such agreements or negotiate comparable agreements with them. If recognition is accorded on an autonomous basis, the Member concerned must give adequate opportunity for any other Member concerned to demonstrate that qualifications acquired in its territory should be recognised. Members must notify the Council for Trade in Services of all existing recognition measures.[348] In the long term, Members aim at adopting common standards for the recognition of diplomas and professional qualifications. A first effort in this respect has been the *Guidelines for Mutual Recognition Agreements or Arrangements in the Accountancy Sector*, agreed upon by the Council for Trade in Services in May 1997.[349]

While *monopolies* or *exclusive service suppliers* can obviously impede trade in services, WTO law does not prohibit them. It is common for governments to grant entities an exclusive right to supply certain services, such as rail transport, telecommunications, sanitation, etc. However, pursuant to Article VIII:1 of the GATS, a Member must ensure that:

> any monopoly supplier of a service in its territory does not, in the supply of the monopoly service in the relevant market, act in a manner inconsistent with that Member's obligations under Article II and specific commitments.

A Member must also ensure that, when a monopoly supplier competes in the supply of a service outside the scope of its monopoly rights, the supplier does not abuse its monopoly position inconsistent with its commitments regarding that service.[350] These obligations also apply with regard to exclusive service suppliers, subject to the conditions set out in Article VIII:5.[351] Business practices, other than monopolies, may also hinder competition and thereby restrict trade in services. Article IX of the GATS requires Members, at the request of

346 See above, pp. 325–38. 347 Emphasis added.

348 See Article VII:4 of the GATS. They must also inform the Council of the opening of negotiations on a recognition agreement in order to give any other Member the opportunity to indicate an interest in participating in the negotiations.

349 See S/L/38, dated 28 May 1997. Negotiations on these guidelines were conducted in the WTO Working Party on Professional Services. See S/WPPS/W/12/Rev.1, dated 20 May 1997.

350 See Article VIII:2 of the GATS.

351 The panel in *China – Electronic Payment Services (2012)* distinguished 'monopoly suppliers' from 'exclusive service suppliers'. See Panel Report, *China – Electronic Payment Services (2012)*, paras. 7.585–7.587.

any other Member, to enter into consultations with a view to eliminating such practices.

It is obvious that restrictions on *international transfers and payments for services* can constitute a barrier to trade in services. Article XI:1 of the GATS requires Members not to apply any restriction on international transfers and payments related to services covered by specific commitments. However, Article XI:2 allows the use of exchange controls or exchange restrictions in certain situations, such as serious balance-of-payments difficulties within the meaning of Article XII, or when such exchange actions are requested by the IMF.

6 SUMMARY

Market access for goods and services from other countries can be, and frequently is, impeded or restricted in various ways. There are two main categories of barriers to market access: tariff barriers, discussed in Chapter 6; and non-tariff barriers, the focus of this chapter. While tariff barriers have been systematically reduced since the late 1940s as a result of successive rounds of tariff negotiations, non-tariff barriers have in recent decades gradually become an ever more prominent instrument of protection. The non-tariff barriers discussed in this chapter include: (1) quantitative restrictions on trade in goods; (2) 'other non-tariff barriers' on trade in goods; (3) market access barriers to trade in services; and (4) other barriers to trade in services. Note, however, that this chapter does not deal with technical barriers to trade, and sanitary and phytosanitary measures. The rules on these 'other non-tariff barriers' are discussed in Chapters 13 and 14 respectively.

A quantitative restriction on trade in goods is a measure which *limits the quantity* of a product that may be imported or exported. Quantitative restrictions take many forms, including bans, quotas and import or export licences. Article XI:1 of the GATT 1994 sets out a general prohibition on quantitative restrictions, whether on imports or exports. Unlike other GATT provisions, Article XI refers not to laws or regulations but more broadly to measures. A measure instituted or maintained by a Member, which restricts imports or exports, is covered by Article XI, *irrespective* of the legal status of the measure. Furthermore, quantitative restrictions which do not *actually* impede trade are nevertheless prohibited under Article XI:1 of the GATT 1994. Note also that restrictions of a *de facto* nature are also prohibited under Article XI:1 of the GATT 1994.

While quantitative restrictions are, as a rule, prohibited, there are many exceptions to this prohibition. Article XIII of the GATT 1994 sets out rules on the *administration* of these GATT-consistent quantitative restrictions. Article XIII:1 of the GATT 1994 provides that quantitative restrictions, when applied, should be administered in a non-discriminatory manner. According to Article XIII:2 of the GATT 1994, the distribution of trade still allowed should be as close

as possible to what would have been the distribution of trade in the absence of the quantitative restriction. Furthermore, Article XIII:2 sets out a number of requirements to be met when imposing quotas. Article XIII:2(d) provides that, if no agreement can be reached with all Members having a substantial interest in supplying the product concerned, the quota must be allocated among these Members on the basis of their share of the trade during a previous representative period. Note that the rules set out in Article XIII also apply to tariff rate quotas, even though the latter are not considered to be quantitative restrictions.

Quotas and tariff quotas are usually administered through import-licensing procedures. A trader who wishes to import a product that is subject to a quota or tariff quota must apply for an import licence, i.e. a permit to import. The *Import Licensing Agreement* sets out rules on import licensing. The most important of these rules, set out in Article 1.3, is that the rules for import-licensing procedures shall be neutral in application and administered in a fair and equitable manner.

Trade in goods is also impeded by 'other non-tariff barriers', including: lack of transparency; unfair and arbitrary application of trade laws and regulations; customs formalities and procedures; and government procurement laws and practices. Lack of information, uncertainty or confusion with respect to the trade laws, regulations and procedures applicable in actual or potential export markets is an important barrier to trade in goods. To ensure a high level of *transparency* of its Members' trade laws, regulations and procedures, WTO law requires their publication and notification, as well as the establishment of enquiry points. The *unfair and arbitrary application* of national trade measures, and the degree of uncertainty and unpredictability this generates for other Members and traders, also constitutes a significant barrier to trade in goods. Therefore, WTO law provides for: (1) a requirement of uniform, impartial and reasonable administration of national trade rules; and (2) a requirement of procedures for the objective and impartial review of the administration of national customs rules. The losses that traders suffer through delays at borders and complicated and/or unnecessary documentation requirements and other *customs procedures and formalities* are estimated to exceed the costs of tariffs in many cases. With the conclusion of the *Agreement on Trade Facilitation* (which is expected to enter into force soon), the WTO now has a significant body of rules on customs formalities and procedures aimed at mitigating their adverse impact on trade. National laws and/or practices relating to the procurement of goods by a government for its own use are often significant barriers to trade. Under such laws or practices, governments frequently buy domestic products rather than imported products. The plurilateral WTO *Agreement on Government Procurement* provides for some disciplines with respect to government procurement. However, it does so only for the forty-seven Members that are currently a party to this Agreement.

As with trade in goods, trade in services is also often subject to restrictions in the form of non-tariff barriers. The production and consumption of services are subject to a vast range of internal regulations. Barriers to trade in services primarily result from these internal regulations. WTO law, and the GATS in

particular, provides for rules and disciplines on barriers to trade in services. A distinction must be made between: (1) market access barriers; and (2) other barriers to trade in services.

Article XVI:2 of the GATS contains an *exhaustive* list of *market access barriers*. This list comprises six types of market access barriers: five of these types are quantitative restrictions (subparagraphs (a)–(d) and (f)); and one type is a limitation on the kind of legal entity or joint venture through which services may be supplied (subparagraph (e)). These market access barriers can be discriminatory or non-discriminatory with regard to foreign services or service suppliers. Four of the five types of quantitative restrictions referred to in Article XVI:2 can be expressed numerically, or through the criteria specified in these provisions, such as an economic needs test. It is important, however, that these criteria do not relate to: (1) the quality of the service supplied; or (2) the ability of the supplier to supply the service (i.e. technical standards or qualification of the supplier). The GATS does not provide for a general prohibition of market access barriers. Whether a Member may maintain or adopt market access barriers with regard to a specific service depends on whether, and if so to what extent, that Member has made market access commitments with regard to the relevant services sector in its Schedule of Specific Commitments, i.e. its Services Schedule. When a Member makes a market access commitment, it binds the level of market access specified in its Services Schedule (see Article XVI:1) and agrees not to impose any market access barrier that would restrict access to the market beyond the level specified (see Article XVI:2).

To achieve *progressively* higher levels of liberalisation of trade in services, the GATS provides for *successive* rounds of negotiations on further market access and national treatment commitments. The approach to negotiations on the liberalisation of services is a request-and-offer approach. It is accepted that developing-country Members undertake fewer and more limited market access commitments than developed-country Members. The terms, limitations and conditions on *market access* agreed to in the negotiations are set out in the second column of the Services Schedules. Each Member has a Services Schedule, and these Schedules, all annexed to the GATS, form an integral part thereof, and are to be interpreted accordingly. Like tariff concessions for goods, market access commitments for services can also be modified or withdrawn. To do so, the procedure set out in Article XXI of the GATS must be followed.

In addition to market access barriers, trade in services can also be impeded by a wide array of other barriers. With regard to a number of these other barriers, WTO law, and in particular the GATS, provides for specific rules. The GATS requires the prompt *publication* of all measures of general application affecting trade in services. It also requires Members to establish *enquiry points* to provide information on laws and regulations affecting trade in services. Furthermore, the GATS requires Members to ensure that all measures of general application affecting trade in services with regard to which specific commitments were

made are administered in a *reasonable, objective and impartial* manner. As noted above, trade in services is primarily impeded or restricted by internal regulation. Most internal regulations do not constitute market access barriers within the meaning of Article XVI:2. Apart from the rules concerning transparency and the rules on unfair and arbitrary application, the GATS currently only provides for a few other disciplines applicable to internal regulations, which do not constitute market access barriers. The most important of these disciplines concerns licensing requirements, qualification requirements, and technical standards. These requirements and standards must: (1) be based on objective and transparent criteria such as competence and the ability to supply the service; (2) not be more burdensome than necessary to ensure the quality of the service; and (3) in the case of licensing procedures, not be, in themselves, a restriction on the supply of the service. Finally, note that the GATS encourages and facilitates the recognition of diplomas and professional certificates of foreign service suppliers.

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ESSENTIALS OF WTO LAW

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Chapter 7

The institutional aspects of the WTO

7.1 Introduction

The World Trade Organization (WTO) was established under the WTO Agreement and became operational on 1 January 1995. The WTO Agreement was signed on 15 April 1994 in Marrakesh, Morocco, by the countries and customs territories that had participated in the Uruguay Round of multilateral trade negotiations (hereinafter the Uruguay Round) from 1986 to 1993. The establishment of the WTO is seen by many as the most important result of the Uruguay Round. Although the WTO is the youngest of the major international intergovernmental organizations, it is arguably among the most influential international organizations in these times of economic globalization.

The origins of the WTO lie in the General Agreement on Tariffs and Trade of 1947 (GATT 1947), which had functioned for almost fifty years as a de facto international organization for trade. At the end of the 1940s, the international community had not succeeded in establishing an international organization for trade alongside the newly created international economic organizations, namely the World Bank and the International Monetary Fund (IMF). Although the Havana Charter establishing an 'International Trade Organization' was

concluded in 1948, it never came into force because of the refusal of the US Congress to approve this agreement. The GATT 1947, which was conceived as a multilateral agreement for the reduction of tariffs and other barriers to trade, and not as an international organization, gradually and very pragmatically, took on the central tasks of the 'stillborn' International Trade Organization. The decisions, procedures and customary practices of the GATT 1947 still guide the WTO (Article XVI:1 of the WTO Agreement).

The GATT 1947 had much success with regard to the reduction of customs duties, particularly on industrial products. However, it was less successful in reducing non-tariff barriers to trade. During the Uruguay Round, the conviction gradually grew that the international community needed a fully fledged international organization to efficiently guide and regulate the increasingly complex trade relations between countries. This conviction, championed by Canada, the European Union (EU), and Mexico but not by the United States, finally led to the establishment of the WTO.

7.2 Objectives

Pursuant to the Preamble of the WTO Agreement, the ultimate objectives of the WTO are:

- the increase of standards of living;
- the attainment of full employment;
- the growth of real income and effective demand; and
- the expansion of production of and trade in goods and services.

However, it is clear from the Preamble that, in pursuing these objectives, the WTO must take into account the objective of sustainable development and the needs of developing countries. These preambular statements contradict the contention that the WTO is only about trade liberalization without regard for the sustainability of economic development, environmental degradation and global poverty. The WTO agreements must be read in the light of the objectives set out in the Preamble.

In *US – Shrimp (1998)*, the Appellate Body stated: '[The language of the Preamble to the WTO Agreement] demonstrates a recognition by WTO negotiators that optimal use of the world's resources should be made in accordance with the objective of sustainable development. As this preambular language reflects the intentions of negotiators of the WTO Agreement, we believe it must add colour, texture and shading to our interpretation of the agreements annexed to the WTO Agreement, in this case, the GATT 1994'.

7.3 Functions

The primary function of the WTO is to provide the common institutional framework for the conduct of trade relations among its Members. More specifically, the WTO, as set out in Article III (and Article V) of the WTO Agreement, has been assigned the following broad functions:

- to facilitate the implementation, administration and operation of the WTO agreements, as well as to further the objectives of these agreements;
- to be a forum for the negotiation of new trade rules;
- to settle trade disputes between its Members (see Chapter 8);
- to review the trade policies of its Members; and
- to cooperate with other international organizations and non-governmental organizations.

In addition, although not explicitly mentioned in the WTO Agreement, the WTO undisputedly has the function of giving technical assistance to developing-country Members.

Each of these functions is discussed briefly next.

7.3.1 Facilitation of the implementation of the WTO agreements

The function of facilitating the implementation, administration and operation of the WTO agreements and furthering their objectives is an essential function of the WTO. It involves most of its bodies and takes up much of their time.

An example of what this function of 'facilitating' implementation entails is found in Article 12.2 of the SPS Agreement, pursuant to which the SPS Committee has created a mechanism whereby Members may raise at each regular meeting of the SPS Committee the specific

trade concerns they have with regard to other Members' sanitary or phytosanitary measures. The multilateral discussion of these concerns may lead (and frequently does lead) to revision of the relevant measure or to the provision of technical assistance to comply with the measure. In this way, trade concerns can be addressed without recourse to dispute settlement.

7.3.2 *Negotiations*

A second function of the WTO is to provide a forum for negotiations among WTO Members on new trade rules. Before the WTO was established, multilateral trade negotiations were conducted in specially convened, time-limited rounds of negotiations, covering a wide variety of issues. The WTO now provides for a permanent forum for negotiations among its Members, in which each trade issue can be negotiated separately on its own merits.

Examples of trade agreements negotiated in the framework of the WTO include the amendment of the provisions of the TRIPS Agreement regarding compulsory licensing, to ensure access to essential medicines; the amendment of the Agreement on Government Procurement to extend its coverage; the accession of thirty-three countries to the WTO; and the adoption of the Information Technology Agreement.

Although it was initially thought that specially convened rounds of negotiations would no longer be necessary, it soon became apparent that, for multilateral negotiations on trade liberalization to be successful, the political momentum and opportunity for package deals brought by old GATT-style negotiation rounds is needed. Members therefore agreed at the Doha Ministerial Conference of 2001 to launch a new round of multilateral trade negotiations, commonly known as the 'Doha Round', with an ambitious agenda. The Doha Round initially adopted a 'single undertaking' approach, meaning that there is no agreement on anything until there is agreement on everything. However, in view of several missed deadlines and repeated deadlocks in the negotiations on core issues, Members decided to abandon the 'single undertaking' approach and advance negotiations in areas where progress was possible. At the Bali Ministerial Conference in December 2013, twelve years after the start of the Doha Round, agreement was reached on a limited number of issues on the negotiating agenda, including trade facilitation, public stockholding for food security purposes and issues relating to preferential treatment of least-developed countries (LDCs). Subsequently, in November 2014, WTO Members adopted the Agreement on Trade Facilitation, to be inserted into the WTO Agreement and to enter into force once two-thirds of Members have completed their domestic ratification process. On the many remaining issues on the agenda of the Doha Round, and in particular on non-agricultural market access (NAMA), trade in agricultural products and trade in services, the negotiations continue.

7.3.3 *Dispute settlement*

A third and very important function of the WTO is the administration of the WTO dispute settlement system. The prompt settlement of disputes under the WTO agreements is essential for the effective functioning of the WTO and for maintaining a proper balance between the rights and obligations of Members (Article 3.2 of the DSU). Chapter 8 examines the basic principles, institutions and procedures of the WTO dispute settlement system.

7.3.4 *Trade policy review*

A fourth function of the WTO is to administer the WTO Trade Policy Review Mechanism (TPRM). Under the TPRM, the trade policies and practices of all WTO Members are subject to periodic review by the Trade Policy Review Body (TPRB) (see Section 7.4) on the basis of a report by the Member under review and a report by the WTO Secretariat. These reports, together with the minutes of the meeting of the TPRB and the concluding remarks by the TPRB Chair are published shortly after the review. The TPRM aims to achieve greater transparency with regard to the trade policies and practices of Members and to contribute to improved compliance by Members with their WTO obligations. The TPRM may serve to 'shame' a Member into complying with its WTO obligations or publicly support its WTO-consistent (but domestically contested) policies. Trade policy review reports can be found on the WTO website and are a very useful source of information on the trade policies and practices of WTO Members.

7.3.5 *Cooperation with other organizations*

A fifth function of the WTO is cooperation with other organizations. Article III:5 of the WTO Agreement requires the WTO to cooperate with the IMF and the World Bank in order to ensure coherence in global economic policy. The WTO has given effect to this obligation through concluding cooperation agreements with the IMF and the World Bank. The WTO is also required to cooperate with other international organizations that have responsibilities related to those of the WTO (Article V:1 of the WTO Agreement). The WTO has made arrangements for cooperation with many international organizations, including United Nations Conference on Trade and Development (UNCTAD), World Intellectual Property Organization (WIPO) and the World Health Organization (WHO). About 140 international organizations have observer status with WTO councils or committees, and the WTO likewise participates in the work of many international organizations.

Furthermore, as allowed by Article V:2 of the WTO Agreement, the General Council has made appropriate arrangements for consultation and cooperation with non-governmental organizations (NGOs). Although NGOs have no role in WTO decision-making, a significant improvement in the relationship between the WTO and civil society has been achieved through pragmatic initiatives by the WTO Secretariat, including regular briefings for NGOs on the work of the WTO, symposia and public fora, dissemination of NGO position papers to WTO Members and the general public, the setting up of an NGO centre at ministerial

conferences and improved access to WTO documents through faster derestriction.

7.3.6 Technical assistance to developing countries

A sixth function of the WTO is the provision of technical assistance to developing-country Members to allow them to integrate into the world trading system and to reap the benefits of international trade. Although this task is not explicitly stated in the WTO Agreement, its importance is emphasized in the Doha Ministerial Declaration of December 2001.

> In paragraph 38 of the Doha Ministerial Declaration of 2001, WTO Members stated, 'We confirm that technical cooperation and capacity building are core elements of the development dimension of the multilateral trading system ... We instruct the Secretariat, in coordination with other relevant agencies, to support domestic efforts for mainstreaming trade into national plans for economic development and strategies for poverty reduction'.

Several WTO agreements provide for technical assistance to developing-country Members by other Members or by the WTO. Technical assistance provided by the WTO is funded mainly from the Doha Development Agenda Global Trust Fund, to which Members make voluntary contributions. These activities include e-learning courses, regional

trade policy courses, advanced trade policy courses held in Geneva, the 'WTO reference centres' in developing countries, the 'Geneva Week' to update developing-country Members with no permanent representation in Geneva on recent developments at the WTO, technical support missions to specific developing-country Members, and support for research and teaching in developing-country Members on WTO law and international trade. At the Hong Kong Ministerial Conference in December 2005, the WTO launched the Aid for Trade Initiative to mobilize resources to address the trade-related capacity constraints faced by developing and least-developed countries and coordinate the aid for trade given by national, regional and international donors and organizations.

7.4 Institutional structure

The WTO has a complex institutional structure with numerous permanent and temporary bodies to carry out its tasks (Article IV of the WTO Agreement). This institutional structure is illustrated in Figure 7.1.

At the highest level is the Ministerial Conference (Article IV:1 of the WTO Agreement). The Ministerial Conference consists of representatives at ministerial level of all WTO Members. It is in session for only a few days every two years. The Ministerial Conference is competent to make decisions on *all* WTO matters. It has further explicitly been granted specific powers, including adopting authoritative interpretations of the WTO agreements, granting waivers of WTO obligations, adopting amendments to the WTO

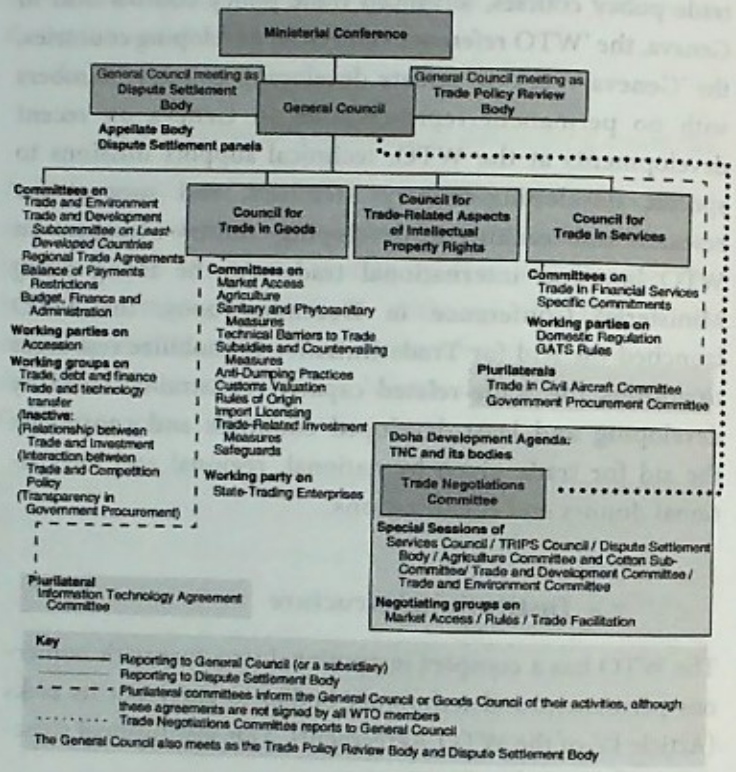

Figure 7.1: WTO Structure (source: WTO website)

agreements, making decisions on accession to the WTO, appointing the WTO Director-General and adopting staff regulations.

At the second level, there is the General Council (Article IV:2 of the WTO Agreement). The General Council exercises all the powers of the Ministerial Conference in

between its sessions. It consists of ambassador-level diplomats of all WTO Members. The General Council normally meets every two months in Geneva. The General Council has two alter egos, namely, the Dispute Settlement Body (DSB) and the Trade Policy Review Body (TPRB). When the General Council convenes to discharge its responsibilities relating to dispute settlement (see Chapter 8), it convenes as the DSB, which has its own chairperson and its own procedural rules. When the General Council convenes to discharge its responsibilities relating to the review of a WTO Member's trade policies (see Section 7.3.4), it convenes as the TPRB, which also has its own chairperson and procedural rules. The DSB and the TPRB meet more frequently than does the General Council.

The Ministerial Conference and the General Council are supported by the Council for Trade in Goods (CTG), the Council for Trade in Services (CTS) and the Council for Trade-Related Aspects of Intellectual Property Rights (TRIPS Council) (Article IV:5 of the WTO Agreement). These specialized Councils, on which all WTO Members are represented, are responsible for overseeing the functioning of the multilateral agreements on trade in goods, the GATS and the TRIPS Agreement, respectively. They meet as often as necessary.

The institutional structure of the WTO further comprises around thirty-five permanent and thirty ad hoc bodies. The permanent bodies include the Committee on Trade and Development, the Committee on Regional Trade Agreements and the Committee on Trade and Environment. In addition, all but one of the multilateral agreements on trade in goods establish a committee to carry out functions relating to the

implementation of the relevant agreement, for example the Committee on Technical Barriers to Trade (TBT Committee) (see Section 6.2.3) and the Committee on Subsidies and Countervailing Measures. The ad hoc bodies are mainly Working Groups on accession and negotiating bodies established especially for the Doha Round negotiations. The Doha Round negotiations are supervised by the temporarily established Trade Negotiations Committee (TNC), which reports to the General Council.

Every year, there are hundreds of meetings of WTO councils, committees and working parties that take place at the WTO headquarters in Geneva. It is nearly impossible for developing countries with no or a limited diplomatic representation in Geneva to attend all the meetings in which issues of importance to them are discussed. Furthermore, the often very technical and/or complex legal nature of the trade issues discussed at WTO meetings creates significant challenges for Members' representatives to the WTO.

Unlike other international organizations with a large membership, the WTO does not have an executive body composed of a limited number of representative WTO Members to facilitate the process of negotiation and decision-making. Instead, all WTO bodies are composed of representatives of all 162 WTO Members, making negotiations in these bodies very difficult and time-consuming. Furthermore, the WTO does not have a permanent body through which the 'dialogue' between the WTO and civil society representatives, such as national parliamentarians, employee and employer organizations, environmental organizations and human rights organizations, can take place.

The institutional structure of the WTO also includes non-political, independent, judicial or quasi-judicial bodies and, in particular, the ad hoc dispute settlement panels and the permanent Appellate Body (see Section 8.5).

The WTO is serviced by its Secretariat based in Geneva, which is responsible for the smooth functioning of the organization. Its main tasks are to provide technical and professional support to the various WTO bodies, to provide technical assistance to developing countries, to monitor and analyze developments in world trade, to provide information to the public and the media, to advise governments of countries wishing to become Members of the WTO and to provide administrative and legal assistance to dispute settlement panels. Note that the Appellate Body has its own Secretariat, separate from the WTO Secretariat.

The Secretariat is headed by the WTO Director-General, who is appointed by the Ministerial Conference. The appointment of a new Director-General is typically a contentious process. New procedures were adopted in 2009 to facilitate the appointment process. The current WTO Director-General is Roberto Azevêdo, previously Ambassador of Brazil to the WTO and other international economic organizations in Geneva.

The WTO Secretariat staff and the Director-General are independent and impartial international officials. They may not seek or accept instructions from any government or any authority external to the WTO (Article VI:4 of the WTO Agreement).

WTO Members often emphasize that the WTO is 'a Member-driven' organization. The Members – and not the

Director-General or the WTO Secretariat – set the agenda, make proposals and take decisions. The Director-General and the WTO Secretariat have no autonomous policy decision-making powers. They act mainly as an 'honest broker' in or a 'facilitator' of the political decision-making processes in the WTO.

The WTO Secretariat is of limited size (less than 650 regular staff as compared to 12,335 regular staff of the World Bank) and possesses limited financial resources (a budget of about US$ 195 million in 2014, as compared to the World Bank's administrative budget of US$2.6 billion in the same year). Nevertheless, a WTO Director-General with vision and drive can play an important role by building consensus among WTO Members on particular agreements or decisions.

7.5 Membership

Since the accession of the People's Republic of China in December 2001, the WTO can be regarded as a universal organization. Its 162 Members account for 99.5 per cent of the world's population and about 98 per cent of all international trade.

This section will examine the current membership of the WTO, the accession process and the obligations and rights of membership.

7.5.1 Current membership

As stated, the WTO has 162 Members at present (i.e. as of 1 December 2015). This membership is very diverse.

Three-quarters of WTO Members are developing countries. There is no WTO definition of a 'developing country'. Instead, developing-country status is largely based on self-selection by Members. Developing countries may rely on the special and differential treatment provisions in various WTO agreements and may receive technical assistance. One-fifth of WTO Members are least-developed countries (LDCs). The WTO recognizes as LDCs those countries that have been classified as such by the United Nations. Additional special and differential treatment is provided for in WTO agreements for LDC Members.

It is noteworthy that not only States but also separate customs territories with full autonomy in the conduct of their external commercial relations – such as Hong Kong, China; Macau, China; and Chinese Taipei – can be, and are, Members of the WTO. Equally noteworthy is that both the European Union (before 2010 referred to as the European Communities) and all twenty-eight Member States of the European Union are Members of the WTO (Article XI:1 of the WTO Agreement). In practice, it is the European Commission that speaks and acts for the European Union and all its Member States in WTO matters (except in the Budget Committee).

WTO Members organize themselves, formally and informally, into various groups and alliances around common interests or positions. For example, previously, the Cairns Group of nineteen agriculture-exporting countries and currently the G-20 group of developing countries have been influential in the negotiations for the liberalization of agricultural trade. Other coalitions include the G-90 group

representing the interests of the poorest Members and the 'Cotton-Four' group of West African countries that campaign against the policies of the European Union and United States that distort trade in cotton. Groups of WTO Members have also emerged to allow negotiations in smaller groups, to permit compromises to be reached or to break deadlocks. Previously the 'Quad', composed of the United States, the European Communities, Canada and Japan, was at the core of all negotiations. Currently, reflecting the new geopolitical reality and the growing economic importance of certain developing-country Members, the Quad has been replaced by the G-5, consisting of the United States, the European Union, China, Brazil and India. Without agreement among these key Members, no progress can be made in WTO negotiations. Furthermore, in recent years, a large group of developing countries, including Argentina, Venezuela, Chile, Peru, Mexico, Thailand, the Philippines, Indonesia, Malaysia, Turkey and Pakistan, often acting as part of a coalition or alliance, has gained significantly in influence in WTO decision-making and negotiations. The WTO is clearly no longer the 'rich man's club' it was in its early days.

7.5.2 Accession

The WTO Agreement initially provided for two ways to become a WTO Member. First, Contracting Parties to the GATT 1947 could become 'original' Members of the WTO by accepting the terms of the WTO Agreement and the multilateral trade agreements and by making concessions and commitments for trade in goods and trade in services,

respectively (Article XI:1 of the WTO Agreement). This method was only available at the time of and shortly after the establishment of the WTO.

Second, a state or separate customs territory can negotiate accession to the WTO by accepting the terms of the WTO Agreement and the multilateral trade agreements and negotiating the terms of accession with the current WTO Members (Article XII of the WTO Agreement). This way of becoming a Member is open indefinitely.

Accession to the WTO is typically a long and difficult process.

> China's accession negotiations lasted fifteen years and those of Russia eighteen years. The shortest accession process has been that of Kyrgyzstan, lasting two years and eleven months.

There are four main phases in the accession process. First, the applicant state or customs territory has to submit a report or 'memorandum' on its trade and economic policies. A working party of all interested WTO Members is established to examine, on the basis of this report and other information, the WTO-consistency of the applicant's laws, regulations and administrative procedures.

Second, candidates for membership must bring their national laws, regulations and administrative procedures into conformity with their obligations under the WTO agreements. Current WTO Members will often have very specific concerns and demands in this respect and will carefully

monitor whether these concerns and demands are addressed. Candidates for membership also have to negotiate a 'ticket of admission' in the form of market access concessions. When they join the WTO, new Members immediately benefit from all the gains in market access achieved by existing WTO Members. In return, they must 'pay' for this benefit by offering access to their own markets to WTO Members. The 'price' of this ticket of admission depends on the level of economic development of the acceding country and is the subject of the accession negotiations. Since different WTO Members have different trade interests, these negotiations are necessarily bilateral. However, the outcome of these negotiations is 'multilateralized' (i.e. it applies equally to all WTO Members) due to the most-favoured-nation (MFN) treatment obligation (see Sections 2.2 and 2.3).

The third stage of the accession process entails the drafting of the 'terms of membership' in the working party report, the draft Protocol of Accession and the draft Goods and Services Schedules of the candidate, containing its market access concessions and commitments. It is possible that, to secure accession to the WTO, a candidate for membership must accept additional ('WTO-plus') obligations or limited ('WTO-minus') rights. This will be reflected in the Protocol of Accession.

> For example, China undertook the 'WTO-plus' obligation to eliminate export duties on all its products, except those listed in Annex 6 to its Protocol of Accession (paragraph 11.3 of the Protocol of Accession of China),

> whereas most other WTO Members are not subject to such an obligation. In addition, China had to agree to WTO-minus rights in the form of a twelve-year transitional product-specific safeguard mechanism, under which other WTO Members could, more easily than under the normal rules on safeguards, restrict Chinese exports that caused or threatened to cause market disruption (paragraph 16 of the Protocol of Accession of China).

The final stage of the accession process is the 'decision stage', in which the General Council or the Ministerial Conference decides on the application for membership. If the application is approved, the candidate becomes a WTO Member thirty days after it has deposited the instrument of ratification of its Protocol of Accession.

> To date, thirty-three accessions have been successfully completed. At this moment, twenty-one countries are negotiating their accession to the WTO.

7.5.3 Membership obligations and rights

Article XVI:4 of the WTO Agreement requires every Member to ensure that its laws, regulations and administrative procedures comply with the obligations of the WTO agreements. However, in exceptional circumstances in which it is very difficult or impossible for a Member to comply with its

obligations, it may be granted a time-limited waiver from specific obligations by the Ministerial Conference or the General Council (Article IX:3 of the WTO Agreement).

There are several well-known examples of waivers granted to WTO Members. These include the waiver from the obligations under Articles I, IX and XIII of the GATT 1994 that was granted to a group of Members allowing them to ban trade in 'blood diamonds' (i.e. diamonds sold to fund conflicts in Africa) under the Kimberly Process. Another notable example is the waiver from the obligations of Article 31(f) and (h) of the TRIPS Agreement granted to WTO Members that produce essential medicines, under compulsory licences, for export to those Members that lack sufficient domestic capacity to manufacture these medicines themselves.

In addition to the possibility to be granted a waiver from certain WTO obligations, WTO law also provides the possibility for a Member to 'opt out' of the application of WTO rules with respect to another Member (Article XIII of the WTO Agreement) for political, economic or other reasons. The non-application clause may only be invoked at the time either of the two Members involved becomes a WTO Member and no later. The decision to 'opt out' must be notified to the General Council or Ministerial Conference before it takes a decision on the accession of the Member involved. The 'opt-out' possibility has been of limited practical importance to date.

The non-application clause has been invoked only eleven times to date. Seven of these were 'opt outs' by the United States with regard to former communist countries acceding to the WTO. Most recently, in 2011, the United States invoked the non-application clause when the Russian Federation was acceding to the WTO. In response, Russia did likewise. These opt-outs have all been revoked. In addition, Turkey invoked the non-application clause with regard to Armenia, and El Salvador did so with regard to China. The latter two 'opt-outs' are the only ones currently still in force.

In recognition of the particular difficulties that developing-country Members may face in participating in international trade, most WTO agreements provide for special and differential treatment (S&D treatment) of these Members. These S&D treatment provisions include those that (1) grant transitional periods to developing-country Members to comply with certain WTO obligations, (2) allow greater flexibility to developing-country Members in making commitments or using policy instruments, (3) encourage the granting of technical assistance to developing-country Members, (4) aim at increasing the trade opportunities for developing-country Members and (5) provide that developed Members should safeguard the interests of developing-country Members. However, because most S&D treatment provisions are either couched in hortatory terms or contain only 'best-endeavour' obligations, they are not easily enforceable.

An example of a S&D treatment obligation of 'best-endeavour' is that at issue in the *EC – Approval and Marketing of Biotech Products (2006)* dispute. In this dispute, Argentina relied on the S&D treatment provision contained in Article 10.1 of the SPS Agreement, which provides that, in the preparation and application of SPS measures, 'Members shall take account of the needs of developing country Members'. Argentina argued that the European Union had not taken account of the great economic impact of its restrictions on importation and sale of biotech products on Argentina. This impact was due to Argentina's status as the world's largest developing-country producer of biotech products and its economic dependence on agricultural exports. The panel, however, held that the obligation 'to take account' of developing-country needs entails only the obligation 'to consider' these needs and does not prescribe any result to be achieved.

With one exception of minor importance, the WTO Agreement does not provide for the possibility to expel Members from the WTO. There is no procedure to expel even Members that systematically violate their WTO obligations or that are guilty of gross violations of human rights or acts of aggression.

Members can unilaterally withdraw from the WTO under Article XV:1 of the WTO Agreement. Withdrawal applies to all the multilateral trade agreements – it is not possible to withdraw from certain of these agreements and not others. The withdrawal takes effect six months after the

notification of the decision to withdraw has been received by the WTO Director-General. No Member has made use of the withdrawal possibility to date.

7.6 Decision-making procedures

In terms of Article IX:1 of the WTO Agreement, WTO Members must first try to take decisions by consensus. A decision is considered to be taken by consensus if no Member present at the meeting when the decision is taken *formally* objects to the proposed decision. In other words, an express objection is needed to prevent a decision being taken. No voting occurs. Each Member has veto power, but Members generally refrain from blocking a consensus unless significant national interests are at stake. A certain degree of deference to economic power occurs.

In theory, when a decision cannot be taken by consensus, it may be taken by majority voting. The required majority varies with the subject matter of the decision. In general, a simple majority is sufficient for a decision to be adopted. However, certain special decision-making procedures are provided for in respect of particular decisions.

For example, a three-fourths majority of the Members is required to adopt an authoritative interpretation of a WTO agreement and to adopt a waiver of WTO obligations (Article IX:3 of the WTO Agreement). For decisions on accession, a two-thirds majority of the Members is required (Article XII:2 of the WTO Agreement).

Each WTO Member has one vote, except for the European Union, which has as many votes as it has Member States (currently twenty-eight). When the European Union exercises its voting right, the European Union Member States, which are all full Members of the WTO (see Section 7.5.1), may not participate in the voting. In practice, however, this matters little, because the WTO very seldom resorts to voting. WTO decisions are made almost exclusively by consensus.

Although the consensus requirement renders decision-making by the WTO difficult and susceptible to paralysis, decision-making by consensus is at the heart of the WTO system and is regarded as a fundamental democratic guarantee. It is also a guarantee of the presence of sufficient economic and political support for the decision to ensure its implementation.

In the early years of the WTO, developing-country Members objected to their marginalization in WTO negotiations and decision-making. As noted earlier, at present, progress can no longer be made in WTO negotiations without the agreement of China, India and Brazil, all members of the G-5. More generally, whereas many other developing-country Members still lack the resources and expertise to participate effectively in WTO negotiations and decision-making, they have increasingly been able to make their voices heard and their concerns considered in WTO negotiations and decision-making. To large extent, this has been the result of the systematic coordination of positions and the pooling of resources and expertise in groups, coalitions and alliances of developing-country Members with common interests. This welcome development does, however, also have a drawback.

The active and effective participation in WTO negotiations and decision-making of a larger number of developing-country Members with very different economic and trade interests has made it more difficult than ever before to reach consensus.

7.7 Status and budget

The WTO has legal personality and must be granted by its Members the legal capacity, privileges and immunities needed to carry out its functions (Article VIII of the WTO Agreement). The WTO is not part of the UN 'family', but is a fully independent organization. However, it maintains a close working relationship with several UN agencies and bodies (see Section 7.3.5).

The WTO has a rather modest budget compared to other international organizations. In 2014, its total budget amounted to 197 million Swiss Francs. The Financial Regulations, adopted by the General Council, provide that the contribution of each WTO Member to the WTO budget is established on the basis of that Member's international trade (both imports and exports) in relation to the total trade of all Members. Thus, contributions depend on each Member's share in global trade. With respect to Members of which the share in international trade is less than 0.015 per cent, a minimum contribution of 0.015 per cent to the WTO budget is required. The largest contributors to the WTO budget are the Member States of the European Union because their share is calculated taking into account both intra-European Union trade and trade between the European Union and third

countries. The European Union itself does not contribute to the WTO budget.

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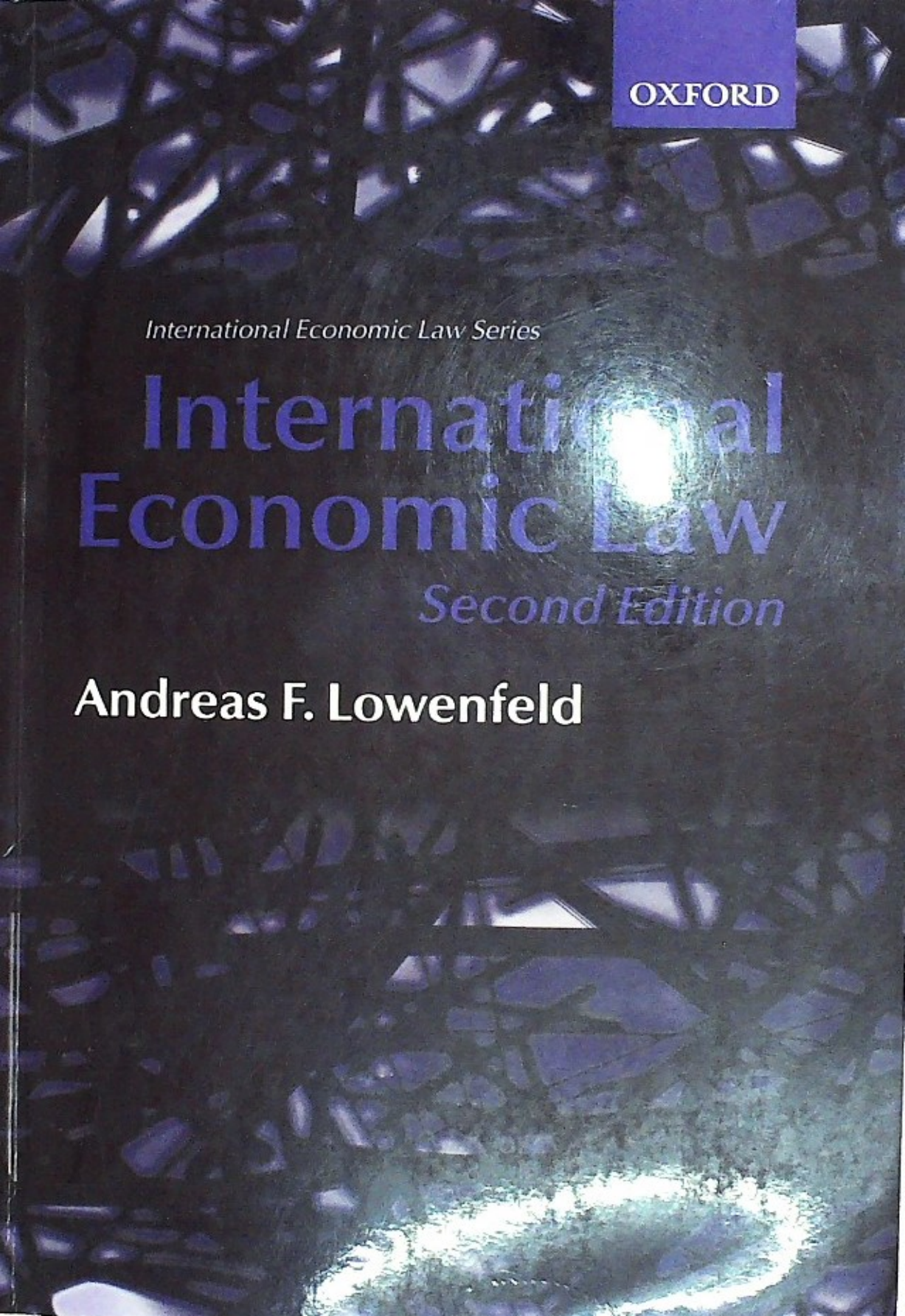
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18

The Bretton Woods System

18.1 Before Bretton Woods: Good And Bad Memories

It would not be accurate to say that before 1945 there was no international monetary system. States and their enterprises traded with one another, currencies were exchanged, and states held monetary reserves—in gold, in silver, and in foreign currencies. It would be accurate, however, to say that prior to the close of World War II no international legal regime governed the conduct of states with respect to monetary affairs.[1]

For about 35 years prior to the outbreak of World War I, the major western countries—the United Kingdom, France, Germany, and the United States—all tied their currencies to gold, so that the rates of exchange among the franc, the mark, the pound, and the dollar were essentially fixed. Many other states in effect tied into what was known as the gold standard by linking their currencies to one of the key currencies and keeping their reserves either in gold or in one of those currencies. No international legal obligation required adherence to the gold standard, and it collapsed almost overnight at the start of World War I. But though the era of the gold standard was neither as long nor as smooth as it seemed in retrospect,[2] the period before World War I brought to the minds of the planners of the post-World War II economy memories of fixed exchange rates, great expansion of trade, and the growth of transnational investment on a scale the world had not previously seen.[3]

By contrast, the period between World War I and Word War II seemed like a nightmare. The pound floated against the dollar from 1919 to 1925, while the dollar remained tied to gold. Then Britain returned to gold as well, pretty clearly at an overvalued rate. The French franc floated—generally down—for most of the 1920s, then was linked to gold, first *de facto* and then *de jure*, accompanied by a variety of exchange controls. Both the franc and the pound, it seems, were sustained by large capital exports from the United States; when these ceased at the close of the decade, Great Britain suspended gold payments, France did not. The United States abandoned the gold standard as one of the first acts of the Roosevelt presidency, and rejected a proposed dollar–franc–pound stabilization proposal at the London International and Monetary Conference of 1933, which broke up in

[1] In contrast, states had for many centuries entered into trade agreements, some providing for most-favoured-nation treatment, others for preferential arrangements, customs unions, and other efforts to influence the movement of goods through governmental regulation.

[2] For a concise demonstration of this point, see Kenneth W. Dam, *The Rules of the Game: Reform and Evaluation in the International Monetary System*, 13–40 (1982).

[3] See Dam, *The Rules of the Game*, n. 2 *supra*, 38.

disarray.[4] As trade contracted sharply and unemployment increased worldwide, each of the major countries tried to use competitive devaluations, multiple exchange rates, trade restrictions, subsidies, and controls of various kinds to divert economic distress abroad.

Seen from the 1940s, the 1930s were a period of 'beggar thy neighbour', every nation for itself, with disastrous results. That Nazi Germany seems to have been particularly adept at the various manipulative devices confirmed the determination that the pattern of the interwar years must not be repeated. In the post-war world there would be an international regime of monetary *law*, established by treaty and overseen by a permanent international organization. The regime would be founded on principles of non-discrimination, fixed exchange rates, and so far as possible, avoidance of exchange controls and other devices that distorted the flow of goods, services, and credits. The American Secretary of the Treasury, in his closing statement as Chairman of the Bretton Woods Conference, summed up:

> I take it as an axiom that after this war is ended no people and therefore no government of the people—will again tolerate prolonged and widespread unemployment. A revival of international trade is indispensable if full employment is to be achieved in a peaceful world and with standards of living which will permit the realization of men's reasonable hopes.
>
> What are the fundamental conditions under which commerce among the nations can once more flourish?
>
> First, there must be a reasonably stable standard of international exchange to which all countries can adhere without sacrificing the freedom of action necessary to meet their internal economic problems.
>
> This is the alternative to the desperate tactics of the past—competitive currency depreciation, excessive tariff barriers, uneconomic barter deals, multiple currency practices and unnecessary exchange restrictions—by which governments vainly sought to maintain employment and uphold living standards. In the final analysis, these tactics only succeeded in contributing to world-wide depression and even war. The International Fund agreed upon at Bretton Woods will help remedy this situation.[5]

[4] For an account of the London Conference as seen through American eyes, see Arthur M. Schlesinger, Jr., *The Age of Roosevelt*, Vol. II, *The Coming of the New Deal*, 201–232 (1959).

[5] *Proceedings and Documents of United Nations Monetary and Financial Conference*, Bretton Woods, N.H., 1–22 July 1947, Vol. I, 1117–1118 (1947). See also the following excerpt from Secretary Morgenthau's article, 'Bretton Woods and International Cooperation', 23 Foreign Affairs 182, 185 (1945):

> The decade of the 1930s was almost unique in the multiplicity of ingenious schemes that were devised by some countries, notably Germany, to exploit their creditors, their customers, and their competitors in their international trade and financial relations. It is necessary only to recall the use of exchange controls, competitive currency depreciation, multiple currency practices, blocked balances, bilateral clearing arrangements and the host of other restrictive and discriminatory devices to find the causes for the inadequate recovery in international trade in the decade before the war. These monetary devices were measures of international economic aggression, and they were the logical concomitant of a policy directed toward war and conquest.

18.2 The Bretton Woods Conference

The history of the negotiations of what became the Bretton Woods Agreement has often been told, and need not be repeated here.[6] What is remarkable in retrospect two generations later is that planning and negotiations began in the United Kingdom and the United States in 1942, at a time when the outcome of World War II was far from clear, and that in July 1944, nine months before signing of the United Nations Charter, ten months before the end of the war in Europe, and more than a year before the end of the war in the Pacific, representatives of 44 nations were able to agree on a plan for the post-war international economy that endured largely intact for a quarter of a century, and that even in a much changed world continues to have significant importance.[7] Lord Keynes wrote in 1942 that only a 'Single act of creation, made possible by the unity of purpose and energy of hope for better things to come' brought about by the war would bring about an international monetary institution.[8] That unity of purpose and energy of hope has not been replicated since the 1940s.

The Bretton Woods Conference created two permanent financial organizations, the International Monetary Fund and the International Bank for Reconstruction and Development (the World Bank), both designed to have universal membership, based on contribution of resources by all members. The World Bank would be devoted to long-term economic development, first to reconstruction of countries ravaged by the war, then to development of countries not yet in the economic mainstream. The International Monetary Fund would enable states to achieve financial stability with growth, by making its resources available to them for purposes consistent with the Articles of Agreement.[9]

[6] See Richard N. Gardner, *Sterling-Dollar Diplomacy* (revd. edn. 1969); Roy F. Harrod, *The Life of John Maynard Keynes*, 525–585 (1951, repr. 1963, 1969); J. Keith Horsefield, *The International Monetary Fund, 1945–1965: Twenty Years of International Monetary Cooperation*, Vol. I, 3–113 (1969).

[7] The 45th nation represented at Bretton Woods—the USSR—did not sign the Final Act, and never joined the IMF or the World Bank. See Sect. 18.3, n. 32 *infra*.

[8] Quoted in Harrod, *The Life of John Maynard Keynes*, n. 6 *supra*, 551.

[9] It is useful to recall the stated purposes of the International Monetary Fund, as set forth in Article I of the Articles of Agreement. The italicized words were added in the First Amendment to the Articles, effective 1969:

The purposes of the International Monetary Fund are:

(i) To promote international monetary cooperation through a permanent institution which provides the machinery for consultation and collaboration on international monetary problems.

(ii) To facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy.

(iii) To promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation. *cont.*

Calls for a 'new Bretton Woods Conference' are heard from time to time; as of 2007, however, no serious plan for such a conference had come to light, and the organizational structure of the IMF remains substantially as it was agreed at Bretton Woods, with a strong Managing Director and Staff, an Executive Board chosen on a regional basis, and weighted voting.[10] Portions of the code of conduct incorporated in the Articles of Agreement and elaborated in early interpretations of the Articles also remain in effect—in particular the provisions concerning exchange controls (Section 18.5) and the provisions concerning drawing by member states on the resources of the Fund (Section 18.7). The provisions concerning fixed exchange rates were abandoned in 1971 and have been replaced by a much looser regime of flexible exchange rates, first created by unforeseen events, and subsequently codified in substantially Amended Articles of Agreement.[11] The overriding concept of the founders of the post-war monetary system, however, remains in effect: the value of a nation's currency, while clearly an important subject of each nation's concern, and indeed an aspect of its sovereignty, is also a matter of international concern—and of international law.

18.3 The IMF as an Organization

Article XII of the Articles of Agreement of the IMF established a three-tiered organization, consisting of a Board of Governors, an Executive Board, and a Managing Director, who presides over the staff and also functions as non-voting chairman of the Executive Board.

The *Managing Director* and the staff owe their duty entirely to the Fund and to no other authority (Art. XII(4)(c)); on the whole this mandate has been complied with—certainly more fully that in the secretariat of the United Nations and many other organizations. In many instances the non-political character of the IMF staff has stood it in good stead, in making unpopular recommendations or prescriptions to member states; on the other hand some critics in and outside of the governments of member states

(iv) To assist in the establishment of a multilateral system of payments in respect of current transactions between members and in the elimination of foreign exchange restrictions which hamper the growth of world trade.

(v) To give confidence to members by making the Fund's resources *temporarily* available to them under adequate safeguards, thus providing them with opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity.

(vi) In accordance with the above, to shorten the duration and lessen the degree of disequilibrium in the international balances of payments of members.

The Fund shall be guided in all its *policies and* decisions by the purposes set forth in this Article.

[10] The same formula is used in governance of the International Bank for Reconstruction and Development, the other institution created at Bretton Woods.

[11] See Ch. 19, Sect. 19.3.

have regarded the staff as inflexible, insensitive to 'political realities', and too much tied to a standard remedy for economic difficulties.[12]

The *Board of Governors* consists of one governor (and one alternate) appointed by each member state—typically the Minister of Finance or the President of the member's central bank. The Board of Governors meets at least once a year or when called into special session;[13] it may also take decisions by postal or telegraphic ballot in specified circumstances.[14] All powers of the Fund not otherwise delegated are vested in the Board of Governors, but unlike the United Nations, the WTO, and most other international organizations, voting at meetings of the Board of Governors, as in the Executive Board, depends on a complicated formula designed to reflect (with some adjustments) the economic importance of the member state, as described below. In practice the Board of Governors delegates to the Executive Board all powers that are not expressly made non-delegable.[15]

The *Executive Board* consists in principle of five appointed directors and a number of elected directors that may not be less than fifteen.[16] The five appointed directors represent the five member states having the largest quotas—as of 2007 the United States, Japan, Germany, France, and the United Kingdom. In addition, each of two member states whose currencies have been drawn from the General Resources Account in the largest amount in the two years preceding an election is entitled to appoint a director as well.[17] For a number of years, Saudi Arabia appointed an Executive Director under this provision.[18]

Under the original Articles of Agreement two places on the Executive Board were reserved for 'American Republics not entitled to appoint directors', i.e. for states from Latin America;[19] this provision was dropped when the Articles of Agreement were amended effective 1978. In practice, the Executive Directors—24 as of mid-year 2007—do represent regional and (in so far as practical) politically compatible groupings of states.

The Executive Directors have a position somewhere in between the staff, who are wholly independent and committed to the organization, and the

[12] As of 2007, the Managing Director of the IMF has always been a national of a European state; by some kind of unwritten understanding, the President of the World Bank has always been a national of the United States. For an account of preservation of the tradition amid tensions at the World Bank in 2007, see Ch. 21, Sect. 21.1, n. 1.

[13] See Article XII(2)(c).

[14] Article XII(2)(f); By-Laws of the IMF, Sect. 13. In fact this procedure was used in the course of both of the general amendments to the Articles of Agreement.

[15] See By-Laws of the IMF, Sect. 15.

[16] Article XII(3)(b). Under the original Articles of Agreement there were five appointed and twelve elected directors.

[17] Article XII(3)(c).

[18] The Board of Governors decided in 1980 to expand the number of elected directors from 15 to 16, and the number has been increased several times since then. As of mid-year 2007, the Executive Board consisted of 5 appointed and 19 elected directors, representing a total of 185 member states.

[19] Articles of Agreement, original version, Article XII(3)(b)-(iv).

Governors, who are political (or central bank) officials of the member states. Executive Directors are supposed to seek and take instructions from the states that appoint or elect them. But the Executive Directors reside in Washington, draw their salaries from the Fund, and have tended to be viewed as Fund professionals.

Since the mid-1970s, when fundamental problems with the international monetary system became apparent,[20] the perception has grown up that the Executive Directors are not sufficiently close to the governments they represent to provide the kind of high-level interchanges necessary for major decisions. An *Interim Committee* chosen along the same voting lines as the Executive Directors but consisting of senior government officials was created in 1975, and functioned until 1999.[21] A 'Council', a more permanent body with similar objective—closer to the political process in member states—was provided for in the Amended Articles, but only upon approval of 85 per cent of the total voting power.[22] An initiative to bring the Council into being was considered in 1999 but failed to pass. However, at the Annual Meeting in 1999, the Board of Governors approved a proposal to transform the Interim Committee into the *International Monetary and Financial Committee*, with similar functions of consultation among senior financial officials, including representatives of states not included in the various informal groups of the major powers—the G-5, G-7, G-10, etc.[23]

The formula for voting power, in the Executive Board as well as in the Board of Governors is, as already noted, designed to reflect member states' economic importance as shown in quotas in the Fund, adjusted to give each member state a minimum voting power. Under the original Articles of Agreement, each member state had 250 basic votes plus one additional vote for each 100,000 US dollars of its quota.[24] In 1945, basic votes accounted for 11.3 per cent of total votes. As of 2007, as a result of numerous increases in total quotas, basic votes accounted for only 2.1 per cent of total votes, the United States' voting power stood at 17.1 per cent, and the European Union, if it voted as a bloc, held 33.9 per cent of the voting power. Developing countries held just under 39 per cent of voting power, as against 61 per cent for developed countries.

At the Fund's Annual Meeting in 2006, as part of a 'medium term strategy' announced by the Managing Director to rethink the role and governance of the Fund, the assembled Governors debated proposals to revise the voting formulas, with a view to proposing an amendment to the Articles

[20] See Ch. 19, Sect. 19.1.

[21] See Ch. 19, Sect. 19.1(c) at n. 11.

[22] See Article XII(l) and Schedule D of the Amended Articles.

[23] The Development Committee, which did not have a name suggesting temporary status, remained as it was.

[24] Under the Amended Articles, the formula remains the same, except that Special Drawing Rights (Sect. 18.8 *infra*) are substituted for US dollars as the unit in which quotas, and therefore voting power, is measured.

of Agreement in 2007. While there was general agreement that quotas (and therefore voting power) were most seriously out of line for China, Korea, Mexico, and Turkey, it was not clear that agreement could be reached on a more general realignment, as the United States, the European Union, the developing countries, and the least developed countries had differing interests and proposals. A related controversy concerned resentment over the fact that the European Union was represented by seven Directors on the Executive Board, compared to one for the United States and twelve for 161 developing countries.[25]

In practice, it is rare for the Fund to actually vote; typically the Managing Director will not bring a matter to the Executive Board unless there is a consensus.[26] However, a few matters, for instance adjustment of quotas, have always been subject to decision by super-majorities, and under the Amended Articles, a substantially increased number of decisions require super-majorities—in some instances 70 per cent of total voting power,[27] in others 85 per cent,[28] thus on the one hand preserving a veto power for the United States, and for the European Union if it votes as a bloc, on the other hand approaching formally the tradition of acting by consensus.[29] The fact that it is the Managing Director and his principal advisers who decide what proposals should be submitted to the Board and when a proposal is ready for decision tends to enhance the role of the staff, which has a greater role in the work of the IMF (as well of the World Bank, which operates under a similar formula) than in most public international organizations. That effect was consistent with the original understanding at Bretton Woods. The effect is particularly apparent in the Fund's relation to developing countries, less so in dealings with the major economic powers.[30]

[25] For more details on voting powers in the Fund, see Leo van Houtven, 'Taking the IMF's Governance Reform Forward', 35 IMF Survey 338 (20 Nov 2006).

[26] See IMF Rules and Regulations, Rule C-10F (Executive Board); By-Laws, Sect. II (Board of Governors).

[27] See e.g. Article V(7)(g) (Postponement of Repurchase Obligations); Article V(8) (Determination of charges); Article XV (Determination of method of valuation of Special Drawing Rights).

[28] See e.g. Article III(2)(c) (Adjustment of quotas); Article IV(4) (Introduction of fixed exchange rate system); Article XVIII (Allocation, cancellation, and determination of conditions of use of Special Drawing Rights); Article XXIX(b) (Overruling Decision of Committee on Interpretation). For a complete list of Special Majorities under Amended Articles, see *Report by Exec. Directors to Board of Governors on Proposed Second Amendment to Articles of Agreement*, 79–84 (IMF 1976), repr. in Gold, *Effects of the Second Amendment*, n. 29 *infra*.

[29] See Joseph Gold, *Voting and Decisions in the International Monetary Fund* (1972); supplemented by Joseph Gold, *Voting Majorities in the Fund: Effects of the Second Amendment of the Articles* (IMF Pamphlet Series, No. 20, 1977).

[30] Paul Volcker, the former US Under-Secretary of the Treasury and Chairman of the Board of Governors of the Federal Reserve System, quotes a 'distinguished finance minister' of a large developing country, 'cynically but not entirely inaccurately':

> When the Fund consults with a poor and weak country, the country gets in line. When it consults with a big and strong country, the Fund gets in line. When the big countries are in conflict, the Fund gets out of the line of fire.

One more institutional feature of the IMF is important in understanding its role in shaping international monetary law. According to Article VIII(5), the IMF acts 'as a centre for the collection and exchange of information on monetary and financial problems', and member states are obligated to furnish detailed information on their economic situation. In a world where statistics were often negotiated or distorted, the Fund has been a source of useful and generally reliable statistics and technical studies.[31] It seems that the requirements of detailed disclosure of economic data figured in the decision of the Soviet Union not to join the International Monetary Fund, though it had participated actively in the Bretton Woods Conference and had secured adoption of several provisions of special concern to it.[32]

18.4 The Fund Agreement as a Code of Conduct

As noted in Section 18.1, one of the principal purposes of the Articles of Agreement of the International Monetary Fund was to impose legal obligations on member states not to engage in the kinds of practices that had contributed, it was believed, to the Great Depression and the outbreak of World War II. Pursuant to Article XX(2)(a) of the original Articles (Article XXXI(2) of the Amended Articles), each state, upon joining the Fund, certifies that 'it has accepted this Agreement in accordance with its law and has taken all steps necessary to enable it to carry out all of its obligations under this Agreement'. Thus it is no defence to a charge of conduct inconsistent with the Agreement that a required action would be contrary to the member state's domestic law, or that a forbidden action is required by that law.[33] Member states were supposed to adopt implementing or authorizing legislation prior to deposit of the instrument of ratification and they generally did so, though in some instances with strings attached.[34] For states

Paul Volcker and Toyoo Gyohten, *Changing Fortunes: The World's Money and the Threat to American Leadership*, 143 (1992).

[31] See, however, Ch. 20 on recent regional crises in Latin America and South-east Asia, which suggests that the information given to the IMF was often incomplete and in some instances simply false.

[32] E.g. the last sentence of Article XII(8) reading:

> The Fund shall not publish a report involving changes in the fundamental structure of the economic organization of members.

It seems also that the Soviet Union demanded a quota of more than $1 billion, as compared to the $800 million proposed in the Agreement; moreover, the Soviet Union objected to paying one-quarter of its quota in gold. The delegates were prepared to raise the Soviet quota but not to make a concession on the requirement for payment in gold. See Edward Bernstein, 'USSR took "Costly Detour" to IMF Association', 20 IMF Survey 337 (18 Nov 1991).

[33] See also the Vienna Convention on the Law of Treaties (1969), Article 46; American Law Institute, *Restatement (Third) of the Foreign Relations Law of the United States*, § 311(3) (1987).

[34] See e.g. the United States Bretton Woods Agreement Act, 59 Stat. 512, approved 31 July 1945, which required specific authorization by Congress for consent to any change in the

such as the United States, under whose law a conflict between a statute and a treaty is resolved in favour of the instrument last adopted, an inconsistent action taken pursuant to a domestic law would not relieve the state of the obligation undertaken in the Articles of Agreement.[35]

The overriding obligation undertaken by member states in the original Articles of Agreement and stated in Article IV(4)(a):

> Each member undertakes to collaborate with the fund to promote exchange stability, to maintain orderly exchange arrangements with other members, and to avoid exchange alteration.

The principal way in which this obligation was to be carried out was to be by maintenance of par values, as set out in Article IV(3), which is no longer in force.[36] The general obligation to collaborate with the Fund to promote a stable system of exchange rates remains in effect under the Amended Articles,[37] and many of the obligations under the original Articles designed to support the overall objective remain in effect as well.

18.5 The IMF and Exchange Controls

(a) Current Transactions

A principal feature of the original Articles of Agreement was Article VIII(2)(a), which provided:

> [N]o member shall, without the approval of the Fund, impose restrictions on the making of payments and transfers for current international transactions.

Further Article VIII(3) provided that:

> No member shall engage in... any discriminatory currency arrangements or multiple currency practices except as... approved by the Fund.

Despite fundamental change in the exchange rate system from the Bretton Woods era and major amendments to the Articles of Agreement, the provisions of Article VIII remain unchanged in substance. However, the disfavour of exchange controls was much weakened by Article XIV(2) of the Articles of Agreement, which provided that:

US quota in the Fund or the par value of the US dollar or any amendment to the Articles of Agreement. The United Kingdom Bretton Woods Agreement Act (9 & 10, Geo. VI, Ch. 19) did not contain a similar constraint.

[35] See *Restatement (Third) of Foreign Relations Law*, n. 33 *supra*, §115(1)(b).

[36] See Sect. 18.9 *infra*.

[37] See Amended Articles Art. IV(1), discussed in Ch. 19, Sect. 19.3.

> *In the post-war transitional period* members may, notwithstanding the provisions [of Article VIII], maintain and adapt to changing circumstances... restrictions on payments and transactions for current international transactions. (emphasis added).

'Payments for current international transactions' was defined in the Articles of Agreement;[38] 'post-war transitional period', however, was not, and the Fund never declared that period to have ended.[39] When the Articles of Agreement were amended in 1976, the reference to 'post-war' was dropped, but the (undefined) concept of transitional arrangements remained, and many member states retained their rights under Article XIV for decades.

A state's undertaking to accept the obligations of Article VIII is, in theory, equivalent to maintaining convertibility of the state's currency.[40] Thus if a Patrian importer seeks to purchase machinery from a Xandian exporter, the government of Patria (an Article VIII country), may not impose restrictions on the importer's expenditures of Patrian pesos to make the purchase, whether directly or by purchasing, say, dollars with which to make payment for the machines. Further, if the purchase is made for Patrian pesos, and the Xandian exporter brings its pesos to Xandia's central bank, the central bank is entitled under Article VIII(4) to require Patria to redeem its pesos for Xandian crowns or for usable reserve assets.[41] If the exporter in Xandia seeks to use its pesos to make a purchase from Tertia, neither Patria nor Xandia (also an Article VIII country) may restrict that transaction, and Patria is required to convert the pesos in the possession of the central bank of Tertia as well.

Once a state notifies the Fund that it is prepared to assume the obligations of Article VIII, i.e. not to impose restrictions on payments and transfers for current transactions, there is no going back. States can move from Article XIV to Article VIII, as all the members of the European Community (as well as the United Kingdom and Ireland) did on the same day in 1961 and Japan did in 1964, but they are not permitted to move the other way. As of the early 1990s, just over half the member states of the IMF remained under Article XIV—all developing or former communist bloc countries. By

[38] See text at n. 46 *infra*.

[39] The question of declaring the transitional period at an end was debated within the Fund in 1959–60, following achievement of *de facto* convertibility by 15 European states. However, the Legal Department advised the Executive Board that the Board had no authority to terminate the transitional period: 'the most it could do would be to express the opinion that conditions were favourable for the withdrawal of restrictions on the ground that, in its opinion, post-war transitional conditions had disappeared'. See Horsefield, *The International Monetary Fund, 1945–1965*, Vol. I, n.6 *supra*, 477–481.

[40] But a number of states declared that their currency was convertible into other currencies without restriction, without making the commitment under Article VIII not to reimpose exchange controls without the Fund's approval.

[41] In the original version of Article VIII(4), Xandia would have been entitled to redeem the pesos for gold. In fact reliance on Article VIII(4) is rarely necessary if an exchange market exists where pesos and crowns are traded.

mid-year 2007, 165 out of 185 member states had accepted the obligations of Article VIII, and thus had become bound to adopt only those restrictions on current transactions that are approved by the Fund.[42] Failure to abide by this prohibition carries no immediate sanction, but may be held against a member if it applies to use the Fund's resources, as discussed below.[43]

(b) Capital Transactions

It is important to note that the prohibition on exchange controls does not include controls on capital transfers, and indeed Article VI(3) of the Articles of Agreement expressly provides that 'Members may exercise such controls as are necessary to regulate international capital movements'. The reason for the distinction appears to have been British fear that without some form of capital controls at the close of World War II, excessive sums would be transferred out of the United Kingdom. In later years, as the role of capital movements became more pronounced, states have been unwilling to forego the right to impose restraints, and several of the leading states, including the United States, have from time to time done so.[44]

It was realized that at the margin capital and current transactions blend into one another, and the characterization of a given transaction as one or the other may be different for purposes of corporate accounting, taxation, or exchange controls. For instance amortization of a loan may be regarded for tax purposes as a capital transaction, if the loan had as its purpose the acquisition of a capital good. For purposes of limiting exchange controls, payments for amortization of such a loan would come within the definition of current payments, meaning that Article VIII countries could not restrict them without the Fund's approval.[45]

The Articles of Agreement do not define capital transactions, except to say that no member may exercise capital controls in a manner which will restrict payments for current transactions. Payments for current transactions are defined as:

(1) All payments due in connection with foreign trade, other current business, including services, and normal short-term banking and credit facilities;
(2) Payments due as interest on loans and as net income from other investments;

[42] India became an Article VIII member in 1994, Russia and China in 1996. Brazil became the last major country to accept the obligations of Article VIII, effective November 1999.

[43] See Sect. 18.6 *infra*.

[44] See e.g. the Foreign Direct Investment Regulations adopted by the United States in 1968 and kept in effect (with various modifications) until 1974. A brief account appears in Andreas F. Lowenfeld, *The International Monetary System*, 80–89 (2nd edn., 1984).

[45] For more complex examples, see Richard W. Edwards, Jr., *International Monetary Collaboration*, 394–396 (1985) and sources there cited.

(3) Payments of moderate amount for amortization of loans or for depreciation of direct investments;
(4) Moderate remittance for family living expenses.[46]

(c) The Question of Discrimination

As noted in Section 18.1, the drafters of the IMF Articles were very much aware of discriminatory currency arrangements such as had been perfected by Nazi Germany in the years prior to the war, and Article VIII(3) expressly prohibits such arrangements. At a minimum, this means that Patria, being an Article VIII country, may not, without permission of the Fund, apply different exchange rates for different current transactions—say one rate for tourists and another for export-import trade, or one rate for 'essential' imports, another for luxury items. Moreover, states may not discriminate against payments in a particular currency, such as the dollar. It was the reluctance to give up such discrimination in the 1950s that delayed the move to Article VIII by Great Britain and other European countries, because the staff of the Fund made clear that it preferred that states wait in assuming Article VIII status until such time as they would be in position not to immediately ask the Fund's permission to retain controls inconsistent with Article VIII.[47]

The question arose early in the history of the Fund whether the prohibition on discriminatory measures applies to capital controls. The Executive Board, after debate and advice from the Legal Department, held that 'Members are free to adopt a policy of regulating capital movements for any reason',[48] which was understood to mean even for a discriminatory purpose. Thus there appears to be no legal impediment to controls that distinguish between long-term and short-term capital, or to controls that permit investments within certain economic blocs but not elsewhere. The 1956 decision has been criticized, both on technical grounds[49] and on the basis of possible inconsistency of the position with the overall objectives of the IMF.[50] But when the Fund Articles were amended in 1976, no effort was made to change Article VI(3), and the Executive Board decision remains in effect.

[46] Article XIX(i) in the original Articles, retained without challenge as Article XXX(d) of the Amended Articles.

[47] See Horsefield, *The International Monetary Fund, 1945–1965*, Vol. I, n. 6 *supra*, 400–402, 477–482.

[48] Ex. Bd. Dec. No. 541-(56/39), 25 July 1956, *Selected Decisions of the International Monetary Fund* [hereafter *Selected Decisions*], 443 (31st issue 2006). See Horsefield, *The International Monetary Fund, 1945–1965*, Vol. I, n. 6 *supra*, 403–404.

[49] Note that while Article VIII(2) is expressly directed to current payments, Article VIII(3) on 'Avoidance of discriminatory currency practices' is not in terms limited to current payments and might thus have been construed to cover controls on capital movements as well.

[50] See Edwards, *International Monetary Collaboration*, n. 45 *supra*, 455–458; Joseph Gold, *International Capital Movements under the Law of the International Monetary Fund*, 16–17, 43–45 (IMF Pamphlet Series No. 21, 1977).

18.6 The Fund as a Pool of Resources

(a) Member States' Quotas

A major purpose of the International Monetary Fund, reflected in its title, was to create a pool of resources based on mandatory contributions from member states, which could be drawn on by member states when needed for balance of payments purposes. Member states entered the organization with a quota designed, roughly, to reflect their importance in the world economy, but subject to negotiation of both economic and political considerations.[51] The larger a state's quota, the greater its contribution of resources to the Fund would have to be; on the other hand, the larger its quota, the greater its entitlement to draw on the resources of the Fund, as well as its voting power in the Fund.[52]

From the outset, contributions to the Fund have been payable one-quarter in hard assets (gold in the original articles,[53] SDRs under the Amended Articles), and three-quarters in the member's own currency (Art. III(3)). As the overall quotas of the Fund were increased following periodic reviews under Article III(2), members were required to make additional payments following the same formula.

In concept, all of the resources contributed by way of quota subscriptions were to be available for drawing by member states. In fact, only those currencies generally accepted for settlement of international accounts, i.e. 'freely usable currencies', were useful for drawings by states. This is one—though not the only—reason that the IMF has had to call regularly for increases in the total quota.[54]

(b) Drawing on the Fund

In effect, member states drawing on the Fund's resources borrow from the Fund, subject to an obligation to pay interest while the loan is outstanding and to repay the principal within a specified period. In form, however, Article V of the original Articles provided for a purchase by a member state of dollars (or other freely usable currency) in exchange for its own currency,

[51] Both prior to and at the Bretton Woods Conference, the United States proposed several formulas based on national economic data, which served as a point of departure from the negotiations that ensued, but not for precise allocation of quotas, either at Bretton Woods or as additional member states applied for membership. See Horsefield, *The International Monetary Fund, 1945–1965*, Vol. I, n. 6 *supra*, 94–98, 149–150.

[52] The USSR urged that it be allocated a larger quota than the Quota Committee had originally assigned, but at the same time urged that it be partly exempt from the obligation to pay one-quarter of its subscription in gold. See Sect. 18.3, n. 32, *supra*.

[53] States with very small holdings of gold or monetary reserves could pay in the 10 per cent of their net official holdings of gold and US dollars. Article III(b)(ii).

[54] As at end-September 2007, total quotas in the Fund stood at SDR 217.3 billion (about US $338.3 billion), compared to the original quota of US $8.8 billion. The Thirteenth General Review of Quotas was scheduled to be completed by 30 January 2008.

subject to an obligation to repurchase its own currency within a given time, and subject to stated charges payable by the purchaser based on the amount of its own currency held at any given time by the Fund.

> Thus suppose at the outset Patria had a quota in the Fund of 200 million dollars, of which 50 million was paid in in gold, and an amount equivalent to 150 million dollars was contributed in Patrian pesos. When Patria draws 50 million dollars (the 'gold tranche'), it must pay in an equivalent amount in pesos, and the Fund's holdings of pesos will be equal to 200 million dollars, or 100 per cent of Patria's quota. If Patria draws another 50 million dollars, the Fund's holdings of pesos will stand at the equivalent of 250 million dollars, or 125 per cent of Patria's quota, and so on. The charges (comparable to interest) payable to the Fund are measured by the Fund's holdings of pesos, and the rate increases in proportion to the percentage of Patria's quota held by the Fund in Patrian pesos.
>
> If another member state, say Xandia, now draws Patrian pesos from the Fund, that reduces the amount of pesos held by the Fund, and therefore reduces the obligation on Patria to repurchase its currency, and *pro tanto* the charges payable to the Fund. This reflects the reality that Patria has a creditor position vis-à-vis Xandia (or Xandia's creditor), with the Fund acting as intermediary.

The unwritten premise is that Patria will always have sufficient amounts of its own currency with which to make purchases (drawings). By the time the 'repurchase obligation' comes due, Patria is supposed to have overcome the problems that led it to make the purchase in the first place, and to have acquired amounts of dollars (or whatever currency it drew) to effect the repurchase.

(c) Conditions for Drawing

The most critical legal question to arise under the original Articles of Agreement concerned the conditions, if any, under which a member state could draw on the resources of the Fund. In the debates preceding the Bretton Woods Conference, Lord Keynes, on behalf of the United Kingdom, which expected to be a debtor or deficit country, had urged that member states have an automatic entitlement to draw on the resources of the Fund. Harry Dexter White, the chief negotiator on behalf of the United States, which expected to be a creditor or surplus country, urged that the pool be available only upon an undertaking by the state to which resources were to be made available that it would comply with conditions to be set down by the Fund. The original Articles of agreement did not resolve the controversy. Article V(3) stated that a member '*shall be entitled* to buy the currency of another member [if]:

> (i) The member desiring to purchase the currency represents that it is presently needed for making in that currency payments which are consistent with the provisions of this Agreement.

Article V(5), however, provided that, subject to procedural safeguards:

> Whenever the Fund is of the opinion that any member is using the resources of the Fund contrary to the purposes of the Fund,[55] ... the Fund may limit the use of its resources by the member ... or may, after giving reasonable notice to the member, declare it ineligible to use the resources of the Fund.

As early as 1946, the first year of the Fund's operation, the Executive Directors, on request of the United States, issued a decision interpreting the Articles of Agreement to mean:

> that authority to use the resources of the Fund is limited to use in accordance with its purposes to give temporary assistance in financing balance of payments deficits on current account for monetary stabilization operations.[56]

In 1947 and again in 1948 Executive Directors issued a further interpretation, holding that a member state representing, in accordance with Article V(3)(a)(i), that the currency it sought to purchase 'is presently needed for making payments in that currency which are consistent with the provisions of the Agreement' had fulfilled the condition mentioned in Article V(3)(i), i.e. the requirement to so represent.

> But [the decision went on] the Fund may, for good reasons, challenge the correctness of this declaration, on the grounds that the currency is not 'presently needed' or because the currency is not needed for payment 'in that currency', or because the payments will not be 'consistent with the provisions of the Agreement'. If the Fund concludes that a particular declaration is not correct, the Fund may postpone or reject the request, or accept it subject to conditions.[57]

Thus was born the practice of *conditionality*, which has been the most important, and most controversial, aspect of the relation between the IMF and member states.

In 1952, the IMF's position on conditionality was further set out in a statement by the Managing Director, accepted by the Executive Board as a formal decision:

> I think it must be clear that access to the Fund should not be denied because a Member is in difficulty. On the contrary, the task of the Fund is to help members that need temporary help, and requests should be expected from members that are in trouble in greater or lesser degree. The Fund's attitude toward the position of each Member should turn on whether the problem to be met is of a temporary nature and whether the policies the Member will pursue will be adequate to overcome the problem within such a period. The policies, above all, should determine the Fund's attitude.

[55] See Sect. 18.2, n. 9 *supra*.
[56] Ex. Bd. Dec. No. 71–2, 26 Sep 1946, *Selected Decisions*, 248 (31st issue 2006).
[57] Ex. Bd. Dec. No. 284–4, 10 March 1948, *Selected Decisions*, 249 (31st issue 2006); *IMF History 1945–65*, Vol. III, 272.

> In addition, the Fund should pay attention to a Member's general creditworthiness, particularly its record with the Fund. In this respect, the Member's record of prudence in drawing, its willingness to offer voluntary repayment when its situation permitted, and its promptness in fulfilling the obligation to transmit monetary reserves data and in discharging repurchase obligations would be important. I would expect that in the years to come, with extended activities of the Fund, we shall be able more and more to rely on the Fund's own experience, thus providing a further link between Fund drawings and repurchases.[58]

Conditionality is explored further in the next chapter.[59] Suffice it to say here that conditionality has been the principal means by which the IMF has endeavoured to impose discipline on member states in respect to their monetary and fiscal policies. For member states in need of resources from the Fund, conditionality has meant a kind of rule of law, extending not only to the terms of a drawing from the Fund but, as the Managing Director wrote, to the economic policies of those members generally.

18.7 Drawing Rights and Stand-by Arrangements

(a) Limitations on Drawing Rights

In the same statement of 1952 quoted in the preceding section,[60] the Managing Director said:

> In view of the Executive Board's interpretation of September 26, 1946, concerning the use of the Fund's resources,[61] and considering especially the necessity for ensuring the revolving character of the Fund's resources, exchange purchased from the Fund should not remain outstanding beyond the period reasonably related to the payments problem for which it was purchased from the Fund. The period should fall within an outside range of three to five years. Members will be expected not to request the purchase of exchange from the Fund in circumstances where the reduction of the Fund's holdings of their currencies by an equivalent amount within that time cannot reasonably be envisaged.
>
> ...
>
> When unforeseen circumstances beyond the member's control would make unreasonable the application of the principles set forth in paragraph 2 above, the Fund will consider extensions of time.
>
> When requesting use of the resources of the Fund in accordance with the arrangements described above, a member will be expected to include in its authenticated request a statement, that it will comply with the above principles.

[58] Ex. Bd. Dec. No. 102-(52/11), 13 Feb 1952, *Selected Decisions*, 100 (24th issue 1999). Joseph Gold, writing in the official history, called this decision, 'the Mount Everest that towers over all other decisions on the use of the Fund's resources', in Margaret de Vries and J. Keith Horsefield, *The International Monetary Fund, 1945–1965: Twenty Years of International Monetary Cooperation*, Vol. II, 523–524.
[59] See Ch. 19, Sect. 19.5.
[60] Sect. 18.6, at n. 58 *supra*.
[61] Sect. 18.6 at n. 56 *supra*.

These principles will be an essential element in any determination by the Fund as to whether a member is using the resources of the Fund in accordance with the purposes of the Fund.

Each member can count on receiving the overwhelming benefit of any doubt respecting drawings which would raise the Fund's holdings of its currency to not more than its quota.

Thus on the one hand, the Executive Board, in ratifying the Managing Director's statement, defined the normal period of a drawing—three to five years—and on the other hand established the principle that a drawing equal to the first 25 per cent of a member state's quota—the so-called gold tranche (later renamed the reserve tranche)—would be virtually automatically available, on the ground that it was fully collateralized. The clear implication, borne out by subsequent practice, was that additional purchases—so-called credit tranches—would be subject to increasing scrutiny and perhaps more stringent conditions. The greater the (cumulative) drawing in terms of the member state's quota, the greater the demands by the Fund for commitments to measures that the Fund would regard, in the Managing Director's words as 'adequate to overcome the problem within [the period of the drawing]'.

(b) The Origins of Stand-by Arrangements

In subsequent years the policies announced in the 1952 decision were spelled out in more formal ways, and in fact both the time period and the size of the credit tranches were enlarged.[62] But the basic principle was confirmed that a drawing beyond the gold or reserve tranche depended on an undertaking by the member state satisfactory to the Fund, with the expectation that before the undertaking could be accepted the Fund itself would conduct an examination of the relevant economic data, which might take several weeks or even longer.

There was thus no assurance that if a member state ran into a balance of payments difficulty it could have speedy access to the resources of the Fund, beyond the gold tranche. Negotiations between a member state and the Fund concerning a prospective drawing might themselves undermine confidence in the ability of the state to cope with its economic difficulties; moreover, the important function of drawing rights as a confidence builder might well be undermined by the process of implementing conditionality. Put another way, drawing rights subject to conditionality did not have the quality of reserves.

[62] In part the Fund's practices with regard to drawings were set down in the First Amendment to the Articles of Agreement, effective 28 July 1969; and further developments of the practice were set down in Article V of the Amended Articles, effective 1 April 1978. See Ch. 19, Sect. 19.5.

The idea soon grew up that the examination and negotiations looking to the Fund's approval of a state's economic commitments could take place in advance of an actual need for a drawing. In June 1952, Belgium became the first state to benefit from what became known as a *stand-by arrangement*, whereby the Fund gave a formal commitment (for a small fee) that if Belgium should request a drawing from the Fund within the next six months up to a stated amount, that request would be immediately approved.[63] Later in the same year the practice of stand-by arrangements was generalized and formalized in a decision of the Executive Board.[64] Thereafter, stand-by arrangements became—and continue to be—the principal device through which the resources of the IMF are made available to member states.[65]

(c) Stand-by Arrangements and Letters of Intent

Typically when a member applies for a stand-by, negotiations are initiated between the staff of the Fund and financial officials of the member state. Usually a mission is dispatched from Fund headquarters, both to gather information and to discuss the undertakings that the Fund will require in return for, in effect, making a line of credit available to the state for six months, a year or—under so-called *Extended Arrangements*—for longer periods.[66] The end-product is a Letter of Intent to the Managing Director of the Fund signed by the Minister of Finance or Governor of the Central Bank of the applicant state (often by both), in consideration of which the Executive Board approves the stand-by. For many years the Fund did not, as a matter of policy, make the documents public, though it generally issued a press release stating that a stand-by had been concluded with the state in question, specifying the amount in question and the period of the stand-by,

[63] See Horsefield, *The International Monetary Fund, 1945–1965*, Vol. I, n. 6 *supra*, 328–330. The stand-by arrangement was regularly renewed until April 1957, when Belgium finally drew the amount specified.

[64] Ex. Bd. Dec. No. 155-(52/57), 1 Oct 1952, repr. in J. Keith Horsefield (ed.), *The International Monetary Fund, 1945–1965*, Vol. III, 230. Several subsequent decisions spelled out the practice in more detail, generally in the direction of greater flexibility and longer duration. See e.g. Joseph Gold, 'Use of the Fund's Resources', in de Vries and Horsefield, *The International Monetary Fund, 1945–1965*, Vol. II, Ch. 23. (n. 58 *supra*.)

[65] Stand-by arrangements, which were not mentioned, or apparently contemplated, in the original Articles of Agreement as drafted and adopted at Bretton Woods, were specifically authorized in Article V(3) of the Amended Articles. Article XXX(b) of the Amended Articles defines a stand-by arrangement as:

> a decision of the Fund by which a member is assured that it will be able to make purchases from the General Resources Account in accordance with the terms of the decision during a specified period and up to a specified amount.
>
> *In consideration of* the policies and intentions set forth in the annexed letter, the *International Monetary Fund agrees* to a stand-by arrangement for the support of those policies and intentions.

[66] See Ex Bd. Dec. No. 4377-(74/114) 13 Sep 1974, amended numerous times, *Selected Decisions*, 301 (31st issue 2006).

and usually supplying some information about the purpose of the stand-by.[67] It was not uncommon, however, for the text of stand-by arrangements to come out, in some instances by leaks to the press, in other instances by decision of the government itself designed to put to rest rumours of undertakings more drastic than were in fact made. More recently, stand-by arrangements as well as the Letters of Intent and accompanying memoranda have been made public and put on the Internet as soon as they are concluded and approved by the Executive Board.

(d) The Legal Status of Stand-by Arrangements

There has been a good deal of discussion in the literature about whether a Letter of Intent and an announcement by the Fund that a stand-by arrangement has been approved together constitute a legally binding agreement. The Fund, and in particular its long-time General Counsel, Sir Joseph Gold, have been at pains since the early 1960s to maintain that a stand-by is an 'arrangement', not an 'agreement', and does not create obligations at law.[68] Early versions of the standard form of stand-by, which began:

> *In consideration of* the policies and intentions set forth in the annexed letter, the *International Monetary Fund agrees* to a stand-by arrangement for the support of those policies and intentions.

have been replaced by a statement deliberately omitting the italicized words:

> Attached hereto is a letter [with annexed memorandum] dated _____ from the Minister of Finance [and/or the Governor of the Central Bank] of Patria requesting a stand-by arrangement and setting forth:
>
> (a) the objectives and policies that the authorities of Patria intend to pursue for the period of this stand-by arrangement;
>
> (b) the policies and measures that the authorities of Patria intend to pursue in the [period] [first year] of this stand-by arrangement;
>
> (c) understandings of Patria with the Fund regarding reviews that will be made of progress in realizing the objectives of the program and of the policies and measures that the authorities of Patria will pursue for the remaining period of this stand-by arrangement.

[67] For a sample of a Letter of Intent and Stand-by Arrangement, see Joseph Gold, 'The Stand-by Arrangements of the International Monetary Fund', p. 57, repr. in Andreas F. Lowenfeld, *The International Monetary System*, DS-246 (2nd edn., 1984). See also Edwards, *International Monetary Collaboration*, n. 45 *supra*, 251–262, reproducing an Extended Arrangement of 1981 for India. A standard form of stand-by arrangement was approved by the Executive Board in 1993, and is reproduced in *Selected Decisions*, 306–316 (31st issue 2006).

[68] See esp. Joseph Gold, *The Legal Character of the Fund's Stand-by Arrangements and Why It Matters* (IMF Pamphlet Services No. 35, 1980).

> To support these objectives and policies the International Monetary Fund grants this stand-by arrangement in accordance with the following provisions.[69]

The comprehensive decision on the Use of the Fund's General Resources and Stand-by Arrangements of 1979 contains an express statement that 'Standby arrangements are not international agreements and therefore language having a contractual connotation will be avoided in stand-by arrangements and letters of intent'.[70] Governments of states entering into stand-by arrangements have generally taken the position that no approval from the legislative branch was required for the commitments made, as would be required in a treaty or other formal agreement.

Nevertheless, as stand-by arrangements have grown beyond the original six- or twelve-month commitment, the Fund has provided for performance targets on such matters as budgetary deficits, tax collection, removal of subsidies, and rates of inflation, with disbursements or drawing at intervals linked to conformance with the targets. If a state is out of compliance with the performance targets, the Fund will not automatically cut off disbursement under a stand-by, but the stand-by arrangement itself usually requires immediate consultation, and if the consultation does not result in agreement to modify the performance targets, the Fund has from time to time suspended disbursement under stand-by arrangements, on the basis that failure to meet the performance criteria has created a new situation not provided for in the stand-by.[71]

More generally, an unjustified failure to live up to a stand-by arrangement may be a basis for non-renewal of a stand-by or for limitations on future drawings. Thus while failure to fulfill a commitment under a stand-by is not regarded as a breach of the Articles of Agreement carrying specified penalties,[72] it is not unfair to regard a stand-by arrangement as constituting an obligation of a state on whose behalf a Letter of Intent is signed and to which a stand-by has been granted.[73] It is not open to a government that takes office after a prior administration has signed a letter of intent to repudiate it as contrary to the programme on which the new administration was elected. A Letter of Intent signed by an authorized official on behalf of a member state commits the state.

[69] Adapted from the form cited at n. 67 *supra*.

[70] Ex. Bd. Dec. No. 6056-(79/38) 2 March 1979, para. 3, *Selected Decisions*, 149 (25th issue 2000). A substantially similar provision was contained in an earlier decision with the same title, Ex. Bd. Dec. No. 2603-(68/132), 20 Sep 1968, para. 7, *Selected Decisions*, 47 at 49 (8th issue 1976).

[71] See Edwards, *International Monetary Collaboration*, n. 45 *supra*, 268 and nn. 179–182; for one well-known instance involving Brazil in 1982–83, see Lowenfeld, *The International Monetary System*, n. 67 *supra*, 299–304. See also Ch. 20, *infra*.

[72] See e.g. Articles V(5), VI(1), and XXVI(2)(a) of the Amended Articles.

[73] Cf. *Restatement (Third) of Foreign Relations Law*, n. 33 *supra*, § 821, comment *e*.

18.8 Creation of Reserves: Special Drawing Rights in the IMF

(a) The Problem of the Supply of Reserves

The Bretton Woods regime contemplated a system in which all member states strive for equilibrium in the balance of payments, using reserves, i.e. convertible foreign currencies and gold, to redeem balances of their currencies held by other states.[74] If Patria's reserves were temporarily insufficient, the Fund was available to sell 'fully usable currencies' to Patria, subject to the conditions described in the preceding sections of this chapter, including the requirement to repurchase its own currency with reserves acquired from other sources within the period prescribed, usually three to five years. Nothing in the Articles of Agreement addressed the total supply of or demand for reserves.

During the first two decades of the IMF, member states' reserves consisted primarily of US dollars and gold (plus, to a declining degree, British pounds). In the mid-1960s, the perception grew that the supply of reserves was not—or might not be—adequate to the ever-growing level of international economic activity. The supply of gold was limited and arbitrary,[75] and increase in foreign holdings of US dollars and British pounds depended on continuing balance of payments deficits of the United States and the United Kingdom, which were neither certain to continue nor in the long run desirable. Moreover, if member states were to lose confidence in the dollar and present their holdings to the United States for conversion into gold, there could be an actual shrinkage in world reserves.[76]

(b) Creating Reserves by Conscious Decision: The First Amendment to the IMF Articles

After several years of negotiation and debate, primarily among the Group of Ten and their Deputies, the IMF in 1968 adopted an amendment to the Articles of Agreement authorizing creation by the Fund itself of a reserve asset, in the form of rights by member state holders to draw on a new Special Drawing Account of the Fund for purposes of clearing outstanding balances.[77]

[74] See original Articles of Agreement, Article VIII(4), modified in the Amended Articles for reasons explained herein, but not changed for purposes of the present discussion.

[75] And much of the world's gold did not go into official holdings.

[76] Thus suppose Germany presented $100 million to the US gold window in accordance with the US understanding to convert official holdings of dollars into gold. The total reserves of Germany would not change, only their composition; the total reserves of the United States would be reduced by the amount of gold paid out, because by definition, holdings of one's own currency do not constitute international reserves.

[77] The First Amendment to the Articles of Agreement was approved by the Board of Governors of the Fund by mail vote on 31 May 1968. The Amendment took effect on 28 July 1969, upon acceptance by three-fifths of the members of the Fund representing four-fifths of the total voting power. The Special Drawing Account was opened on 6 August 1969, with the participation of 50 members of the Fund having 75 per cent of the total quota. 21 Int'l Financial News Survey 254 (15 Aug 1969). The provisions of the First Amendment relating to SDRs appear in the current version of the Articles of Agreement (somewhat modified) in Articles XV–XXV.

Special Drawing Rights (SDRs) may be created only by deliberate decision of the Board of Governors, approved by a vote of 85 per cent of the total voting power in the Fund, on the basis of proposals of the Managing Director concurred in by the Executive Directors. In fact agreement on an allocation of SDRs has been difficult to achieve. In the first twelve years (1969–81), a total of SDR $21.4 billion was authorized, in two series of allocations (1970–72 and 1979–81); as of year-end 2006 no further allocations of SDRs had been made, and SDRs constituted no more than about one per cent of total world reserves.

When a decision to allocate SDRs is taken, the amount agreed on is to be allocated to all participating member states in proportion to their quota in the Fund, with no questions asked and without any conditionality. Member states are supposed to use SDRs only in case of need (i.e. not just to get rid of them), but their use is not subject to challenge.[78] When a participating state wishes to use its SDRs to acquire foreign currency for balance of payments purposes, it notifies the Fund, which will designate the member state that must accept the SDRs in return for other reserves.[79] The idea behind the provision for designation was to assure, as far as possible, a balanced distribution of SDRs, with no country being obliged to take an excessive share.[80] Under the Amended Articles of Agreement, countries may also engage in transactions involving SDRs by agreement,[81] and in recent years transfers by agreement have comprised the majority of transfers of SDRs with the Fund acting as an informal broker.[82]

(c) Special Drawing Rights, Reconstitution, and Links to Development

In their original version as adopted in 1969, the amendments creating the Special Drawing Account contained a requirement for partial reconstitution of SDR holdings by each participating state. A member that used its allocation to finance a balance of payments deficit was required to replenish its supply so that at the end of the first five years, and thereafter on a quarterly

[78] First Amendment, Article XXV(3), current version Article XIX(3).

[79] First Amendment, Article XXV(5), current version Article XIX (5).

[80] Also, at the time when the SDR scheme was first developed, it contained a provision for partial reconstitution of SDR holdings (see sub-section (c)); designation could be used to assist member states in meeting the requirements for reconstitution. As of mid-year 2007, no reconstitution requirements are in effect, though the Fund is authorized to reintroduce a restoration requirement by a qualified majority vote.

[81] Amended Articles of Agreement, Article XIX(2)(b).

[82] See *IMF Annual Report 2006*, 100–101 and accompanying tables.

basis, the moving average of its holdings of SDRs would be equal to 30 per cent of its net cumulative allocation over the same period.[83] Presumably a country would meet this requirement by achieving a balance of payments surplus or otherwise acquiring reserves usable to redeem SDRs from other states. The requirement for reconstitution was reduced to 15 per cent of net cumulative allocation in 1979, and eliminated entirely in 1981, apparently in the belief that elimination of the reconstitution requirement would contribute to greater use of SDRs.[84]

Developing countries and a number of academic commentators have often urged that allocation of SDRs be linked to development assistance, so that for instance eligible member states might share in an allocation of SDRs in a proportion equal to twice their quota (or some other multiple), rather than in proportion only to their actual quota. As of mid-year 2007, all suggestions along these lines had been rejected, principally on the ground that any such link would destroy or impair the character of SDRs as money, and on the related ground that if developing countries transferred extra SDRs to industrial countries to clear balance of payments deficits, the industrial countries would in effect be making foreign assistance grants without having voted for them or having established conditions for their use. The Amended Articles of Agreement do not authorize allocation of SDRs except in accordance with a recipient's quota, so that any attempt to revive the idea of linkage of SDRs to development aid would require an amendment to the Articles of Agreement.[85]

(d) Valuation of Special Drawing Rights

Initially the value of Special Drawing Rights was defined in terms of gold, with one SDR being equal precisely to the value of the US dollar at its

[83] First Amendment, Article XXV(6) and sched. G.

[84] Exec. Bd. Dec. No. 6832-(81/65)S (22 April 1981) *Selected Decisions*, 413 (17th issue 1992). Professor Edwards regards this decision as a mistake, because if some members spent all of their SDR allocations while holdings of SDRs were concentrated in a few member states, the usefulness of SDRs as a reserve asset would be impaired, if not destroyed. Edwards, *International Monetary Collaboration*, n. 45 *supra*, 211–212, 220. In fact, as of the end of FY2000, holdings of SDRs by all non-industrial countries as a group stood at 54.6 per cent of their net cumulative allocations and holdings of SDRs by industrial countries stood at 96 per cent. The volume of SDR transactions peaked in FY1999 at SDR49.1 billion, largely because many states used SDRs in connection with the increased payments required under the Eleventh General Quota Review. In FY2000 the volume of SDR transactions fell to SDR22.9 billion, and in FY2001 it fell further to SDR18.7 billion.

[85] See Amended Articles, Article XVIII(b). At the 1997 Annual Meeting of the Fund, the Board of Governors adopted a resolution proposing an amendment to the Articles of Agreement to equalize the cumulative allocation of SDRs as a percentage of the member states' quota, designed to allow the 38 member states that had never received an SDR allocation to participate in the SDR system. If ratified by three-fifths of the member states having 85 per cent of the total voting power, the amendment would authorize a one-time allocation of SDR21.4 billion, thus doubling the total amount of SDRs allocated. As of 30 August 2006, the Amendment had received assent by 131 members holding 77.33 per cent of the voting power. It would go into effect if the United States, with 17.16 per cent of the voting power, would give its approval.

official rate of $35 per ounce. As early as 1972, the Fund began to use the SDR as the unit in which it stated its own accounts, including not only allocations of SDRs, but contributions to quotas, drawings under stand-by arrangements, and all other official transactions. When the dollar was devalued in terms of gold in 1973 (Sect. 16.9 *infra*), the value of the SDR was not changed in terms of gold, so that for a time one SDR was equal to approximately US$1.20. In 1974, as most major currencies (as well as gold) were floating, the Executive Board of the Fund adopted an interim system of valuation of SDRs on the basis of a composite basket of 16 currencies, weighted roughly in accordance with the issuing countries' shares of world trade and finance.[86] The Second Amendment to the Articles of Agreement (Ch. 19, Sect. 19.2) simply contains an enabling clause authorizing the Fund to establish the method of valuation of SDRs by a 70 per cent majority of the total voting power. From 1981 to 1998, the value of the SDR was calculated on the basis of a basket of five currencies—the US dollar, the British pound, the French franc, the German mark, and the Japanese yen, weighted according to their relative share of world trade and finance; since the introduction of the euro in January 1999, the franc and the mark have been replaced by the euro, so that the basket now consists of four currencies.[87] The SDR has been used as a unit of account in some private long-term transactions, and in numerous international treaties, particularly those establishing limits of liability for accidents, including the Montreal Convention of 1999 for Unification of Certain Rules for International Carriage by Air.[88]

(e) Interest and Charges

The Fund imposes charges on net cumulative allocations of SDRs, and pays interest at the same rate on holdings of SDRs.[89] Thus if a member state neither uses its SDRs nor takes in SDRs from other states, the charges and interest cancel each other out. States holding SDRs in excess of their allocation receive interest on the excess, and states that have used their SDRs pay charges on the net amount used. The appropriate rate of interest for SDRs

[86] Exec. Bd. Dec. No. 4233-(74/675) (13 June 1974), amended by Dec. No. 4261-(74/78S) (1 July 1974). See *IMF Annual Report 1974*, 116–117.

[87] The weights in the basket have varied from time to time, but effective 1 Jan 2006 for a period of 5 years, the basket consists of 44 per cent US dollar, 34 per cent euro, 11 per cent yen, and 11 per cent pound sterling. As of 5 June 2007, SDR1 = US$1.517 and US$1 = SDR 0.659.

[88] For a list with explanation of the treaties and proposed treaties using SDRs rather than gold or particular currencies, see Joseph Gold, *Floating Currencies, Gold and SDRs. Some Recent Legal Developments* (IMF Pamphlet Series, 19 Nov 1976); *Floating Currencies, Gold and SDRs. Further Legal Developments* (IMF Pamphlet Series No. 22, 1977); and further pamphlets in the series, No. 33 (1980); No. 36 (1980); No. 40 (1983), and No. 44 (1987).

[89] Original version, Article XXVI; Amended Articles, Article XX.

has long been a subject of debate. In principle, it should be set high enough to compensate a country for holding SDRs rather than foreign currency, but not so high as to discourage member states from using their SDRs for their intended purpose. Initially the interest rate was set at 1.5 per cent, in 1974 the rate was increased to 5 per cent, and since 1981 the rate has been set at a market rate based on the short-term interest rate of the currencies used in valuation of the SDR.

(f) Special Drawing Rights in the International Monetary System

The original version of the amendments concerning SDRs stated that 'each participant undertakes to collaborate with the Fund and with other participants in order to facilitate the effective functioning of the Special Drawing Account'.[90] In the Second Amendment, this provision was augmented by the statement of 'the objective of making the special drawing right the principal reserve asset in the international monetary system'.[91] In the three decades since the creation of SDRs, that objective has not been achieved, and indeed it is no longer seriously seen as a goal of the international monetary system.

The shortage of international liquidity anticipated in the 1960s did not occur, and as noted above, the required consensus to create new SDRs was achieved only twice. The idea of creation and allocation of reserves by decision of the Fund remains on the books, however, and it might again come to be viewed as a significant policy instrument.

18.9 The Fixed Exchange Regime (1945–71)

As noted in the Introduction to this Part, one of the principal decisions taken by the architects of the Bretton Woods agreements was a commitment to fixed exchange rates. The organizing idea was that the many changes in exchange rates in the inter-war period had produced instability, introduced extra risk to international trade, encouraged manipulation, and generally contributed to the depression and war that were on the minds of all those who planned the post-war world.

(a) The Par Value System

Under Article IV of the original Articles of Agreement, each member state was required to adopt a par value for its currency, expressed in terms of gold or of the US dollar, it being understood that the value of the dollar in

[90] First Amendment, Article XXVIII.
[91] Amended Articles, Article XXII. The same statement appears also in Article VIII(7).

terms of gold had been fixed in 1934 at $35 per ounce and would not be changed, i.e. that the United States Treasury would continue to buy and sell gold in transactions with monetary authorities at that price.[92] For original parties to the IMF whose territory had not been under enemy occupation, the par value was required to be based on the rate of exchange prevailing on the sixtieth day before the Agreement entered into force, which turned out to be 27 December 1945, subject to negotiation between the Fund and the member state within 90 days.[93] Other states could set their own par values, but they were required to do so and to notify the Fund.[94]

All member states were required by Article IV(3) to maintain that value— by governmental intervention in the market if necessary—so that spot transactions within their territory did not differ from the stated par value by more than one per cent.[95] Typically member states carried out this obligation by buying their own currency with US dollars or selling their currency for dollars, but other currencies convertible into dollars, such as the British pound or the German mark, could also be used.[96] One purpose of drawings from the Fund, as described in Section 18.6, was to obtain reserves to carry out the obligation imposed by Article IV(3).

Par values were not expected to last forever, but Article IV(5) prohibited a change (whether up or down) except to correct 'fundamental disequilibrium'—a term not defined but understood, it seems, to mean a situation not correctable within the time for which resources of the Fund would be made available to members under drawings.[97] The Fund could not itself initiate a

[92] The US policy was announced in a statement of the US Secretary of the Treasury on 31 Jan 1934, 20 Federal Reserve Bulletin 69 (1934). Fifteen years later, well after entry into force of the IMF Agreement, the policy was confirmed by a letter from the Secretary of the Treasury to the Managing Director of the Fund on 20 May 1949. The letter, together with the Fund's acknowledgement that 'the policy of the United States has not changed in this respect since prior to the signing and entry into force of the Articles of Agreement', are reproduced in *The Balance of Payments Mess*, Hearings before Subcomm. on International Exchange and Payments of Joint Economic Committee at 417, 92d Cong. 1st Sess. (1971).

[93] Original Articles, Article XX(4)(a).

[94] Original Articles, Article IV(1).

[95] Original Articles, Article IV(3)(i). Article IV(3)(ii) obligated members to maintain the value of their currency in other transactions, such as forward contracts, within margins that the Fund could prescribe.

[96] The United States did not intervene in exchange markets, but complied with its obligation under Article IV by freely buying and selling gold at the stated rate, as was permitted by the second sentence of Article IV(4)(b); no other state availed itself of this option.

[97] The principal American author of the Bretton Woods system, Harry Dexter White, explained the absence of a definition of fundamental disequilibrium as follows:

> In the drafting of the Articles of Agreement no attempt was made to define fundamental disequilibrium. This, as we know, was not an oversight. It was generally agreed that a satisfactory definition would be difficult to formulate. A too rigid or narrow interpretation would be dangerous; one too loose or general would be useless in providing a criterion for changes in currency parities. It was felt too that the subject matter was so important, and the necessity for a crystallization of a harmonious view so essential that it were best left for discussion and formulation by the Fund. Because of the key position of the term and the importance attached to its precise meaning, it would be desirable, if possible, to reach

change in the par value of a member state's currency, but if a member state wanted to change the par value of its currency it was required to consult with the Fund in advance, and (except for an initial 10 per cent change from its original value) to secure approval by the Fund (Art. IV(5)). The theory was that the Fund needed to be satisfied that the proposed change (presumably a devaluation) was neither too small, so that it would not stick, nor too large, so that the state's exports would gain unfair competitive advantage. If a state violated the injunction of Article IV(5) and changed its par value despite the objection of the Fund, then according to Article IV(6) the member would (unless the Fund otherwise determined) be ineligible for drawings from the Fund, and might even be expelled from the organization.

In fact, the idea that in a currency crisis—that is at a time when more persons were seeking to sell the currency than were offering to buy it—a state could wait for the Fund to satisfy itself of the correctness of a proposed change proved unattainable for major currencies.[98]

(b) Demise of the Par Value System

In the event, the par value system as described above was only partially adhered to. France made an unauthorized change in par value in 1948, Canada permitted its dollar to float in the 1950s, i.e. it did not intervene in the market to maintain a given par value, and many of the developing countries did not establish par values for their currencies at all. No punishment was meted out by the Fund. But until the late 1960s a rough approximation of the Bretton Woods goal was maintained, dependent on the 'fixed star', i.e. the US dollar and the undertaking by the United States to convert dollars to gold and vice versa at the rate in effect incorporated into the Articles of Agreement.

Eventually, following many years of current account deficits, the pressure on the US dollar became too great to sustain. The causes were manifold and cumulative—the war in Vietnam; the massive rise in imports from Japan, which maintained its exchange rate of ¥360 = US$1 from 1949 on; continuing direct foreign investment by corporations based in the United States; and overall a very changed economic environment from the early post-war years, when only the United States had economic strength. In the spring of 1971, the Managing Director of the Fund suggested devaluation of the dollar, but the United States rejected the idea. In May 1971 the German mark and the Netherlands guilder were permitted to float, and

agreement on a tentative formulation before any definitive position be taken by any of the officials of the Fund.

Unpublished memorandum of Aug 1946, reproduced in Joseph Gold, 'The Legal Structure of the Par Value System', 5 Law & Policy in Int'l Business 155, 161 (1973).

[98] See e.g. Lowenfeld, *The International Monetary System*, n. 67 *supra*, 47–67, describing the devaluation of the British pound in November 1967.

they floated upward against the dollar. The yen was not permitted to float, but the Bank of Japan was forced to acquire several billions of US dollars in order to maintain the par value of the yen.

Finally on 15 August 1971, after the United States gold stocks were approaching the symbolic level of $10 billion, as contrasted with $13 billion in 1967 and $25 billion in 1949, and as even the Bank of England sought to convert its dollar holdings into gold, the United States acted. In a dramatic Sunday night broadcast, President Nixon announced that the United States would no longer convert foreign-held dollars into gold or other reserve assets, 'except in amounts and conditions determined to be in the interest of monetary stability and in the best interests of the United States'.[99] Moreover the United States would not intervene in exchange markets to maintain the par value of the dollar against other currencies.

There was some discussion, at the time and later, about whether the United States action was in breach of its international obligations. The maintenance by the United States of the gold window could not be said to be an absolute requirement—it was an option permitted by the second sentence of Article IV(4)(b) that had been designed for the United States and that no other country had taken up.[100] On the other hand, many countries, large and small, had held their reserves in dollars in reliance on the undertaking of the United States around which the par value system had been built. It was also true that once the United States had renounced the option of buying and selling gold at a fixed rate, it became subject to the requirement in Article IV(3) to maintaining the exchange rate for its currency within the prescribed margins, and it did not honour that requirement.[101] For the time being, however, neither did any of the other major states. The United States did formally communicate to the IMF its commitment to 'collaborate with the Fund to promote exchange stability, to maintain orderly exchange arrangements with other members, and to avoid competitive exchange alterations' (tracking Art. IV(4) of the original Articles).[102]

(c) Attempt at Repair: The Smithsonian Agreement

Throughout the fall of 1971 the United States, the major European states, and Japan engaged in negotiations about realigning exchange rates. In December 1971 in a conference at the Smithsonian Museum in Washington, they reached agreement on what were called 'central rates'—a ratio of

[99] Address of President Richard Nixon of 15 Aug 1971. *Public Papers of the Presidents: Richard Nixon* (1971), 263.

[100] See n. 96 *supra*.

[101] Further, the United States action made clear that it was not prepared, for the time being, to comply with the provision in Article VIII(4) concerning conversion of foreign acquired balances held as a result of current transactions.

[102] See Memorandum from Secretary of the Treasury Connolly to Managing Director, IMF, summarized in 23 Int'l Financial News Survey 261 (25 Aug 1971).

major currencies to each other with a wider margin within which they were permitted to fluctuate, and with several options available to member states as to how these rates would be maintained.[103] The link of the dollar to gold was maintained (or rather re-established) at a new price of $38 per ounce, representing a devaluation from pre-August 15 of 8.5 per cent; the yen was revalued to ¥308 = US$1, up 16.88 per cent against the pre-August 15 dollar, the German mark was revalued by 13.58 per cent, and the British pound and French franc remained unchanged, i.e. they appreciated against the dollar only by the amount of the dollar's devaluation. Never before had so many countries agreed on a set of exchange rates at one time. From the point of view of the IMF, while the technical rules of changes in par value had been put aside and a system of wider margins had been reintroduced, it seemed that the fixed exchange rate system overall had been preserved or restored.

In the event, the Smithsonian Agreement lasted about six months. Great Britain announced in June 1972 that it would no longer maintain the agreed rate of exchange for the pound. The remainder of the Smithsonian Agreement held for another half year, and in February 1973 the United States negotiated another realignment of currencies, in effect a further devaluation of the dollar against the yen and the major European currencies.[104] This realignment, however, lasted only a few weeks; another effort was made in March, but it too failed to achieve stability. By July 1973, all the major currencies were floating, i.e. central banks were not intervening in markets at all, or at any event were not intervening to maintain any particular exchange rate. It had become clear that it was no longer possible to design a fixed exchange system with sufficient accuracy to withstand global volatility—not only in exchange markets, but in interest rates, rates of inflation, capital movements, trade flows, and political expectations.

Even as consensus was building around this conclusion, the Arab–Israeli War of October 1973 broke out. Though the War soon ended, it provided the opportunity for fourfold increase in the price of oil, carried out by the members of the Organization of Petroleum Exporting Countries—resulting in the largest shift in real resources ever seen in peacetime.[105] Notwithstanding the shock of the OPEC coup, the world economy did

[103] See Decision of the Executive Board ratifying the agreement made by the Group of Ten Ministers, Ex. Bd. Dec. No. 3463-(71/126); 18 Dec 1971, 23 International Financial News Survey 419 (22–30 Dec 1971). The same issue also contains the G-10 Communiqué and a table of value of all the currencies. Id. at 417–418, 421–422. For a description by the present author of the negotiations and analysis of the result, see Lowenfeld, *The International Monetary System*, n. 67 *supra*, 144–160, reproducing the relevant documents. For eyewitness accounts of the negotiations see Volcker and Gyohten, *Changing Fortunes*, n. 30 *supra*, 81–90, 95–100.

[104] See Volcker and Gyohten, *Changing Fortunes*, n. 30 *supra*, 105–112, 129–131.

[105] See *IMF Annual Report 1975*, 12, reporting a collective surplus on current account for the major oil exporters for 1974 of $70 billion, compared with less than $6 billion in 1973.

not plunge into depression, as many had feared, and as might well have occurred had the member states of the IMF regarded themselves as bound to intervene to maintain fixed exchange rates. The *de facto* regime of floating exchange rates, not tied to any legal agreement, seemed to enable the major internationally traded currencies to 'roll with the punch', and as it turned out, even enabled the non-oil-producing developing countries to secure financing for their continued development.[106]

The press, as well as academic economists concluded unanimously that the Bretton Woods regime was finished. In fact, not only the IMF itself but much of the law and practice described in the preceding sections of this chapter remain in place, and remain relevant, a full generation after the collapse of the par value system. In particular, the rules and practice of resort to the resources of the Fund, through purchase of currencies with obligation to repurchase (Sect. 18.6), and the practicer of stand-by agreements, including conditionality (Sect. 18.7) were not rendered obsolete by the events of 1971–73. Only the exchange rate regime established at Bretton Woods, based on the US dollar and its fixed relationship to gold, has become obsolete. What took its place is the subject of the next chapter.

[106] See Ch. 19, Sect. 19.6(c).

PART II
The GATT/WTO System

3

The General Agreement on Tariffs and Trade: Origins and Overview

3.1 The Antecedents

The modern law of international trade may fairly be described as a product of World War II, or to be more precise, of the perceptions of the Allied planners of the post-war world. While the details do not fully conform to the general perceptions, the architects of the post-war settlement saw the nineteenth century as a time of relatively open trade, and of peace, in contrast to the first half of the twentieth century, a time of high tariffs, discriminatory economic arrangements, import quotas, unilateralism and

bilateralism—plus a global depression and barely two decades between two devastating world wars. As with other aspects of post-war planning—the creation of the United Nations, the trial of war criminals, the exaction of reparations—there was a determination not to repeat the mistakes following World War I.[1]

In the trade field, this determination called for a regime of non-discrimination—i.e. a generally applicable regime of most-favoured-nation treatment, a prohibition of quantitative restrictions, and a commitment to reduction of trade barriers and opening of markets. Moreover, there was a perception among the post-war planners, led by Churchill and Roosevelt, that the failure of the United States to join the League of Nations and the failure of the League itself had been a disaster, and that the prospects for peace and prosperity were linked to establishment of multilateral (if possible universal) organizations that could serve both as a forum for negotiations and as a guardian of the rules. Agreement on the creation of two such organizations, the International Monetary Fund and the World Bank, was reached as early as July 1944 at Bretton Woods;[2] agreement on creating an International Civil Aviation Organization was reached in Chicago in December 1944.[3] Agreement on the United Nations Charter was reached in San Francisco in April 1945. The effort to reach agreement on a trade organization only came later, as described below, but there is no doubt that the post-war planners at all times had in mind the creation of such an organization.[4]

Discussions on trade took place between officials of the United Kingdom and the United States from 1943 on. As with regard to international financial relations, it was always understood that the objectives were a set of rules applicable to all states, and an organization to develop and

[1] Perhaps the first important example of planning for the end of the war was the Atlantic Charter, signed by President Roosevelt and Prime Minister Churchill aboard an American cruiser near Newfoundland in August 1941, four months before the United States entered the war and indeed while the outcome of the war was still in doubt. The President and the Prime Minister, making known 'certain common principles... on which they base their hopes for a better future for the world', wrote:

> Fourth, they will endeavour with due respect for their existing obligations, to further the enjoyment by all states, great or small, victor or vanquished, of access on equal terms, to the trade and to the raw materials of the world which are needed for their economic prosperity.

Roosevelt sought to insert the words 'without discrimination and on equal terms' in Churchill's draft. Churchill resisted, on the basis that these words might call into question the Imperial (or Commonwealth) Preferences, and the phrase 'with due respect for their existing obligations' resolved the issue. See Winston S. Churchill, *The Second World War*, Vol. III: *The Grand Alliance*, 433–434 (1950).

[2] See Ch. 18.

[3] See e.g. Andreas F. Lowenfeld, *Aviation Law*, Ch. 2, Sect. 1.12; Ch. 6, Sect. 6.12 (2nd edn., 1981).

[4] See e.g. Clair Wilcox, *A Charter for World Trade*, 37–41 (1949, repr. 1972).

administer those rules.[5] The details remained to be filled in, and there were some real differences between the British and American priorities.[6] The basic assumptions, however, were clear. Trade across national frontiers was to be encouraged; it was to be conducted primarily by private firms, not by state enterprises; and government intervention was to be subject to a code of conduct designed to limit interference with the movement of goods. These assumptions have remained the essential premises for the law of international trade ever since.

3.2 The Birth of GATT: Almost by Accident[7]

In November 1945, the United States government issued a document entitled 'Proposals for Expansion of World Trade and Employment' for consideration by an International Conference on Trade and Employment, purporting to represent a consensus resulting from the United States–United Kingdom discussions over the preceding two years.[8] The *Proposals* called for a detailed charter or code of conduct relating to governmental restraints on international trade, and for creation of an International Trade Organization. The proposed code affirmed the principle of unconditional most-favoured-nation treatment and the prohibition of quantitative restrictions (subject to several exceptions including agriculture). It also dealt in principle with limitations on subsidies, conforming state trading to market

[5] It is striking, and to some extent puzzling, that different negotiators at different times focused on the trade issues and on the financial issues. Possibly the explanation is that both in the United Kingdom and in the United States, different officials were responsible for the Treasury from those charged with Trade and Commerce, and they answered to different constituencies, in and out of government.

[6] One major area of controversy concerned the future of the system of Imperial or Commonwealth preferences created in the early 1930s. In accordance with the Ottawa agreements of August 20, 1932 (135 British and Foreign State Papers 151 (1932)) the United Kingdom had raised its duties on some raw materials originating outside the Empire and Commonwealth, in return for preferences in the participant countries for manufactured products originating in the United Kingdom. See e.g. Howard P. Whidden, Jr., *Preferences and Discrimination in International Trade* (Commitee on Int'l Economic Policy, 1945). Eventually the preferences were preserved, but frozen, in GATT Articles I(2)(a), I(4), XIV(5)(b), and Annex A.

[7] For two contemporaneous accounts of the events here described, see Wilcox, *A Charter for World Trade*, n. 4 *supra*; William Adams Brown, *The United States and the Restoration of World Trade: An Analysis and Appraisal of the ITO Charter and the General Agreement on Tariffs and Trade* (1950). For later accounts, see Gerard Curzon, *Multilateral Commercial Diplomacy: The General Agreement on Tariffs and Trade and its Impact on National Commercial Policies and Techniques* (1965); Richard N. Gardner, *Sterling-Dollar Diplomacy: The Origins and the Prospects of Our International Economic Order* (2nd edn., 1969, rev. 1980); Robert E. Hudec, *The GATT Legal System and World Trade Diplomacy*, Pt. I (2nd edn., 1990); John H. Jackson, *World Trade and the Law of GATT: A Legal Analysis of the General Agreement on Tariffs and Trade*, Ch. 2 (1969).

[8] US Dep't of State, Press Release of 6 Dec. 1945, 13 US Dep't of State Bulletin 912–929 (1945); US Dep't of State, Publication No. 2411 (Commercial Policy Series No. 79, 1945).

conditions, prevention of cartels, limited resort to commodity agreements, and it contemplated exceptions for countries with balance of payments difficulties. There was no explicit mention of economic development. As for the proposed International Trade Organization, it was to administer the code, to provide a forum for settlement of disputes, and to perform related functions such as collection and dissemination of trade statistics and preparation of guidelines for customs valuation.

A few days after issuing the *Proposals* looking to long-term arrangements, the United States issued an invitation to fifteen countries to enter into negotiations looking to early conclusion of a multilateral trade agreement.[9] Every invited country except the Soviet Union accepted the invitation. Eventually this initiative turned out to have long-term consequences, while the long-term initiative failed to survive.

The proposal for an International Conference on Trade and Employment was taken up by the United Nations Economic and Social Council (Ecosoc) at its first meeting in Paris in February 1946;[10] in accordance with a resolution introduced by the United States, Ecosoc appointed a Preparatory Committee of nineteen countries to draft the document to be considered at such a conference. The Preparatory Committee met in London in October–November 1946, working from a Suggested Charter drafted by the United States. A first draft of a Charter for an International Trade Organization was produced at the London meeting, and a second draft was produced by a technical drafting committee that met in January–February 1947 at the temporary seat of the United Nations in Lake Success, New York. The full Preparatory Committee met again in Geneva from April to August 1947 and produced a third draft, which became the basis for a Plenary Conference on Trade and Development convened by the United Nations in Havana in November 1947.

At the same time as these negotiating and drafting sessions were in progress, representatives of the countries that had been invited by the United States to negotiate a trade agreement,[11] plus eight others that had been invited subsequently, were engaged in a tariff-cutting negotiation. Typically the negotiations were one-on-one sessions focusing on products for which one side was an important market and the other side was the principal supplier, with concessions on such products 'paid for' by concessions in which

[9] US Dep't of State, Press Release of 13 Dec. 1945, 13 US Dep't of State Bulletin 970 (1945). The countries invited were the United Kingdom, the Soviet Union, France and China; also Canada, Australia, New Zealand, South Africa and India; The Netherlands, Belgium, Luxembourg, and Czechoslovakia, and Brazil and Cuba.

[10] The Economic and Social Council is a 'principal organ' of the United Nations, consisting of 54 members of the United Nations elected by the General Assembly. See UN Charter, Articles 7(1) and 61–72. As it turned out, Ecosoc has subsequently played no significant role in international economic relations. Ecosoc has had significant roles in the 'social' aspects of its mission, particularly in the area of human rights.

[11] See n. 9 *supra*

the roles were reversed. A total of 123 sets of such negotiations took place in Geneva in the period April–October 1947 among 23 countries, including 22 involving the United States (i.e. one with each potential negotiating partner) and 101 between other pairs of countries. Altogether more than a thousand meetings were held over a period of six months, considering some 50,000 items of trade. As to some of the products, substantial reductions were negotiated; on others, low rates of duties or duty-free entry were made subject to binding obligations.[12]

Apart from the details, these negotiations had several consequences still significant more than half a century later. *First*, it seems clear that the pace and volume of the negotiations could not have been maintained had they not been held all at the same time and (figuratively speaking) all in the same room, spurred on by a United States statute that gave the executive branch negotiating authority but was due to expire in June of 1948.[13] The Geneva negotiations of 1947 set the precedent for subsequent 'Rounds'—eight in all throughout the life of the GATT as an organization—that played a major part in the development of international trade law in the second half of the twentieth century.[14] *Second*, as was understood from the initial invitation, all the 'concessions', i.e. the negotiated reductions and bindings with respect to tariffs, were generalized to all the participants, in implementation of the most-favoured-nation principle. *Third*, the concessions were recorded in a single document—the General Agreement on Tariffs and Trade, which not only comprised the schedules of tariff bindings but contained a code of conduct designed to safeguard, at least provisionally, the undertakings given and to commit the participants to a common (if incomplete) standard of behaviour with respect to international trade. Since the countries participating in the tariff negotiations were for the most part the same ones participating—in the same city—in the preparation of the proposed charter for the International Trade Organization, the code of conduct largely paralleled the commercial policy sections of the draft of the ITO Charter as it then stood. The General Agreement was opened for signature on 30 October 1947, and entered into effect—provisionally—on 1 January 1948.

Meanwhile, the Havana Conference on Trade and Employment opened on 21 November 1947, with more than twice as many participants as had negotiated at Geneva, and with an agenda that included employment, economic development, restrictive business practices, commodity agreements, as well as trade (labelled 'commercial policy') and an elaborate structure for the International Trade Organization. After much debate and acrimony, the Final Act of the Havana Conference embodying the ITO Charter, was

[12] See e.g. Wilcox, *A Charter for World Trade*, n. 4 *supra*, pp. 46–47.

[13] See US: Trade Agreements Extension Act of 1945, 59 Stat. 410, July 5, 1945.

[14] A Ninth Round, known as the Millennium or Doha Round, was begun in 2001, but remained suspended as this book went to press (mid-year 2007).

signed on 24 March 1948 on behalf of 53 states. For various reasons, however, the ITO Charter never entered into effect. Most governments waited for the United States before beginning their own ratification procedures, and the United States Congress showed little enthusiasm for the ITO. For some, the ITO charter was too favourable to state intervention in the economy, for others it was too favourable to free trade, and for still others the creation of yet another international organization clashed with the disillusion setting in about the United Nations, as well as about some of the other organizations established at the end of the war. The United States administration was itself ambivalent about the ITO, at least to the extent that support for the Havana Charter might impair support for higher-priority issues of foreign affairs such as the Marshall Plan for the reconstruction of Europe, the establishment of a programme of controls on the export of strategic materials,[15] and (from the summer of 1950 on) pursuit of the war in Korea. In December 1950, the US State Department issued a press release announcing that the proposed Charter would not be resubmitted to the new Congress.[16] The ITO was never formally rejected, but it faded away.[17] What remained was the GATT, essentially as drafted as an interim arrangement in the summer of 1947, with some rectifications agreed to at Havana or just after the close of the Havana Conference. GATT 1947, conceived as a provisional agreement not requiring parliamentary approval, remained in effect from January 1948 to January 1995. When a World Trade Organization was eventually established almost half a century later, as described in Chapter 4, GATT 1947 remained the basic text and the point of departure for the new agreements embodied in the WTO.

3.3 An Overview of the GATT

(a) The Architecture

The architecture of the General Agreement was dictated by the problem of ratification (or rather the effort to get around the need for formal ratification), particularly by the United States. The Reciprocal Trade Agreements Act of 1934,[18] as amended and extended most recently in July 1945,[19]

[15] See Andreas F. Lowenfeld, *Trade Controls for Political Ends*, Ch. I (2nd edn., 1983).
[16] US Dep't of State, Press Release of 6 Dec 1950, 23 US Dep't of State Bulletin 977 (1950).
[17] For an account of the fate of the ITO in the United States, including discussion of the reasons for lack of support by groups that might have been expected to favour it, see William Diebold, Jr., 'The End of the I.T.O.,' Princeton Essays in International Finance No. 16 (1952). See also Gardner, *Sterling-Dollar Diplomacy*, n. 7 *supra*, 348–380.
[18] 48 Stat. 943, approved 12 June 1934.
[19] An Act to Extend the Authority of the President under Section 350 of the Tariff Act of 1930 and for Other Purposes, 59 Stat. 410 (5 July 1945).

delegated to the President authority to negotiate and implement 'trade agreements', i.e. modifications in tariffs, but did not authorize changes in substantive law, which would have to be submitted to Congress. Since the object was to achieve effectiveness of the duty reductions being negotiated before expiration of the delegated authority, the General Agreement was designed so as to avoid having to submit it to the US Congress, as well as to other parliaments that might well have concerns about substantive changes in the respective national laws concerning international trade.

The solution had three aspects. *First*, in place of a Final Act that normally records the undertakings at the close of a law-making international conference, the signatory states signed a Protocol of *Provisional* Application, the idea being that definitive application, with formal ratification, would be directed to the forthcoming Charter of the ITO. This technique had been used in other contexts that called for prompt action before the full ratification process had been completed, for instance in the creation of a Provisional International Civil Aviation Organization (PICAO) by the Chicago Conference of 1944, to last until the convention creating a permanent organization—ICAO—was ratified by the requisite number of states.[20] In the case of civil aviation, the period of provisional application of the convention lasted just over two years; in the case of international trade, the period of 'provisional application' of the principal agreement lasted for 47 years.

Second, the Protocol of Provisional Application bound the signatories to apply Parts I and III of the General Agreement without reservation, but Part II only 'to the fullest extent not inconsistent with existing legislation'.[21] Part I contained the most basic provisions—most-favoured-nation treatment (Art. I), and binding of scheduled concessions (Art. II); Part III contained 'procedural provisions', though following several amendments in the early years of the GATT, some of these, notably those concerned with customs unions and free trade areas (Art. XXIV), with waivers (Art. XXV(5)), and with tariff negotiations (Art. XXVIII*bis*), became highly significant. Part II contained most of the substantive provisions of the code of conduct—about national treatment with respect to internal taxation and regulation (Art. III), about anti-dumping and countervailing duties (Art. VI), about valuation for customs purposes (Art. VII), about quantitative restrictions (Art. XI), about measures to safeguard the balance of payments (Arts. XII–XV), and about subsidies (Art. XVI)—important elements in the emerging law of international trade, but subject to a giant 'grandfather

[20] See Interim Agreement on International Civil Aviation, repr. in *Proceedings of the International Civil Aviation Conference: Chicago, Illinois, November 1–December 7, 1944*, Vol. I, 132–146 (US Dep't of State 1948).
[21] Part IV of the GATT, concerned with economic development, was not drafted until the 1960s, and was opened for signature in February 1965. It entered into force—provisionally—on 17 June 1966.

clause' which provided that national measures inconsistent with the GATT provision were not unlawful if they were required by legislation existing as of 30 October 1947 for the original members, and as of the date of accession for states that joined later.[22]

Third, the GATT was established without any text that looked as if an organization was being created. Of course if the Agreement were to last any appreciable time, there would be some need for collective action—to call meetings, to grant waivers, to hire staff, and to conduct formal or informal dispute settlement. All of these functions were assigned (explicitly or by default) to the CONTRACTING PARTIES, written in capital letters, as contrasted with 'Contracting Parties' in small letters when referring to some or all of the state parties to the General Agreement.[23]

As it turned out, the founders of the GATT proved to be sufficiently agile to keep the organization alive despite its structural shortcomings. Indeed, the early growth of the GATT to some extent took the wind out of the sails of those who were pushing for the ITO in the late 1940s. Likewise when the United Nations created the UN Conference on Trade and Development (UNCTAD) in the 1960s, that body did not succeed in replacing GATT as the principal international organization concerned with trade. Not until completion of the Uruguay Round in 1994 did the GATT officially become a permanent organization, with a new name, similar to, but not quite the same as the organization that was stillborn in the 1940s.

(b) The Major Principles[24]

The brief Preamble to the GATT looks to raising standards of living, ensuring full employment and a 'large and steadily growing volume of real income and effective demand', by expanding the production and exchange of goods. The participating states aim to accomplish these goals by entering into reciprocal and mutually advantageous arrangements directed to the substantial reduction of tariffs and other barriers to trade, and to the elimination of discriminatory treatment in international commerce. Thus:

(1) *Universal MFN. Trade should be conducted on the basis of non-discrimination*, that is, all Contracting Parties undertake in Article I

[22] See Jackson, *World Trade and the Law of GATT*, n. 7 *supra*, Sect. 4.10, for confirmation both as to the effective date and of the use in the text of the term 'required', in contrast to 'authorized'. For the origin and meaning of the term 'grandfather clause' see Sect. 3.4(b), n. 40 *infra*.

[23] The term 'member states' was also avoided, again because that term would have given the impression that an organization had been created.

[24] Though the GATT as negotiated in 1947–48 has been superseded by GATT 1994, as described in Chapter 4, the latter document is virtually the same as the original agreement, and thus it makes sense to describe the major obligations in the present tense. Of course, many of the obligations were explained and developed further in the ensuing decades, as discussed in subsequent chapters.

the obligation to apply duties and similar charges on the import of goods equally, without regard, as among Contracting Parties, to the origin of the goods.[25]

(2) *No Increased Trade Barriers. Governmental restraints on the movement of goods should be kept to a minimum, and if changed, should be reduced, not increased.* All Contracting Parties undertake in Article II to apply to all other Contracting Parties the duties set forth in the Schedules submitted at the close of the tariff negotiations, i.e. to bind the accepted offers reflected in these schedules. Bound duties may be unbound every three years, but the balance of concessions is to be maintained, either by agreement with the original beneficiary of the concession or other principal supplier, or subject to reciprocal withdrawal of concessions by the beneficiary.[26]

(3) *Tariffs Only. The accepted form of trade restraint is the customs tariff*, i.e. a tax imposed by the importing state as a condition of importation of goods into its territory. The unstated assumption has always been that though the importer pays the tariff, the foreign producer/exporter bears the burden, in reduced market for its product in competition with producers in the importing country, or in reduced profit from sales in that country. Tariffs are generally easy to understand (compared, for instance with license schemes), and are suitable for negotiation with other Contracting Parties. In principle, tariffs are to be formulated as a percentage of the value of the goods imported—the so-called *ad valorem* tariff; specific tariffs, i.e. tariffs imposed per unit or other measure—ten cents per pair of shoes, or five pesetas per metre of cloth—are not excluded;[27] other bases of setting tariffs, for instance measured by the value of competing products of domestic origin, are prohibited (Art. VII).[28] Most important—and most controversial—other forms of governmental restraints on trade, in particular quantitative restrictions (quotas) on imports and exports and licensing schemes are expressly prohibited, subject, like much of the GATT, to numerous exceptions (Art XI).[29]

[25] Note that throughout this discussion, and of the GATT through 1994, the focus is solely on *goods*. Services and intellectual property did not enter into the discussion until the Uruguay Round, 1986–94, as described in Ch. 4.

[26] See para. (5), *Regular Negotiations*, *infra*.

[27] Combinations of specific and *ad valorem* tariffs—e.g. 25 pence per pound plus 10 per cent *ad valorem*—are also not excluded.

[28] Still other forms of import duties, such as the variable levies imposed by the European Economic Community on agricultural imports, measured by the difference between the landed price and a target price set by the Community, were apparently not thought of when the GATT was drafted, and are thus neither expressly permitted nor expressly prohibited.

[29] Clair Wilcox, the principal trade negotiator for the United States in the period 1945–50, wrote in 1949:

> Quantitative restrictions present the major issue of commercial policy... If uncontrolled, they promise to become universal and permanent. Freedom to employ them is not readily to be surrendered. The proposal that this freedom be limited evoked a debate that went on

(4) *National Treatment. Internal taxes, charges, and other regulations must not be imposed so as to discriminate between domestically produced and imported products.* States are not disabled from imposing sales or consumption taxes, or regulatory and labelling requirements on imported goods; but neither in motive nor in effect may there be a distinction between the burden borne by imported goods and the burden borne by domestic goods. There are exceptions to this, as to other principles, and a good many nuances, but the objective is clear, and was insisted on by the United States at Havana over substantial objection. Together with principle (1) and (3), the national treatment principle establishes the emphasis on tariffs as the sole accepted instrument of trade protection, and the commitment against discriminatory treatment of goods based on their country of origin. It is worth pointing out that the national treatment provision applies not only to goods on which tariffs have been bound in GATT schedules, as many states advocated in Geneva and Havana,[30] but to all goods.

(5) *Regular Negotiations. Contracting Parties are to meet regularly to engage in negotiations looking to lower trade barriers on the basis of reciprocity within a multilateral framework* (Art. XXVIII*bis*). Since the GATT was originally expected to be folded into and succeeded by the Charter of the International Trade Organization, the article calling for negotiations directed to the 'Substantial reduction of the general level of tariffs... from time to time' was not introduced into the text of the General Agreement until a Review Session held in Geneva in 1954–55. In the mean time two other rounds of multilateral negotiations had been held,[31] in connection with the accession of additional Contracting Parties. The GATT text does not prescribe a specific interval between the 'rounds' of multilateral trade negotiations, nor the duration of these rounds. Moreover, there has been a substantial expansion in the subject matter considered in successive rounds from 1947 to 1994.[32] An attempt to launch a new 'Millennium Round' did not succeed in Seattle in November 1999, but a decision to launch a new round of trade negotiations was approved at a Ministerial Conference held at Doha, Qatar in November 2001.[33] There is no doubt that the periodic convening of the CONTRACTING PARTIES of GATT for detailed negotiation of the conditions of international trade has become a fundamental ingredient of the law of international trade.

for many months. The toughest problem in the trade negotiations came to be known by its initials: Q.R. It would not be inaccurate to describe the meetings at London, Geneva, and Havana as the United Nations Conferences on Q.R.

Wilcox, *A Charter for World Trade*, n. 4 *supra*, 82.

[30] See Jackson, *World Trade and the Law of GATT*, n. 7 *supra*, Sect. 12.2.

[31] Annecy, France 1949; Torquay, England 1950–51.

[32] See Ch. 4, Sect. 4.2 *infra*.

[33] See WTO Ministerial Declaration adopted at Doha, Qatar, 14 November 2001, WT/MIN(01)DEC/1 (20 Nov 2001).

3.4 A FIRST LOOK AT THE QUALIFICATIONS

If one stopped looking at GATT after surveying only the principles set out in the preceding section, the picture that emerged would not only be incomplete, but would be severely distorted. Each of the principles is subject to exceptions, some spelled out in the text of the General Agreement, others understood at the time or developed subsequently. Yet a conclusion that the exceptions have overtaken the principles would be an even greater distortion. Indeed, the fact that the principles have survived for more than sixty years and have attracted nearly all of the world's commercial states suggests that, despite the mercantilist instincts reflected in every state's trade laws, the commitment to non-discrimination and coordinated reduction of trade barriers has become the foundation of the international law of international trade.[34]

(a) Preservation of Existing Preferences

The debate between British and American negotiators, going back to the wartime discussions,[35] was resolved by qualifying Article I, the fundamental MFN article, by explicit authorization to maintain the Imperial or Commonwealth preferences[36] as well as comparable arrangements for overseas territories or affiliated states of France, Belgium, and the Netherlands.[37] It was understood that permitting continuation of these preferences was a significant inroad into the principle of most-favoured-nation treatment. In the early post-war years, however, the desire of the principal colonial powers to preserve by economic means some of the ties that were dissolving, and likely to dissolve further, at the political level, proved strong enough to persuade the drafters of the GATT to permit this substantial undercutting of the MFN principle. Article I stated, however, that the margin of preference could not be increased from the margin prevailing at the start of the Geneva conference, 10 April 1947.[38] The failure of United States

[34] As of mid-year 2007, 150 states were members of the World Trade Organization, which, as set forth in the following chapters, retains the GATT as its principal agreement and code of conduct. China and Taiwan (Chinese Taipei) were admitted at the Doha Conference in 2001; only Russia, among major countries in the international economy, was not a member state, but it continued to negotiate its admission.

[35] See Sect. 3.1 *supra*.

[36] See n. 6 *supra*.

[37] Also preferential arrangements between the United States and Cuba and the Philippines, between Chile and several South American states, and between Lebanon/Syria and Palestine and Transjordan.

[38] An explanatory note to Article I, para. 4 makes clear that margin of preference means the absolute difference between the MFN rate and the preferential rate, not the proportional rate. Thus if the MFN rate of duty on a given product is 36 per cent *ad valorem* and the preferential rate is 24 percent, the margin of preference is 12 per cent *ad valorem*; if the MFN rate is reduced to, say, 18 per cent, the preferential rate could be set at anywhere between 6 and 18 per cent, but not at zero. For various permutations of the margin of preference rules,

negotiators to secure elimination of Commonwealth and other preferences was one of grounds raised by critics of the proposed ITO Charter. In the event, the preferences permitted by Article I have played a declining role in international trade,[39] except as they might be seen as precursors of arrangements by the European Community and others, to be discussed later on.

(b) 'Existing Legislation' and the Protocol of Provisional Application

As pointed out above, the contracting states were not obligated to change existing legislation with respect to the rules contained in Part II of the General Agreement, which include provisions or subsidies, dumping, state trading, and customs valuation, as well as the provisions on national treatment and quantitative restrictions discussed in the preceding section. This 'grandfather clause'[40] made it possible for several states, notably including the United States, to join the GATT without submitting the Agreement to their respective parliaments.[41] Comparable provisions were inserted in most of the subsequent protocols of accession.

'Not inconsistent with existing legislation' was interpreted by several GATT panels or working parties to justify implementation of a measure contrary to a provision of the GATT only when such a measure was *required* under pre-existing law, as contrasted with merely being *authorized*.[42] Also, a GATT panel held that when a pre-existing law expired and was re-enacted with a brief gap, the new law could not regain the benefit of the Protocol of Provisional Application.[43]

whose importance has diminished as nearly all duties have come down, see Jackson, *World Trade and the Law of GATT*, n.7 *supra*, Sect. 11.5.

[39] See e.g. Curzon, *Multilateral Commercial Diplomacy*, n.7 *supra*, 75–76.

[40] The term 'grandfather clause', now generally used in the United States to describe any law or regulation that permits existing arrangements to remain in place notwithstanding new laws or regulations, got its name from the practice of several Southern states of the United States to condition the right to vote on proof that a prospective voter had a male ancestor entitled to vote in 1868, prior to adoption of the Fifteenth Amendment to the Constitution. The practice was declared unconstitutional by the Supreme Court in 1915, *Guinn v United States*, 238 U.S. 347 (1915); *Myers v Anderson*, 238 U.S. 368 (1915), but the expression 'grandfather clause' has remained in the language.

[41] For a detailed account, see John H. Jackson, 'The General Agreement on Tariffs and Trade in United States Domestic Law', 66 Michigan L. Rev. 249 (1967).

[42] See in particular the *Belgian Family Allowances* case (Norway and Denmark v Belgium), GATT, *Basic Instruments and Selected Documents* [hereafter BISD] 1st Supp. 59 (1953), discussed in detail in Hudec, *The GATT Legal System and World Trade Diplomacy*, n. 7 *supra*, 135–157; see also *Norway—Restrictions on Imports of Apples and Pears* (US v Norway), BISD 36th Supp. 306 (1989). (Official documents issued under the GATT are now available on the WTO website, at <http:www.wto.org>. Select 'Documents' from the main page, then 'GATT Documents' for a searchable index.)

[43] This was the well-known *United States—'Manufacturing Clause' in U.S. Copyright Legislation* (EC v US), BISD 31st Supp. 74 (1985), discussed in Robert E. Hudec, *Enforcing International Trade Law*, 171–172 (1993) and at greater length in Frieder Roessler, 'The

A significant illustration of the effect of the Protocol of Provisional Application was the anti-subsidy statute that was first adopted by the United States in 1897 and remained in effect as part of the Tariff Act of 1930 until 1979.[44] The statute provided for imposition of a countervailing duty upon dutiable imports found to have benefited from a subsidy, with no reference to any finding of injury to a competing domestic injury. But for the Protocol of Provisional Application, imposition of countervailing duties without a finding of material injury would have violated Article VI(6) of the General Agreement;[45] given the Protocol, there was no legal obligation on the United States to amend its countervailing duty statute, but failure to bring its law into conformity with the law applicable to nearly all the other parties was a principal matter held against the United States in the course of the Tokyo Round negotiations (1973–79).[46] Commitment by the United States to a change in its legislation, giving up reliance on the Protocol of Provisional Application, became a critical element in negotiation of the Subsidies Code that became a centerpiece of the Tokyo Round.

Like temporary barracks that become a permanent part of the landscape, the Protocol of Provisional Application lasted for 48 years. The effect was that the code of conduct was something less than a universally applicable set of laws. However, the Protocol was important in overcoming resistance on the part of a substantial number of countries to joining the GATT, both initially and as the membership in the GATT continued to expand. When the GATT was folded into and replaced by the World Trade Organization, as described in Chapter 4, the device of provisional application was discarded, along with the device adopted in the 1960s and expanded in the Tokyo Round whereby some codes, asserted to be in 'implementation' or 'interpretation' of the General Agreement, were permitted to go into effect only for those Contracting Parties that chose to adhere to them.

(c) Political Exclusions (Art. XXXV)

As pointed out in Section 3.3, the idea of the GATT rested, more than on any other principle, on the commitment by all parties to treat all other

Provisional Application of the GATT: Note on the Report of the GATT Panel on the Manufacturing Clause in the U.S. Copyright Legislation', 19 J. World Trade L. 289 (1985). The gap in US law came about because in 1976 Congress first adopted a sunset law that would have abolished the statute in question on 30 June 1982, shortly before the scheduled expiration date, Congress passed a bill that would postpone the sunset by four years, but on July 8, the President vetoed that bill. Thereafter, on July 13, 1982, Congress enacted the bill over the President's veto by a two-thirds majority in each House of Congress. The GATT panel held that the 1976 statute had been a move toward greater conformity with the GATT, and that the 1982 statute had constituted a reversal of this move and therefore was not protected by the grandfather clause.

[44] 19 U.S.C. § 1303 (1930–75).

[45] See Sect. 3.5(c) *infra*.

[46] See Ch. 4, Sect. 4.3.

parties on terms of entire equality. Could this commitment be squared with deeply felt animosities going well beyond considerations of trade? Could India and South Africa, for instance, be compelled to open their markets to each other, or else be excluded from the GATT? Or Israel and Egypt, Portugal (when it was a colonial power) and neighbouring African countries, the United States and Hungary and Romania at the height of the Cold War?

The solution to this problem, first proposed by India, was a practical one. Article XXXV, added to the text of the General Agreement in 1948 during the Havana Conference, provided that when a state joins the GATT, it could announce that it would not enter into tariff negotiations with another state and intended not to apply the GATT in relations with that state. Correspondingly, Contracting Parties were not entitled to veto the accession of a new contracting party, as had been the original design,[47] but any existing contracting party could announce at the time of accession of a new party that it would not apply the GATT to that party.

The decision on invocation of Article XXXV could be made only at the time of accession of a party to the GATT, but could be rescinded at any time. Article XXXV was abused when Japan acceded to the GATT in 1955, as some fifteen states that had no current political reason for not establishing commercial relations with Japan—including Australia, Belgium, France, the Netherlands, and the United Kingdom—invoked Article XXXV to avoid granting MFN status to Japanese products. Eventually all of these states rescinded their invocation of Article XXXV, but in a number of instances did so as part of a negotiation in which Japan had to agree to some import liberalization or export restraint.[48]

As of mid-year 2007, Article XXXV had not again played a major role, but the substance of the article was retained in the Agreement Establishing the World Trade Organization, and indeed made subject to an understanding that a contracting party and a new party may enter into tariff negotiations with each other without thereby waiving the right to invoke Article XXXV against the other party.[49]

(d) National Security (Art. XXI)

Another important exception to the GATT code of conduct had political as well as economic aspects. According to Article XXI, nothing in the

[47] To be precise, under the original version of Article XXXII, accession of a new contracting party required unanimous consent of the existing parties. At the same time that Article XXXV was added to the General Agreement, Article XXXII was modified to require a two-thirds majority for approval of new Contracting Parties.

[48] See e.g. Treaty of Commerce, Establishment and Navigation between Great Britain and Japan signed at London on 14 November 1962, 53 T.S. 1963, Cmnd. 2085, 478 U.N.T.S. 29, 86.

[49] See Agreement Establishing the World Trade Organization, Art. XIII and accompanying understanding on the Interpretation of Article XXXV of GATT 1947.

Agreement is to prevent a contracting party from taking any action 'which it considers necessary for the protection of its essential security interests'.[50] Since Article XXI is a self-judging measure and no procedure has ever been created to subject a contracting party's assertion of national security to international scrutiny, the provision had the potential to become a significant means for evading GATT obligations.

The Chairman of the commission that drafted Article XXI at the Geneva Conference of 1947, recognizing the danger, said that the spirit in which Members of the Organization would interpret the provisions was the only guarantee against implementations that really have a commercial purpose under the guise of security.[51] In the event, on this issue, the spirit of the parties to the GATT held up, and the abuse did not take place. All the known instances of invocation of Article XXI have grown out of genuine political confrontations—e.g. EC, Canada, Australia/Argentina during the Falklands/Malvinas war of 1982; US/Nicaragua during the Sandinista control of Nicaragua and guerrilla activity in neighbouring countries (1984–85); EC/Yugoslavia after the break-up of the former Yugoslav federation and beginning of hostilities in the former constituent territories (1991–92).[52] The maintenance by the United States for many years of import controls on oil under a national security provision of US domestic law[53] was not challenged in the GATT, but when advocates for other industries, notably the steel industry, urged resort to the national security authority for import restraints, successive American administrations resisted the effort. The question has come up from time to time whether a contracting party affected by a trade measure taken for political reasons could resort to the complaint procedure under Article XXIII. In one of the complaints arising out of the United States' imposition of an embargo against Nicaragua, a dispute panel was established, but its report stated that 'both by the terms of Article XXI and by its mandates [the Panel] was precluded from examining the validity of the United States invocation of Article XXI'.[54]

[50] GATT, Article XXI(b). The quoted phrase is followed by three conditions, relating to fissionable materials, traffic in arms or other goods used for the purpose of supplying a military establishment, or actions taken in time of war or other emergency in international relations. A separate provision, Article XXI(c), states that nothing precludes any action taken pursuant to an obligation under the United Nations Charter for the maintenance of international peace and security.

[51] Quoted in *Guide to GATT Law and Practice: Analytical Index*, 554 (6th edn., WTO 1995).

[52] For these and other cases with citations to the GATT documentation, see id. at 552–564 (Art. XXI). See also Ch. 25, Sect. 25.5.

[53] Trade Expansion Act of 1962, § 232; 19 U.S.C. § 1862. For discussion of the US Mandatory Oil Import Programme as it existed from 1959 to 1973, see Kenneth W. Dam, 'Implementation of Import Quotas: The Case of Oil', 14 J. of L. & Econ. 1 (1971).

[54] *United States—Trade Measures Affecting Nicaragua* (Nicaragua v US), Report of Panel [not adopted by GATT Council], GATT Doc. L/6053 (13 Oct 1986). For more on this and similar cases, see Ch. 25, Sect. 25.5.

(e) 'General Exceptions'

Many kinds of restrictions and prohibitions imposed by states for reasons of health, safety, and public morals may result in restraints on imports that could be regarded as inconsistent with the General Agreement, particularly Article XI, even when they were not intended as restrictions on trade. On the other hand, safety, health, and similar grounds might be asserted as justification for measures that were actually protectionist measures in disguise. To some extent the national treatment provision of the GATT, Article III, can sort out the mixture of motives in such measures, but some border measures—for instance regulations requiring inspection of meat imports—would not qualify as internal regulations.[55] Article XX is designed specifically to justify—but to limit—exceptions to the general provisions of the GATT. 'Nothing in this Agreement,' it states, 'shall be construed to prevent the adoption or enforcement of measures' listed in ten subparagraphs.

Some of the listed exceptions simply exclude subjects not addressed in the GATT—trade in gold and silver, national artistic treasures, products of prison labour—as well as intergovernmental commodity agreements.[56] The critical provisions that have gained in importance as governments have become increasingly concerned with environmental controls as well as with protection of intellectual property, refer to measures necessary to protect human, animal, or plant life or health (paragraph (b)); measures necessary to secure compliance with laws relating to...protection of patents, trademarks, and copyrights, and prevention of deceptive practices (paragraph (d)); and measures relating to the conservation of exhaustible natural resources (paragraph (g)).

All of the measures authorized (or rather exempted from prohibitions) in Article XX are subject to maintenance of the principle of non-discrimination among supplying countries, and to the requirement that the measures are not applied in a manner that would constitute a disguised restriction on international trade. Several GATT panels have taken the position that as Article XX authorizes departure from the generally applicable rules, the burden is on the importing country to show not only that a challenged measure was not imposed for protectionist motives, but that it is *necessary* to accomplish the stated purpose, i.e. that less trade restrictive measures could not accomplish the purpose.

[55] The example is given in Jackson, *World Trade and the Law of GATT*, n. 7 *supra*, 743–744.

[56] The relation of commodity agreements to the GATT is complicated. Article XX(h) and an explanatory note thereto refer to the provisions of the Havana Charter, which contained an entire chapter (Arts. 53–70) on the subject. In general, in order to satisfy the criteria of the Havana Charter, commodity agreements must be open to all producers and must reflect the interests of importers as well as exporters. Commodity agreements have not been the subject of activity under the GATT. See e.g. B. S. Chimni, *International Commodity Agreements: A Legal Study* (1987).

Article XX remains a problematic provision in the GATT, but as part of the resolution of the Uruguay Round, some of the issues raised by Article XX have been addressed in agreements relating to Technical Barriers to Trade, and to Sanitary and Phytosanitary Measures.[57]

(f) Permissible Quantitative Restrictions

Almost all states intervene to some extent in their agricultural economy. In many instances the intervention takes the form of limits on output or on land under cultivation, as part of a programme to adjust output to estimated demand and thereby to raise (or to maintain) the price of a given commodity. If the commodity in question could be imported freely, such a programme could well be seriously undermined. Accordingly, though Article XI sets out in paragraph (1) the principle that all quantitative restrictions are prohibited (see Section 3.3(b), paragraph (3) above), paragraph (2)(c) permits Contracting Parties to impose restrictions on imports on any agricultural or fishing product when 'necessary to the enforcement' of a governmental programme restricting production.

Article XI(2)(c) provides that the permitted quota 'shall not be such as will reduce the total of imports relative to the total of domestic production, as compared with the proportion which might reasonably be expected...in the absence of restrictions'. Thus increased domestic output or increased domestic market share are not acceptable motives for imposition of import restrictions. Moreover, several GATT panels have pointed out that Article XI(2)(c) authorizes import *restrictions*, not *prohibitions*. Efforts to add domestic price support programmes to output limitations as permissible justification for a quantitative restriction on imports constitute an inroad into the principle of Article XI(i), and led to the perception (and to a considerable extent the reality) that the GATT did not fully apply to trade in agricultural products.[58]

A second condition permitting import quotas, less important than it was in the early days of GATT, authorizes a contracting party to impose import restrictions 'in order to safeguard its external financial position and its balance of payments' (Art. XII). At first, critics of the GATT/ITO feared that since most countries other than the United States were in balance of payments difficulties, Article XII could significantly undercut Article XI. In fact, by the early 1960s all major currencies had become convertible, and while balance of payments difficulties did not cease, Article XII did not destroy the thrust of the basic principle of Article XI.

[57] See e.g. the *Beef Hormones* case, discussed in Ch. 13, Sect. 13.7.

[58] For the major change with respect to trade in agriculture in the Uruguay Round, see Ch. 5, Sect. 5.5, and in more detail, Ch. 11.

One reason why quotas were so vigorously opposed as a generally acceptable device for import restrictions was that it is very difficult to administer quotas without violating the principle of non-discrimination. Quotas based on historical market shares disfavour new entrants, global quotas disfavour suppliers that cannot meet a 'first come...' test, and licensing systems invite favouritism and worse. Having permitted inroads into the prohibition of quotas in Articles XI and XII, the architects of the GATT provided in Article XIII that any quantitative restrictions on imports shall be applied on a non-discriminatory basis.[59] Article XIV in turn authorizes limited exceptions to the rule of non-discrimination by developing countries or in connection with balance of payments restrictions.

3.5 Rounding Out the Overview

Considering that they expected their text to last only a short time,[60] the drafters of the General Agreement in 1947 covered a surprisingly large number of topics. On some of these topics—for instance on subsidies—the drafting, and indeed the understanding, was incomplete; on others, later events showed that the experience in 1947 and 1948 was insufficient. Many (though not all) of the specific topics that make up the public law of international trade as it has developed are addressed in separate chapters of this volume—devoted to dumping, subsidies, safeguards, and dispute settlement. Only a brief first look is presented in this chapter.

(a) The Escape Clause

The architects of the GATT understood that they would have difficulty persuading the respective states to accept permanent arrangements reducing the barriers to imports without some means to reverse a process that turned out differently from what was expected. 'Escape clauses' had been included in bilateral trade agreements made by the United States under its Reciprocal Trade Agreements program, and these served as a model for what became Article XIX of the GATT. In addition to the 'open season' in Article XXVIII which permitted Contracting Parties to withdraw any binding at three-year intervals, provided that the overall balance of concessions was

[59] Article XIII(5) states that the requirement of non-discrimination shall apply also to tariff quotas, thereby by inference permitting such measures. Under a tariff quota, imports up to a specified level per year may enter at one rate (or duty-free), and imports above that level may enter only at a higher rate.

[60] Article XXIX(2) stated that part A of the GATT 'shall be suspended on the day on which the Havana Charter enters into force', and the remaining paragraphs of Article XXIX (retained intact as part of GATT 1994 although they have no current application) make various other provisions all focused on the relation of the General Agreement to the entry into force of the Havana Charter.

maintained (Section 3.3(b)(2) *supra*), Article XIX authorizes emergency action to impose a restriction on imports of a particular product if, 'as a result of unforeseen developments and of the effect of the obligations incurred by a contracting party under this Agreement, including tariff concessions, any product is being imported into the territory of that contracting party in such increased quantities and under such conditions as to cause or threaten serious injury to domestic producers... of like or directly competitive products'.

As under the open season provision, Article XIX contemplates a rebalancing of concessions, preferably by agreement between the exporting and importing country. In fact the procedures set out in Article XIX were often not used, though import relief of various kinds through 'safeguards' was common in situations that came to be known as 'market disruption'.[61] Efforts to introduce more specific standards concerning the use of safeguards—in particular with respect to defining *serious injury*, describing the permitted measures, determining whether the measures were subject to most-favoured-nation requirements or could be applied to imports from selected countries—failed in the Tokyo Round (1973–79), but succeeded in the Uruguay Round (1986–94).[62] One issue that occupied negotiators as well as national legislatures over the years was the extent to which, if the elements of unforeseen developments and market disruption were present, the cause must be attributed to tariff concessions or other obligations of a party under the General Agreement.[63] Eventually, as injury and causation were defined and the rules on safeguards were more specifically set out, the requirement of a causal link between injury and trade agreement concession eroded, and was not restated in the 1994 Safeguards Code.[64]

[61] Article XIX contains a requirement for notification to the Contracting Parties, if practicable in advance of any import relief action taken under Article XIX. A list of 150 such notifications in the period 1950–93 appears in *GATT: Analytical Index*, n. 51 *supra*, 500–516. Many other instances, in particular 'voluntary restraint agreements' were not notified to the Contracting Parties.

[62] See Ch. 5, Sect. 5.4.

[63] In §201(b)(1) of the Trade Act of 1974, Pub. L. No. 93–618, 19 U.S.C. § 2251(b)(1), the domestic import relief provision corresponding to GATT Article XIX, the U.S. Congress omitted the phrase 'as a result in major part of concessions granted under trade agreements' contained in the predecessor legislation, § 301(b)(1) of the Trade Expansion Act of 1962, Pub. L. No. 87–794. Professor Jackson has suggested that GATT obligations in this context include not only tariff concessions but elimination or reduction of quantitative restrictions and even the obligation not to impose such restrictions. But if substantial time passed between entry into force of the GATT and the market disruption in question, it would be difficult to claim that the promise not to impose a quota was the cause that justified import relief. See Jackson, *World Trade and the Law of GATT*, n. 7 *supra*, 559–560.

[64] However, a subsequent WTO panel held that Article XIX had not been repealed, and that the requirement of a causal link between a trade concession and injury was still in force. See *Argentina—Footwear* case, discussed in Ch. 5, at nn. 67–68.

(b) Customs Unions and Free Trade Areas

The drafters of the GATT had mixed feelings about customs unions. On the one hand a customs union—that is an arrangement whereby sovereign states undertake not to impose duties or comparable charges on imports of goods from one another—is by definition inconsistent with the principle of most-favoured-nation treatment. On the other hand, a customs union (as well as a free trade area)[65] entails elimination of barriers to trade *inter se*, and is thus consistent with the objectives of the GATT. Moreover, even in 1947–48, the Netherlands, Belgium, and Luxembourg, all founding parties of the GATT, had formed a customs union, and the idea of a 'unified and democratic Greater Europe' had already been put forward and was being discussed in the context of the reconstruction of Europe. The solution, embodied in Article XXIV of the GATT, as revised at the first session of the CONTRACTING PARTIES during the Havana Conference in 1948, was to permit Contracting Parties to enter into customs unions (as well as free trade areas) provided (i) that the arrangement must cover substantially all the trade between or among the parties (to avoid the aspects of preferential or discriminatory deals of the kind seen in the inter-war years); (ii) that on the whole the tariffs and other barriers to trade be no higher or more restrictive than the average of tariffs of the constituent territories before the formation of the customs union or free trade area. Further, (iii) if the formation of the customs union leads to the unbinding of bound duties, there is an obligation to negotiate with the beneficiaries of the concession, in order to re-establish the prior balance; and (iv) if the customs union is to be phased in, there must be a plan and schedule to do so within a reasonable time period. The drafters of the Treaty of Rome Establishing the European Economic Community, the most important customs union in the Age of the GATT, clearly had Article XXIV of the GATT in mind, and on the whole the EEC complied with the requirements of that article. Six decades later much more law—and a good deal of improvisation—have gone into the interpretation of the relation between regional arrangements and the universal organization.

(c) Dumping and Subsidies

The drafters of the GATT were generally agreed that dumping, defined as sales by an exporter at prices less than the home market price,[66] was an unfair trade practice, and that a proper defence by an importing country

[65] In a customs union, the member states both eliminate trade barriers *inter se* and adopt a common set of trade barriers to products originating in non-member states. In a free trade area, only the trade barriers *inter se* are eliminated.

[66] Or, where there was no home market, at prices lower than the price at which the product in question is sold to a third country. For a detailed discussion, see Ch. 10.

was an anti-dumping duty designed to offset the unfair pricing. The drafters were not in agreement about the fairness or unfairness of government subsidies to producers or exporters of goods exported abroad, but they did agree that an importing country was entitled to impose a so-called countervailing duty to offset the effect of the subsidization. The architects of the GATT were concerned, however, that anti-dumping and countervailing duties might be abused for protectionist purposes.[67] Import quotas as a defence to dumping, as advocated by some states, were not accepted, and neither were punitive tariffs, i.e. duties greater than needed to offset the effect of the dumping or subsidy.

Accordingly, dumping was 'condemned' but not prohibited, since the assumption was that it was private firms, not states, that engaged in the practice. Subsidies were neither condemned nor prohibited in the original versions of the GATT, which contained only a notification requirement and no clear definition (Art. XVI). But both anti-dumping and countervailing (i.e. anti-subsidy) duties were permitted as an exception to the most-favoured nation and bound duty obligations, provided the duties did not exceed the amount of dumping or subsidy and provided that the authorities of the importing country had made an explicit determination that as a result of the dumping or subsidy an industry in the importing country had suffered or was threatened with material injury (Art. VI(6)). As a result of the 1954–5 review session of the GATT Contracting Parties, the subsidies article of the General Agreement was expanded to include a statement that a subsidy on the export of a product may have harmful effects for other Contracting Parties, a statement that Contracting Parties *should seek to avoid* subsidies on primary products, but that in any event such subsidies shall not be applied to bestow *more than an equitable share* of world export trade in that product, and that for other products Contracting Parties *shall cease* to grant subsidies on any product which results in an export price lower than the domestic price.

As ordinary duties were reduced over time in consequence of negotiations under GATT auspices, the subject of 'unfair trade' became increasingly important and controversial, and the law was not only clarified but in several respects was significantly altered from the original understanding. These developments are described in Chapters 9 and 10.

(d) Waivers

All of the versions of what became the General Agreement, as well as the Havana Charter, contained a provision for waiver of obligations undertaken by Contracting Parties. Under Article XXV(5), waivers could be granted

[67] See Wilcox, *A Charter for World Trade*, n. 4 *supra*, 55–56; Brown, *The United States and the Restoration of World Trade*, n. 7 *supra*, 110–111.

by the CONTRACTING PARTIES, i.e. by all the states acting together, upon approval by a two-thirds majority, 'in exceptional circumstances not elsewhere provided for in this Agreement'.[68] The waiver provision did not lead to erosion of the GATT—some 100 waivers were granted in the first forty years—but it did permit the GATT to avoid conflicts of priorities that might have threatened its existence. For example, the CONTRACTING PARTIES granted a waiver in 1952 to the European Coal and Steel Community,[69] though it was plainly a customs union limited to certain sectors, contrary to Article XXIV of the GATT. The waiver, a negotiated document, was subject both to detailed annual reporting requirements and to a commitment that the customs duties and other regulations of the Community shall be lower and less restrictive than the general incidence of duties and regulations previously applicable. When the same six states formed the European Economic Community in 1958, the criteria of Article XXIV were met, and no waiver was sought or granted.

A waiver covering restrictions on imports of virtually all agricultural products was granted to the United States in 1955,[70] and remained in effect for forty years, until phased out pursuant to the agricultural settlement reached in the Uruguay Round. Without the waiver, it was believed, the United States Congress might not have continued to support (or at least tolerate) America's participation in the GATT. The existence of the waiver, and its long duration, doubtless led other Contracting Parties, and later the European Community, to disregard the principles of the GATT in formulating their agricultural policies, with or without waivers. Although the United States exercised its rights under the waiver with moderation, continuation of the waiver inevitably led to the charge of hypocrisy on the part of the United States in its efforts to reduce export subsidies and import restraints by the European Community, Japan, and others. Whether without the waiver the GATT would have been more successful in applying its rules to the products of agriculture may be doubted. With the waiver granted to the United States and similar waivers to others, it was possible to maintain the overall integrity of the GATT code of conduct, without imposing the code on an unwilling world.[71]

[68] When waivers have been granted, no special effort has been made to define 'exceptional circumstances'. In one of the few cases in which an application for a waiver was denied, involving an application by Greece in 1970 to grant a preferential tariff quota to the Soviet Union to offset the competitive disadvantage that Soviet products faced as a result of the Association Agreement between the EEC and Greece, a GATT working party wrote that members 'were not convinced that exceptional circumstances as required under Article XXV(5) existed and were therefore opposed to granting of a waiver'. GATT Doc. L/3447, BISD 18th Supp. 129, paras. 6, 13 (2 Dec 1970).

[69] Decision of 10 Nov 1952, BISD 1st Supp. 17 (1952).

[70] Decision of 5 March 1955, BISD 3d Supp. 32 (1955), authorizing imposition of import restrictions under Section 22 of the US Agricultural Adjustment Act.

[71] Professor Hudec catalogued complaints under the GATT dispute settlement process, and demonstrated that, taking only the formal complaints, the success rate in controversies concerning agriculture is about the same as in respect to other products. However, as Hudec pointed out, most of the important restrictions on trade in agriculture were either outside the rules altogether, including US restraints under the section 22 waiver and the EEC's Common Agricultural Policy, or else were not effectively regulated by the GATT code. See Hudec, *Enforcing International Trade Law*, n. 43 *supra*, 326–337.

The waiver authority was essentially retained when GATT 1947 was folded into the World Trade Organization, but subject to approval by a three-quarters majority, and to a requirement that all waivers shall have a terminal date, and if a waiver extends beyond one year, that it will be subject to annual review.[72]

(e) Dispute Settlement in GATT

As originally conceived, the GATT (as well as the ITO) could function as a forum for resolution of disputes among the Contracting Parties, if possible through direct consultations, and if necessary with the help of the secretariat or a small group of neutral GATT experts to act as a kind of arbitration panel. Article XXII states that each contracting party 'shall accord sympathetic consideration' to representations regarding *any matter* that may be made by another contracting party. Article XXIII states that if any contracting party should consider that 'any benefit' accruing directly or indirectly under the Agreement is being 'nullified or impaired', the matter may be referred to the CONTRACTING PARTIES (i.e. the collective body) which shall make recommendations or give a ruling on the matter 'as appropriate'. Nothing was stated about how the recommendation or rulings should be arrived at, and no procedure was set out in the Agreement. Article XXIII does say, however, that if they consider that the circumstances are serious enough, the CONTRACTING PARTIES may authorize a contracting party [i.e. the successful complainant] to suspend the application to any other contracting party [i.e. the respondent found to be out of compliance] of 'such concessions or other obligations under [the] Agreement as they determine to be appropriate in the circumstances'.

Out of these rudimentary provisions there developed over time a kind of dispute settlement mechanism, similar in some ways to arbitration, in others to a club keeping members in line. The GATT as a dispute resolution forum had ebb and flow, as prevailing views moved back and forth between a desire to compose disputes and keep controversies from spreading and a desire to arrive at clear rules with law-making effect. In fact more than 200 formal complaints were filed over the first 45 years of the GATT, alleging either violation of the General Agreement or one of the codes subsequently adopted, or in some instances 'non-violation' nullification and impairment.[73] In the period 1948–89 analysed in detail by Professor Hudec, a

[72] Agreement Establishing the World Trade Organization, Article IX.

[73] See Ch. 7, Sect. 7.3.

GATT panel and/or plenary assembly ruled on the legal validity of the complaint in 88 cases; in 64 other cases, the respondent state settled or otherwise conceded the validity of the complaint (at least by implication) without a legal ruling, and in 55 cases the complaint was withdrawn or abandoned, without either a legal ruling or a settlement.[74]

A detailed discussion of the evolution of dispute settlement as a major element of the GATT/WTO system is presented in Chapters 7 and 8. In this introductory overview, only a few points need to be made. *First*, when it is determined that a challenged measure violates a provision of the GATT (or one of the later GATT codes), the preferred solution is a recommendation that the respondent state modify or withdraw the measure. Retaliation, by way of suspension by the complainant state of a corresponding concession is disfavoured, because the result would be not one but two barriers to trade.

Second, for many years disputes were presented by the contestants' delegates to GATT, typically to panels or working parties made up of other delegates from third countries. The GATT secretariat usually participated, but until 1981, the GATT did not have a legal division. More recently, the role of lawyers has grown both as representatives of parties and as panelists, reflecting a trend in the direction of rule-based decisions.

Third, until 1995 panels or working parties were authorized only to make recommendations, not decisions. Their reports were circulated to the GATT Council, where they could be approved, disapproved, or action could be postponed. Since the GATT Council operated by consensus, it happened not infrequently that a losing party succeeded in postponing consideration of a panel report, or even in blocking its approval. In some instances, the parties in question worked out a settlement in the interval; in other instances, the process was stymied. Overall, however, the process worked in over half the cases, as losing parties considered that next time around they might be complainant, and as self-judging became unattractive to the GATT community.[75]

Fourth, the object of settlement of trade disputes in the GATT, as in the various provisions authorizing withdrawal of concessions (e.g. under the escape clause[76] or the open season[77]) was a restoration of the prevailing balance of concessions. Even when retaliation was authorized—which rarely occurred, the purpose was compensation, not punishment or damages.

[74] See Hudec, *Enforcing International Trade Law*, n. 43 *supra*, 274–276.

[75] Proposals to modify the procedure to require participants in GATT panel proceedings to abstain from voting on panel reports were made from time to time, but were not accepted. See Ch. 7, Sect. 7.4.

[76] See Sect. 3.5(a).

[77] See Sect. 3.3(b), para. (2).

Summary

It is evident that no first look or overview can give a complete picture of a complex institution such as the GATT. It is remarkable, however, that the GATT, always fragile and controversial, and designed to be 'provisional' only, survived for five decades with relatively little change, compared for example with its older and originally much stronger sister, the International Monetary Fund.[78] Many of the rules of the GATT were made more explicit, some were changed by design or practice, and not all were obeyed with equal ardour. New mechanisms and indeed a new institution have grown up, and the agenda has grown wider in scope. But the principles have remained standing, despite ambivalence within almost every contracting party and continuing tensions among the various parties. The details of these tensions and ambivalences, as well as analyses and precedents that make up the public law framework of international trade, are set out in the succeeding chapters of this book.

[78] See Ch. 19.

4

Evolution of the GATT and GATT Law

4.1 Introduction

When the GATT was being drafted and negotiated in 1947–48, the Cold War between the Western democracies and the Soviet bloc was just beginning; the recovery of Western Europe from the ravages of World War II was in its early stages; Japan was essentially outside the international economy; most of Africa and major parts of Asia and Oceania were subject to colonial rule; and the European Common Market was a decade away. The United States was the unchallenged leader of the world economy—in capital, technology, and resources, and with an apparently permanent trade surplus. Indeed, the United States was a net exporter of petroleum, and the price of crude oil stood at well under $3 a barrel. The US dollar itself stood as a firm anchor of the international trading system, tied to gold, and most other currencies were linked to the dollar by the par value system, established pursuant to the Articles of Agreement of the IMF.[1]

[1] See Ch. 18.

Seven decades later, the par value system is gone; the Cold War is over, but so is the United States' unchallenged dominance of the international economy. The European Common Market has grown to twenty-seven states and has become at least equal to the United States in matters of trade. Oil-producing nations in the Middle East have become major participants in the international economy, though not in the rule-making bodies such as the WTO. Japan has become the world's second largest trading nation, and China has become a major participant in the global economy. The developing countries—at first ignored, then patronized, have turned out not all to belong to a single class, with some active participants in the global trade system, others largely outside that system.

Given all these changes, it is surprising that the GATT—rules and institution—did not change more than it did. But no Great Depression took place, as had occurred in the 1930s, and no Great War broke out, as had occurred twice in the first half of the twentieth century. Moreover, except for some portions of Africa, standards of living rose everywhere. There were of course changes in the subjects here addressed. But the changes came largely in the form of filling in the gaps—again both in the rules and in the institution. The principles, on the whole, remained intact.

4.2 MFN, Reciprocity, and the Negotiating Rounds

(a) The First Five Rounds (1947–61)

As pointed out in the preceding chapter, one of the governing themes of the GATT was that the Contracting Parties should meet regularly to negotiate about reducing tariffs and other trade barriers. The first such round, as we saw, was held in Geneva contemporaneously with the drafting of the General Agreement in April–October 1947. The two succeeding rounds (Annecy, France, 1949; Torquay, England 1950–51) combined modest tariff-cutting with negotiation of the conditions of accession of new entrants, including at Torquay the recently established Federal Republic of Germany. A fourth round of tariff-cutting was held in Geneva in 1955–56. The typical pattern in these rounds was for each pair of countries first to exchange 'request lists', and subsequently to exchange 'offer lists'. After the lists were exchanged, they were made available to all the participants, which would take them into account in their own bilateral negotiations and preparation of revised lists. If two exporting countries might benefit from a proposed concession, the importing country might make its offer subject to being 'paid' by both of the potential beneficiaries.[2]

[2] See e.g. John W. Evans, *The Kennedy Round in American Trade Policy: The Twilight of the GATT?* 10 (1971).

As it turned out, each of the rounds after the first one had small, but not very significant, results in terms of duty reductions. The Fourth Round was restrained by the fact that in the Trade Agreements Extension Act of 1955,[1] the US Congress had authorized the President to negotiate duty reductions of only 15 per cent of the duties in effect on 1 January 1955 or to 50 per cent *ad valorem*. If the United States could not offer greater reductions, the combination of the MFN principle and the reciprocity principle meant that other states could not offer more substantial reductions either.

Just after the close of the Fourth GATT Round in May 1956, the Foreign Ministers of the Benelux countries, France, Italy, and the Federal Republic of Germany, met in Venice to consider and approve the Spaak Report commissioned a year earlier, looking to establishment of the European Common Market. If the GATT could not be the vehicle for significant tariff cuts, the six European countries—without the United Kingdom and without the United States—could and would do so among themselves. Some observers thought at the time that the Western European states were turning their back on the GATT concept, and that that concept had essentially failed.[4] In the event, the creation of the European Common Market in 1958 changed, but did not weaken the international law of international trade as embodied in the GATT. On the one hand, the Treaty of Rome creating the European Economic Community on the whole conformed to the requirements for customs unions prescribed in the GATT.[5] On the other hand, the European Community came to be a principal force within the GATT, negotiating and acting as a unit and on substantially equal terms with the United States.

The Fifth Round, named after Douglas Dillon, at the time the US Under Secretary of State for Economic Affairs under President Eisenhower,[6] came to have two aspects. In one aspect it was another effort to engage in multilateral tariff-cutting along the lines of the prior rounds, but spurred on by new United States negotiating authority, permitting duty reductions of up to 20 per cent from the level of January 1958. The other aspect was a negotiation between the European Community and other GATT Contracting Parties pursuant to Article XXIV(6) about compensation for unbinding of duties of member states of the EEC bound in prior GATT rounds.

The initial position of the EEC was that a common external tariff on a given item created by arithmetic average of the previous duties of the constituent countries, as called for (with some exceptions) by the Treaty of Rome,[7] did not require any compensation to third countries.

[1] 65 Stat. 162 (1955).

[4] See Gerard Curzon, *Multilateral Commercial Diplomacy: The General Agreement on Tariffs and Trade and its Impact on National Commercial Policies and Techniques*, 94–97 (1965).

[5] See in particular Article XXIV, discussed in Ch. 3, Sect. 3.5(b).

[6] And later Secretary of the Treasury under Presidents Kennedy and Johnson.

[7] See Treaty of Rome Establishing the European Community (1957), Art. 19.

Thus, suppose on a given item the pre-existing duties, all bound in GATT schedules pursuant to Article II, were:

Benelux	12 per cent *ad valorem*
Germany	15 per cent *ad valorem*
France	20 per cent *ad valorem*
Italy	25 per cent *ad valorem*

An arithmetic average, without weighting for the amount of trade moving over the tariff, would result in a common tariff of 18 per cent *ad valorem*. The initial position of the Community was that the rise in the Benelux duty from 12 to 18 per cent was compensated to beneficiaries of the Benelux concession by the reduction in the duty on the same item on the part of France and Italy.

That position was rejected, and the principle was established that third parties were entitled to make item-by-item claims for compensation pursuant to Article XXIV(6) when a customs union was established or—as occurred frequently with respect to the EEC—enlarged by admission of new members.[8]

Putting aside agriculture (as the Contracting Parties did), the Dillon/XXIV(6) Round was regarded as successful, in that the EEC was integrated into the GATT without major friction. But the actual reduction of duties was once again modest, and the process of product-by-product negotiation was tedious. The members of the EEC had utilized across-the-board adjustment of duties in the transition to complete elimination of duties *inter se*, and had proposed a similar technique for use by GATT in the Dillon Round negotiations. For the United States, such a proposal was inconsistent with its negotiating authority, which seemed to require individual reports by the US Tariff Commission before an item of import could be placed on an offer list, and so the idea was abandoned during the Dillon Round. Both the United States and the European Community, however, were determined to find a better way to conduct multilateral trade negotiations in the next round.[9] The objective remained to preserve the twin principles of reciprocity and non-discrimination. The impetus had to come from the United States, and it did,

[8] The principle was formally stated in a Dispute Panel Report three decades later. EEC—*Payments and Subsidies Paid to Processors and Producers of Oil Seeds and Related American Feed Proteins* (United States v EEC) 'Soya Panel', paras. 144–146, GATT BISD 37th Supp. 86, 126–128 (25 Jan 1990). (Official documents issued under the GATT are now available on the WTO Website, at <http://www.wto.org>. Select 'Documents' from the main page, then 'GATT Documents' for a searchable index.)

[9] Note that Article XXVIII*bis* of the GATT states that 'Negotiations under this Article may be carried out on a selective product-by-product basis *or by application of such multilateral procedures as may be accepted by the contracting parties concerned*' (emphasis added).

in the Trade Expansion Act of 1962, which in turn stimulated what came to be known as the Kennedy Round of Trade Negotiations.[10]

(b) The Kennedy Round

The United States government was at first divided about how to respond to the creation of the European Economic Community. From a political standpoint, the United States welcomed the EEC, as a promising way to solve the problem of Germany in Europe, and as a way to strengthen the defence of the Western democracies against the threat of communism. From an economic standpoint, however, there was fear in some quarters that the EEC might become an inward-directed, high-tariff area, inimical to the trading interests of the United States.

The Trade Expansion Act of 1962,[11] in the words of President Kennedy, was to be 'a new and modern instrument of trade negotiations'.[12] The architects of the Trade Expansion Act understood that the effect of a customs union, even when it meets the requirements of Article XXIV of the GATT, may be to deprive an outsider, such as the United States (and at the time the United Kingdom) of the benefits of most-favoured-nation treatment, as well as the benefits of concessions previously negotiated and paid for.

> Suppose, for instance, that prior to creation of the customs union a machine made in the United States competed in the Italian market on equal terms with a machine originating in the Federal Republic of Germany. Once the customs union or common market is in effect, the machine originating in Germany can come into Italy free of duty, whereas the machine originating in the United States could come in only over the common external tariff, and may therefore no longer be able to compete in the Italian market.

The significance of this effect—i.e. the trade diversion effect—will depend, other things being equal, on the height of the common external tariff. The response of the United States government was to seek to negotiate a

[10] According to Theodore Sorensen, President Kennedy's counsel and later biographer, the designation 'Kennedy Round' originated in Europe, and did not altogether please the President. See Theodore C. Sorensen, *Kennedy*, 412 (1965). A brief movement to name the next round (1973–79) the 'Nixon Round' foundered as President Nixon had doubts about the future of the negotiations, and others—in the United States and elsewhere—had doubts about the future of President Nixon. Accordingly, the Seventh Round became known as the Tokyo Round after the site of the ministerial conference that launched it, though the negotiations, as always, were held primarily in Geneva. That precedent was followed for the Eighth Round (1986–94), which was launched at a ministerial meeting in Punta del Este, Uruguay, as well as for the Ninth Round, launched at Doha, Qatar in 2001 and incomplete as this volume went to press (mid-year 2007).

[11] Pub. L. No. 87–794, 76 Stat. 872, approved 11 Oct 1962.

[12] President John F. Kennedy, 'Special Message to the Congress on Foreign Trade Policy' (25 Jan 1962), in *Public Papers of the Presidents: John F. Kennedy (1962)*, 68 (1963).

reduction in that tariff. In the context of the GATT, this meant seeking to launch a new round of trade negotiations with a broad mandate to reduce duties. In the context of United States law, it meant getting away from the prior confinement to article-by-article negotiation and securing authority for across-the-board or linear negotiations.[13] Moreover, the President sought, and after some controversy, the Congress granted, the authority 'through trade agreements affording mutual trade benefits', to decrease any rate of duty by up to 50 per cent of the rate existing on 1 July 1962. The authority, which determined the duration of the subsequent negotiations, was granted for five years, that is until 30 June 1967.[14]

Shortly after passage of the Trade Expansion Act by the United States Congress, the CONTRACTING PARTIES to GATT made a tentative decision to hold a new round of trade negotiations—in principle on the basis of linear or across-the-board tariff reductions. The decision was finalized—that is recorded in a formal Ministerial Decision—in May 1963.[15] But translating the idea of linear reductions into actual negotiating procedures while retaining the principle of reciprocity proved to be a task that occupied the participants for many months, and ultimately resulted in a Kennedy Round rather different from what the planners in Europe and the United States had foreseen.

> Suppose, for instance, that Patria maintains an average level of duties of 30 per cent, and Xandia maintains an average level of duties of 20 per cent *ad valorem*. If both countries reduce all their duties by 50 per cent, the average level of Patria's duties (after phasing) will be 15 per cent and the average level of Xandia's duties will be 10 per cent *ad valorem*. Patria has reduced its duties by 15 percentage points, Xandia only by 10 percentage points. Has the principle of reciprocity been violated?[16]

The question was never answered in a definitive way during the Kennedy Round, or indeed in succeeding negotiating rounds. But the pull of the concept of reciprocity exercised a strong influence on the negotiations, and may fairly be said to have become a permanent aspect of the ground rules—not to say the law—of international trade.[17]

[13] In fact the Trade Expansion Act does not expressly authorize or direct linear negotiations, but the section containing the basic authority, § 201, unlike the predecessor statute, did not contain the words 'of any article', and the President's message, the legislative debates, and the committee reports made the intention clear.

[14] For low-rate articles, with a starting duty of 5 per cent *ad valorem* or less, there was no limit on the authority to negotiate duty reductions, so that the duty could be reduced to zero.

[15] Ministerial Meeting May 1963, GATT BISD 12th Supp. 36, 47 (21 May 1963).

[16] For variations on how to state this question, see e.g. John B. Rehm, 'The Kennedy Round of Trade Negotiations', 62 American J. Int'l L. 403, 410 (1968).

[17] Accord: Andrew T. Guzman and Alan O. Sykes (eds.), *Research Handbook in International Economic Law* (2007), 4: '[W]hile the concept of reciprocity plays a marginal

Reciprocity became a dominant issue in several other aspects of the Kennedy Round. In negotiating with the United States and the United Kingdom, the European Community pointed out that its tariffs on industrial products—as a result of averaging member countries' tariffs in the process of forming the common external tariff[18]—were nearly all in the medium range of 10–20 per cent *ad valorem*, whereas British and American tariffs were widely distributed, with some quite low but others in the 30–50 per cent range. The EEC argued in the Kennedy Round that even if the overall average of its tariffs, compared, say, with United States tariffs, was roughly equal, so that the Patria/Xandia problem illustrated above would not arise, a 50 per cent linear cut would leave most of its tariffs at relatively low levels, whereas many British and American (as well as Japanese and others) duties would continue to constitute substantial restraints on trade. The solution proposed by the EEC, which came to be known as *écrêtement*, meaning levelling of the peaks,[19] was a formula whereby Contracting Parties would agree on target rates by major categories, and then would undertake to cut their duties by an agreed percentage of the difference between the actual rate and the target rate.

Thus suppose the target rate for manufactured products was 10 per cent *ad valorem*, and the parties agreed to reduce applicable duties by 50 per cent of the difference between the actual and the target rate. Assume on the starting date four different industrial products imported by four different countries with four different rates of duty. Each importing country would be required to reduce the duty in question by half the difference between its original duty and the uniform target set for industrial products, 10 per cent *ad valorem* in the example[20] (see Table 4.1).

TABLE 4.1

	Starting rate (%)	Target rate (%)	Percentage pts above target	Required reduction in pctge pts	Reduction as pctge of starting rate
(*a*)	50	10	40	20	40
(*b*)	30	10	20	10	33.3
(*c*)	15	10	5	2.5	16.6
(*d*)	10	10	0	0	0

role in classical trade theory, it is nonetheless crucial to an understanding of the institutional arrangements that govern international trade.'

[18] See Ch. 3, Sect. 3.5(b).

[19] From the French *crête*, crest or peak.

[20] Adapted from a more detailed illustration in Evans, *The Kennedy Round*, n. 2 *supra*, 186–189.

The United States took the position that conformity of the formula with reciprocity would be defined by the last column in the Table, and the discrepancy there displayed showed that the formula was unacceptable—inconsistent with the agreed procedures for the Kennedy Round and inconsistent with the requirement in United States law of 'mutual trade benefits'. Quite apart from the legal argument, of course, the products subject to the highest rates of duty (category *a* in Table 4.1) were likely to be the most sensitive items for the importing country imposing the tariff. Without more information—much more than could ever be assembled on a range of thousands of products originating in or destined for tens of countries—it would be impossible to make a truly balanced assessment of duty reductions from application of the EEC's proposed formula or any of its variations. But though the point was made that 'linear reductions' might fall unevenly on different products, tariff structures, or countries, the *écrêtement* formula was not accepted, and the concept of reciprocity was not further refined.

A second aspect in which reciprocity became significant was attributable in the first instance to the negotiating authority granted by Congress to the United States executive branch. Though the authority was very broad—up to 50 per cent reduction for a five-year period—it excluded products on which actions had been taken under the escape clause and national security provisions of United States law, as well as on products on which escape clause action had been recommended by the US Tariff Commission but rejected by the President.[21] The United States delegation announced that this restriction would exclude some 12 per cent of United States imports from the negotiations.[22] Other participants in the negotiations, again in reliance on the reciprocity principle, thereupon reserved the right to present their own exceptions. After strenuous discussions, a compromise Ministerial Declaration was agreed to, stating that the tariff negotiations would be based

> upon a plan of substantial linear tariff reductions *with a bare minimum of exceptions* which shall be subject to confrontation and justification. The linear reductions shall be equal. In those cases where there are significant disparities in tariff levels, the tariff reductions will be based upon special rules of general and automatic application (emphasis added).[23]

The formulation concerning disparities suggested that a deviation from linear reductions might be justified for individual products or groups of

[21] US Trade Expansion Act of 1962, § 225.

[22] GATT Doc. L/1982 (14 March 1963), at 5. Among the goods reserved by reason of prior escape clause actions were lead and zinc, sheet glass, safety pins, and chemical thermometers. The national security reservation related to petroleum and its derivatives. See Rehm, 'The Kennedy Round', n. 16 *supra*, 411.

[23] GATT Ministerial Meeting 16–21 May 1963, *Resolution on Arrangements for the Reduction or Elimination of Tariffs and Other Barriers to Trade, and Related Matters*, para. A(4), GATT BISD 12th Supp. 36, 47, para. 4 (1964).

products, and in fact the EEC came up with several proposed triggers for exceptions or partial exceptions to linear reductions, focusing on differences between high and low duties on given product categories.[24] The requirement for justification of exceptions, that is reservations from a plan for across-the-board reductions, seemed to suggest that Xandia could not table an exception just because Patria had done so, but it also seemed to invite negotiations about balancing of concessions. The disparities issue and the exceptions issue led not only to an inroad in the principle of linear reductions, but also to partial return to the pattern of prior rounds of bilateral negotiations, with offers subject to reservations, including reservations based on the offers or reservations of third parties.

Thus the Kennedy Round became a hybrid of product-by-product and linear negotiations. Reciprocity remained a pervasive principle of trade negotiations. It was not defined in the Kennedy Round, or in subsequent rounds, nor has it ever been defined by a dispute settlement panel.[25] To the extent there is an agreed definition of reciprocity, or mutual exchange of benefits, it is only that there are to be no free rides, that is that each contracting party (putting aside developing countries) is to open its markets in return for gaining access for its exporters to the markets of other Contracting Parties.

Overall, negotiation in the Kennedy Round came within that definition. And while the Kennedy Round took longer than expected, and was more of an economic tug of war as contrasted with a political statement than had been hoped,[26] it did result in duty reductions on 20 per cent of the dutiable products of the industrial countries, about two-thirds by 50 per cent or

[24] See Evans, *The Kennedy Round*, n. 2 *supra*, 191–200.

[25] A GATT Working Party Report on Schedules and Customs Administration submitted to the 1955 Review Session stated:

> The representative of Brazil invited the Working Party to discuss...the proposals which had been put forward by his delegation. His delegation wished to establish certain rules for the conduct of tariff negotiations and, in particular, for the measurement of concessions. The Working Party considered that governments participating in negotiations should retain complete freedom to adopt any method they might feel most appropriate for estimating the value of duty reductions and bindings....The Working Party noted that there was nothing in the Agreement, or in the rules for tariff negotiations which had been used in the past, to prevent governments from adopting any formula they might choose, and therefore considered that there was no need for the CONTRACTING PARTIES to make any recommendation in this matter.

GATT Doc L/329, 26 Feb 1955, GATT BISD 3rd Supp. 205, 219–220, para. 38.

A later report, prepared in connection with the Dillon Round, cited this report as 'the traditional attitude of the CONTRACTING PARTIES...that governments participating in negotiations should retain complete freedom to adopt any method they might feel most appropriate for estimating the value of duty reductions and bindings'. GATT Doc. COM. I/3, 19 Nov 1959, GATT BISD 8th Supp. 103, 110, para. 10.

[26] It may be noted that shortly before the opening of the Kennedy Round, Britain's application for membership in the European Economic Community was vetoed by President de Gaulle, thus not only undermining President Kennedy's vision of the Grand Alliance, but also causing a major rift within the EEC that was not healed until de Gaulle's resignation in 1969.

more.[27] But the shortcomings of the Kennedy Round compared with the initial expectations demonstrated how difficult it is to move away from equating reciprocity with symmetry, and how ingrained is the concern of contracting states and their representatives that they may be 'giving away' more than they are 'receiving'.

When Patria and Xandia agree to exchange ambassadors or consuls on the basis of reciprocity, they do not attempt to measure how large the respective embassies will be or how many visas each consulate will issue. When they agree to recognize each others' civil judgments or arbitral awards or extradition requests, they do not seek to establish in advance which country will 'come out ahead'. In the trade context, however, the participants start out with some numbers, and the temptation is to construct others. Thus figures are usually available on (a) the amount or value of Patria's imports of a given product; (b) the duty that Patria imposes on that product; and (c) the amount or value of the product imported by Patria from Xandia. The tendency is to attach a specific value to an offer to reduce (b) as predictive of an increase in (a) and (c), and to compare this calculation with an offer from Xandia on another product in the light of (d) the value of the imports by Xandia of that other product; (e) Xandia's duty on that product; (f) the amount or value of Xandia's imports of that product originating in Patria.

Multilateral trade negotiations from the time of the Kennedy Round, and in particular linear or across-the-board duty reductions subject to various formulas, have taken as their point of departure that the attempt to make predictions on a product-by-product basis is not only massively burdensome but is inevitably illusory. Further, to the extent that Patria is restrained or dissuaded from offering to reduce a trade barrier until it is satisfied that Xandia, as well as other potential suppliers, have made reciprocal offers, the effort to aim for reciprocity in arithmetic estimates of increased exports is inconsistent with a regime based on access, not outcomes. The experience of the Kennedy Round and of the succeeding rounds suggests, however, that reciprocity remains a deeply felt element in the economic relations of states, and that a perception of that term without reference to trade statistics—past and projected—is difficult to escape.

4.3 The Tokyo Round and the Separate Codes

(a) An Expanded Agenda

Though Article XVIII*bis* of GATT refers explicitly only to negotiations directed to reduction of tariffs and similar changes, the Kennedy Round

[27] For a detailed summary of the results of the Kennedy Round including the text of the Director General's closing statement see Ernest H. Preeg, *Traders and Diplomats: An Analysis of the Kennedy Round of Negotiations Under the General Agreement on Tariffs and Trade* (1970).

was the last round of GATT negotiations in which tariff reduction was the major focus. By the time that the results of the Kennedy Round had became fully effective in the early 1970s, tariffs on industrial products had been reduced substantially and no longer appeared to be the major impediment to trade that they had once been. Other restraints and distortions on trade—known collectively as non-tariff barriers or NTBs—had taken on increasing importance. Accordingly, the focus of the GATT, and of the negotiating rounds, shifted to the substantive rules of international trade, many of which had been only sketchily addressed in the General Agreement drafted a generation earlier.

Some of the NTBs were based on formal statutory constraints, such as 'buy national' laws and regulations for government procurement; others were less visible governmental practices such as subsidies of various kinds, including export credits and tax rebates; still others had begun as health or safety standards, but with no international scrutiny or attempt at harmonization. Perhaps most ominous was the rise of so-called 'voluntary export restraints' which seemed to be spreading without reference to the GATT, though they affected major industrial sectors such as steel and automobiles.[28]

By the early 1970s, the major trading countries, particularly the United States and the European Community had reached the conclusion that if the gains of the Kennedy Round were not to be dissipated and the momentum for liberalization of international trade was not to be reversed,[29] a new round of trade negotiations should be undertaken, with a broader and more creative agenda. A Joint Declaration by the United States and the European Community to the Director-General of GATT urging a new round of negotiations was issued in February 1972,[30] and a formal Ministerial Meeting in Tokyo in September 1973 declared the 'comprehensive multilateral trade negotiations' officially open.[31] The declaration stated that as before,

> The negotiations shall be conducted on the basis of the principles of mutual advantage, mutual commitment and overall reciprocity, while observing the most-favoured-nation clause... [looking to achievement of] an overall balance of advantage at the highest possible level.[32]

[28] Textiles and apparel were also subject to restraint, going back to the early 1960s, but these were, at least nominally, subject to rules approved by the GATT. See e.g. Gary H. Perlow, 'The Multilateral Supervision of International Trade: Has the Textiles Experiment Worked?', 75 American J. Int'l L. 93 (1981).

[29] Recall that this was the period of the collapse of the Bretton Woods monetary regime (Ch. 18, Sect. 18.9(b)) as well as of the rise of the Middle East oil-producing states to economic power.

[30] See 66 US Dep't of State Bulletin 515 (1972).

[31] GATT BISD 20th Supp. 19 (1974).

[32] Id. at para. 5.

The Ministers' expressed aim that the negotiations be concluded in 1975[33] proved unattainable by more than three years.[34] Among their other aims, reduction or elimination of non-tariff measures, or 'where this is not appropriate,... to bring such measures under more effective international discipline' proved possible, in part, but by means of a significant departure from the initial model.

(b) Separate Codes and the Question of MFN

Overall reciprocity and a well-balanced package suggested that not every agreement must favour the interest of all the negotiating parties equally, as long as the overall settlement is satisfactory to all the participants. Thus, for instance, one party might agree to open up opportunities for non-nationals to bid for its government procurement projects to a greater extent than it expected its nationals to benefit from government procurement abroad if it considered that this 'concession' would enable it to prevail on a contentious issue in regard to, say, dumping. On the other hand, it soon became clear that while the principal participants from the industrial countries—the United States, the European Community (since 1973 including the United Kingdom), Canada, and Japan—were interested in all the subjects proposed for negotiation and legislation, many other states had no interest in NTBs or had interests opposed to those of the major industrial countries. But the GATT had actively sought out new Contracting Parties, and close to a hundred states participated in the Tokyo Round, twice as many as had taken part in the Kennedy Round. The prospect of securing a series of amendments to the GATT within a reasonable time period seemed dim and might well have given influence to some states out of proportion to their participation in the international economy.[35] The idea grew up, accordingly, to develop a number of 'codes', nominally in implementation or interpretation of provisions of the General Agreement, that would create more specific understanding and more precise undertakings with respect to particular topics. The codes would be open to all Contracting Parties, but no particular number of signatories would be required to bring them into effect. The codes would be binding only on the signatories, and contracting parties could pick and choose among the codes. One such code—on Anti-Dumping—had been signed by 18 states at the close of the Kennedy

[33] Id. at para. 11.

[34] In fact the negotiations did not start in earnest until 1977, by which time the European Community had more or less integrated the United Kingdom into its decision-making process, and the United States had recovered from the Watergate crisis and the deposition of President Nixon.

[35] Article XXX of the General Agreement requires unanimous consent to amend Articles I and II (the MFN and Tariff-binding articles), and approval of two-thirds of the Contracting Parties for all other amendments. Weighted voting, such as prevails in the Bretton Woods organizations and some commodity agreements, was never introduced into the GATT.

Round, though as precedent for the programme contemplated in the Tokyo Round the legal status of the code was ambiguous.[36]

The contracting parties and particularly the industrial states that sponsored and negotiated the codes—as usual predominantly the European Community and the United States—understood that a regime of non-compulsory codes to some extent undermined the claim of the GATT as a universal organization. Moreover, at least for those codes that conferred benefits on the signatories, notably the Government Procurement Code and the Subsidies Code, the principle of unconditional most-favoured-nation treatment was to some extent replaced by a form of conditional MFN, whereby in order to gain the benefits, a state had to sign on to the code in question and to undertake to abide by the commitments set out in that code.[37]

The advantage of the emphasis on the separate codes was that international legislation could be completed within a given time frame, and as suggested earlier, that a package deal could be put together in which advantages for one state on one subject could be used to offset a perceived unsatisfactory result for that state in another, since the understanding was that 'nothing is agreed until everything is agreed'.

In addition, the strategy of conditional MFN—no 'free rides'—was designed to offer incentives to sign on to contracting states that might be wavering. To cite the clearest example, in return for stricter definitions of subsidy and a prohibition on export subsidies on non-primary products in the Subsidies Code, the United States agreed to amend its law to require an independent finding of material injury to a domestic injury before imposing a countervailing duty.[38] The amendment applied, however, only to signatories to the Agreement. Brazil, which had the ability to compete in the

[36] In November 1968, at the 25th Session of the Contracting Parties, the Director-General was asked for a ruling on whether parties to the Anti-Dumping Code had a legal obligation under Article I of the General Agreement to apply the provisions of the code in their trade with all GATT Contracting Parties. The Director General replied in the affirmative. The European Community representative, however, took the position that the parties were under no obligation to apply the provisions of the code to non-signatories. See *Guide to GATT Law and Practice: Analytical Index*, 46, 30 (1993).

[37] For government procurement, a signatory had the right to have its firms bid for contracts of state agency set out in a schedule; for subsidies, a signatory faced with a countervailing duty had the right, important in view of the prior United States practice, to have an independent determination of injury to an industry before the countervailing duty could be imposed. For all the codes there were consultative committees that would give interpretations and shape consultations, oversee dispute settlement, and recommend other measures; non-signatories were unable to participate in these activities, but a decision adopted by the Contracting Parties before the codes entered into effect gave assurance that non-signatory contracting parties could receive regular reports and could follow the proceedings of the relevant Committees or Councils in an observer capacity.

Action by the Contracting Parties on the Multilateral Trade Negotiations 28 Nov. 1979, GATT BISD 26th Supp. 201 (1980).

[38] The details of the 1979 Subsidies Code, and its substantial revision in the Uruguay Round are addressed in Ch. 9.

American market but maintained a vast programme of subsidies, signed on, in order to make it more difficult for the United States to impose countervailing duties against its exports.[39] So, eventually, did most of the developing countries whose exports had realistic chances in the United States. But at least for a time, the resort to separate codes left a bad taste in the GATT community, as it seemed to depart—probably more in theory than in fact—from the most-favoured-nation principle.[40] Moreover, creation of the separate codes demonstrated in a readily visible way the disparity in influence and importance between the developed and the developing countries.

When the issue came up again in the Uruguay Round in the early 1990s, as discussed hereafter, the opposite decision was taken, and all states that wished to be part of the GATT/WTO system were required to sign all the agreements, except those that clearly could have no relevance for them.[41] But from the point of view of legislation to fill in the gaps in the law of international trade left in 1947, the Tokyo Round codes were the point of departure. The Tokyo Round codes were revised—in some instances significantly—in the Uruguay Round, but they served as the bridge between GATT 1947 and GATT 1994.

(c) Achievements and Failures of the Tokyo Round

After a slow start and various ups and downs,[42] the Final Act of the Tokyo Round was submitted for signature on 12 April 1979. All the industrial countries signed, but at first only Argentina among developing countries did so, apparently in a silent boycott designed to show disappointment that despite their numerical majority, they had played a relatively minor role, particularly in the law-making aspects of the Tokyo Round. Later in the year, however, a number of developing countries signed one or more of the codes, after a resolution by the Contracting Parties had been adopted 'reaffirm[ing] their intention to ensure the unity and consistency of the GATT system', and 'not[ing] that existing rights and benefits under the GATT of contracting parties not being parties to the

[39] For a long and complicated controversy covering imports of shoes from Brazil into the United States, involving two GATT panel decisions and more than a decade of litigation in the United States, see *Footwear Distributors and Retailers of America v United States*, 852 F. Supp. 1078 (Ct. Int'l Trade 1994).

[40] For an interesting, though not wholly convincing, attempt to demonstrate that the United States could comply with its MFN obligations while changing its laws only for benefit of signatories to the codes, see G. C. Hufbauer, J. Shelton Erb, H. P. Starr, 'The GATT Codes and the Unconditional Most-Favored-Nation Principle', 12 L. & Policy in Int'l Business 59 (1980).

[41] Ch. 5, Sect. 5.2.

[42] See Gilbert R. Winham, *International Trade and the Tokyo Round Negotiation* (1986), an account focusing on the process of negotiations by a Canadian political scientist.

[specialized] Agreements, including those derived from Article I [i.e. MFN], are not affected by these Agreements'.[43]

Seen a generation later, the greatest achievement of the Tokyo Round was maintenance of the 'unity and consistency' of the GATT system in the face of the strenuous differences expressed during the six-year negotiations, as well as the outside pressures—involving collapse of the international monetary system and recessions and energy crises throughout both the developed and less developed world. Maintenance of unity and consistency, it was understood, meant bringing the Tokyo Round to a successful conclusion, however success was defined, for failure—the break-up of the conference without agreement on at least a major portion of the items on the agenda—could well have led to the disintegration of the still-fragile GATT. It appears that the GATT, and with it the public law of international trade, had a need to be renewed every few years, like a slow-burning fire, lest the flames go out. Whether the same can be said about the World Trade Organization created in the last round held under the GATT, as set forth in the next section is not clear.[44] The need to keep the momentum going was certainly present during the Tokyo Round in the 1970s, as well as during the Uruguay Round in the 1980s and 1990s. Still, the Director General of the GATT, Olivier Long, could fairly state, at the signing ceremony for the Tokyo Round:

> Never before have there been trade negotiations so ambitious in aim, so complex in structure and subject matter, or, perhaps so long-drawn-out over time. But the enormous effort in them has paid off.[45]

If the Director-General was understandably anxious to stress the positive achievements of the Tokyo Round, he could point first to international legislation on Subsidies and Countervailing Duties, on Dumping and Anti-Dumping (revised from 1967), on Government Procurement, on Technical Standards, on Customs Valuation, and on Import Licensing. Each of these agreements or codes contains substantive rules, and each established committees of signatories to oversee their implementation and in most cases, dispute settlement as well. The details of the more important of the agreements, as well as their revision, in the Uruguay Round are presented in

[43] Decision of 28 November 1979 on Action by the *Contracting Parties* on the Multilateral Trade Negotiations, GATT BISD 26th Supp. 201, cited also in n. 36 *supra*.

[44] A first effort to launch a 'Millennium Round' at a Ministerial Conference of the WTO in Seattle in November–December 1999 proved unsuccessful, partly because of a failure to agree in advance on an agenda, partly because of organized opposition and demonstrations by a variety of non-governmental groups. A commitment to a new Round was agreed to in November 2001 in Doha, Qatar, but as of mid-year 2007 its success seems doubtful. On the other hand, as demonstrated in the succeeding chapters, the foundation, both in terms of the institution and in terms of substantive development and the build-up of case law, suggests that the WTO is not as fragile as the GATT was in the 1970s and 1980s.

[45] GATT, Press Release containing Statement by Director-General, 12 Apr 1979, GATT Doc. GATT 1234.

subsequent chapters of this book. The fact of creation of a large body of law—much of it technical but nonetheless important—is without doubt the major achievement of the Tokyo Round.

Against these achievements must be set the one great failure of the Tokyo Round, the failure to achieve agreement on a Code on Safeguards. Safeguards, as mentioned earlier, was the name applied to measures of relief against sudden or unforeseen imports of a given product, usually in the form of some kind of quantitative restraint. In some instances safeguards were applied by importing states acting alone; in other instances safeguards were applied by agreement between the importing and exporting states, or by the industries in one or both countries with the tacit approval of the respective governments. Most 'grey area' measures were made public; others were kept secret as long as possible.[46] The GATT Secretariat estimated that such arrangements outnumbered Article XIX actions by about ten to one.[47]

Most of the participants in the Tokyo Round agreed that some kind of international discipline should be imposed on safeguards which were clearly 'managed trade' and made up a significant portion of all trade. Indeed several versions of a draft code, or rather an 'Outline of an Arrangement' on safeguards were published near the close of the Tokyo Round. There appeared to be agreement that safeguard measures as defined could be taken only in the case of *serious* injury to domestic producers, but whether imports must be 'the cause', or 'the principal cause' of serious injury was left blank and the overall duration permitted listed 3 years and 8 years as alternatives. The most contentious issue—stated to be the reason for inability to reach agreement—was what came to be known as 'selectivity', that is whether safeguards must be imposed on an MFN basis or could be imposed against a particular source of increased or excessive imports only.

The European Community insisted on the opportunity to impose safeguards selectively; the developing countries (as well as Japan) resisted, and the United States appeared to be in the middle, attempting without success to promote some kind of compromise. It is not clear whether inability to resolve this issue was the cause, or the excuse for failure to agree on a Safeguards Code, as had been called for by the Tokyo Declaration of

[46] For instance, the US steel industry initiated a proceeding in 1976 before the United States Special Representative for Trade Negotiations seeking retaliation by the United States for the consequence of a secret agreement between the Japanese and European steel industries, apparently with official sanction both in Tokyo and Brussels, to restrict and divide up steel exports from Japan to the European Community. The US Special Trade Representative investigated, and concluded that such a Japanese–EC understanding had in fact been reached, but he found insufficient impact on the American market to justify counteraction by the United States. See Andreas F. Lowenfeld, *Public Controls on International Trade*, 247–251 (2nd edn., 1983) and sources there cited.

[47] See John Croome, *Reshaping the World Trading System: A History of the Uruguay Round*, 53–54 (2nd edn., 1999).

1973.[48] Everyone understood, however, that this was a major unfinished issue. If there were to be another round after the Tokyo Round, safeguards would be high on the agenda.[49]

Amid the many debates, working groups, and task forces on the codes, it was almost forgotten that the Tokyo Round was also a tariff-cutting round. This time, once it was understood that agricultural tariffs would not be subjected to whatever tariff-cutting formula emerged, agreement on a formula for linear reductions proved comparatively easy. The principle was that the higher the initial tariff, the higher the percentage by which it would be cut, subject to an eight-year period of staging.[50] There were of course exceptions, which gave rise to other exceptions, and indeed some of the details were not filled in until November 1979, seven months after the formal close of the Tokyo Round. But the principle of linear tariff reductions was accepted (again excepting agricultural products), and 'overall reciprocity' was understood to comprehend harmonization. In contrast to the Kennedy Round, negotiations about tariffs in the Tokyo Round were neither the main event nor the object of protracted legal conflict.

4.4 The Uruguay Round[51]

(a) The Exploding Agenda

As early as 1982, well before the results of the Tokyo Round had been fully implemented and tested, the United States urged that a new round of GATT negotiations be undertaken. In part the supporters of the proposal sought to counter protectionist trends in the United States and elsewhere, stimulated by large and apparently growing trade deficits vis-à-vis Japan and other East Asian countries. But proponents of a new round of negotiations had in mind an agenda significantly broader than any that had previously come before the GATT. Up to now, the GATT had been focused exclusively

[48] Tokyo Ministerial Declaration of 14 September 1973, n. 31 *supra*, para. 1(d).

[49] See Ch. 5, Sect. 5.4 for the outcome.

[50] The formula, proposed by Switzerland, provided that if an initial duty was x per cent, the final duty, after staging, would be $\frac{A(x)}{A+x}$.

For the United States and Japan, A was set at 14, so that, for example, a 30 per cent duty would be reduced in stages until it came to rest at $\frac{14(30)}{44} = 9.54\%$; a 15 per cent duty would be reduced to $\frac{14(15)}{29} = 7.24\%$.

For the European Community and the Nordic countries, A was set at 16, so that, to take just the second example, a 15 per cent duty would be reduced to $\frac{16(15)}{31} = 7.74\%$.

[51] A comprehensive account of the Uruguay Round through 1992, including the principal documents, is Terence P. Stewart (ed.), *The GATT Uruguay Round: A Negotiating History, 1986–1992* (1993).

on trade in goods—first, as we saw, on tariffs, and in the Tokyo Round on non-tariff measures as well. The global economy, however, consisted of much more than trade in goods. For all its imperfections, ambivalence, and fragility, the GATT seemed to combine the right principles and the right techniques to serve as the arena for negotiation about what came to be known as the New Areas—services, intellectual property, and investment. The United States now urged that these subjects be added to the agenda of the GATT, along with the unfinished subjects from prior rounds, notably safeguards and agriculture.

At first the United States was unsuccessful in persuading its potential negotiating partners to launch a new round or to adopt a new agenda. Opposition, or at least reluctance, came both from the developing countries, which had felt let down in the Tokyo Round, and from the European Community whose trade officials feared that a new round would present a new opportunity to attack the Common Agricultural Policy. But the United States persisted, and late in 1985 a Preparatory Committee was established to draft a programme for a new GATT round, for submission to a Ministerial Meeting in the following year.[52]

The Ministerial Meeting was convened in September 1986 at Punta del Este in Uruguay, almost forty years after a conference with a comparably broad agenda had convened in Havana. The Ministerial Meeting was far from harmonious,[53] but after five days of arguments, a Ministerial Declaration was agreed to initiating the Eighth Round of Multilateral Trade Negotiations.[54] The Declaration stated that the 'launching, the conduct and the implementation of the outcome of the negotiation shall be treated as part of a single undertaking', which seemed to invite the kinds of considerations that played a crucial role as the negotiations were winding up five, six and seven years later.[55] However, the Declaration also stated that 'Balanced concessions should be sought within broad trading areas and subjects to be negotiated, in order to avoid unwarranted cross-sectoral demands'.

[52] GATT BISD 32nd Supp. 9 (1986).

[53] See e.g. the account of the meeting based on numerous interviews, in Steve Dryden, *Trade Warriors: USTR and the American Crusade for Free Trade*, 321–325 (1995).

[54] Ministerial Declaration on the Uruguay Round, 20 Sept 1986, GATT BISD 33rd Supp. 19–30 (1987).

[55] Oversimplifying for illustrative purposes only, as the negotiations developed, the United States and the developing countries were allied on issues of access for agricultural products, with the European Community and Japan on the other side; the EC and the United States were allied on issues of intellectual property and (to a lesser extent) on services, with the developing countries on the other side; and the developing countries and EC were, if not allied, at least resistant to American positions on dumping and subsidies. Of course this list does not include all the issues before the Uruguay Round, and the positions of participants shifted from time to time, both as particular issues arose in the negotiations, and as new administrations came into office in the participating countries and sent new representatives to the negotiations.

Judging by the topics listed as subjects for negotiation, the Uruguay Round was to be by far the most ambitious round of trade negotiations ever, dealing not only with tariffs, as had the first six rounds, or non-tariff barriers, as had the Tokyo Round, but also with trade-related aspects of investment regulations; of intellectual property rights (i.e. patents, trademarks, copyright, and counterfeiting); and of services, including perhaps, banking, accounting, insurance, shipping, and even legal services. In addition, another effort was to be made to reform trade in agriculture, and to reduce the bizarre system of subsidies and overproduction that had developed in many countries at the same time as horrifying famine prevailed in others. The Ministers also undertook once again to address the problem of safeguards, and to try to bring trade in textiles back more than nominally into the GATT framework. Also, they committed themselves to two immediate actions—so-called *standstill*—i.e. not to take any trade-restrictive or distorting measure inconsistent with the GATT, or to take measures in exercise of GATT rights 'that would go beyond that which is necessary' to remedy specific situations; and *rollback*, i.e. to eliminate such trade-restrictive or distorting measures previously taken, without requesting GATT concessions in return. Interestingly enough in the light of the eventual outcome, nothing in the Ministerial Declaration addressed the creation of a new organization, to supplement or supplant the GATT. Also, the Ministers separated out negotiation on trade in services into a separate Part II of the Declaration, apparently because the developing countries, led by Brazil and India, wanted to make sure at the outset that if rules were to be established to open up access to service providers and they were accused of violating these rules, retaliation would not be permitted against their exports of manufactured products. One other subject became more important in the Uruguay Round than it had ever been before, again with the United States as principal proponent. If states were prepared, as they declared at Punta del Este, to draft rules on such a large number of subjects, there must be a more definite and predictable method of enforcing the rules and resolving disputes. Without giving any indication in which direction the solution would go, the Declaration stated:

> [N]egotiations shall aim to improve and strengthen the rules and the procedures of the dispute settlement process...[including] the development of adequate arrangements for overseeing and monitoring...compliance with adopted recommendations.

(b) The Ups and Downs of the Uruguay Round

Negotiating groups were established on some fifteen topics, concerning the various old and new subjects to be taken up in the Uruguay Round. Most of these groups met in 1987, but a few had their first meetings early in 1988.

In December 1988, a mid-term Ministerial Meeting was held in Montreal, and agreement was said to have been reached on eleven of the fifteen topics being negotiated. But agreement could not be reached on four subjects—agriculture, textiles, protection of intellectual property, and safeguards—and doubts began to arise whether it would be possible to complete the Uruguay Round.

In April 1989, at a late-night bargaining session in Geneva at 'senior official' level (i.e. not the Ministers themselves), guidelines were adopted for continuing negotiations on the four topics on which no agreement had been reached at Montreal. It seemed that the deadlock at Montreal had been broken, and that the chances were good that the Uruguay Round could be successfully concluded by the 1990 target date. In July 1989, the Trade Negotiations Committee agreed that the final Ministerial Meeting of the Uruguay Round would be held in Brussels in December 1990.

As the many negotiating groups and drafting groups continued to meet on the fifteen major items on the agenda of the Uruguay Round, it was not clear that a package deal could be achieved, but increasingly clear that partial deals—say on tariffs or dispute settlement or amendments to the Subsidies Code—were not acceptable to the major actors. In July 1990, the Group of Seven Economic Summit, meeting in Houston, said in its closing communiqué: 'The successful outcome of the Uruguay Round has the highest priority on the international economic agenda.' But reports from Houston disclosed that the Summit had been stormy, with the American delegates maintaining that the European Community was 'not engaged' in the negotiations on agriculture, and insisting that without agreement on planned reduction (if not elimination) of the subsidies of the Common Agricultural Policy, there could be no successful conclusion of the Uruguay Round. The United States sought commitments on substantial reduction in all three elements of the Common Agricultural Policy—the levels of domestic support, import barriers (i.e. the variable levy),[56] and export subsidies. It did not get them.

In the course of fall 1990, the attention of several of the principal participants in the Uruguay Round was directed elsewhere—notably the unification of Germany, the crisis in the Persian Gulf, and the replacement after nearly a dozen years in office of Prime Minister Thatcher of Great Britain.

[56] The variable levy, a device employed by the EEC since the formation of the Common Agricultural Policy, was an import duty measured by the difference between the landed cost of a given commodity such as wheat or corn and a target price negotiated among the member states of the Community and between producers and consumers, but not with non-member states. The higher the target price the higher the levy, and over time, the higher the proportion of crops produced within the Community rather than imported from lower-cost producers such as the United States, Canada, or Australia. The variable levy seemed to be inconsistent with several articles of the GATT but had never been directly challenged in the GATT or in bilateral controversies, except when it affected entry of new members, such as Spain and Portugal in 1986.

While the trade delegations kept meeting and exchanging drafts, it became clear that if there was to be a breakthrough, it would have to come from commitment of the political leaders.

The press reported the issue as United States versus Europe; in fact the deadlock was more complicated. Not only was Japan challenged on its support of inefficient growers of rice and soya beans; the Cairns group[57] and developing countries generally made it clear that if they were not assured of greater access for their agricultural and other primary products in the markets of the industrial countries, they would not accept other parts of the proposed package, i.e. they would not agree to open their markets to Western services, liberalize their investment regimes, or agree to grant protection to the industrial world's intellectual property rights (including patents on pharmaceuticals and protection for computer software). Without these concessions from the developing countries, the United States said, the whole project of the Uruguay Round would fall apart.

For two more years, the parties negotiated about the many issues in the Uruguay Round. The warning in the Punta del Este Declaration against 'unwarranted cross-sectoral demands' was regularly disregarded. One party or another always asserted that its 'concession'—on services, on TRIPS (Trade-Related Aspects of Intellectual Property Rights) or TRIMs (Trade-Related Investment Measures), or Textiles, or whatever—would be taken off the table if agreement could not be reached on the most divisive issues, which seemed to be agricultural subsidies and trade in agriculture in general.

In November 1990, the trade ministers from 107 countries met in Brussels to attempt a final push to bring the Uruguay Round to conclusion. In this first test of economic cooperation in the post-Cold War world, the United States appeared to behave more combatively than in prior rounds, less willing, it seemed, to subordinate economic aims to security concerns. The European Community, on the other hand, with three more members than in the last round (Greece, Portugal, and Spain) as well as a reunited Germany that had problems of its own, seemed to find it more difficult than ever to make a political decision. The developing countries played a substantially greater role than in prior rounds, and efforts by the European Community to buy off members of the Cairns group by individual offers—more flowers from Colombia, more beef from Argentina—on the whole proved unavailing. In midweek of the Brussels Conference, the Latin American countries withdrew their delegates from working groups on Intellectual Property and

[57] This was a group of 14 food-exporting countries that had met in Cairns, a resort city in North-east Australia, a month before the meeting at Punta del Este. The group formulated and on the whole maintained a joint policy throughout the Uruguay Round, looking to open up markets for their products and reduce subsidization and other devices that distorted the flow of agricultural products. The members of the Cairns Group were Argentina, Australia, Brazil, Canada, Chile, Colombia, Hungary, Indonesia, Malaysia, New Zealand, Philippines, Thailand, Uruguay, and Fiji.

on Services to protest the lack of progress on agriculture. The United States almost walked out as well, but decided to stay till the end of the conference. But, as the Financial Times put it, the GATT session broke off in disarray.[58]

Many observers thought the failure of the Brussels Ministerial Conference meant the end of the Uruguay Round, and perhaps of the GATT itself. But none of the participants were willing to go that far, and for two months the Director-General of the GATT, Arthur Dunkel, struggled to keep the Uruguay Round alive.[59]

GATT working groups continued to meet throughout 1991, but no breakthrough was achieved. At year-end 1991, the Director-General issued a Comprehensive Draft Final Act, a document of 436 pages containing what he thought were either agreed texts or feasible compromises. The Dunkel Draft, as it came to be known, was impressive in demonstrating how much had been (almost) achieved, and how much would be given up if it all came to naught. In an accompanying statement, Mr Dunkel asked the participants to provide a first appraisal of his draft at a meeting scheduled for January 1992. The meeting was held, and much of the text was tacitly accepted, but each of the major participants had major objections, and all concurred that nothing is agreed unless everything is agreed.

Agriculture, and particularly efforts to limit the subsidy programmes of the European Community, turned out to be the major and continuing obstacle throughout 1992; the effort to complete the negotiations while President Bush remained in office almost succeeded—but not quite.[60] It is interesting to note that three elements of the Dunkel Draft that eventually effected major changes in the law and organization of international trade, attracted little notice or public attention in the two years between the

[58] Financial Times, 7 Dec 1990, at 1.

[59] The Director-General's task was made urgent by the fact that the 'fast track' negotiating authority under United States law expired 31 May 1991, and in order to meet the strictures of that legislation, the President had to submit proposed agreements 90 days before 1 June 1991. 19 U.S.C. § 2903 (b)(1), as enacted in the Omnibus Trade and Competitiveness Act of 1988, Pub. L. No. 100–318 (23 Aug. 1988). However, the statute added that if the President was of the opinion that the fast-track procedures (which permit no amendments once the implementing bill is introduced and set a timetable for action by each House of Congress) should be extended, he could request an extension of the authority for two years, provided his request was submitted by 1 March 1991, accompanied by a description of the progress made to date and a statement of the reasons why the extension is needed to complete the negotiations. President Bush made such a request on 1 March 1991, and (with difficulty) secured a two-year extension until 31 May 1993. As it turned out, the Round was not completed by that date either, and President Clinton was obliged to seek another extension, which the Congress reluctantly granted through 16 April 1994, but with a 120-day advance-notice requirement, so that the effective deadline for completing the Uruguay Round became 15 December 1993.

[60] The key was a long-running dispute between the United States and the EC over soybeans, which appeared to be settled at an agreement at Blair House (the Presidential guest house in Washington) in November 1992, negotiated for the Community by its Commissioner for Agriculture. But France blocked the agreement, and with it the possibility of concluding the Uruguay Round in 1992.

publication of the Dunkel Draft and the final agreement. Dunkel proposed (i) that the Balkanization of GATT law that had taken place in the Tokyo Round[61] be reversed, and that all agreements should be signed by all parties; (ii) that an integrated system of binding dispute settlement be instituted covering not only the General Agreement but all the associated agreements and codes, and including authority for retaliation; and (iii) that the GATT be placed on a firm organizational footing by creation of what the draft called a Multilateral Trade Organization and eventually became the WTO. Of course these proposals did not emerge full-blown from the Director General's head.[62] But they had not been the subject of the sharp and acrimonious debate devoted to subsidies, to trade in services, to agriculture, and to the many others that had divided the Contracting Parties for more than half a decade.

(c) The Final Stage

The negotiations continued throughout 1992, prodded by a new Director-General, Peter Sutherland, an energetic Irishman who had previously served as Competition Commissioner of the European Community and as the chairman of a major bank. In the United States, much of the new Clinton administration's energy in the summer and fall of 1993 was focused on the North American Free Trade Agreement, which proved to be much more controversial in the United States than the Uruguay Round, or than the predecessor Canada–US Free Trade Agreement. After NAFTA made it through the US Congress, all the major participants made a renewed effort to complete the Uruguay Round by the deadline set by the Congress.[63] Even the controversy over agriculture was eventually resolved, with agreement that the EEC could cut back its export subsidies more slowly than had previously been understood, in return for imposed access to the European market for the United States and other suppliers, and 'tariffication' of all quotas and other import restraints, so that they would be subject to negotiations in future rounds along the pattern that had been followed with respect to customs duties since the beginning of the GATT.[64] New issues kept coming up,[65] but on 15 December 1993, the last day for the 'fast track' authority

[61] See Sect. 4.3(b) *supra*.

[62] The suggestions about making final decisions of dispute panels binding, and about establishment of a Multilateral Trade Organization, had been included in an earlier Draft Final Act circulated by the Secretariat at the Brussels Conference in December 1990. But the proposals had been in alternative form or in brackets, and were not debated intensively. In the Dunkel draft, the proposals were made in an affirmative, not an optional form, substantially as they appeared in the final text.

[63] See n. 59 *supra*.

[64] For an explanation of tariffication, see Ch. 11, Sect. 11.2(a). A brief summary of the Agreement on Agriculture is presented in Ch. 5, Sect. 5.5.

[65] One issue that almost scuttled the agreement at the last moment concerned a box office tax imposed by France on (largely American) motion pictures, the proceeds of which were used to subsidize French films. Eventually this controversy, which had emerged very late in the negotiations, was put over without resolution.

[66] See GATT, *News of the Uruguay Round*, 21 Dec 1993, 1.

[67] Id.

of the United States executive branch, it was announced that the Uruguay Round had been successfully concluded. 'Today', the new Director-General said, 'the world has chosen openness and cooperation instead of uncertainty and conflict.'[66] While in the enthusiasm of the moment the Director-General may have exaggerated the promise of decline of uncertainty and conflict, Mr Sutherland was surely right to point out that 'important new areas of the World economy have been brought under multilateral disciplines, and that added together, the achievements amount to a major renewal of the world trading system'.[67] He did not add, though many must have felt, that the effort had come very close to failure, and that the commitment to the original principles, now covering a much wider area, was still fragile and not free from ambivalence in any country.

Summary

The GATT evolved unevenly from its almost accidental beginnings in the 1940s to a vastly greater organization and corpus of law. In the first five rounds of multilateral trade negotiations (1947–61), the emphasis was largely on reduction of tariffs on the basis of most-favoured-nation treatment and 'mutual exchange of benefits'. Beginning with the Kennedy Round (1964–67) and more particularly in the Tokyo Round (1973–79), the Contracting Parties turned their attention to crafting rules applicable to non-tariff measures that affected trade in goods, including dumping and anti-dumping, subsidies and countervailing duties, government procurement, and various techniques of valuation of merchandise for purposes of assessing customs duties. In the Uruguay Round (1986–93), the GATT contracting states, by now over 100, continued the practice of negotiating rules to govern international trade, but moved well beyond trade in goods to address also intellectual property and aspects of services and transnational investment. They also reached agreements that previously eluded them concerning so-called 'safeguards', and concerning trade in agriculture, they formally established a new World Trade Organization, and they created a system of binding dispute settlement designed to be applicable to the vast new body of law developed by the Uruguay Round and its predecessors.

An overview of the law and institutions of international trade at the beginning of the twenty-first century is presented in Chapter 5. The succeeding chapters address the principal subjects in more detail.

Modern GATT Law

A Treatise on the Law and Political Economy of the General Agreement on Tariffs and Trade and other World Trade Organisation Agreements

Second Edition
Volume I

Professor Raj Bhala

SWEET & MAXWELL

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Volume I
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CHAPTER 1

GATT as Constitution of International Trade (1947 GATT and 1995 WTO Agreement)

SECTION I: DEFINITION OF "CONSTITUTION"

1–001 Nearly everything to do with international trade is controversial. On any day, in any respectable newspaper, a scan of titles on global, domestic, or even local business stories proves the truth of the statement. *What Price Free Trade?*, authored by Mark Davis, is an example from the July 21, 2003 issue of the *Australian Financial Review*. Every year, plenty of good books are published on the political economy of trade policy that chronicle disputes, both within and among countries. The account by Alfred E. Eckes, Jr., former Chairman of the International Trade Commission and the Ohio Eminent Research Professor in Contemporary History at Ohio University, entitled *Opening America's Market: U.S. Foreign Trade Policy Since 1776* (1995) is particularly noteworthy. Another commendable illustration is James Shoch, *Trading Blows – Party Competition and U.S. Trade Policy in a Globalising Era* (2001).

Likewise, nearly everything to do with the General Agreement on Tariffs and Trade (GATT) is controversial. No less an authority than the Appellate Body of the World Trade Organisation (WTO), in its first Annual Report (covering its activities between 1995–2003), points out most appeals it receives concern alleged violations of GATT.[1] This empirical fact is unsurprising once the significance of GATT is grasped. It is nothing less than the Constitution of international trade law. A constitution, if it is worth anything, is controversial.

To dub GATT the "Constitution" is to uncover two levels of controversy. First, is it defensible to call GATT the "Constitution" of international trade law? That depends on what is meant by the word "Constitution," a matter discussed below. Secondly, what principles underlie the legal obligations in GATT, what are those obligations, and how have they been interpreted and applied since 1947? This question is the subject of the rest of *Modern GATT Law*.

1–002 No less a source than the *Oxford English Dictionary*—which the WTO Appellate Body consistently and heavily relies on in case after case—defines "constitution" as follows:

> "The system or body of *fundamental principles* according to which a nation, state, or body politic is constituted and governed".[2]

The source widely used among American attorneys, *Black's Law Dictionary*, defines a "constitution" thusly:

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[1] See Daniel Pruzin, *WTO Appellate Body Issues its First Annual Report on 2003 and Earlier Activities*, 21 International Trade Reporter (BNA) 860 (May 20, 2004); Appellate Body Report for 2003 (May 7, 2004) at *http://www.wto.org/english/tratop_e/dispu_e/wt_abl_e.doc* (stating that of the 62 appellate decisions issued between 1996 and 2003, 33 concerned GATT provisions).

[2] J.A. Simpson & E.S.C. Weiner (eds), *Oxford English Dictionary*, 2nd edn (1989) Vol. 3, p.790 (emphasis added).

> "The *fundamental* and organic *law* of a nation or state, establishing the conception, character, and organisation of its government, as well as prescribing the extent of its sovereign power and the manner of its exercise".[3]

The final clause of the *Black's* definition is explicit about sovereign power and its exercise, which the *Oxford* definition leaves implicit in the phrase "constituted and governed." Conversely, the *Oxford* definition is less state-centric than the *Black's* definition, as it uses the term "body politic."

1–003 That term can be extended to the original contracting parties of GATT, the expanded membership on the eve of the birth of the WTO, December 31, 1994, the founding WTO Members on January 1, 1995, and the Members in the GATT–WTO system today. In other words, the term "constitution" is not restricted to a document the territorial reach of which is defined by national boundaries.

Indeed, there are various examples of international and non-governmental organisations, and private sector bodies, having constitutive documents. Most significantly, the term "constitution" as defined above is appropriate for GATT because this remarkable document contains the "fundamental" legal principles on which the modern multilateral trading system is organised and operates. Those principles are what *Modern GATT Law* is all about.

Section II: Accidental Constitution

1–004 *Modern GATT Law* is not a history book about GATT, and less so of the WTO. Yet, a full appreciation of GATT as a legal document is impossible without some understanding of the drafting of GATT, and what relationship it now bears to the WTO.[4] In other words, the history of GATT becomes relevant to its interpretation and application in the context of modern trade controversies. Therefore, it is important to discuss—if only briefly—the essential facts of how GATT came about and what legal status it now has relative to other multilateral trade agreements listed in Annexes 1–4 of the *Agreement Establishing the World Trade Organisation* (WTO Agreement).

[3] *Black's Law Dictionary* (Bryan A. Garner (ed.), 7th edn (1999)) p.306 (emphasis added).

[4] Likewise, it is helpful to have a full appreciation of the (1) global economic depression of the late 1920s and early 1930s, the initial response by major governments (including the United States) with protectionist, beggar-thy-neighbour policies, (2) reversal of those policies (led by the United States, with the Reciprocal Trade Agreements Act 1934), and (3) vision of Cordell Hull (1871–1955), the Secretary of State to President Franklin Delano Roosevelt (FDR) (1882–1945), of peace-through-trade.

A full history is beyond the scope of the present work. Thus, for example, the above discussion does not cover the aspect of the Schlesinger thesis concerning economic nationalism, i.e. that some New Dealers "looked homeward and saw both the depression's cause and its cure in the national economy" and "extended this idea almost into a form of economic autarchy." Arthur M. Schlesinger, Jr., *The Age of Roosevelt: The Coming of the New Deal 259* (Boston, Massachusetts: Houghton Mifflin Company/The Riverside Press, Cambridge, 1959) (emphasis added). This book, which focuses on 1933–34, is the second of three volumes in Professor Schlesinger's monumental history of FDR and the New Deal Era. Volume one is *The Age of Roosevelt: The Crisis of the Old Order, 1919–1933* (1957). Volume three is *The Politics of Upheaval, 1935–1936* (1960).

Among the many good accounts, in addition to that of Professor Schlesinger (which is just two pages of his three volume work) are Alonzo L. Hamby, *For the Survival of Democracy – Franklin Roosevelt and the World Crisis of the 1930s* (2004); Peter Temin, *Lessons from the Great Depression* (1989); Charles P. Kindleberger, *The World in Depression, 1929–1939* (revised edn 1986). In addition, the memoirs of Secretary Hull, who holds the record as the longest-serving Secretary of State in American history (11 years, 1933–44), are a treasure. For a legal perspective on the founding of GATT, see American Law Institute (ALI), *Report to ALI: Legal and Economic Principles of World Trade Law: The Genesis of the GATT, The Economics of Trade Agreements, Border Instruments, and National Treatment* (April 16, 2012).

GATT became the Constitution of international trade law by accident, not design. It was to be only a provisional document—a bridge from the immediate post-Second World War years to the subsequent period in which the *Charter for the International Trade Organisation* (ITO Charter) would govern. Why was this bridge needed? The short answer is to liberalise trade and thereby help generate output, employment, and income amidst a profound shift from military- to civilian-driven economies.

Section III: Great Depression, *1934 Act*, and Schlesinger Thesis

Some of the original 23 GATT contracting parties, including the United States, were eager to commence multilateral tariff reductions. They knew well the history of the Great Depression, an unprecedented slump exacerbated by protectionist legislation such as the Tariff Act 1930 (United States) (the infamous portion of which bears the rubric of the *Smoot-Hawley Tariff Act* 1930 (United States)) (and reciprocal enactments by other countries), and competitive currency devaluations. Certainly, the Reciprocal Trade Agreements Act 1934 (United States) did much to unwind the Depression Era protectionist legislation. New Deal historian and Pulitzer Prize winning author Arthur M. Schlesinger, Jr. (1917–2007) explains:

> "*By the end of 1935*, reciprocal trade agreements were in effect with *14 countries*; *by 1945, with 29 countries*. The spread of the area of reciprocity was accomplished by steady increases in the volume and value of trade".[5]

But, the problem with using the 1934 Act as a model for post-Second World War trade liberalisation was three-fold.

1–005 First, that model was cumbersome because it was bilateral. The United States had to negotiate tariff reductions one by one, on a country-by-country basis. After the Second World War (1939–45), time was of the essence. Avoiding a rerun of Depression Era beggar-thy-neighbour policies was a pressing matter. All of the warring countries, including all the GATT contracting parties, would have to absorb into their economies millions of decommissioned military service personnel. They might be tempted to implement protectionist measures as a way to maintain output, keep jobs, and steady incomes, not only for men, but also for women. Many women manned the factories during the War (symbolised by the famous American "Rosie the Riveter" poster), and their presence in the formal labour force ushered in a new era of expectations. So, what was needed was a multilateral process and forum, to bring and keep down tariff barriers among the widest array of countries as quickly as possible.

Secondly, the motivation behind the 1934 Act may have been as much mercantilist as trade liberalising. Professor Schlesinger argues:

> "It is impossible, however, to isolate the contribution of the trade agreements programme to the world commercial revival. For example, for the first year or two, devaluation undoubtedly did more than trade agreements to stimulate American exports. The problem of judgment is further complicated by the *confusion of purpose* which continued to surround trade agreements policy. Even its advocates seemed uncertain whether its objective was to correct the imbalance in international accounts caused by America's position as a creditor nation, *or only, through pushing exports equally with imports, to transfer that balance to a higher level*. Thus [Secretary

[5] Arthur M. Schlesinger, Jr., *The Age of Roosevelt: The Coming of the New Deal 259* (Boston, Massachusetts: Houghton Mifflin Company/The Riverside Press, Cambridge, 1959) (emphasis added).

of State] Cordell Hull, writing his memoirs fourteen years after the passage of the [*1934*] *Act*, began his case for the policy by arguing that exports to trade agreement countries had risen faster than exports to other countries! And, indeed, in the thirties this increase in United States exports was not offset by a corresponding increase in imports. From 1934 to 1939, exports rose by over a billion dollars, while imports rose by less than $700 million. The excess of merchandise exports over imports, which had stood at $477 million in 1934, was (with devaluation, European recovery and the fear of war) over a billion in 1938 and just under a billion in 1939. The debt of the outside world to the United States grew steadily throughout the decade.

The trade agreements programme thus did little in the thirties to meet the world's or America's balance-of-payments problem. . .".[6]

Thirdly, the extent to which the bilateral tariff reductions wrought by the 1934 Act actually stimulated domestic economic output and employment was uncertain. Again, Professor Schlesinger writes:

". . . nor is it even clear that all its [the *1934 Act*] supporters intended it should. In addition, it is probable that the programme had *limited effect* on the level of domestic economic activity. In general, its advocates persistently *exaggerated* its economic achievements. Still, this was done not with an intent to deceive but out of an *unconquerable evangelism*".[7]

1–006 Notably, the contracting parties ignored the second problem of mixed motives, and the third problem of cause and effect. They did not focus on, or worry much, about these two possible inferences from the experience with the 1934 Act that Professor Schlesinger draws.

That is not to say the contracting parties were immune from export-promotion intentions, or from trade-liberalising "evangelism," as Professor Schlesinger puts it. To the contrary, they suffered both. He writes:

"With quite intensity Hull and [Assistant Secretary of State Francis B. Sayre (1885–1972)] Sayre resurrected the vision of a *freely trading civilisation*, opposed it to the image of totalitarian control, and thereby laid the foundation for one more effort in the forties and fifties to liberate world trade. The very confusion of objectives in the reciprocity policy of the thirties mirrored a time of transition. *What emerged in the end was the appealing objective of an expanding world economy*".[8]

So, even if the 1934 Act had been adulterated with such intentions, or its stimulatory effect on domestic economies was unclear, these were historical points of no great moment in the climate in which GATT and the ITO Charter were negotiated.

1–007 Here, then, is a response to the Schlesinger thesis on the 1934 Act and its aftermath: to the extent the second problem mattered, by 1946, 1947, and 1948, trade negotiators from the contracting parties reasonably might have described their work as

[6] Arthur M. Schlesinger, Jr., *The Age of Roosevelt: The Coming of the New Deal 259* (Boston, Massachusetts: Houghton Mifflin Company/The Riverside Press, Cambridge, 1959) (emphasis added).

[7] Arthur M. Schlesinger, Jr., *The Age of Roosevelt: The Coming of the New Deal 259* (Boston, Massachusetts: Houghton Mifflin Company/The Riverside Press, Cambridge, 1959) (emphasis added).

[8] Arthur M. Schlesinger, Jr., *The Age of Roosevelt: The Coming of the New Deal 260* (Boston, Massachusetts: Houghton Mifflin Company/The Riverside Press, Cambridge, 1959) (emphasis added). Professor Schlesinger credits Hull not only with a "quiet intensity," but also with giving multilateralism a "unique moral force."

an effort to put disciplines on mercantilist behavior. And, to the extent the third problem was true, it was true because the 1934 Act was cumbersome (the first problem). Hence, the third problem with the 1934 Act, like the first one, was an argument for a multilateral solution.

So, the fact a bilateral programme would take too long, and in the *inter regnum*, might allow protectionist forces to galvanise, was compelling enough logic to move forward on a new multilateral scheme: the ITO Charter, with GATT as an interim accord. If that was "unconquerable evangelism" in favour of "a freely trading civilization," then so be it.

1–008 In this immediate post-War economic environment, the contracting parties crafted GATT as a provisional, skeletal framework through which to conduct tariff-cutting negotiations, without having to wait until each of them ratified the *Charter for an International Trade Organisation* (*ITO Charter*). After all, ratification of the Charter through domestic legislation in the individual contracting parties would take time, so it might be years before the *Charter* entered into force. Better, then, to nip protectionist pressures in the bud, not only by eschewing the 1934 Act model, but also by starting a multilateral trade round right away, under the auspices of GATT.

The *Charter* was to have been that Constitution.

When it failed, largely because President Harry S. Truman elected not to submit it to the Senate for advice and consent, what was left for the post-War multilateral trading system? The GATT.

President Truman knew the Senate would look askance at the *Charter*. There were plenty of reasons for politicians to oppose the *Charter*. They were suspicious about the creation of another international organisation, the ITO (in addition to the Bretton Woods institutions, the International Monetary Fund (IMF) and the International Bank for Reconstruction and Development (IBRD, or World Bank). They feared surrendering American sovereignty to such bodies. They were moved by a long-standing theme in American foreign policy – isolationism. They complained the *Charter* contained a plethora of exceptions to trade-liberalizing rules.

1–009 The death of the *Charter* in the White House and on Capitol Hill meant the death of the *Charter* in the other 22 original contracting parties. All saw from the experience with the League of Nations that American participation was essential. But, the GATT remained, though no President ever submitted it to Congress for approval until 1994, when President Bill Clinton did so as part of the Uruguay Round Agreements Act 1994, the implementing legislation for the *WTO Agreement* and the accords annexed to it. GATT (technically, GATT 1994, as legally distinct from GATT 1947) was none other than the first document listed in Annex 1A to the *WTO Agreement*. Passage by Congress, as a Congressional–Executive Agreement, of the 1994 Act, meant formal enactment of GATT for the first time in American history.

Section IV: Seeds of GATT in 1941 *Atlantic Charter*

1–010 To be sure, GATT was not entirely an accident. The United States Department of State had conceived a design for a post-Second World War international economic order that included a multilateral trade body. One early version of an American blue print was published as *U.S. Proposals* in Department of State Pub. No. 2411 (1945). A subsequent version came out as *U.S. Suggested Charter* in Department of State Publication No. 2598 (1946).[9]

In drawing up such plans, as in many other respects, the United States worked closely with its steadfast ally, the United Kingdom. In August 1941, President Roosevelt and

[9] See *Suggested Charter for an International Trade Organisation*, United States Department of State, Commercial Policy Series, Number 93 (1946).

Prime Minister Winston S. Churchill met on a boat off the coast of Newfoundland, Canada. They approved the *Atlantic Charter*, in which seeds of the GATT exist.[10] This Charter stated (inter alia), that the United States and Great Britain seek:

> "the fullest collaboration between all nations in the economic field with the object of securing, for all, improved labour standards, economic development and social security [and,] with due respect for their existing obligations, [aim] to further the enjoyment by all states, great or small, victor or vanquished, of access, on equal terms, to the trade in the raw materials of the world which are needed for . . . economic prosperity".[11]

These words, while generic, proved remarkably bold and far-sighted.

In August 1941, victory over Nazi Germany and its allies was yet far off. Indeed, the United States would not enter the fight for another four months. Yet, already the planning was underway for a post-Second World War era free from the scourge of fascism in which a forum would exist to reduce trade barriers multilaterally—not, as in the pre-War era, bilaterally, which was a cumbersome, episodic, and haphazard process that might be more easily unwound.

Section V: 1946 and 1947 GATT Preparatory Conferences

1–011 As for the text of GATT, it was drafted in two sets of pivotal meetings of delegates from many countries that took place in 1946 and 1947.

1) First Session of the Preparatory Committee of the United Nations Conference on Trade and Employment, held in London in from October 15 to November 20, 1946, and known as the "London Preparatory Conference." The key summary of this Session is the *London Report*, First Session of the Preparatory Committee (1946).

2) Second Session of the Preparatory Committee of the United Nations Conference on Trade and Employment, held in Geneva from April 10 to October 30, 1947, and known as the "Geneva Preparatory Conference." The key summary of this Session is *Report of the Second Session of the Preparatory Committee of the United Nations Conference on Trade and Employment*, United Nations Document EPCT/186 (1947), *i.e.*, the *Geneva Report*.

On October 30, 1947, delegates from 23 countries signed the GATT. The official citation to the original publication of GATT is *Final Act*, Geneva, 55 U.N.T.S. 194 (1947). The 23 signatories to GATT are the original "contracting parties" to GATT. To return to the metaphor of a Constitution, they are the Founding Fathers of the contemporary world trading system. On January 1, 1948, GATT entered into force, and the modern multilateral trading system was born.

Almost immediately, the United States published two studies:

1) *Analysis of GATT* in Department of State Publication Number 2983 (1947).

2) *The Geneva Charter for an International Trade Organisation* in Department of State Publication Number 2950 (1947).

[10] See *Atlantic Charter*, August 14, 1941, 55 Stat. 1600, E.A.S. No. 236.
[11] *Atlantic Charter*, August 14, 1941, 55 Stat. 1600, E.A.S. No. 236.

These documents provide helpful explanations into certain textual provisions, and also lend insight into the thinking of drafters, and the positions of the United States.

Section VI: *ITO Charter* Drafting History

1–012 The drafting history of the *Charter for an International Trade Organisation* (*ITO Charter*) is largely parallel to that of the GATT. For the *Charter*, the key drafting conferences, which occurred between 1946 and 1948, were:

1) The 1946 London Preparatory Conference (as above).

2) The 1947 New York Preparatory Conference, held from January 20 to February 25, 1947. The key summary of this Conference is The *New York Report*, United Nations Document EPCT/34 (May 29, 1947), concerning the "*New York Draft.*"

3) The 1947 Geneva Preparatory Conference (as above).

4) The Havana Conference, held from November 21, 1947 to March 24, 1948. The key summary of this Conference is United Nations Conference on Trade and Employment, *Havana Reports*, United Nations Document ICITO/1/8 (1948).

Because the text of the *ITO Charter* was finalised in Havana, the document also is referred to as the "*Havana Charter.*" All of these sessions took place under the auspices of the United Nations Conference on Trade and Employment.[12]

Section VII: 1971 Hudec Analysis of GATT

• *Role of Substantive Rules in International Trade*

1–013 In 1971, Professor Hudec observed a general decline in the effect of the code of detailed substantive obligations contained in GATT.[13] He attributed this decline to the old age of GATT, thinking that rules agreed upon in 1947 no longer necessarily responded to market conditions or attitudes in the 1970s. Professor Hudec noted an increasing scepticism among GATT contracting parties about the practical utility of detailed substantive rules. The critics among the contracting parties advocated non-directive consultative procedures, rather than rule-oriented regulations, to influence government trade laws and policies. Their advocacy offset the legalistic tendencies of other contracting parties.

Professor Hudec suspected the arguments in favor of non-directive, consultative procedures as against legalistic rules had a significant effect on GATT regulatory practice. These arguments even encouraged a movement in favor of operating the multilateral trading system without any detailed rules. Perhaps one day, GATT could be abandoned in favor of another institution that promotes and serves as a forum for non-directive consultations. The suspicions of Professor Hudec were reinforced by an American proposal to establish a new forum for trade policy discussion, namely, the Organisation for Economic Co-operation and Development (OECD), which had been created in 1961. The proposal

[12] See *http://www.wto.org/english/docs_e/legal_e/havana_e.pdf* (providing limited information about the Conference).
[13] Robert E. Hudec, *GATT or GABB? The Future Design of the General Agreement on Tariffs and Trade*, 80 Yale Law Journal 1299–1387 (1971). Part I of this article examines the debate over the usefulness of GATT substantive rules. Part II examines how detailed substantive rules influence government behavior in the area of international trade policy. Part III analyses the use of GATT up to 1971. Part IV sets out the proposal of Professor Hudec for future revision of the GATT legal structure.

was successful, as the OECD became an alternative and not always complimentary forum to GATT.

Thus, the central issue Professor Hudec raised was what rule, if any, detailed substantive rules play in international trade policy. This issue fits within a fundamental question resonating across international law, and within every domestic legal systems: what is the relationship between principles (that is, broad standards) and rules (that is, nitty-gritty regulations), and what ought that relationship to be? The focus the 1971 analysis rendered by Professor Hudec was the then-rising tide of criticism of detailed directions in GATT, i.e. that the GATT was erring too far to one side. Professor Hudec characterised that criticism as tantamount to a proposal for an alternative institution, called the General Agreement on Better Bargaining (GABB), which would operate without any substantive rules.

- *Not a Zero-Sum Game*

1–014 Significantly, Professor Hudec did not view the aforementioned issue as a zero-sum game. The ultimate choice was not between GATT or GABB. The basic legal design of GATT was sound and worth trying to save wherever conditions permit. However, preservation of that design was difficult, because the substance of existing rules and the legal framework for applying them needed to be brought up to date. Professor Hudec argued that such an effort was worthwhile.

GATT was part of the post-Second World War effort to restructure international trade in a way that would prevent a recurrence of the autarkic policies of the 1930s. Its legal form was influenced by the repeated failures of broadly worded international agreements negotiated during the pre-War period. GATT drafters sought to write detailed rules that would leave no doubt about the trade practices governments were expected to follow. So, the level of tariffs was to be negotiable and subject to legally binding commitments. Most other forms of trade restrictions would be prohibited, with exceptions meeting specific criteria.

In its first decade of life (1948–58), GATT as a code—the "GATT code" as Professor Hudec dubbed it—seemed to work well. Under the code, initially the contracting parties handled disputes in a plenary session. Then, they referred disputes to Working Parties, some of which made use of third-party tribunals. In 1952, the contracting parties adopted as their dispute settlement device a third party Panel on Complaints, one for each dispute. That is, reference of a case to an ad hoc dispute settlement tribunals became the norm.

1–015 During that first decade, the contracting parties successfully disposed of over 15 cases, issuing full judicial opinions, via plenary sessions, Working Parties, and third-party panels. Around 1960, the tone of GATT legal affairs changed. There were occasional charges that a contracting party violated the law, but etiquette seems to dictate that charges not be pressed beyond a consultation stage, i.e. that no effort should be spared to resolve the charges diplomatically through consultations. The tradition of third-party panels and a consultation phase under the World Trade Organisation (WTO) *Understanding on Rules and Procedures Governing the Settlement of Disputes* (*DSU*) dates to this first decade.

- *Legalist—Pragmatist Debate*

Some contracting parties were unhappy about the demise of GATT legalism. They argued GATT must return to the attitudes of its first decade if it was going to continue to function effectively. This legalistic position was countered by a pragmatic argument, namely, that to be legalistic is to be naïve about how countries actually conduct trade relations with one another. In practice, GATT as a non-directive consultative forum would be far more successful than GATT as a system of specific and binding rules. This legalist—pragmatist debate has been part of GATT since 1947, and continues today in the WTO system. That is not surprising, because the tension Professor Hudec highlighted in 1971 is even more apparent in the WTO system, which contains a larger network of rules, and thus is more of a rule-oriented institution, than GATT.

Professor Hudec calls the reading of GATT rules on their face a kind of "surface legalism." He explains that critics of surface legalism say that the detailed rules of GATT contribute to the view GATT is ineffective. Why? Because GATT embodies substantive international trade rules, but adheres to a naïve view of international relations and legal process.

1–016 Critics of the legalist approach to GATT argue GATT history provides considerable evidence that contracting parties generally do not respond to such rules. They point out that economists explain that trade restrictions are the product of underlying economic problems. To economists, protectionist measures are inevitable as long as the problems are not solved. The mere existence of GATT rules will not make those economic problems disappear. Rules will not promote the kind of discussion needed to understand or solve those problems. So, say the champions of pragmatism, the better approach to GATT is to encourage under its auspices full and open consultation about the economic problems themselves. So, pragmatists emphasise the advantages of solving problems by ad hoc negotiation. Negotiation is less abrasive and negotiated solutions avoid the win-lose mentality of a lawsuit. A negotiated result is more likely to hold.

Of course, the legalists have a rebuttal. Negotiation alone cannot serve as an adequate basis for all of the work of GATT. That is because negotiation has three main disadvantages. First, the outcome from use of a negotiating technique may depend on asymmetric economic or political muscle in favour of one of the parties. Secondly, an ad hoc approach builds no precedents for future decisions. Thus, it is inefficient, as the "wheel" may be "reinvented," or unjust, as like cases may be treated in dissimilar ways. Thirdly, the ad hoc approach to trade problems is simply not manageable with the increased number of players in the world trading system, and the growing value, volume, and complexity of transactions.

Moreover, the opponents of a purely pragmatic approach to GATT argue the GATT substantive code can be made to work, because it once did work. The only thing that is need is for the citizenry to make up its mind to be law-abiding. Such arguments tend to reinforce the pragmatist criticism rather than dispel it because it makes it appear that the legal design being argued for is actually naive.

- *Effect of Substantive GATT Rules on Trade Policies of Contracting Parties*

1–017 Rules have no worth unless their validity is accepted by the addressees of those rules. Scepticism about the impact of rules reflects doubt about the existence of any underlying consensus in favor of the rules. Professor Hudec explained that much of the criticism of GATT rules was of the following nature: even if a consensus among contracting parties existed to support legalisation of GATT, it would not do much good to reduce GATT merely to a set of codified rules. That is because the pressures that operate on government trade policy are too strong and too varied to be affected by such rules.

The drafting history of GATT adduces the point. The leading trade negotiators in 1946–47 were experienced trade policy officials who understood the challenges of creating international rules. Among them was a fairly solid consensus that the rules ought to be written. But, no major government felt it could promise any important changes in its existing trade practices for the sake of those rules. Exceptions to the rules had to be carved out in almost every instance in which a rule was proposed.

Professor Hudec notes two points about the substantive objectives of the drafters of GATT. First, for the most part they did not try to legislate removal of existing trade barriers. The commitments to which they agreed represented one of two typical situations:

1) A government did not violate the rule at issue, and negotiators bet that the future trade policy of that government could be kept within bounds, or
2) A government imposed extensive temporary trade controls due to is post-Second World War balance of payments (BOP) crisis, and negotiators bet that the

government would follow the rule at issue when it formulated "normal" policy in the future, so the rules helped prevent bad future occurrences.

The first situation was that of the United States. The second was that of Europe.

1–018 The second point Professor Hudec makes is the GATT substantive rules themselves were intended to channel trade restrictions into acceptable forms; they were not designed to legislate any particular ceiling on the level of restriction. The most harmful forms of trade restriction were prohibited outright (such as quantitative restrictions in Article XI:1), but the tariff remained as a valid instrument of policy (per Article II) to be used to satisfy demands for protection. Although the GATT drafters also hoped to negotiate legally binding reductions in tariffs over time, they still created escape valves, as it were, for tariff bindings commitments, such as a right to suspend concessions immediately in the case of serious injury, and a periodic right to withdraw concessions for any reason. Contracting parties were to determine their respective levels of tariff protection through periodic negotiations, as and when they were ready to make commitments.

The essence of this second point is seen in the following basic question: why are the substantive rules of GATT important? The rules matter in the context not only of preventing disputes, but no less importantly, of guiding the resolution of disputes, and thereby avoiding their exacerbation. Consider the fairly common occurrence of threats of direct economic retaliation by an aggrieved contracting party against a target contracting party, because the former believes a trade measure of the latter nullifies or impairs benefits of the former (to use the language of Article XXIII:1). The effect of threats varies according to the way they are perceived. Unless the target of a threat is persuaded economic retaliation is justified, it may perceive a threat as bare power tactics and, therefore, behave in an even more intransigent manner than before. Agreed-upon substantive rules can play an important function in addressing the underlying question of whether a threat is appropriate (i.e. whether it is justified under those rules), and whether it is fair (e.g. proportionate to the claimed wrong). The legal justification will affect not only the reaction of the decision-making officials themselves, but also their ability to use such threats as a justification to others. At some point the decision-making official may argue the rules more vigorously than foreign governments.

1–019 Still another context in which GATT substantive rules matter, says Professor Hudec, is their service as justifications for difficult decisions. That is, pointing to one or more GATT provisions is a way to defend a difficult decision. Such decisions arise, for example, when a trade negotiator opts to oppose a demand made by a domestic legislator, or by a trade negotiator from a different contracting party. The first official shall have to explain that opposition, to the politician or diplomat, and is helped by having a substantive rule in GATT on which to base this explanation.

Substantive GATT rules can be used in service of persuading officials to reconsider decisions already made. By that time, with a decision already taken by one contracting party, an allegedly aggrieved contracting party already may have taken some initial steps, before invoking formal GATT procedures. Persuasion in this context is difficult, as officials in the first contracting party are being challenged to reverse a measure, even change a policy. Yet, observes Professor Hudec, GATT experience indicates a fair number of trade policy decisions rest on foundations that can be changed by subsequent review, i.e. by careful, honest application of substantive GATT rules. Formal GATT action can provide a new "event" that serves as an excuse to reopen the issue. GATT procedures also offer a series of graduated steps that communicate seriousness of purpose in a way that bilateral representation alone cannot do. Finally, international action can certify the normative standards in question, validating the often-ignored claims of trade officials from the allegedly aggrieved contracting party. Alongside the use of substantive rules essentially as pressure devices, GATT procedures also offer the opportunity to explore possible solutions through consultation and negotiation in a neutral setting.

- ***GABB Alternative***

Does a code of substantive rules contribute to the success of these procedures? Professor Hudec addresses this question. Ultimately, he concludes substantive rules at least should serve as a guide for contracting parties, even if they are not necessarily required. The alternative to a formal, mandatory code of substantive rules Professor Hudec considers is GABB, which is his model for a multilateral trade institution that would account for all criticisms (discussed earlier) of GATT. The GABB approach is well described as a preference for "conciliation" rather than "confrontation."

1–020 The major difference between GATT dispute resolution (under Article XXIII) and the GABB procedures suggested by Professor Hudec is the GABB procedures would not entail formal judgments about previously defined normative standards. Rather, they would attempt to produce a satisfactory result through consultation that addresses all social and economic factors relevant to a dispute. Professor Hudec hesitates to say GABB procedures would reject all forms of normative judgment, because he believes even in negotiations both sides strive to apply the normative sentiments of the contracting party community as a persuasive tool. However, GABB would reject prior standards, trusting instead to the analysis of causes and consequences to reveal whatever normative judgments are appropriate.

Professor Hudec argues conciliation procedures would not work as effectively as the more rule-oriented GATT procedures. The main problem with the GABB approach is it assumes a much greater degree of cooperation from the contracting party alleged to commit a violation than usually exists. Generally, officials in the government of that contracting party responsible for the decision are not enthusiastic to reversing themselves. Even officials friendly to GATT objectives often are wary of generating too much pressure for results they cannot guarantee. Although absolute refusal to participate is rare, these considerations often produce lesser forms of resistance along the line. Government officials in the allegedly offending contracting party may try to find reasons for not discussing the matter at all. They may try to draw out and divert what discussion there is by insisting on consideration of as many other things as possible. And, they may as a final defense take whatever plausible position there is in defense of its action and hold that position to a deadlock.

- ***Use of GATT***

Again, Professor Hudec acknowledges that the GATT substantive code saw success during its first decade. Yet, thereafter, its influence eventually declined. Professor Hudec believes two basic changes in the GATT environment triggered this decline.

1–021 First, the attitude towards GATT rules waned. They no longer commanded the tight consensus they once did. In some circumstances changing economic conditions have made rules inapposite to their original purpose. Secondly, creations of large trade blocs among GATT contracting parties, and the passing of the post-Second World War, removed some of the political incentives that influenced governments to work through a formal legal structure.

- ***Hudec Proposal for Revising GATT Legal Structure***

Professor Hudec identified two major limitations to the original substantive design of the GATT. First, agricultural trade does not work under the same type of rules developed for industrial trade. He believed the United States and other contracting parties would require special provisions about agricultural trade—ones that would benefit their domestic farm constituencies—before agreeing to any larger agreement. The only solution in the interim was creation of ad hoc side agreements. Secondly, new rules on industrial trade would not be able to embrace all of the specific rules in the GATT code. The GATT consensus was not as committed to those specifics as the rules themselves suggested.

Professor Hudec believed GATT rules should continue to be a single column code. Its substance should reflect the behavior contracting parties hoped to achieve. He recommended removing the binding character of the rules, instead framing them as written standards of "nullification or impairment." This concept would include the following four rights:

1) To ask for a third-party ruling on whether a particular measure conformed to applicable norms.
2) To treat a transgression of a norm as "nullification or impairment."
3) To secure a polite Recommendation addressed to the offending party.
4) To redress the balance of concessions if the transgression itself is not cured.

1–022 Professor Hudec argued that if "nullification or impairment" were defined thusly, then the actual force of the substantive rules in the GATT code would be kept intact. Further, the impact of GATT on national decision-making would be substantially the same as it was (i.e. had been) before.

- ***Three Summary Points***

What, then, are the bottom line conclusions from the 1971 GATT analysis of Professor Hudec? Three might be gleaned. First, there was and continues to be a tension between legalism and pragmatism in GATT, that is, between viewing GATT as a substantive legal document with mandatory, detailed rules, and as an institution dominated by lawyers, versus GATT as a set of loose procedures and a forum operated by diplomats to bargain their way through issues.

Secondly, the principal function of substantive GATT rules is they are an ideal standard. That is, they are a set of requirements to persuade officials the GATT viewpoint is correct, or that retaliation is a legitimate response to transgressions. Consequently, the GABB alternative is not relatively better than GATT, for all its flaws.

1–023 Thirdly, there is force in the substantive GATT rules even if they are not a mandatory legal code. The words "legal obligation" make it clear GATT norms should be complied with. But, in practice the response among contracting parties to "agreed standards of good behavior" would not be significantly different. This more realistic attitude counters the view GATT law is idealistic, and focuses the attention on the rules themselves.

Section VIII: GATT 1947 and GATT 1994

Notwithstanding the proliferation of multilateral trade law, especially during and after the 1986–94 Uruguay Round of trade negotiations, GATT remains the true Constitution. Technically, "GATT 1947" is item (1) in Annex 1A to the *Agreement Establishing the World Trade Organisation* (*WTO Agreement*).[14] Since the birth of the World Trade

[14] In addition, Article XVI, entitled "Miscellaneous Provisions," of the *WTO Agreement* contains two paragraphs that emphasise continuity. Paragraph 1 ensures a continuing role for GATT decisions, procedures, and customary practices, and paragraph 2 essentially continues the position of the GATT Director General of the GATT Secretariat through to the WTO Director General. Article XVI:1-2 of the *WTO Agreement* state:

> "1. Except as otherwise provided under this Agreement or the Multilateral Trade Agreements, *the WTO shall be guided by the decisions, procedures and customary practices followed by the Contracting Parties to GATT 1947* and the bodies established in the framework of GATT 1947.
> 2. *To the extent practicable, the Secretariat of GATT 1947 shall become the Secretariat of the WTO*, and the Director General to the Contracting Parties to GATT 1947, until such time as the Ministerial Conference has appointed a Director General in accordance with paragraph 2 of Article VI of this Agreement, shall serve as Director General of the WTO."

(Emphasis added.)

[15] Similarly, no longer is the GATT the pre-eminent document, in terms of priority. Article XVI of the WTO Agreement is entitled "Miscellaneous Provisions." Paragraph 3 of this Article XVI explains the hierarchy between the WTO Agreement, on the one hand, and all other annexed accords, on the other hand. "In the event of a conflict between a provision of this Agreement and a provision of any of the Multilateral Trade Agreements, the provision of this Agreement shall prevail to the extent of the conflict." (Emphasis added.) Of course, WTO Members are obligated to make their trade measures consistent with the WTO Agreement and all annexed accords. Article XVI:4 of the WTO Agreement sets out this requirement:

Organisation (WTO) on January 1, 1995, it has been known as—or more technically, renamed—"GATT 1994."

But, to say GATT is an "annexed" agreement and thereby incorporated by reference into the *WTO Agreement* is to understate its contemporary importance. That is why the term "GATT 1994" is not used herein. Such use is technically accurate, and precision should not be discouraged.

1–024 Indeed, the formula, as it were, for the relationship between GATT 1947 and GATT 1994 is this:

GATT 1994 = GATT 1947 (i.e. the complete text)

+

All *Decisions* and *Understandings* agreed upon by the Contracting Parties (i.e. the contracting parties acting jointly) concerning GATT (but not including adopted or unadopted Reports issued by GATT Working Parties or Panels in dispute settlement matters under GATT Article XXIII)

+

All *Decisions* and *Understandings* agreed upon by the *Contracting Parties* concerning GATT 1947 during the 1986–94 Uruguay Round

+

All *Decisions* and *Understandings* rendered by WTO members concerning GATT following the Uruguay Round

Note the minor ambiguity in the last term of the formula: "GATT" in the post-Uruguay Round era technically "GATT 1994," so that term should say as much. But, to do so would put the same variable on both sides of the equation.

In any event, to distinguish here between "GATT 1947" and "GATT 1994" would be incongruous with the thesis unifying the entire treatise—namely, that GATT transcends the decades, which simply is another way of saying GATT is the Constitution. Moreover, as a practical matter, aside from formal references to "GATT 1994" in WTO panel and Appellate Body reports, and other official documents, in common parlance international trade professionals speak simply of "GATT."

Section IX: Projections of GATT into Other WTO Agreements

1–025 Admittedly, GATT is not the constitutive document in the sense of setting up the institutional infrastructure for the WTO and its dispute settlement mechanism, or in the sense of containing all of the trade-liberalising principles for new frontiers like services, foreign direct investment (FDI), and intellectual property (IP).[15] However, even these

features of the WTO draw on, or are inspired by, GATT provisions—for example, Article XXIII on dispute settlement, Article XXV on joint action, and Articles I, II, III, and XI on trade liberalisation obligations. The point is GATT is the Constitution in the sense of laying out the trade-liberalising principles that the WTO oversees, that are the subject of adjudication at the WTO, and that have been extended to new frontiers precisely because they are so valuable.

This point is evident not only in the indirect influence of GATT on the development of the *General Agreement on Trade in Services* (*GATS*), but also in a number of specialties within international trade law. For instance, in anti-dumping (AD) law, GATT Article VI is the font of many AD rules found in the WTO *Agreement on the Implementation of Article VI of the General Agreement on Tariffs and Trade 1994* (i.e.the *Anti-dumping Agreement* or *AD Agreement*). As another example, in customs law, Article VII, which deals with valuation, is the foundation for the WTO *Agreement on the Implementation of Article VII of the General Agreement on Tariffs and Trade 1994* (i.e. the Customs Valuation Agreement). Admittedly, there is no obvious end to this line of reasoning. For example, Article XIX, which establishes a general safeguard action, is the conceptual basis for special safeguard actions, such as the remedy in Article 5 of the WTO *Agreement on Agriculture*. It would be hard to conceive of disciplines on agricultural support (or, for that matter, non-agricultural support) without the disciplines on subsidies in GATT Articles VI and XVI.[16]

1–026 The extensions from GATT into specialty areas of international trade law are evidence that in respect of concepts, there is no adamantine distinction between many of the Articles in GATT, on the one hand, and one or more of the large number of agreements and understandings reached in multilateral trade rounds (particularly the 1986–94 Uruguay Round) on the other hand. The title of this treatise should not suggest otherwise. The rubric *Modern GATT Law* connotes a concentration on GATT, as a Constitution, and indicates the treatise does not purport to cover all of the WTO accords too. At the same time, the title allows for some flexibility, which is appropriate given the inevitable and myriad connections between the GATT Constitution and WTO law.

Indeed, in the areas of customs and AD law in particular, special attention is paid to the extensions from GATT. To ignore these obvious links would risk rendering this treatise less useful to some practitioners and scholars. Moreover, legal scholars and teachers sometimes overlook these links. Further, the relationships between GATT, on the one hand, and the WTO accords on customs valuation and AD law, are keenly interesting. Certainly, drawing the line can be more of an art than a science. There is no end either to depth on GATT or projections of GATT into the WTO texts.

Perhaps another—and complementary—way to characterise the relationship of GATT to the WTO is that of parent to child. The child (in the best of worlds) exceeds beyond the hopes of the parent. The child could not have begun the journey without the parent. And, the child always carries the teachings of the parent.

"Each Member *shall ensure the conformity* of its laws, regulations and administrative procedures with its obligations as provided in the annexed Agreements."(Emphasis added.) Further, paragraph 5 of Article XVI precludes the possibility of reservations: "*No reservations may be made in respect of any provision of this Agreement.* Reservations in respect of any of the provisions of the Multilateral Trade Agreements may only be made *to the extent provided for in those Agreements.* Reservations in respect of a provision of a Plurilateral Trade Agreement shall be governed by the provisions of that Agreement." (Emphasis added.)

[16] For discussions of the WTO *Agriculture Agreement*, see, e.g. Michael N. Cardwell, Margaret R. Grossman & Christopher P. Rodgers (eds), *Agriculture and International Trade – Law, Policy and the WTO* (2003); Melaku Geboye Desta, *The Law of International Trade in Agricultural Products – From GATT 1947 to the WTO Agreement on Agriculture* (2002); Raj Bhala, *World Agricultural Trade in Purgatory*, 79 North Dakota Law Review 691–830 (2003); Merlinda Ingco & L. Alan Winters (eds), *Agriculture Trade Liberalisation in a New Trade Round – Perspectives of Developing Countries and Transition Economies* (World Bank Discussion Paper No.418, 2000).

Section X: WTO Structure

1–027 The World Trade Organisation (WTO) was born on January 1, 1995, a product of the Uruguay Round. The treaty by which it was created is the Agreement Establishing the World Trade Organisation (WTO Agreement). This treaty sets up the structure of the WTO and the rules by which it operates. In four Annexes to this treaty are all of the substantive texts containing multilateral trade law. The first agreement, in the first Annex, is GATT. That is as it should be, as GATT contains so many rules, principles, and even precepts that are reincarnated, in one form or another, in the accords annexed to the WTO Agreement.

A subsequent Chapter on the Uruguay Round (1986–94) summarises the four Annexes to the *WTO Agreement* and the texts contained in them. Then, in appropriate Chapters throughout this treatise, these texts are treated. This treatment is GATT-centric, in that they are discussed in light of their origins, direct or indirect, from the GATT, and in light of the ways they extend GATT into new territory. That is, rather than follow a conventional approach and work through the WTO accords, one by one, *in seriatim*, these texts are examined in relation to the GATT Article to which they most closely relate. After all, it is GATT that came first.

Thus, for instance, it is historically accurate and legally enlightening to understand the GATT Article III national treatment principle before encountering the national treatment principle in Article 2:1 of the WTO *Agreement on Technical Barriers to Trade* (*TBT Agreement*). It is even more helpful to know Article III before looking at WTO Appellate Body jurisprudence on Article 2:1, which is grounded considerably on the GATT principle. Similarly, it is better to understand GATT Article XIX, and then look at the WTO *Agreement on Safeguards*, rather than open up this *Agreement* first and treat Article XIX has an historical curiosity. Knowledge of GATT Article XIX is all the more helpful when learning about and evaluating WTO jurisprudence on safeguards.

1–028 The *WTO Agreement*, and each text annexed to this Agreement, entered into force on January 1, 1995, except for the *Agreement on Trade Related Aspects of Intellectual Property Rights* (*TRIPs*), which took effect on January 1, 1996. Of course, manifesting special and differential treatment for poor countries, deferred entry dates pertained to developing and least developed countries.

For present purposes, it is important to appreciate the basic structure of the WTO. Diagram 1-1 sets out the organisation chart of this international body.[17]

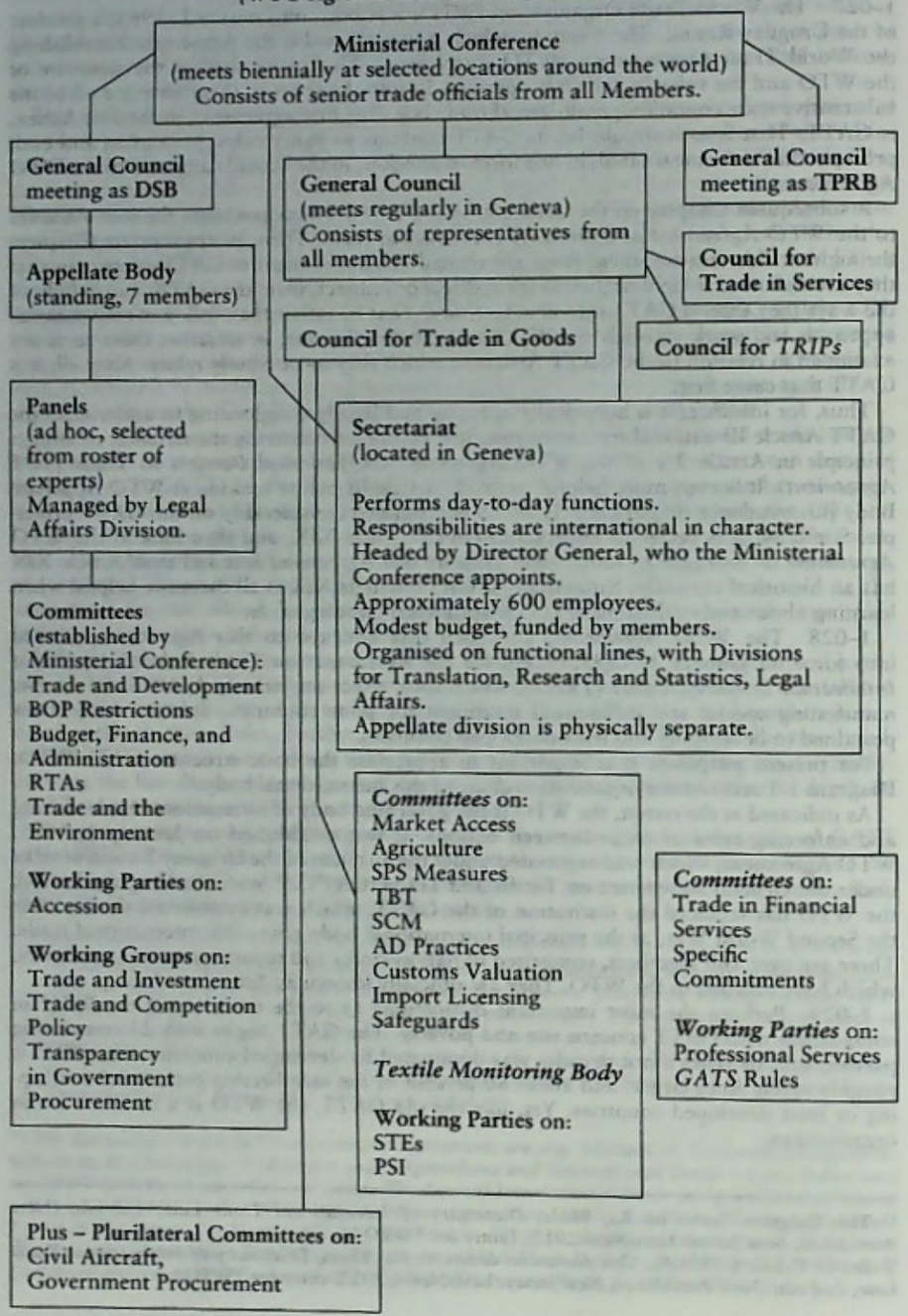
As indicated at the outset, the WTO is the governing body of international trade, setting and enforcing rules of trade between nations. It was established on January 1, 1995, WTO Agreement, which was negotiated under the auspices of the Uruguay Round of talks under the General Agreement on Tariffs and Trade (GATT).[18] Since the Uruguay Round, the WTO has replaced the institution of the GATT, which was established shortly after the Second World War, as the principal international body governing international trade. There are over 160 members, comprised of nation-states and separate customs territories, which have acceded to the WTO. They are officially known as "members."

1–029 Perhaps the most important distinctions as to the make-up of the WTO in comparison with GATT concern size and poverty. The GATT began with 23 contracting parties, and for years if not decades was dominated by developed countries. The WTO is roughly seven times larger, and about 80 percent of the membership consists of developing or least developed countries. Yet, like the old GATT, the WTO is a member-driven organisation.

[17] This Diagram draws on Raj Bhala, *Dictionary of International Trade Law*, 2nd edn (New Providence, New Jersey: LexisNexis2012), (entry for "WTO").

[18] *See* 19 U.S.C. § 3501(8). This discussion draws on Raj Bhala, *Dictionary of International Trade Law*, 2nd edn (New Providence, New Jersey: LexisNexis, 2012) entry for "WTO".

Diagram 1-1: WTO Organisation Chart
(WTO Agreement Articles IV, VI–VII, XII)



All major decisions are made by the membership as a whole, either by ministers at the Ministerial Conference, or by their ambassadors or delegates under the General Council. This distinguishes the WTO from other international organisations, such as the International Monetary Fund (IMF) and the World Bank. Major decisions at the IMF and World Bank are taken by a Board of Directors, or by the head of the organisation. Manifestly, as the Membership grows in size and economic, social, cultural, and religious diversity, consensus-based decision making and single-undertaking requirements for trade deals is increasingly different.

The principal goal of the WTO is to help producers of goods and services, exporters, and importers conduct their business and to improve the welfare of the peoples of its member countries by lowering tariff barriers and providing a platform for negotiation of trade. In other words, the primary objective of the WTO is to ensure trade flows as smoothly, predictably, and freely as possible. To achieve this aim, the primary functions of the WTO include:

1) Administering trade agreements;
2) Acting as the forum for trade negotiations;
3) Settling trade disputes;
4) Reviewing national trade policies;
5) Assisting developing countries in trade policy issues, through technical assistance and training programs; and
6) Co-operating with other international organisations.

1–030 The WTO abides by five principles when carrying out its primary functions. That is, five points define the raison d'être of the WTO, all of which are discussed in detail in subsequent chapters.

First, the WTO requires non-discrimination amongst its members. The two elements of this principle include the most-favored nation (MFN) principle and national treatment requirement. The MFN principle forbids discrimination in respect of like products originating in different members. National treatment requires equal treatment of imported and locally produced goods in respect of like or directly competitive or substitutable products.

Secondly, the WTO seeks achievement of freer trade through negotiations. Trade liberalisation occurs progressively as countries mutually agree to reduce their tariff and non-tariff barriers to trade.

1–031 Thirdly, the WTO aims to facilitate trade by requiring members to bind their tariff rates and increase transparency. Enduring commitments encourages stable, predictable terms for commercial intercourse between and among public and private parties.

Lastly, the fourth and fifth principles ensure WTO operations promote fair competition, while also supporting development and economic reform.

As is clear from Diagram 1-1, the WTO is led by three governing bodies. First, the Ministerial Conference is the top decision making body of the WTO. It is comprised of trade ministers from each member. The Ministerial Conference meets once every two years. The Conference takes decisions concerning the fundamental operations of the organisation, such as the accession of new members and selection of a new Director General.

1–032 There have been nine Ministerial Conferences since the birth of the WTO in 1995:

1) Singapore (December 9–13, 1996)
2) Geneva, Switzerland (May 18–20, 1998)
3) Seattle, Washington, United States (November 30 to December 3, 1999)

4) Doha, Qatar (November 9–14, 2001)
5) Cancún, Mexico (September 10–14, 2003)
6) Hong Kong, SAR, China (December 13–18, 2005)
7) Geneva, Switzerland (November 30 to December 2, 2009)
8) Geneva, Switzerland (December 15–17, 2011)
9) Bali, Indonesia (December 3–6, 2013)

Article IV:1 of the *WTO Agreement* calls for a Ministerial Conference every two years. Hence, the WTO violated its own rules with the four-year gap between 2005 and 2009.

The 2009 Geneva Ministerial Conference was not intended as a venue for negotiations on the Doha Development Agenda (DDA). Doha Round negotiations continued on a separate track. Of course, the tracks were not entirely separate. One reason for the four year delay was exhaustion—negotiating fatigue—over the DDA. Moreover, the theme of the 2009 Geneva Conference, which was "The WTO, the Multilateral Trading System, and the Current Global Economic Environment," certainly was wide enough to include Doha Round discussions at the margin. This Conference also sought to be a so-called "FIT" one, meaning full participation, inclusiveness, and transparency, amidst a lean, non-extravagant atmosphere.

1–033 Cities that host Ministerial Conferences are in the firing line of anti-globalisation and anti-WTO protestors. Not surprisingly, given its reputation for order and security, Geneva is a favorite spot for the conferences. To be sure (and at the risk of some cynicism), some WTO diplomats from dreadfully poor, dangerous, or uneventful capital cities enjoy these attractions of Geneva, as well as the shopping opportunities there. Yet, the fact is some cities understandably prefer not to host a major international economic gathering of "establishment" figures knowing that the event will trigger "anti-establishment" protestors, and thus require an investment of time and money on logistics and security.

Directly below the Ministerial Conference is the General Council. This Council is composed of ambassadors and heads of delegation in Geneva, Switzerland. The General Council undertakes the day-to-day operations of the WTO. Meeting several times a year, the General Council also meets as the Trade Policy Review Body (TPRB) to review Member States national trade laws, and as the Dispute Settlement Body (DSB), to settle disputes between Member States.

Three additional entities operate under the General Council. These subsidiary entities are the Goods Council, Services Council, and Intellectual Property (TRIPS) Council. Under these Councils, several further subsidiary bodies, such as committees, work to formulate policies on particular trade issues. Examples of these committees include the Committee on Trade and the Environment, Committee on Regional Trade Agreements, and the Working Party on Accession.

1–034 Last, the WTO Secretariat is located in Geneva and operates with a staff of about 625 and a modest budget of approximately 182 million Swiss *francs* (US $150 million). The main function of the Secretariat, which is led by a Director General, is to supply technical support for the various councils, committees and ministerial conferences. It also provides technical assistance to developing countries, analyses world trade, and serves as the official medium by which the WTO relays its policies to the public and the media.

The first four Director Generals to serve the WTO were:

1) Renato Ruggeiro (May 1, 1995 to August 31, 1999), from Italy.
2) Mike Moore (September 1, 1999 to August 31, 2002), from New Zealand.
3) Supachai Panitchpakdi (September 1, 2002 to August 31, 2005), from Thailand.

4) Pascal Lamy (September 1, 2005 to August 31, 2009, and reappointed for a second term from September 1, 2009 to August 31, 2013), from France.

It is regrettable that notwithstanding the vast majority of WTO members being developed or least developed countries, and despite the manifest importance of the Asia-Pacific region in the latter half of the 20th century and at least the first half of the 21st century, the Director Generals have tended not to come from, or grown up in, such places. This shortcoming is due in part to the selection process, which tends to be influenced heavily—perhaps too heavily—by Europe and the United States.

1–035 In any event, selection of the Director General is a four-step procedure. First, WTO members make nominations of individuals for the post. Secondly, the nominated candidates go to Geneva for interviews with members. Thirdly, a Selection Committee consisting of the Chairmen of the WTO General Council, Dispute Settlement Body, and Trade Policy Review Body, consults with the members as to the candidates. The goal of the consultations is to allow the Committee to narrow the field of candidates to one finalist. Following each round of consultations, the Committee asks the candidate with the least support to withdraw his or her name from consideration. Iterations of this process continue until one candidate is left. Finally, the Committee puts forth the single name to the WTO members with the recommendation that he or she be selected as Director General by consensus. In the final step, the members may request the single candidate to make a presentation outlining his or her vision for the future of the WTO, and engage in a question-and-answer session with them. They did so, for example, in April 2009 with respect to the re-appointment of Pascal Lamy as Director General.

Selection of the Director General has at times been acrimonious, revealing schisms in the membership between rich and poor countries, and among rich countries, and among poor countries. For example, in 1998–99, members divided themselves into various coalitions over the selection of Mike Moore versus Supachai Panitchpakdi, and ultimately compromised by splitting one full term between the two men. A bitter aftertaste persisted among many members. Top management of the Secretariat, beneath the Director General level, consists of four Deputy Director Generals. They are chosen in part to embody regional balance.

Section XI: Consensus Decision Making

1–036 Decisions at the WTO are reached by consensus.[19] Beginning in early GATT trade rounds, tradition has held that decisions are reached by a consensus of all contracting parties—i.e. the Contracting Parties (with large/small capitals, or all capitals, signifying joint action by consensus). The tradition carries into the WTO (without the corresponding use of "Members" or "MEMBERS"). Effectively, then, "consensus" means unanimity, in that all members agree to take the proposed decision, with no member or group of members raising objections in a way to block movement forward.

The process of reaching consensus can be time-consuming, as (among many examples) the Doha Round suggests. Notably, WTO Director General Pascal Lamy once described the WTO as a "medieval" organisation, because of its tradition of consensus-based decision making.[20] Of course, that description rides roughshod over the interests of smaller WTO members, and the principle of treating nations with equal dignity, regardless of size, wealth, or power.

[19] This discussion draws on Raj Bhala, *Dictionary of International Trade Law*, 2nd edn (New Providence, New Jersey: LexisNexis,2012) entry for "WTO".
[20] See Daniel Pruzin, *Lamy Moves Early, Gets Support in Bid for Second Term as WTO Director-General*, 25 International Trade Reporter (BNA) 1601–1602 (November 13, 2008).

What happens if a consensus is not possible? Then, the WTO Agreement allows for voting. On the basis of one country, one vote, a vote is won with a majority of the votes cast. However, actual votes rarely, if ever, occur. That was true under the old GATT system, and remains the case in the WTO.

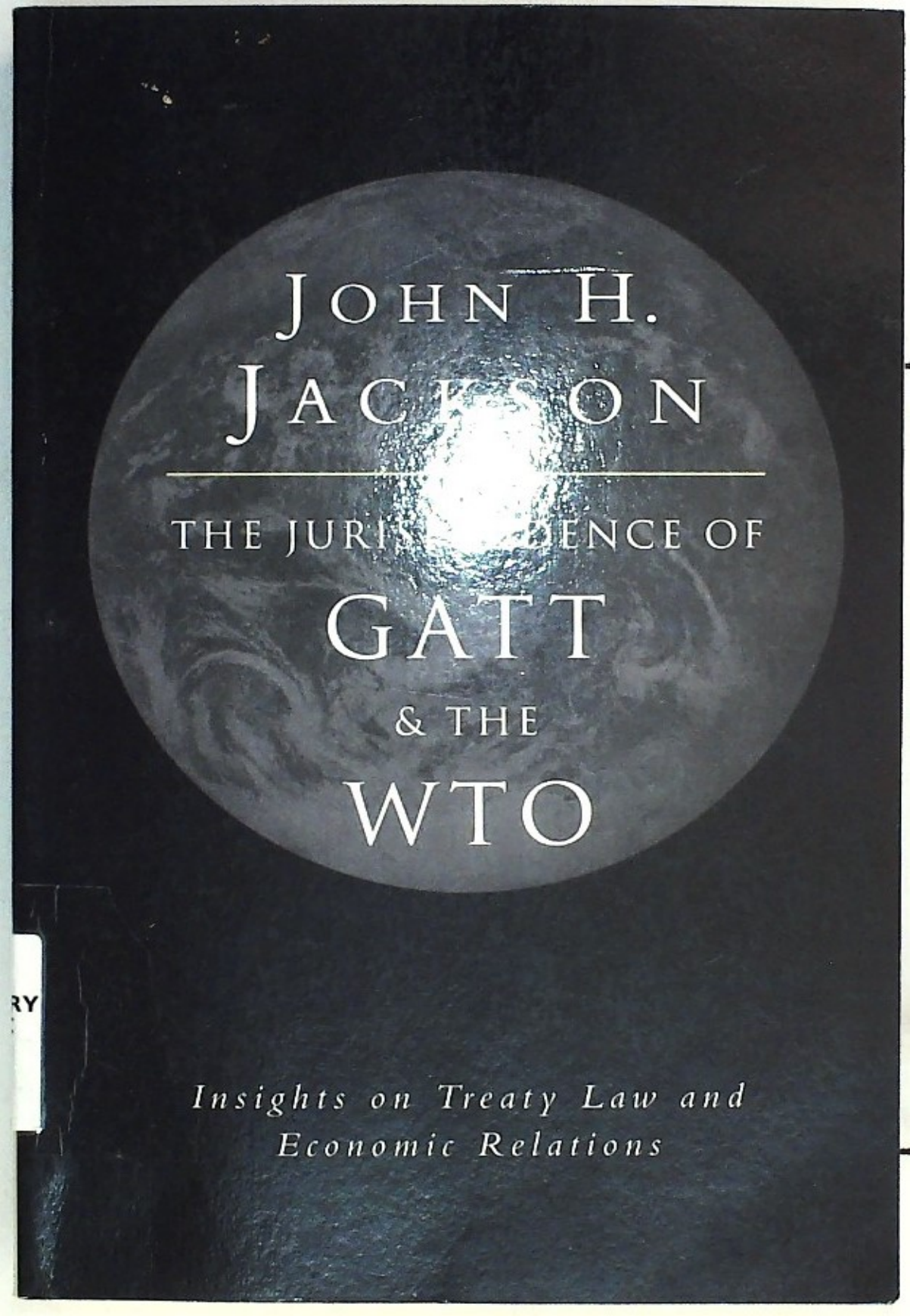
1–037 Observe the consensus system, with the underlying possibility of equal voting rights, is—on paper, at least—highly democratic. It is not "might is right." It is not budget weighted voting. It is not voting based on share ownership, which in turn depends on capital contributions. Again, in theory, it is not nearly so antithetical to small, poor countries, nor so skewed in favour of a few, rich, powerful countries, as many anti-WTO critics contend. That said, of course, in practice certain countries—developed and developing—do wield disproportionate influence. That, however, may well be a feature of any human institution.

There are four exceptions to this general rule. A vote of three-fourths of all WTO members is required to 1) adopt an interpretation of a multilateral trade agreement, or 2) waive an obligation due from a WTO Member State under a multilateral trade agreement. A two-thirds majority vote of all WTO members is needed to 3) admit a new member to the WTO, or 4) amend provisions of any multilateral trade agreement. Amendments to multilateral agreements may be enforced against only those countries that adopted them.

Note that decisions by the General Council operating as the DSB are taken by the "reverse consensus" rule, also called the "negative consensus" rule. That means the DSB agrees to a proposed course of action (typically, formation of a panel, or adoption of a panel or Appellate Body report), unless there is a consensus not to do so. The reverse consensus rule is an important innovation of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* (*Dispute Settlement Understanding*, or *DSU*), to facilitate adjudication and avoid problems of delays, blockage, and enforcement, which plagued the pre-Uruguay Round dispute settlement system under GATT Article XXIII.

1–038 Since its inception in 1995, the WTO has only attempted one trade round, namely, the Doha Development Agenda (DDA), commonly called the "Doha Round."[21] As of December 2012, that Round is dead. It, and all previous Rounds, are discussed in subsequent chapters.

[21] Mangling Trade, *Economist*, June 28, 2007 p.86.


JOHN H.
JACKSON
THE JURISPRUDENCE OF
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& THE
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Insights on Treaty Law and
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Contents

2 The puzzle of GATT: legal aspects of a surprising institution*

Nineteen years ago last October delegates of twenty-two nations signed a temporary agreement involving tariffs and international trade.[1] Today, two decades later, this "temporary agreement" is one of the principal regulating institutions for the international trade of over seventy nations.[2]

If one were asked in the early years of the General Agreement on Tariffs and Trade (GATT) whether or not it would survive long, the answer no doubt would have been very pessimistic. With scarcely any institutional framework, with no provision for a secretariat,[3] and with

* This chapter is based on John H. Jackson, "The Puzzle of GATT: Legal Aspects of a Surprising Institution" (1967) 1 *Journal of World Trade Law* 2, 131–161. I wish to acknowledge the assistance of the University of California School of Law, Berkeley (where I was Professor of Law until the summer of 1966), in providing resources and leave time for conducting research on the law of GATT. I also wish to acknowledge the cooperation of various members of the GATT Secretariat in Geneva, Switzerland, as well as members of various delegations there.

[1] General Agreement on Tariffs and Trade, October 30, 1947, 55 UNTS 194.

[2] The latest status of the GATT membership is set forth in GATT Press Release 973 of November 1, 1966. There are seventy contracting parties to the GATT, plus four countries which have acceded provisionally, two countries which participate in GATT under special arrangements, and eight countries which apply GATT *de facto* pending final decision as to future commercial policy. GATT documentation is extensive. Letter and number document designations in this article are GATT documents unless otherwise specified. Citations to GATT documentation in this article will utilize the following abbreviations and symbols: "PR" for press release; and "L/" followed by a number, indicates the "L" series of documents. The *Basic Instruments and Selected Documents* are a series of volumes, usually one per year, containing selected documents from GATT. Recently, GATT has completely revised its policy of derestricting documents, so as of December 8, 1966 a large number of GATT documents have become available to the public for the first time. See INF/121, L/2647, and INF/122.

[3] The General Agreement itself contains no mention of a secretariat. The original idea was that the secretariat of the International Trade Organization (ITO) would service GATT, and at the beginning of GATT the "Interim Commission for the International Trade Organization" (ICITO) performed the services of the secretariat. To this day, the legal structure, when it is not blurred, consists of this relationship. Rule 15 of the Rules of Procedure for the Contracting Parties of GATT provides: "[T]he usual duties of a Secretariat shall, by agreement with the Interim Commission for the International Trade Organization, be performed by the Executive Secretary of the Interim Commission on a reimburs-

legal ties to an organization that failed to materialize,[4] the GATT would hardly have qualified as "most likely to succeed" among the international organizations set up in the years immediately following World War II. Indeed, in theory at least, GATT was not an "international organization" at all – merely an "agreement."[5] Despite the lack of an institutional framework, despite lack of financial support except of the most meager sort,[6] and despite the powerful forces for trade protectionism which killed the International Trade Organization (ITO)[7] and tried to kill GATT,[8] GATT survived. The fact that GATT did survive, and that it has become a major force in international relations today, is not only surprising but instructive.

It is instructive because it tends to indicate that legal structures or institutions have less to do with the development of affairs than dimly understood political or economic forces, aided by the efforts of dedicated men. One could argue that, despite the apparent obstacles, GATT survived and developed because history "required" it to do so. These explanations, more appropriate for the historian, the political scientist, or the economist than for the lawyer, suggest that constitutional form may not be as significant in international institutions as it seems.

These reflections suggest the danger of a "legal approach" to the GATT. This is reinforced when one observes GATT work at close hand. Lawyers' considerations seem to play a small part. The secretariat which serves GATT presently has no position for a lawyer. Delegates and secretariat members often express an attitude such as "Let's not be concerned with legal technicalities." The GATT has consciously abandoned an attempt to

able basis." Further discussion of the many interesting legal problems of the Secretariat of GATT had to be omitted from this article due to space limitations.

[4] The International Trade Organization (ITO) Charter was drafted at the Havana Conference 1947–1948, but when the US President finally decided in 1950 not to submit the ITO Charter to Congress for ratification, the ITO died. See Diebold, "The End of the ITO . . ." (Princeton Essays in International Finance No. 16, 1952); and Gardner, *Sterling–Dollar Diplomacy* (Clarendon Press, Oxford, 1956), 378.

[5] The General Agreement refers to "contracting parties" and to "CONTRACTING PARTIES." The latter, according to Article XXV(1) means the contracting parties "acting jointly." At one of the preparatory sessions for GATT is was decided to use the term "contracting parties," instead of "committee" or some other term, in order to remove any connotation of formal organization. GATT, *Analytical Index to the General Agreements* (2nd revision, 1966), 133. See UN Doc. EPCT/TAC/PV/12, 3.

[6] The total GATT budget today is about US$3 million (L/2694), as compared to about US$18 million for the International Monetary Fund, US$19 million for the International Labor Organization, and US$21 million for the Food and Agriculture Organization.

[7] See Diebold, "The End of the ITO"; and Gardner, *Sterling–Dollar Diplomacy*.

[8] There is a history of hostility in the US Congress against GATT. One example of this is still in 19 USC 1351 where Congress states: "[T]he enactment of the Trade Agreements Extension Act of 1955 shall not be construed to determine or indicate the approval or disapproval by the Congress of the executive agreement known as the General Agreement on Tariffs and Trade."

solve some legal problems which seemed perplexing and irreconcilable, proceeding on to other business.[9]

Yet legal problems there are. The GATT is being invoked before national courts.[10] Certain provisions of GATT have proved very confining and yet have been respected.[11] Some delegates to GATT have expressed a plea to "know where we stand, to know our rights," and others have been pushing for greater sanctions in the event of breach.[12]

The purpose and commission of this article is to survey the legal aspects of the GATT. It is not an easy assignment because any selection of problems is certain to leave out interesting and important topics, and because most of the problems selected for treatment here can each form the focus of a lengthier work. Nevertheless, this discussion may serve as a starting point for those who wish to study GATT law.[13]

This article will discuss legal aspects of GATT under five major headings as follows:

I. The fundamental treaty law of GATT.
II. Tariff negotiations and tariff bindings.
III. Protecting the value of tariff concessions.
IV. Exceptions and escape clauses: continuous negotiation in GATT.
V. Dispute resolution in GATT.

[9] See, for example, GATT, "Report of the Working Party on the Association of Overseas Territories with the European Economic Community including Commodity Trade Studies" (GATT Doc. L/805/Rev. 1, 1958), 5. See also GATT, Report by the Intersessional Committee, "The Treaty Establishing European Economic Community," para. 3, reprinted at *Basic Instruments and Selected Documents*, 7th Supplement, 69, 70.

[10] See, for example, US *amicus curiae* brief in the case of *Tupman Thurlow Company Inc.*, v. *W. F. Moss, Commissioner*, 252 F. Supp. 641 (1966), 5 ILM 483; *Baldwin-Lima-Hamilton Corp.* v. *Superior Court*, 208 Cal. App. 2d 803, 25 Cal. Reptr. 798 (1962) (hearing denied December 19, 1962). See also Comment, "GATT, the California Buy American Act, and the Continuing Struggle Between Free Trade and Protectionism" (1964) 52 *California Law Review* 335; Comment, "National Power to Control State Discrimination Against Foreign Goods and Persons. A Study in Federalism" (1960) 12 *Stanford Law Review* 355; Comment, "California's Buy-American Policy: Conflict with GATT and the Constitution" (1964) 17 *Stanford Law Review* 119.

[11] See the discussion of Article XXX of GATT concerning amendments in Part I.C below.

[12] For proposals to amend Article XXIII of GATT to establish rules increasing sanctions for breach of GATT, see GATT Doc. COM.TD/F/1–4.

[13] See, in addition, Seyid Muhammad, *The Legal Framework of World Trade* (Praeger, New York, 1958); and Note, "United States Participation in the General Agreement on Tariffs and Trade" (1961) 61 *Columbia Law Review* 505. For a more general treatment from an economist's viewpoint, see G. Curzon, *Multilateral Commercial Diplomacy: The General Agreement on Tariffs and Trade and Its Impact on National Commercial Policies and Techniques* (Michael Joseph, London, 1965).

I. The fundamental treaty law of GATT

The basic treaty, the "General Agreement" itself, was completed in October 1947. It has technically never come into force,[14] being applied by a "Protocol of Provisional Application" described below.[15] The GATT has been amended a number of times,[16] and affected by other protocols, including some not technically "in force" themselves,[17] so that even the basic treaty is a complex set of instruments, applying with different rigor to different countries. For the lawyer to ascertain, at any given time, the precise legal commitments between any two nations is no easy task.[18] This part will outline the steps necessary to make such a determination, in four subtopics:

1. a brief survey of the preparatory work for GATT with an analysis of its relevance to GATT and its relation to the ITO which was drafted at the same time;

[14] Article XXVI of GATT governs how governments may accept the Agreement itself, and provides a formula for ascertaining when a sufficient number of governments has accepted the agreement so that it enters into force. From the GATT documentation it appears that only one country, Haiti, has accepted the General Agreement itself. See L/2375/Add. 1, 20 (March 5, 1965 document, reprinting a document of September 25, 1958).

[15] See subpart B below.

[16] Lists of protocols and treaties affecting the GATT may be found in UN Doc. ST/LEG/3, Status of Multilateral Conventions, for instruments drawn prior to February 1, 1955 and deposited with the Secretary-General; and GATT Doc. PROT/2 (as revised through August 1966) for instruments drawn subsequent to February 1955. Some of these instruments actually amend the text of GATT, while others simply affect the rigor or force, or the parties involved, of various clauses in GATT. There are thirty-six treaty instruments including the General Agreement itself listed in UN Doc. ST/LEG/3. GATT Doc. PROT/2 lists sixty-seven instruments up to July 1966. For protocols subsequent to July 1966, see L/2714 (December 2, 1966). It should be noted that, in addition to the instruments listed in the two official lists as relating to GATT, there are certain other instruments with treaty force or treaty-like characteristics which also relate to GATT. Some are in force and some not. Among these are, of course, the Havana Charter itself (see UN Doc. ICITO/1/4; and UN Doc. E/CONF.2/78), two GATT "Certifications of Rectifications and Modifications"; Long-term arrangement regarding international trade and cotton textiles (GATT 1963). There are also others, including a number of bilateral agreements between parties to GATT which relate to their GATT obligations.

[17] GATT Doc. PROT/2 indicates which of the instruments listed therein are in force, and to which countries they apply.

[18] For instance, obligations relating to subsidies found in Article XVI(4) of GATT are affected by a series of Declarations and "*procès-verbaux*." Since some newly independent countries became members of GATT under sponsorship procedures outlined in this article below at subpart D of this part, and since such independent countries are deemed to have the same position in GATT as the sponsoring country at the time of sponsorship, such new GATT parties might be considered to have the same position with respect to Article XVI(4) as the sponsoring country at the time of the sponsorship. Yet an examination of GATT Doc. PROT/2, 42 regarding the Declaration Giving Effect to the Provisions of Article XVI(4) indicates that no new independent, less developed country which entered GATT under sponsorship is deemed to be applying this clause of the GATT. It is not clear why this is the case, although added information from specific governments concerned might enable one to rationalize this position.

2. the Protocol of Provisional Application and its relation to GATT, to introduce the problem of what is the legal force of GATT;
3. the amending process of GATT; and
4. a short introduction to the complex "membership" law of GATT, suggesting an approach to the question of which nations are legally bound by portions of the General Agreement.

A. Preparatory work

The collapse of international trade in the 1930s and its effects on peace and war led some world leaders to conclude that new international economic institutions were essential.[19] The goals envisaged for such institutions were as much political as economic – the prevention of war and the establishment of a just system of economic relations were as important as the economic benefits that might derive from international trade and economic stability.[20] During World War II preparations were made for developing such institutions.[21] The Bretton Woods Conference and the resulting agreements were the early result of these preparations.[22] But even at that conference it was recognized that an international organization to regulate trade was a necessary complement to the IMF and the IBRD.[23]

The US State Department had prepared a draft charter of an International Trade Organization.[24] At the first session of the United Nations, the Economic and Social Council resolved[25] that a conference to draft a charter for an ITO should be called, and that a preparatory committee for this conference be established.

In all, four international conferences were held to draft an ITO charter, three of which were "preparatory."[26] The first was a meeting of the

[19] See Gardner, *Sterling–Dollar Diplomacy*; US State Department, "Sumner Welles Speech 1941" (Commercial Policy Series No. 71), and US State Department, "Harry Hawkins Speech 1944" (Commercial Policy Series No. 74).

[20] In addition to the speeches and materials referenced in the previous footnote, see the general policy speeches made by delegates at the opening of the Second Session of the Preparatory Committee at the Geneva Conference in 1947, UN Doc. EPCT/PV2/1–4.

[21] See Gardner, *Sterling–Dollar Diplomacy*.

[22] See Bretton Woods Proceedings, the Articles of Agreement of the International Monetary Fund, and of the International Bank for Reconstruction and Development.

[23] Bretton Woods Proceedings, vol. 1, 941. The conference resolved "complete attainment of... purposes and objectives [of the IMF] ... cannot be achieved through the instrumentality of the fund alone," and recommended that the governments seek agreement "to reduce obstacles to international trade and in other ways promote mutually advantageous international commercial relations."

[24] US State Department Doc. 2411, December 1945.

[25] UN Economic and Social Council Resolution 1/13, February 18, 1946, UN Doc. E/22.

[26] The documents of all conferences are officially United Nations documents. The first three bear the document numbers E/PC/T (herein shortened to EPCT) plus other letters and numbers designating sub-bodies of the Preparatory Committee. The fourth, the Havana

"Preparatory Committee" in London from October 15 to November 26, 1946.[27] The second was a meeting of the "Drafting Committee" of the Preparatory Committee, held at Lake Success, New York, from January 20 to February 25, 1947[28] to edit and draft a charter in light of the London meeting, with alternatives for provisions on which the London meeting could not agree. The third was the Geneva Conference, officially the Second Session of the Preparatory Committee, which was held from April 10, 1947 to October 30, 1947.[29] This conference had a dual function. On the one hand the Committee continued its drafting of an ITO charter, preparing for the Havana Conference. On the other hand, twenty-two nations undertook negotiations with a view to reducing tariffs and embodied the results of these negotiations in the General Agreement on Tariffs and Trade.[30]

Fourthly, the Havana Conference itself was held from November 21, 1947 to March 24, 1948 for the purpose of finally drafting an ITO charter.[31]

Clearly from the point of view of GATT problems, the Geneva Conference was the most important. The GATT was finally drafted there (a previous draft had been prepared at Lake Success[32]) and transmitted to governments.[33] But in an important sense all preparatory work for the ITO charter is relevant to GATT. Much of the GATT was taken verbatim from the draft of the ITO charter as it stood at the end of the Geneva Conference deliberations on ITO.[34] The General Agreement was expressly tied to the prospective ITO.[35] For example, certain clauses resulting from the Havana

Conference, bears the document numbers E/CONF.2/-. See GATT, *Analytical Index to the General Agreements* (2nd revision, 1966), ii and iii.

27 Report of the First Session of the Preparatory Committee of the United Nations Conference on Trade and Employment, London, October 1946.

28 Report of the Drafting Committee of the Preparatory Committee of the United Nations Conference on Trade and Employment, Lake Success, New York, EPCT/34, March 5, 1947.

29 Report of the Second Session of the Preparatory Committee of the United Nations Conference on Trade and Employment, Geneva, August 1974, EPCT/186; Final Act adopted at the conclusion of the Second Session etc., 55 UNTS 188 (October 30, 1947).

30 The documents of the Geneva Conference most relating to GATT were in a series EPCT/TAC/- (the Trade Agreement Committee).

31 Final Act and related documents, United Nations Conference on Trade and Employment, April 1948. UN Doc. ICITO/1/4 and E/CONF.2/78. See also ICITO, September 1948, Reports of Committees and Principal Subcommittees [of United Nations Conference on Trade and Employment held at Havana, Cuba], UN Doc. ICITO/1/8.

32 Report of the Drafting Committee of the Preparatory Committee, EPCT/34, 65 (note 28 above). See also "Resolution regarding the negotiation of a multilateral trade agreement embodying tariff concession," in Report of the First Session of the Preparatory Committee, EPCT/33, 47.

33 Final Act adopted at the conclusion of the Second Session etc. (note 29 above).

34 See EPCT/189, August 30, 1947, the draft of the General Agreement on Tariffs and Trade taken from the Preparatory Committee's text of corresponding Articles in the draft Havana Charter as embodied in EPCT/180.

35 Article XXIX of GATT is entitled "The Relation of the Agreement to the Havana Charter."

Conference were to be substituted in the General Agreement, absent objection, if the ITO came into effect, and later amendments to GATT reflected Havana Conference work on the ITO.[36] Finally, when the ITO failed to come into being, the GATT had to fill the gap in international relations.[37] However, persons dealing with the GATT were often those who had drafted the ITO and their attitudes towards GATT were undoubtedly colored by their experiences in the ITO negotiations.[38]

The function of the preparatory work for ITO in the interpretation of the GATT is thus complex. Although a broad brush generalization would state that all ITO preparatory work is relevant to GATT, a stricter view would conclude that the ITO preparations must be specifically traced as a source of language in the GATT, to be relevant.

Even when the ITO preparatory work relates to a clause of the ITO charter which was selected for inclusion in GATT, there is arguably a difference in the effect of that preparatory work on interpretation of GATT. The GATT was drafted as a "trade agreement," including only those clauses which the draftsmen felt were normally found in trade agreements,[39] and which were considered essential to protect the value of tariff concessions.[40] Consequently the preparatory work pointed to interpretations of GATT which would fulfill these two criteria. GATT was not considered an "organization,"[41] it was merely a contract with specific limited purposes. It is fair to state that the subsequent development of GATT has pushed it far beyond this initial image.[42] The extension of

36 Article XXIX(2) of GATT as it was originally worded stated: "[O]n the day on which the Charter of the International Trade Organization enters into force, Article I and Part II of this Agreement shall be suspended and superseded by the corresponding provisions of the Charter; Provided that ... any contracting party may lodge ... an objection ..." See GATT, *Analytical Index to the General Agreements* (2nd revision, 1966), 125.

37 The official death of the ITO is considered to be the press release of the President of the United States announcing that he would not submit the ITO Charter to the Congress. Gardner, *Sterling–Dollar Diplomacy*, 378.

38 For instance, L. D. Wilgress of Canada was a signatory of the Final Act of the Geneva Conference in 1947 and the Havana Conference in 1948, and was Chairman of the Contracting Parties of GATT from their first through to the fifth and their ninth through to the eleventh sessions (spanning the first nine years of GATT existence).

39 UN Doc. EPCT/TAC/PV/11, 34–35 (September 5, 1947, discussion at Geneva conference).

40 UN Doc. EPCT/TAC/PV/1, 24 (August 5, 1947, Geneva conference discussion).

41 See note 5 above, and discussion in the preparatory work at Geneva, 1947, UN Doc. EPCT/TAC/PV/12 (September 16, 1947).

42 This is evidenced by the continual development of the committee structure in GATT including the early Balance of Payments Committee and the Intersessional Committee, culminating in the development of the "Council" (see *Basic Instruments and Selected Documents*, 9th Supplement, 7, 1961). Another action reflecting the attitude of the Contracting Parties towards the GATT is a decision of March 23, 1965 changing the title of the "Executive Secretary" to "Director-General," thus conforming the title of the chief executive to that of a number of other international organizations. *Basic Instruments and Selected Documents*, 13th Supplement, 19.

GATT's role can be justified not only on the basis of its practice and custom (if one is prepared to accept this as a basis) but also on the basis of continued participation, policy statements, and the utilization of GATT institutions by many of the governments concerned.[43] Coupled with a right to withdraw on relatively short notice,[44] this continued participation suggests an ongoing basic consensus that one can use to rationalize the flexible and pragmatic approach that has characterized GATT during its existence. In any event it is clear that in practice GATT will continue to be treated as a major international organization.

B. *The legal force of GATT and the Protocol of Provisional Application*

In August 1947 at Geneva, the parties to the GATT negotiations were faced with a dilemma. There was the desire to put the tariff concessions into effect as soon as possible in order to prevent market disruption and speculation as well as political opposition that could ensue if details of the concessions leaked or became public information before the Agreement became effective. Against this was the legal necessity for some nations to obtain legislative changes in laws inconsistent with parts of the GATT.[45] The solution chosen was "provisional application," by a protocol which stated that eight named governments undertake:

> provided that this Protocol shall have been signed on behalf of all the foregoing Governments not later than 15 November 1947, to apply provisionally on and after 1 January 1948:
> (a) Part I and III of the General Agreement on Tariffs and Trade, and
> (b) Part II of that Agreement to the fullest extent not inconsistent with existing legislation.[46]

The Protocol allowed other Geneva participants to sign, and stated that any nation could withdraw on sixty days' notice (compared to the six months' notice required in the General Agreement).[47]

This Protocol became effective when the eight named countries signed before November 15, 1947,[48] and it is still effective. The General Agreement

[43] For instance, the Council of GATT has no authorization in the General Agreement itself, but is set up by decision of the Contracting Parties. Yet a considerable number of the contracting parties participate in the work of the Council. Any contracting party who desires can become a member of the Council if it is willing to assume the responsibilities.

[44] See subpart B below.

[45] See the preparatory discussion, Geneva, 1947, UN Doc. EPCT/TAC/PV/1–5.

[46] 55 UNTS 308. [47] *Ibid.*; *cf.* GATT Article XXXI.

[48] The signatures, including some with reservations, are set out at 55 UNTS 312–316. The eight named countries, essential for the Protocol to come into force, were Australia, Belgium, Canada, France, Luxembourg, Netherlands, the United Kingdom, and the United States. These eight signatures were completed before November 15, 1947. Subsequently fourteen other governments signed the Protocol, but four (China, Syria, Lebanon, and Liberia) later withdrew. Curzon, *Multilateral Commercial Diplomacy*.

is applied through this Protocol or similar protocols signed by governments which later became contracting parties to GATT.[49]

What is the effect of this on GATT? There are two major effects; first, the withdrawal period is shorter, as stated above; and, secondly, a large portion of GATT obligations are effective only to "the extent not inconsistent with existing legislation." The first effect needs no additional explanation, except to note that it reinforces the "continuing consensus" interpretation of GATT mentioned above. The second effect needs some elaboration. It might also be argued that the word "provisional" affects the interpretation of the whole GATT agreement because the Protocol applies the entire GATT "provisionally." No instance where the term "provisional" has resulted in any noticeable difference in the approach or application of GATT has been found except as just stated above. "Provisional" seems to be defined by the remainder of the Protocol, and apparently that means only the "fullest extent not inconsistent with existing legislation" (for Part II).

The concept "not inconsistent with existing legislation" needs elaboration. There are three problems that merit discussion. First, "existing" at what point of time? Secondly, whose legislation, that of local subdivisions as well as that of the nation? Thirdly, what does "inconsistent" mean, especially in the context of legislation that is not mandatory but permissive, i.e. which authorizes (but does not require) executive action or regulation which would be inconsistent with GATT Part II?

First, what point of time is relevant? At the third session of the GATT Contracting Parties, an issue was raised whether "existing legislation" in the Protocol meant that which existed at the date a nation signed the Protocol, or the date in the last paragraph of the Protocol (October 30, 1947). After consideration the then chairman of the Contracting Parties ruled that it refers to the latter.[50] The procedure is perhaps more intriguing than the substantive result of this ruling, i.e. the apparent acceptance by states of a ruling of a chairman of a group of government representatives as a definitive interpretation of treaty language.

Secondly, whose legislation is relevant? In a federal state, does "existing legislation" also include legislation of the federal subdivisions? Although this issue has arisen in litigation,[51] it is not easy to answer. The preparatory

[49] The protocols of accession are listed in GATT, *Analytical Index to the General Agreements* (2nd revision, 1966), 155–157.

[50] *Basic Instruments and Selected Documents*, vol. II, 35, Ruling on August 11, 1949.

[51] *Baldwin-Lima-Hamilton Corp.* v. *Superior Court*, 208 Cal. App. 2d 803, 25 Cal. Reptr. 798 (1962) (hearing denied December 19, 1962).

work for GATT does not completely settle it.[52] In the subsequent practice of GATT only one reference to this issue can be found. (India in reporting on "existing legislation" expressly excepted specified subdivision legislation from its report because it had not had the time to study it).[53] Article XXIV, paragraph 12 relates to this problem also and leads one to an analysis that depends heavily on the constitutional law of the nation concerned, both as to the supremacy or non-supremacy of the federal treaties and as to the effect of GATT and the Protocol of Provisional Application as municipal law (without additional implementing legislation).[54]

The third problem concerning the Protocol that must be discussed is the question of what is the "fullest extent not inconsistent with existing legislation." This issue is best posed by a hypothetical.

Legislation of nation A (signatory in 1947 of the Protocol) existing on October 30, 1947 "*authorizes* the President to limit imports by quota whenever they injure a domestic producer, for such time as the President shall determine." Such quotas would be inconsistent with Article XI of the GATT.

1. Prior to October 30, 1947 the President of A had limited imports of perfume to one million units per year, effective indefinitely.
2. In 1948 the President proclaims a quota on wheat of one million units per year.

In either case is A violating its international obligations? If the key word in A's legislation were "requires" instead of "authorizes," one would probably conclude that neither case 1 nor case 2 were a violation of the Protocol. But what about "authorizing" legislation? This issue has generated some controversy in GATT resulting in practice which suggests a conclusion that both cases are a violation of GATT.

When the issue was initially raised in GATT, a working party report adopted by the GATT concluded that measures are within the "existing legislation" exception of the Protocol:

> provided that the legislation on which it is based is by its terms or expressed intent of a mandatory character – that is, it imposes on the executive authority requirements which cannot be modified by executive action.[55]

This ruling was reaffirmed in 1955, at a time when the GATT members considered and accepted a proposal that would allow members to accept

[52] Mention of the problem is found at UN Doc. EPTC/TAC/PV/11, 44; and UN Doc. EPCT/TAC/PV19, 33.
[53] L/2375/Add. 1, 11.
[54] Article XXIV(12) of GATT reads: "Each contracting party shall take such reasonable measures as may be available to it to ensure observance of the provisions of this Agreement by the regional and local governments and authorities within its territories."
[55] *Basic Instruments and Selected Documents*, vol. II, 62.

the GATT "definitively" (i.e., directly, without application through the appropriate Protocol), while expressing a reservation as to that legislation "existing" within the Protocol's meaning.[56]

Several cases have arisen testing this concept of "not inconsistent with existing legislation." In each case the GATT official position was in accord with the discussion above.[57] However, in at least one case a waiver was issued by GATT to the nation concerned, in a sense "legitimizing" its action which that nation claimed was allowed in any case under the Protocol.[58]

C. *Amending the GATT*

Article XXX provides the basic framework for amending GATT, requiring unanimous consent to change Part I (i.e., Articles I and II and the Schedules incorporated by reference), Article XXIX and Article XXX itself. Other amendments become effective "in respect of those contracting parties which accept them" upon acceptance of two-thirds of the members.

Article XXX has proven one of the most troublesome and restricting in GATT. The unanimity requirement has engendered an almost hopelessly confusing situation regarding the schedules (the author has been told that some nations do not even know the true status of their *own* tariff concessions in GATT). In addition, the provision that amendments which are authorized by two-thirds vote apply only to those governments who accept them, has the potential for needless procedural confusion. Three problems in particular will be discussed: the unanimity requirement and schedule adjustments; the relation of waivers under Article XXV to amendments; and procedural difficulties caused by Article XXX.

The schedules of tariff concessions are by Article II "hereby made an integral part of Part I of this Agreement." A schedule is a detailed list of products for a specific GATT party, which states for each product that party's maximum allowable tariff. Thus a schedule for the United Kingdom might list "Widgets – 10 percent," meaning that the UK has promised or "bound" itself to impose a tariff on widgets that will never exceed 10 percent *ad valorem*. The schedules fill many volumes and altogether contain some 65,000 items. Because errors are found, and because the GATT contains procedures for modifying or renegotiating items on the schedules

[56] *Basic Instruments and Selected Documents*, 3rd Supplement, 249.
[57] *Basic Instruments and Selected Documents*, 1st Supplement, 61, *Basic Instruments and Selected Documents*, 6th Supplement, 60–61, *Basic Instruments and Selected Documents*, 7th Supplement, 104–107.
[58] Waiver to West Germany for its marketing laws which apply quantitative restrictions to certain agricultural products, decision of May 30, 1959, *Basic Instruments and Selected Documents*, 8th Supplement, 31. This waiver has apparently expired.

(see Part II below), the schedules are constantly being changed. Since its inception there have been twenty-six protocols of "rectification, modification, or supplementary concessions" amending the schedules, of which six are technically not in force.[59] Protocols completed for signature as long ago as 1955 are still not in force.[60] However, oddly enough, and again illustrative of the pragmatic approach of the GATT, these schedule changes are treated by GATT parties as if they were in force.[61]

In 1955 an attempt was made, at the major review session of GATT, to amend Article XXX to provide:

> any amendment to the schedules . . . which records rectifications of a purely formal character or modifications resulting from action taken under paragraph 6 of Article II, Article XVIII, Article XXIV, Article XXVII or Article XXVIII, shall become effective on the thirtieth day following certification to this effect by the C*ONTRACTING P*ARTIES: *Provided* that prior to such certification, all contracting parties have been notified of the proposed amendment and no objection has been raised, within thirty days of such notification by any contracting party on the ground that the proposed amendments are not within the terms of this paragraph.[62]

Because one nation still has not accepted this amendment, it remains technically not in effect.[63] Yet subsequent changes to the schedules have been embodied in a series of "certifications" which state:

> on the date of the entry into force of paragraph 3 of Article XXX this decision shall constitute a certification by the C*ONTRACTING P*ARTIES on that date . . .[64]

These certifications are also treated by GATT parties as if they were in effect![65]

The relation of Article XXV to Article XXX has posed an intriguing legal problem. Article XXV paragraph 5 provides that by two-thirds votes including half of the members, GATT contracting parties may "In exceptional circumstances not elsewhere provided for in this Agreement . . . waive an obligation imposed upon a contracting party by the Agreement."

[59] GATT Doc. PROT/2, revised to August 1966. [60] *Ibid.*

[61] This was stated to be the case in discussions which the author had with various government and secretariat personnel, and is illustrated by the fact that no complaints of breach of GATT obligations have been brought when nations institute the tariff changes resulting from the changes to the GATT schedule.

[62] GATT, Final Act adopted at the Ninth Session of the Contracting Parties and Protocol Amending Part I and Articles XXIX and XXX of the General Agreement, etc. March 10, 1955, Geneva, 28.

[63] GATT Doc. PROT/2, 5. L/2575 (March 10, 1966).

[64] GATT, Certification Relating to Rectifications and Modifications of Schedules to the General Agreement on Tariffs and Trade, January 15, 1963, Geneva; GATT, Second Certification Relating to Rectifications and Modifications of Schedules to the General Agreement on Tariffs and Trade, April 29, 1964, Geneva.

[65] Note 61 above.

Often waivers are granted to obligations under Part I of GATT (including schedules), so as, for instance, to allow a party to change tariff concessions pursuant to a revision of its customs tariff.[66] Article XXX, however, requires unanimity to amend Part I. Therefore, it has been argued, waivers should not be granted to Part I if they amount in effect to an amendment, unless the vote is unanimous. This argument has been rejected by the GATT contracting parties, partly because of the opening clause of Article XXX (which states: "Except where provision for modification is made elsewhere in this Agreement . . .") arguing that Article XXV is just such other provision for modification excepted from Article XXX.[67] The problem is, of course, that if the waiver power is unlimited[68] it could be used to produce an effect substantially the same as an amendment. In fact, at least two waivers[69] have been framed in general terms to apply to any contracting party who fulfilled the *criteria* just as an amendment would be. Most waivers apply to just one named contracting party, and often for a limited time.[70] At their eleventh session the Contracting Parties formulated a series of guidelines for the issuance of waivers, partly as a response to the "amendment" problem.[71]

The procedural difficulties that can result from Article XXX can be illustrated by the following hypothetical. Article XXV provides that most actions of the Contracting Parties be by majority vote. Suppose an amendment were adopted by two-thirds under Article XXX which changed Article XXV to require a majority of GATT members (not just those present and voting), and suppose nation A voted for the amendment but B did not. Article XXX provides that such amendment is effective "in respect of those contracting parties which accept it." Thus the amended Article XXV applies to A but not to B. B is governed by the prior Article XXV. Now consider a vote at a meeting of the Contracting Parties! How is it to be evaluated?[72]

[66] Waiver to Brazil of November 16, 1956, *Basic Instruments and Selected Documents*, 5th Supplement, 36. Recent waivers to obligations under Part I of GATT include a waiver to the United States (automotive products), *Basic Instruments and Selected Documents*, 14th Supplement, 37, December 20, 1956, and to Australia (preferences for less developed countries), March 28, 1966, *Basic Instruments and Selected Documents*, 14th Supplement, 23.

[67] L/403, September 7, 1955.

[68] Working Party report adopted by Contracting Parties on November 10, 1952, *Basic Instruments and Selected Documents*, 1st Supplement, 86.

[69] Decision of October 22, 1951 extending the time limit in Article XX, Part II, *Basic Instruments and Selected Documents*, vol. II, 28; decision of March 5, 1955 ("hard-core" decision relating to import restrictions), *Basic Instruments and Selected Documents*, 3rd Supplement, 38.

[70] See list of waivers at *Basic Instruments and Selected Documents*, 14th Supplement, 224–228.

[71] Procedures adopted November 1, 1956, *Basic Instruments and Selected Documents*, 5th Supplement, 25.

[72] *Basic Instruments and Selected Documents*, 13th Supplement, 108.

Article XXX's phrasing reflects ideas stemming from days when trade relations were primarily bilateral, and no obligations could be imposed on a nation without its consent.[73] In addition it fails to distinguish between the rules which are procedural in nature and those which are substantive. It is submitted that the idea that no international trade obligations should be imposed on a nation without its consent no longer deserves unwavering recognition. Such an idea was truly effective, if at all, for only a few large, powerful nations. For most countries, dependence on international trade is a fact of life and leaves them vulnerable to forces beyond their control including sometimes selfish and irresponsible actions of trading parties.[74] The very purpose of an international organization of trading relationships is to reduce the chance of such actions hurting other nations and thereby to increase the stability of international trading relations. A change in the amending Article of GATT seems in order. Even the 1955 amendment (not yet in effect) is probably inadequate for the future of GATT.

D. Membership and participation in GATT

There are basically four ways to become a "contracting party" (loosely referred to as a "member") of GATT. Three involve accession by a government: by the Protocol of Provisional Application;[75] by subsequent protocol and agreement under Article XXXIII of GATT;[76] and by directly accepting the GATT itself under Article XXVI(2) (only one nation has accepted GATT in this manner and then only after acceding to GATT through a protocol).[77] These methods of accession are preceded by tariff negotiations, the "ticket of admission,"[78] and often these negotiations extend for several years, during which time, by special declaration (proto-

[73] See, for example, discussion at EPTC/TAC/PV15, as excerpted in GATT, *Analytical Index to the General Agreements* (2nd revision, 1966), 150.

[74] An analysis of the percentage ratio of exports to total GNP is one measure of dependence on international trade. For example, the percentage for Netherlands is 48 percent, for Switzerland 31 percent, for Canada 21 percent, whereas for the US only 5.7 percent (based on IMF, *International Financial Statistics* (1966)).

[75] 55 UNTS 308, October 30, 1947.

[76] A list can be found in GATT, *Analytical Index to the General Agreements* (2nd revision, 1966), 155–156. This includes the so-called "Annecy Protocol" and the "Torquay Protocol."

[77] The sole nation accepting the agreement pursuant to Article XXVI is Haiti, L/2375/Add. 1, 20.

[78] The second and third "rounds" of tariff negotiations, at Annecy in 1949 and Torquay in 1951, were in substantial part negotiations for the accession of groups of governments. Ten new contracting parties entered GATT by the Annecy Protocol, and six by the Torquay Protocol. See *Basic Instruments and Selected Documents*, vol. II, 33–35, and 62 UNTS 121, 142 UNTS 34.

col) the applicant government is given "provisional accession"[79] to GATT, or relations with GATT are established by other special arrangements.[80]

The fourth "route" to membership is open to "customs territories, in respect of which a contracting party has accepted this Agreement: when such territory "possesses or acquires full autonomy in the conduct of its external commercial relations . . ."[81] In 1957 GATT set forth a series of recommended procedures to guide this sponsorship route to membership,[82] which enabled a newly independent government to have *de facto* participation in GATT pending a final decision as to entry into GATT.[83] Since 1960 a large group of new members have entered GATT in this manner.[84] The "sponsored" government is deemed to step into the GATT legal relations and obligations of the sponsoring parent just as they were when sponsorship occurred.[85]

[79] GATT Doc. PROT/2, Rev. 2. For example, Declaration on Provisional Accession of Yugoslavia, November 13, 1962, *Basic Instruments and Selected Documents*, 11th Supplement, 50.

[80] GATT Doc. PROT/2/Rev. 2. For example, Declaration on Relations between Contracting Parties and the Government of Poland, November 9, 1959, *Basic Instruments and Selected Documents*, 8th Supplement, 12. See also L/2595.

[81] Article XXVI(5)(c) provides: "If any of the customs territories, in respect of which a contracting party has accepted this agreement, possesses or acquires full autonomy in the conduct of its external commercial relations and of the other matters provided for in this agreement, such territories shall, upon sponsorship through a declaration by the responsible contracting party establishing the above-mentioned fact, be deemed to be a contracting party." See Kunugi, "State Succession in the Framework of GATT" (1965) 59 *American Journal of International Law* 28.

[82] *Basic Instruments and Selected Documents*, 6th Supplement, 11.

[83] *Ibid.*, para. 2. "At their next ordinary session, the contracting parties, after consultation with the representatives of the responsible contracting party and of the territory in question, should set a reasonable period during which the contracting party should continue to apply *de facto* the agreement in their relations with that territory, provided that that territory also continues to apply *de facto* the agreement to them . . ." The latest report on GATT membership contained in GATT press release 973 of November 1, 1966 indicates that eight countries are now applying GATT *de facto* pending a decision as to their future commercial policy. These countries are Algeria, Botswana, Congo, the Democratic Republic of Lesotho, the Maldive Islands, Mali, Singapore, and Zambia.

[84] A list can be found at GATT, *Analytical Index to the General Agreements* (2nd revision, 1966), 140.

[85] Report adopted on December 7, 1961 by the Contracting Parties, *Basic Instruments and Selected Documents*, 10th Supplement, 73. "The working party . . . wishes to point out that there can be no doubt that a government becoming a contracting party under Article XXVI(5)(c) does so on the terms and conditions previously accepted by the metropolitan government on behalf of the territory in question." The report in which this paragraph is contained concerns the application by a country of Article XXXV against Japan so that the GATT would not apply between that country and Japan. Newly sponsored states were deemed to inherit the same position *vis-à-vis* Japan under Article XXV as the sponsoring contracting party. It is not entirely clear how far this principle will extend, however, particularly with reference to protocols and treaties relating to GATT. See note 19 above.

Conclusion

GATT has clearly worked better during the two decades of its existence than anyone had the right to expect at the time the ITO died. Despite an inadequate constitutional base, the GATT has pragmatically picked its way from obstacle to obstacle to the point where its achievements are generally recognized.

But the future is always uncertain, and the GATT as it presently exists has defects which could prove troublesome if not disastrous. The complex tangle of treaties and protocols that have resulted from cumbersome amending processes and nineteen years of groping have several inherent dangers:

1. it makes it more difficult for the public to understand GATT and therefore more difficult to build the base of popular support that is probably essential for such an international institution to survive the onslaught of local or narrow protectionist interests;
2. its potential for unnecessary misunderstandings among nations concerning their obligations; and
3. it makes it more difficult to adjust flexibly to new circumstances and adapt to new needs.

This inflexibility may prove particularly troublesome now that the homogeneity of GATT membership has been destroyed by the accession of a large number of less developed countries. The added diversity of interest and viewpoint introduced by this phenomenon, plus the greater diversity that may be introduced as more state trading countries (especially those of Eastern Europe) become interested and join, will impose greater needs for flexibility and change upon GATT.

On the other hand GATT has strong points worth preserving. The specific trade conduct rules have been tested and are beginning to have a context of experience that is invaluable for interpretation and appraisal. There is a basic core of delicately balanced obligations recognized as desirable by most nations, including the tariff bindings and concessions which few governments would want to lose. There is a procedure for almost daily consultation and study about international trade problems, that, however, probably needs strengthening by more secretariat and staff resources, and by a procedure for speedy confidential consultation and decisions in those cases where speed and secrecy are essential to forestall a trade or payments crisis.

Thus, it would seem that soon after the Kennedy Round, careful attention should be given to a new or revised legal structure for GATT. As indicated early in this article, at balance may not only be economic

and material benefits, but the fabric and essential conditions of peace itself.

The fact that GATT has survived and actually achieved much in the course of its history to date should not lead to the conclusion that the same will occur in the future. The fact that GATT has developed in spite of legal and constitutional defects does not automatically mean that the forces now coming to bear on GATT are very different from those of much of its experience. The participation of less developed countries and of socialist state trading countries has been mentioned. Indeed some observers already note in GATT a more strident tone of debate, and an increasing degree of procedural maneuvering, centering on bloc politics, and a tendency to ignore or overlook GATT obligations whenever they get "in the way." These tactics are justified on the ground that without them some GATT members seem to overlook legitimate aspirations of less powerful nations. But these tactics can destroy whatever values that presently exist in the GATT unless the various conflicting aspirations are reconciled or compromised by formal (i.e., legal) undertakings, both procedural and substantive.

A further factor suggests the need for greater attention to the "law" of GATT. So far GATT has existed in a period of overall growth and growing prosperity. In such a period nations as well as individuals become confident and sometimes lax. Failure to develop legal institutions can, however, come back to haunt the world if a real crisis occurs and the structure begins to break apart. It may break apart anyway, of course, but it would be tragic if the destruction were aided by misunderstandings engendered by a lack of adequate legal craftsmanship, or by the absence of appropriate institutions worked out in advance and impossible to develop during the heat of a crisis.

The pieces of the GATT puzzle now need to be fitted together.

3 The birth of the GATT–MTN system: a constitutional appraisal*

Introduction

The Multilateral Trade Negotiation (MTN) has now been completed.[1] This is an impressive accomplishment because the MTN[2] was conducted during one of the most difficult periods of peacetime economic stress.[3] Although launched in September 1973, at a General Agreement on Tariffs and Trade (GATT)[4] ministerial-level meeting,[5] the MTN proceeded by fits and starts and suffered long periods of relative inactivity. The negotiations were targeted for substantial completion in the summer of 1978,[6] but the formal initialing of the Agreements actually occurred on April 12, 1979.[7] Nevertheless, the international negotiations are now formally and substantially over, and the MTN results are entering the implementation phase.[8] Except for the original drafting of the GATT itself, the MTN results may well be the most far-reaching and substantively important product of the seven major trade negotiating rounds of the GATT. The immediate predecessor of the MTN, the Kennedy Round,[9] was very extensive and probably accomplished more in terms of tariff reductions.[10] Unfortunately, the Kennedy Round failed to achieve significant progress on the formulation of rules relating to nontariff barriers to trade (NTBs),[11] which have become increasingly troublesome.[12] The MTN was the first negotiating effort since the origin of the GATT to address significantly the problems of nontariff measures affecting international trade.[13] It produced an extensive series of international Agreements relating to nontariff measures,[14] including Agreements on:

1. subsidies and countervailing duties;[15]
2. antidumping duties;[16]
3. technical barriers to trade;[17]

* This chapter is based on John H. Jackson, "The Birth of the GATT–MTN System: A Constitutional Appraisal" (1980) 12 *Law and Policy in International Business* 21–58. During 1978–1979, I was legal consultant to the US Senate Finance Committee on matters relating to the implementation of the Multilateral Trade Negotiations Agreements. Substantial portions of this article were drawn from a report I made to the Senate Finance Committee.

[1] Agreements Reached in the Tokyo Round of the Multilateral Trade Negotiations, HR Doc. No. 153, 96th Cong., 1st Sess., Part 1 (1979) (hereinafter cited as MTA). Ministers from developed countries and some developing countries initialed the MTA in Geneva on April 12, 1979. S. Rep. No. 249, 96th Cong., 1st Sess., 4 (hereinafter cited as S. Rep. No. 249), reprinted in (1979) *US United States Code Congressional and Administrative News*, Part 6A, at 3, 12.

[2] The MTN is often called the "Tokyo Round" because it was launched in Tokyo. See notes 4–5 below and accompanying text.

[3] The groundwork for the MTN was begun in 1967. S. Rep. No. 249, 2.

[4] General Agreement on Tariffs and Trade, opened for signature October 30, 1947, 61 Stat. A3, TIAS No. 1700, 55 UNTS 187. The GATT has been modified in several respects since 1947. The current version of the Agreement is contained in General Agreement on Tariffs and Trade, *Basic Instruments and Selected Documents* (1969), vol. Iv. The GATT is a multilateral international agreement that is the principal instrument for the regulation of world trade. See generally J. Jackson, *World Trade and the Law of GATT* (1969). The ministerial level meeting in Tokyo began the seventh round of trade negotiations held under the auspices of the GATT since 1948. S. Rep. No. 249, 1.

[5] S. Rep No. 249, 1–2. [6] *Ibid.*, 3.

[7] *Ibid.*, 4. A number of issues required further attention after the initialing. *Ibid.* One of the most important of these unfinished segments of the MTN concerns "safeguard" procedures that would allow a country to restrict imports found to be causing injury to competing domestic industries. Negotiations on a safeguards agreement continued into the summer of 1979, but as of this writing it appears an agreement will not be reached.

[8] See note 14–23 below and accompanying text.

[9] See J. Evans, *The Kennedy Round in American Trade Policy* (1971), 183. The Kennedy Round of trade negotiations officially started in 1964 and lasted until 1967. S. Rep. No. 249, 1.

[10] The Kennedy Round centered primarily on tariff reductions, although some nontariff barriers were discussed. The MTN, on the other hand, focused primarily on the nontariff barriers. S. Rep. No. 249, 1–2. For example, the Kennedy Round achieved an average reduction of 35 percent on tariffs on manufactured products. W. Cline, N. Kawanabe, T. Kronsjö, and T. Williams, *Trade Negotiations in the Tokyo Round: A Quantitative Assessment* (1978), 9 See Subcommittee on International Trade of the Senate Committee on Finance, 96th Cong., 1st Sess., *MTN Studies: An Economic Analysis of the Effects of the Tokyo Round of Multilateral Trade Negotiations on the United States and Other Major Industrialized Countries* (Committee Print, 1979), vol. V, 34–37 (report prepared by A. Deardorff and R. Stern).

[11] For a discussion of NTBs and their underlying economic theories after the Kennedy Round, see Marks and Malmgren, "Negotiating Nontariff Distortions to Trade" (1975) 7 *Law and Policy of International Business* 327.

[12] Although the Kennedy Round did negotiate agreements on national antidumping laws and national customs valuation laws, Congress did not implement these two NTB agreements. S. Rep. No. 249, 1.

[13] *Ibid.*, 2.

[14] The Agreements are set out in the MTA. The word "Code" is used in this article to describe the separate Agreements emerging from the MTN. The structure and text of all Codes cited in this article comport with the rectified MTA text.

[15] Agreement on Interpretation and Application of Articles VI, XVI, and XXIII of the General Agreement on Tariffs and Trade, done April 12, 1979, MTN/NTM/W/236 (hereinafter cited as Subsidies and Countervailing Measures Agreement), reprinted in MTA, 257–307.

[16] Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade, done April 9, 1979, MTN/NTM/W/232 (hereinafter cited as Anti-Dumping Agreement), reprinted in MTA, 309–337.

[17] Agreement on Technical Barriers to Trade, done March 29, 1979, MTN/NTM/W/192/Rev. 5 (hereinafter cited as Technical Barriers to Trade Agreement), reprinted in MTA, 209–256.

4. government procurement;[18]
5. procedures for licensing of imports (when licensing is permitted);[19]
6. valuation for customs purposes;[20]
7. a framework of GATT (with subparts relating to developing country privileges and obligations, balance-of-payments measures and disputes settlement procedures);[21]
8. agricultural products;[22] and
9. trade in civil aircraft.[23]

The MTN results are particularly impressive in light of the enormous difficulties through which the international economic system has been passing for the past decade:[24] the economic impact of US military activity in Vietnam; the dramatic increases in oil prices; and slowing economies, high unemployment, and rampant inflation. All of this has occurred at a time of increasing economic interdependence (resulting partly at least from three decades of successful trade liberalization under GATT leadership and through the six rounds of GATT trade negotiations). At the same time, major political systems have had to operate on narrow parliamentary majorities – majorities that consequently had to respond to constituent complaints about harm caused by imports. It is little wonder that the MTN was difficult to complete or that it bears the scars and blemishes of the gauntlet it had to run.

Despite these obstacles, the MTN has produced a large variety of complex and technical Agreements. These Agreements should increase

[18] Agreement on Government Procurement, done April 11, 1979, MTN/NTM/W/211/Rev. 1 (hereinafter cited as Government Procurement Agreement), reprinted in MTA, 67–189.

[19] Agreement on Import Licensing Procedures, done April 10, 1979, MTN/NTM/W/231/Rev. 2 (hereinafter cited as Import Licensing Procedures Agreement), reprinted in MTA, 191–207.

[20] Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade, done April 12, 1979, MTN/NTM/W/229/Rev. 1 (hereinafter cited as Customs Valuation Agreement), reprinted in MTA, 3–65.

[21] Texts Concerning a Framework for the Conduct of World Trade, done April 12, 1979, MTN/FR/W/20/Rev. 2 (hereinafter cited as Framework for World Trade), reprinted in MTA, 619–661.

[22] International Dairy Agreement, done April 12, 1979, MTN/DP/8 (hereinafter cited as Dairy Arrangement), reprinted in MTA, 339–412; Arrangement Regarding Bovine Meat, done April 12, 1979, MTN/ME/8 (hereinafter cited as Meat Arrangement), reprinted in MTA, 583–595. In addition, the MTN contains a number of bilateral agreements on cheese, other dairy products, and meat. See MTA, 413–581.

[23] Agreement on Trade in Civil Aircraft, done June 12, 1979 (hereinafter cited as Civil Aircraft Agreement), reprinted in MTA, 597–618.

[24] See GATT, Press Release No. 1199, November 9, 1977, "The Future of World Trade" (address by Olivier Long, Director-General, General Agreement on Tariffs and Trade to the Zürich Economic Society), 9: "These negotiations have so far moved slowly, for various reasons which include the complexity of the issues, the influence of political factors in several of the leading participating countries, and the reluctance of governments to undertake major economic commitments at a time of recession."

considerably the international community's awareness of and surveillance over the activities of national governments that affect international economic relations. In short, the scope of the existing GATT system has been greatly broadened. We have witnessed no less than the birth of the GATT–MTN system for the international surveillance, consultation, and regulation of world trade.

It is very difficult at this early stage to appraise the MTN and its future impact. Some studies conducted before the completion of the negotiations used computer-modeling techniques to forecast the economic impact of those portions of the MTN that were relatively amenable to quantification (such as tariff reductions, quota liberalization, and even government procurement regulations).[25] A majority of the MTN results, however, concern matters not easily quantified. These matters are in the form of obligations that will have varying impacts, depending heavily on the manner in which these obligations are in fact *administered* at the national and international level.

Furthermore, important as the economic result of international trade obligations are, the political results are equally important. For example, will the system help nations resolve disputes more peacefully in the future? Will the system be perceived as fair, and will it therefore minimize international tensions that inevitably arise when one nation's economic policies cause economic distress in another country? Will the system permit a fair degree of national decision-making over internal priorities and goals (i.e., will it permit a fair degree of sovereignty)? Will the system facilitate the degree of international coordination and cooperation essential to general economic progress in the world? Will it enhance the ability of national leaders to cooperate in the resolution of persistent and potentially dangerous world economic problems: extreme poverty, economic welfare disparities, and uncertain resource supplies?

The purpose of this article is to formulate some very preliminary judgments – more in the nature of hypotheses – concerning these questions. The article assumes that some answers to these difficult questions will emerge from an examination of the "institutional–legal" structure – what might be called the "constitution" – of the new GATT–MTN international economic system. There are, of course, other factors that could be examined. The chosen scope of this article, however, is the new GATT–MTN constitution in light of the history, impact and effectiveness (weakness) of the preceding GATT constitution.

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[25] See, e.g., Cline, Kawanabe, Kronsjö, and Williams, *Trade Negotiations in the Tokyo Round*; and *MTN Studies: An Economic Analysis of the Effects of the Tokyo Round.*

II. The GATT constitution[26]

...

The developing weaknesses of the constitution

The GATT system overall has been enormously successful, reducing tariff barriers and promoting a surge in post-World War II international trade.[27] This increase in world trade, in turn, has created the problems attendant to growing international economic interdependence. During the last three decades, weaknesses have appeared in the GATT system. Some of these weaknesses can be termed "substantive" in that they involve rules that are substantively inadequate or out of date. For example, the GATT obligation of nondiscrimination[28] – the most-favored-nation (MFN) principle – has been eroded by expansive use (or abuse) of a series of exceptions in the GATT.[29] Similarly, the GATT lacked rules to apply to many newly important nontariff measures that influenced or distorted trade flows.[30] In addition, the GATT rules regarding trade in agricultural goods[31] and the tragic problems of developing countries[32] were not always adequate. Finally, in

[26] For a comprehensive treatment of the GATT, see generally Jackson, *World Trade*; and J. Jackson, *Legal Problems of International Economic Relations* (1977).

[27] See generally Hudec, "GATT or GABB? The Future Design of the General Agreement on Tariffs and Trade" (1971) 80 *Yale Law Journal* 1299 (1971).

[28] GATT Article I. Article I contains the major MFN obligation in the GATT. Jackson, *World Trade*, 255. Other articles, however, contain similar nondiscrimination language specific to the subject covered. *Ibid.* These provisions pertain to "cinema films, internal mixing requirements, transit of goods, marks of origin, quantitative restrictions, state trading, measures to assist economic development, and measures for goods in short supply." *Ibid.* (parentheticals omitted).

[29] See Jackson, *World Trade*, 264–272, for a discussion of the exceptions to GATT's MFN obligation.

[30] As tariffs decline, various nontariff measures become relatively more important in their impact on the restriction or distortion of world trade flows. See generally R. Galdwin, *Nontariff Distortions of International Trade* (1970). The whole area of standards gained increasing prominence, as countries exercised their legitimate governmental powers to impose on products various standards for the purposes of achieving consumer protection, environmental protection, safety requirements, etc. In promulgating many of these regulations, however, it was often conveniently easy to arrange the specifications of the regulations so that they would be most conveniently achieved by domestic producers, and often somewhat less conveniently achieved by foreign producers who were exporting to that market. See Sweeney, *Technical Analysis of the Technical Barriers to Trade Agreement*, 179–217. Other examples of the way the GATT rules became out of date, or at least difficult to apply because of their ambiguity, include the developments of various limiting devices such as the "import deposit" schemes of the United Kingdom or Italy which require the importer to deposit for periods of up to ninety days an amount equal to the value of the imported items. Although the deposit is returned at the end of the time period, the schemes represent an economic cost to the importer.

[31] See Houck, *US Agricultural Trade and the Tokyo Round*, 265–295.

[32] Jackson, *World Trade*, 663–671. "In several clauses in GATT, a distinction is made between primary products and industrial products. It can be argued that since less-developed countries tend to depend more upon primary commodities for export than upon industrial products, such a division operates to discriminate between less-developed and industrial

recent years, new "safeguards" techniques – ways to restrict imports that were injuring domestic producers – were developed that fell outside the discipline of the GATT rules.[33]

III. The MTN response: appraising the GATT–MTN constitution

An overview

Upon reading the MTN Agreements, one is struck by their remarkable complexity, variety and far-reaching scope. The willingness of nations to yield "sovereignty" (if that is a meaningful concept) on such matters as government procurement is impressive. Yet the overall impact is perplexing. The variety of Agreements and the variety of approaches within the Agreements on both substantive and institutional questions reflect a somewhat fragmented method to the negotiation.

On a number of substantive issues, there seems to be a variety of approaches, probably reflecting the different objectives of national domestic interest groups who influenced different parts of the negotiations. (Of course, because of the complexity of many of these substantive issues, negotiations had to proceed in subgroups.) Thus, some of the Agreements seem tuned towards the direction of trade liberalization to increase the flow of trade;[34] others seem more trade-restricting.[35] Some seem to enhance MFN;[36] others seem to erode it further.[37]

nations." *Ibid.*, 666. See also Jackson, *Legal Problems of International Economic Relations*, 1009–1016.

[33] One of the more prominent techniques developed was the broader use of the so-called "voluntary restraint agreement" (VRA) or "orderly marketing agreement" (OMA). In a VRA, an exporting nation concerned that unilateral trade measures would otherwise be imposed against it by an importing country "voluntarily" agrees to restrain its exports to that country. See Smith, "Voluntary Export Quotas and US Trade Policy – A New Nontariff Barrier" (1973) 5 *Law and Policy of International Business* 10; and Jackson, *Legal Problems of International Economic Relations*, 668–678. It has been argued that these arrangements are technically illegal under the GATT, but in general these arguments have had little effect. One of the objectives in the MTN was to obtain a new safeguards code that would bring some measures of discipline to the use of VRAs or OMAs. A safeguards code ultimately was not agreed upon at the Tokyo Round.

[34] See, e.g., Technical Barriers to Trade Agreement, Article 2.1, reprinted in MTA, 216: "Parties shall ensure that technical regulations and standards are not prepared, adopted or applied with a view to creating obstacles to international trade." In the preamble to the Government Procurement Agreement, reprinted in MTA, 72, the parties to the Agreement recognized "the need to establish an agreed international framework of rights and obligations with respect to laws, regulations, procedures and practices regarding government procurement with a view to achieving greater liberalization and expansion of world trade." See also the preamble to the Customs Valuation Agreement, reprinted in MTA, 7.

[35] See, e.g., the Subsidies and Countervailing Measures Agreements.

[36] See, e.g., the Technical Barriers to Trade Agreement, Articles 5.1.1 and 7.2, reprinted in MTA, 221, 223; and the Import Licensing Agreement.

[37] See, e.g., Framework for World Trade, points 1 and 4, para. 1, reprinted in MTA, 622 ("Notwithstanding the provisions of Article I of the General Agreement, contracting

Generally, these substantive problems of international trade can be approached in two divergent ways, each resulting from a particular philosophy. On the one hand, there is the "freer trade" or nongovernmental approach, which attempts to create international rules designed generally to minimize government interference.[38] On the other hand, there is a more "managed" approach,[39] which encourages governments to cooperate and to manage or direct the type and amount of trade flow.[40] The original GATT reflected the views of the first approach;[41] whereas in the MTN Agreements, different Codes seem to take differing approaches. Some of the Agreements seem designed to establish new mechanisms through which governments and international bodies can manage trade. The creation of new "committees" in many of the Codes leans in this direction.[42] Portions of the subsidies Agreement suggest the same.[43] Other Agreements, however, appear to be more in tune with the first approach – that is, with the traditional GATT view – and thus seem designed to limit further governmental interference with international trade.[44]

It is also difficult to discover an overall consistent policy on the institutional and legal questions addressed by this article. The Agreements vary widely on such matters as dispute settlement, the degree of precision in rule statements, and the extent and nature of international decision-making authority.

With respect to the weaknesses of the GATT constitution discussed above, a number of the tougher questions unfortunately were avoided.[45]

parties may accord differential and more favorable treatment to developing countries, without according such treatment to other contracting parties."); and the Subsidies and Countervailing Measures Agreement, Part III, Article 14, reprinted in MTA, 284–285.

[38] See Subcommittee on International Trade of the Senate Committee on Finance, 96th Cong., 1st Sess., *MTN Studies: MTN and the Legal Institutions of International Trade* (Committee Print, 1979), vol. IV, 4–5 (report prepared by J. Jackson at the request of the Subcommittee on International Trade). See generally K. Dam, *The GATT: Law and International Economic Organization* (1970), 12–13.

[39] This approach is sometimes called "organized free trade" or "*dirigisme*." *MTN Studies: MTN and the Legal Institutions of International Trade*, 5.

[40] *Ibid.* [41] Dam, *The GATT: Law and International Economic Organization*, 12–13.

[42] See, e.g., Dairy Arrangement, Part I, Articles II(2) and IV, reprinted in MTA, 344–346 (establishment of an International Dairy Products Council to evaluate "the situation in and outlook for the world market for dairy products" and to propose possible solutions for disequilibria in that market); and Meat Arrangement, Part II, Article V(1), reprinted in MTA, 593 (establishment of an International Meat Council to "carry out all the functions which are necessary to implement the provisions of the Arrangement").

[43] The Agreement, for example, establishes a procedure for consultation among signatories whose products are subject to an investigation. Subsidies and Countervailing Measures Agreement, Part I, Article 3; Part II, Article 12, reprinted in MTA, 266–267 and 282.

[44] See, e.g., Government Procurement Agreement; the Technical Barriers to Trade Agreement; and the Customs Valuation Agreement.

[45] The MTN, for example, failed to design a better system for amending the GATT or for

This is perhaps understandable; to achieve any agreement at all, it might have been necessary to avoid many tough issues that could have sidetracked the negotiations. Yet it must be recognized that many of these tough issues remain and are even more perplexing as a result of the MTN. Some of the comments later in this article illustrate this point.

Although the focus of this article is on legal–institutional questions, it should be noted that a number of substantive GATT problems also were avoided by the MTN. For example, the erosion of the MFN policy of nondiscrimination seems to perpetuate and extend important deviations from the MFN policy on behalf of developing countries.[46] The restriction of some Code benefits to signatories also makes inroads into the general concept of MFN.[47] These inroads do have some policy justifications. The question that must be asked, however, is whether the general policies favoring MFN have been weighed adequately against the particular desires in certain contexts to depart from MFN.

Another example of a difficult substantive problem relatively unresolved by the MTN is control of agricultural products. This tough question of how best to manage international trade in agricultural products seems largely unanswered, although some particular attempts to nudge agriculture into the general discipline of international trade rules can be found.[48]

Finally, some perplexing questions of developing country trade are handled primarily by a "legalization" of the currently tolerated noncompliance practices of those countries,[49] the extension of the legal opportuni-

making decisions for developing new rules in the GATT. It did not address many difficult questions of voting; indeed, it may have worsened the general voting question by the studied ambiguity contained in various Codes Committees and their procedures. In addition, the negotiations did not seriously address the issue of "grandfather rights," although certain specific rights, such as in the injury test in countervailing duty cases, were the subject of particular negotiations.

[46] See, e.g., the Framework for World Trade, points 1 and 4 (Differential and More Favorable Treatment; Reciprocity and Fuller Participation of Developing Countries), reprinted in MTA, 622–625. Other portions of the Framework for World Trade have favorable conditions for developing nations as well. See, e.g., *ibid.*, point 2A, para. 2, reprinted in MTA, 627 (developed countries in applying restrictive import measures for balance-of-payments purposes must take account of "the export interests of the less-developed contracting parties and may exempt from its measures products of export interest to those contracting parties").

[47] See, e.g., Subsidies and Countervailing Measures Agreement, Part II, Article 8(3), reprinted in MTA, 277 (mandating *signatories* "to avoid causing, through the use of any subsidy" injury, nullification or the impairment of benefits received by, or serious prejudice to the interests of, another signatory (emphasis added)). The Agreement implies that nonsignatories will be treated less favorably.

[48] See, e.g., Trade Agreements Act of 1979, Pub. L. No. 96–39, § 101, 93 Stat. 144 (hereinafter cited as Trade Agreements Act), adding Title VII to the Tariff Act of 1930. See generally Houck, *US Agricultural Trade*.

[49] See, e.g., Framework for World Trade, points 1 and 4, paras. 5–7, reprinted in MTA, 624–625.

ties of those countries to deviate from GATT rules,[50] and an expression of desire that developing countries will "graduate" to the more significant GATT and MTN rules of trade.[51]

Perfection, of course, cannot reasonably be expected in a negotiation among so many nations with so many divergent goals. The real and substantial gains made by the MTN on such matters as government procurement policy, valuation, and product standards may more than offset the failure meaningfully to address some problems, particularly when those problems have become almost perennial. A tidy world certainly is not the likely characteristic of any foreseeable trade policy. Yet the MTN bargaining process and the resulting Codes, which stand virtually alone as treaties in themselves, have an overall impact on the GATT legal system. The interrelationships between the various Codes and the GATT will become increasingly complex. Such complexity, in turn, will make it harder for the general public to understand the GATT–MTN system, perhaps resulting in less public support for that system over time. The complexity will hurt those countries that cannot devote additional governmental expertise to GATT representation problems. In addition, such complexity inevitably will give rise to a variety of legal disputes among GATT parties. Finally, it will contribute to the belief that the richer nations can control and can manipulate the GATT system for their own advantage.

It should be noted that many (maybe all) of these MTN-created technical and legal problems with the GATT may be fully justified as fulfilling important policy objectives in the face of the rigidity and unamendability of the GATT and in the face of the GATT's inadequate constitutional structure. In each such case, however, it must be recognized that there is a long-term cost to the usefulness of the GATT and its related agreements. That cost may be worth it. But what is suggested by this discussion and the discussion that follows is that there are still many important, unresolved issues that will require considerable efforts in the years ahead.

In the next sections, this article will examine more thoroughly several important constitutional institutions, including the dispute resolution mechanism, rule information,[52] and the role of national government processes in the GATT–MTN constitution.

[50] *Ibid.*, para. 7, reprinted in MTA, 625.

[51] As their economies progressively develop and their trade situations improve, developing countries are expected "to participate more fully in the framework of rights and obligations under the [GATT]." *Ibid.*

[52] See generally Jackson, "The Crumbling Institutions of the Liberal Trade System" (1978) 12 *Journal of World Trade Law* 93 for a more comprehensive treatment of the thesis.

Dispute resolution and rule application

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National government processes and the GATT–MTN constitution

Although there is a tendency to divide an analysis of governmental institutions into two parts – the international institutions and the domestic or national institutions – the two are so inextricably interrelated, particularly in relation to economic affairs, that to talk about the constitution of the GATT System or the GATT–MTN System without discussing its relationship to national institutions would be a mistake. This article cannot go into this subject for many countries, not even for all the influential countries, but some interesting and potentially significant developments in the United States can be reviewed briefly.

The salient feature of the US conduct of its international economic policy is the constitutionally induced tension between the Executive and the Legislative branches of government. Congress is highly conscious of its explicit constitutional power to regulate interstate and foreign commerce.[53] But Congress cannot effectively negotiate foreign agreements and, as a result of the history outlined earlier, delegation and Executive assertion resulted in a substantial transfer of power from Congress to the President.

The Kennedy Round negotiations of 1967 ushered in a period of increased Congressional hostility towards US trade policy. The Congress, very disappointed with the Kennedy Round results, refused to approve those few subjects requiring action.[54] Indeed, Congress attempted to block US implementation of the Kennedy Round Anti-Dumping Code (one of only two agreements devoted to nontariff measures completed in that Round) even though Executive branch lawyers had argued that this agreement did not need Congressional approval.[55]

With this history in mind, those who participated in the drafting of the Bill that became the Trade Act of 1974[56] (which, *inter alia*, established the authority and conditions for US participation in the MTN)[57] sought to establish a procedure for meaningful Congressional participation and approval of nontariff barrier negotiations.[58] They also sought a procedure that would still give the Executive branch negotiating credibility and room

[53] US Constitution, Article I, sec. 8, cl. 3.

[54] See Evans, *The Kennedy Round*, 299–304.

[55] See Jackson, *Legal Problems of International Economic Relations*, 740–753.

[56] Pub. L. No. 93–618, 88 Stat. 1978 (1975) (codified at 19 USC §§ 2111–2487 (1976)).

[57] *Ibid.*, § 101 (codified at 19 USC § 2111 (1976)).

[58] S. Rep. No. 1298, 93rd Cong., 2nd Sess., 8 (hereinafter cited as S. Rep. No. 1298), reprinted in (1974) *US United States Code Congressional and Administrative News* 7186 at 7186–7187.

to maneuver so that a negotiation could be successful.[59] The procedure initially designed was one adapted from the familiar legislative veto process. In that process, the President lays a proposal (e.g., a government agency reorganization plan[60]) before Congress, and if Congress does nothing – i.e., fails to adopt a resolution of disapproval – the proposal becomes law.[61] In designing the procedure for approval of an international agreement, some modifications were necessary. One such modification was a provision for a ninety-day consultation period with Congress *before* the international agreement and proposed implementing legislation were laid before it.[62] The purpose of this provision was to allow Congressional (and citizen) comments and suggestions to be taken into account by the US representatives in their negotiations, so that the results would be more likely to achieve Congressional approval.[63]

During the 1973–1974 Congressional consideration of this NTB procedure, constitutional and other objections caused the abandonment of the legislative veto proposal.[64] As a substitute, a special Congressional procedure, often called the "fast-track" procedure, was designed, which retained the ninety-day consultation period.[65] The "fast-track" procedure, while following the normal constitutional statutory approval process (positive adoption by both Houses and signing by the President),[66] also retained three important attributes inherent in a "legislative veto" procedure: automatic discharge from a committee so a committee could not "bottle up" the legislation; prohibition of amendments; and limited debate on the floor of each House.[67] This approach ensured that the negotiation results would, within a reasonable time, be voted upon by Congress without amendment (important because amendments would likely make it necessary to reopen the international negotiations).

This process in fact worked in some unanticipated ways. The Executive branch duly notified the Congress, in early January 1979, of its intent to conclude agreements ninety days or more later.[68] The then current negotiating texts were in fact transmitted to all members of Congress (and soon became generally available to the interested public).[69] After the January

[59] S. Rep. No. 1298, 18. [60] 5 USC § 906 (1976).
[61] Jackson, *Legal Problems of International Economic Relations*, 147–148, note 15 (list of US laws containing legislative veto provisions).
[62] S. Rep. No. 1298, 22. [63] *Ibid.* [64] See *ibid.* [65] 19 USC § 2112(e) (1976).
[66] *Ibid.*, § 2112(d) and (e). [67] *Ibid.*, § 2191 (1976). See S. Rep. No. 1298, 22.
[68] Memorandum of January 4, 1979, 44 Fed. Reg. 1933, 1934 (1979).
[69] This access represented unprecedented generosity with current negotiating information while an international economic negotiation was pending. In addition to this notification, the members of Congress were briefed frequently throughout the course of the negotiations, and key Congressional Committees (particularly Finance and Ways and Means) assigned several staff members each to devote full time to following the course of the negotiation. These staff members had broad access to negotiating information, made trips to Geneva and attended some negotiating sessions. S. Rep. No. 249, 5–6.

1979 notification, the key Congressional committees – especially the Finance Committee of the Senate and the Ways and Means Committee of the House – began consulting with Executive branch negotiators, holding public hearings and studying the negotiation results.[70] In fact, the Senate Finance Committee and the House Ways and Means Committee went further than expected and, in private sessions with Executive branch officials, actually began *drafting* the text of proposed legislation they would like to see introduced by the President.[71] The Committees even went so far as to hold a joint "conference" to resolve differences between the House and Senate versions – in essence duplicating the normal post-vote legislative process *before the Bill was even introduced*.[72]

The significant difficulty, however, was that the Bill finally introduced was an Executive branch Bill, which did not in all respects conform to the draft proposed by the consultation procedure.[73] Nevertheless, the careful consultation and bargaining between the Executive branch and Congress (occasionally resulting in US negotiations with foreign countries concerned) so that the international agreements would not diverge from domestic law, resulted in a product in which the Congress had great confidence. Thus, Congress gave the Bill an overwhelming vote of approval.[74] The process was so well accepted that Congress agreed to extend the life of the "fast-track" procedure by eight years (to January 3, 1988).[75]

Although it is hard to forecast the impact of this procedure, it raises some encouraging possibilities for economic diplomacy. Not everyone got all he wanted from the process. One persistent worry is that sensitivity to domestic pressure groups may have led Congress to force the Executive branch into yielding too much to statutory language that may make it easier to erode the liberal trade discipline of the international trade system. Only time will tell whether this perception is accurate. Finally, the US government is currently undertaking a process of reorganization that could substantially alter its techniques of conducting its trade policy. This too, could have substantial impact on the implementation of the MTN results, for better or worse.[76]

[70] See *ibid.*, 6. [71] See *ibid.* [72] *Ibid.*
[73] This author has not yet seen a complete textual analysis of the differences between the two drafts, but he was informed that there were only five or six differences between the Bill introduced by the Executive branch and that drafted by Congress in the consultation period. One example of such differences is section 1101 of the final draft of the joint "conference" print (on file at the offices of *Law and Policy in International Business*), which would have extended certain tariff negotiating authority. This was omitted entirely from the Executive branch version ultimately submitted and passed into law without amendment.
[74] 125 Cong. Rec. H5690–91 (daily edition, July 11, 1979) (House vote: 395 to 7); 125 Cong. Rec. S10340 (daily edition, July 23, 1979) (Senate vote: 90 to 4).
[75] Trade Agreements Act, § 1101 (amending 19 USC § 2112).
[76] See Presidential Reorganization Plan No. 3 of 1979, 44 Fed. Reg. 69273 (1979).

Conclusion

The MTN produced impressive results, but many of these results are understandably short-term oriented. Very little was accomplished in dealing with the long-term (and very real) problems of the institutional–legal structure of a workable and effective international system for economic relations. Indeed, the MTN Agreements could increase the difficulty of those institutional problems. The great expansion of the scope of this subject matter into government procurement, technical standards, subsidies, and other areas, the balkanization of institutions and dispute settlement procedures, and the lack of attention on the overall ability of the existing GATT system to shoulder these new responsibilities will cause a number of stresses on that system. Further inroads on the principles of MFN, the introduction of a series of rules that contain ambiguity and the failure to complete a new safeguards Code hold the potential for deterioration of the liberal trade discipline built up over the last three decades.

What we have witnessed is nothing less than the birth of a new system – the GATT–MTN system – which, similar to a newly born federal state, is still relatively formless, with many critical constitutional questions yet to be answered. The probable dangers to the new constitution are subtle: a dwindling faith in the system by private-enterprise decision-makers and the public at large, an increasing pressure on national governments to react or retaliate against perceived unfair actions taken abroad, and a slight but gradual spiraling down of the economic benefits from trade. The US Congress could become more assertive and surly on matters of trade. European national leaders could become more critical of a failure of US leadership and could move significantly towards "go it alone" policies. This in turn would anger the body politic in the US and elsewhere.

Fortunately, the risks and fears mentioned above are not inevitable. The MTN put in place a number of building blocks upon which an effective international trade system could be built. In the process of experimentation, some mistakes will undoubtedly occur. But if government leaders have in mind a general constitutional direction they wish to see the GATT–MTN system take, the system *can* be nudged in that direction. Some direction seems both feasible and advisable.

What should be that direction? Some ideas have been implicit in the previous sections of this article. Modest movement towards a more rule-oriented diplomatic system may seem unattainable to those accustomed to viewing governments through cynical eyes. There is doubt, for example, that government officials and diplomats *want* rules that can limit their own freedom of action and sense of power.[77] There is also particular doubt that the great economic powers really want to move away from the power-oriented system that seems to favor them so much.

Yet, there are important contrary indications. The largest economic powers of the GATT–MTN system today are modern democratic states. They do not have monolithic governments but are composed of a multitude of competing interest groups and political factions. These factions often distrust government (or at least the other party's government!) and thus often seek to limit executive discretion. One technique for such limiting is the development of rules and participatory procedures to accompany these rules. The litigiousness of US society may in fact be a necessary concomitant to real democracy (although many would dispute that idea and blame it on the lawyers!). Even more striking is the situation in those large democratic powers that have a federal structure. In such cases, where the "one-city" form of government proves impossible, there is a tendency to develop a rule-oriented approach. The emerging European "federal state" – the EC – seems to bear this out as one examines the work of the Luxembourg Court and the relations of the Brussels bureaucracy to member states and private citizens. This experience, of course, is not without exceptions. Counter-examples can be cited. But the EC strikes a foreign observer as remarkably "rule/court"-oriented even when compared with the governments of some of its member states.

In the United States, there seems to be considerable support in Congress for a better international system of trade rules. This support, no doubt, is influenced in part by distrust of the Executive branch and in part by a desire to reduce constituent pressure for measures that members of Congress secretly feel bear long-run dangers.

What other directions might the GATT–MTN system take? It is possible that the GATT could become viewed as a loose umbrella organization for a kaleidoscope of economic agreements with a variety of nation groups on a variety of subjects. Indeed, this could have a number of advantages. If the tight cohesiveness and the single code idea of the original GATT is abandoned, there is the possibility of a broader-based system – one accommodating a larger membership with a greater variety of economic structures. Such an organization could play a greater role in interfacing widely disparate economic philosophies in a world of increasing interdependence. For the essential discipline and predictability of rules governing trade among particular subsets of the broader member-

[77] The carefully crafted Treaty of Rome limitations on the powers of the EC institutions suggest, however, that government officials can be limited. See Treaty Establishing the European Economic Community, Articles 137–198, entered into force January 1, 1958, 298 UNTS 11.

ships, however, officials and the public would look to separate "codes" and even "subcodes," some of which have now sprung up in the context of the GATT.

The umbrella GATT–MTN system, then, can provide the essential logistical and procedural support for a variety of particular codes on particular areas, perhaps subjecting these codes to some overall minimum standards of world citizenship (for example, a modified MFN for nondiscrimination), and of procedural fairness (including a right for noncode members to be heard on particular code actions that might harm them). It is even possible, despite the initial balkanization of the dispute settlement process, to work towards a unified procedure through the development of secretariat services specializing in dispute settlement, and a model set of effective procedural rules that can be offered for adoption by various MTN dispute panels. In sum, the elements necessary to the development of a more effective system are present – if those elements are properly utilized.

That is the challenge of the next few years.

Modern GATT Law

A Treatise on the Law and Political Economy of the General Agreement on Tariffs and Trade and other World Trade Organisation Agreements

Second Edition
Volume I

Professor Raj Bhala

SWEET & MAXWELL

CHAPTER 26

Early Rounds (1948–62): Tariff Cutting

SECTION I: PATTERN OF MULTILATERAL TRADE NEGOTIATIONS

26–001 In the history of GATT, there have been a total of nine sets, known as "rounds," of multilateral trade negotiations (MTNs) aimed at reducing trade barriers.[1]

1) The *original GATT negotiations* in Geneva in 1947, known as the *Geneva Tariff Conference*:
The 23 original contracting parties participated. The 24th country involved (to a limited degree) in preparing the *ITO Charter*, the Soviet Union, declined to join the talks. The negotiations covered roughly 45,000 tariff concessions and US $10 billion of trade (measured in 1938 prices).

2) The *Annecy Tariff Conference*, known as the *Annecy Round*, 1948–49:
The Round, involving 33 countries, was named after the place where the negotiations were conducted, Annecy, France. Roughly 5,000 tariff concessions were exchanged.

3) The *Torquay Tariff Conference, known as the Torquay Round*, 195–51:
This Round involved 34 countries. The Round was named after the place where the negotiations were conducted, Torquay, England. About 8,700 concessions were negotiated, resulting in tariff reductions of 25 per cent compared to the 1948 level.

4) The *Geneva Tariff Conference*, known as the *Geneva Round*, 1955–56:
This Round involved 22 countries and US $2.5 billion of trade. The Round occurred in Geneva.

5) Another *Geneva Tariff Conference*, known as the *Dillon Round*, 1960–62:
This Round involved 37 contracting parties, 23 of which offered concessions. There were 4,400 tariff concessions covering US $4.9 billion of trade. The Round, conducted in Geneva, was named in honour of Under-Secretary of State Douglas Dillon, who had proposed the Round.

6) The *Kennedy Round*, 1964–67:
The Round involved 76 contracting parties, though only 31 of them, including the six-member European Economic Community (EEC), granted tariff concessions. The negotiations covered US $40 billion of trade, or roughly 75 per cent

[1] The discussion of the Rounds draws partly on Anwarul Hoda, *Tariff Negotiations and Renegotiations under the GATT and the WTO* (2001), para.A.1, p.25, paras H.1–4, pp.67–68; Raj Bhala, *International Trade Law: Interdisciplinary Theory and Practice* 3rd edn (Newark, New Jersey: LexisNexis 2008) 12–18; Robert Gilpin, *The Political Economy of International Relations* (1987), 192, 196–97); Kenneth W. Dam, *The GATT* (1970) 68–73, 76–77; John H. Jackson, *World Trade and the Law of GATT* (1969) s.10.5 pp.227–28; G. Curzon, *Multilateral Commercial Diplomacy: The General Agreement on Tariffs and Trade and its Impact on National Commercial Policies and Techniques* (1965) 81; *A Brief History of the GATT*, *in* Trade Policies for a Better Future – The "Leutwiler Report," the GATT and the Uruguay Round (1987) 160–64.

of world trade at the time. The Round was named after the late President John Fitzgerald Kennedy (who was assassinated on November 22, 1963), and the negotiations took place in Geneva.

7) The *Tokyo Round*, 1973–79:
The Round involved 85 contracting parties, yet just 36 of them, including the 10-member European Community (EC), granted tariff concessions. The talks covered US $300 billion of trade. This Round, launched in Tokyo, was the most ambitious to date and took place in Geneva.

8) The *Uruguay Round*, 1986–94:
This Round involved 118 contracting parties and covered US $3.7 trillion of trade. It was launched in Punta del Este, Uruguay, and the last day of substantive negotiations was December 15, 1993 (though bargaining, in fact, continued well beyond that date). his Round easily eclipsed the Tokyo Round as the most far-reaching and complex. Most of the negotiations occurred in Geneva. However, a Mid-Term Review was held in Montreal in 1990. In addition, an accord on farm support (particularly export subsidies) was hammered out between the United States and European Union (EU) at Blair House in Washington, D.C. (the *Blair House I Accord*) in November 1992, a deal on industrial tariffs was reached in July 1993 in Tokyo among the "Quad" countries (Canada, EC, Japan, and EU), and another accord between the United States and EU at Blair House focusing on oilseeds subsidies (the *Blair House II Accord*) was reached in November 1993.

10) The *Doha Development Agenda*, 2001–present:
This Round involves approximately 150 WTO members and roughly US $3 trillion of trade. Known colloquially as the "*Doha Round*," it was launched in Doha, Qatar, at the Fourth WTO Ministerial Conference. Held from November 9–13, of 2001, coming to an agreement on an agenda, in the wake of the terrorist attacks of September 11, and given many competing interests of not only members but also non-governmental organisations (NGOs), was a major achievement. Yet, after over a decade of negotiations, this Round is distinguished as the first failed one in GATT-WTO history. The WTO did not achieve the objectives of the Doha Development Agenda (DDA), and certainly not as a single undertaking.

Each Round is discussed more fully later in this and subsequent Chapters. For now, it is worth observing how the Rounds obtain their rubrics. The name of the first four Rounds is based on the geographic location where they were held. The name of the next two Rounds is named after individuals who inspired the Rounds. The recent practice has been to name Rounds after the location in which trade ministers adopted a Declaration launching the Rounds.

26–002 It also is worth observing that the historical record, in terms of the number of Rounds in a reasonably short span of modern economic history, is remarkable. It should not, however, be inferred from this record that commencing a round is easy. It is not. A mix of political and economic factors must come together.

In particular, trade policy makers, heads of government, and ultimately domestic constituencies must agree on a common agenda. Yet, since the founding of GATT, the mix of political and economic factors world leaders must marshal to trigger a round has become ever-more complex. That is because the membership of the multilateral trading community has grown in number and diversity, hence the range of topics that members seek to discuss, and their perspectives and interests on the topics, have expanded. To some degree, leadership from the GATT Secretariat, and now the WTO—in the person of the Director General, may be a factor in whether a round is launched or not. However,

as Dr. Supachai Panitchpakdi of Thailand, who served as Director General in 2002–05, was fond of saying, the WTO is a "member-driven organisation." Strong and charismatic leadership can compel members to compromise on an agenda to some degree, but pushing the members too far when the political and economic environment is not ripe for a round may marginalise the Director General.

26–003 The ninth Round illustrates these problems. The ninth Round was to have been launched in Seattle during the Third WTO Ministerial Meeting from November 30–December 3, 1999, and was to have been dubbed the Millennium Round. The agenda for this Round was hotly debated in the run up to, and during, the Seattle Ministerial Conference. Ultimately, negotiations collapsed amidst loud and sometimes violent protests by groups and NGOs representing an array of concerns, notably environmental, labour, human rights, and consumer protection interests. Many fissures were exposed in Seattle, and violent clashes occurred on the streets.

For example, the United States and Cairns Group favoured talks aimed at ending agricultural subsidies, such as those prescribed by the European Union (EU) Common Agricultural Policy (CAP). The EU objected unless the new round also included a broad array of other topics, including all four "Singapore Issues." These issues had been identified in the First WTO Ministerial Conference in Singapore in 1996. (The Second Ministerial Conference was held in Geneva in 1997, marking the 50th anniversary of GATT). These issues are customs facilitation, liberalisation of foreign direct investment (FDI), the relationship between trade and competition policy, and transparency in government procurement. Developing countries, led by Brazil and India, opposed inclusion of these issues on the agenda.

26–004 As another example, the United States favored discussions on trade-related environmental and labour issues. Developing countries, again led by Brazil and India, opposed including these items for discussion. They were outraged by President Clinton's advocacy of trade sanctions for violations of labour rights, made during the Seattle Ministerial Conference. Many developing countries instead sought an examination of the use of trade remedies, especially antidumping (AD) rules, against their exports. The United States Congress exerted a great deal of pressure on the United States Trade Representative not to concede to re-consideration of AD or countervailing duty (CVD) rules in a new round. In this polarised environment, there was little any Director General could do.

By November 2001, two months after the terrorist attacks of September 11, the environment changed. The Fourth WTO Ministerial Conference was held in Doha, the capital of Qatar. A strong WTO Director General, the Right Honourable Mike Moore (the former Prime Minister of New Zealand, who served as Director General from September 1, 1999 to August 31, 2002, splitting the normal six year term with Dr. Supachai, who served from September 1, 2002 through August 31, 2005), was determined to push though an agenda for a new Round. He persuasively reminded members failure to agree on an agenda would send a signal to terrorists they succeeded in dividing the community of peaceful, lawful nations and prevented them from expanding the benefits of free trade. The Doha Round was launched.

26–005 What general trends emerge from the many Rounds of multilateral trade negotiations? The question is asked during a time of living history, as multilateral trade negotiations continue. The following five broad observations, however, may be offered:

1) The successive Rounds involve an increasing number of countries, reflecting new accessions to GATT and the WTO. Consequently, the WTO membership is far more diverse, in terms of levels of economic development and nature of political systems, than the original GATT contracting parties of 1947.

2) The successive Rounds cover a greater dollar value of world trade. This coverage is partly a mark of the success. It reflects growth in world trade made possible in

part by liberalisation from preceding Rounds. It also is owed to the ambition of trade negotiators to cover a larger number of product categories.

3) The successive Rounds, particularly since the Kennedy and Tokyo Rounds, expand well beyond the traditional topic of tariffs. Trade negotiations no longer are just about tariff reductions (if, in reality, they ever were). Depending on the member and its perspective, they relate to matters from agriculture to national security, and from dispute settlement to sanitary standards.

4) Especially since the Uruguay Round, a large number of non-governmental organisations (NGOs) have "participated" in trade talks, in one way or the other. Sometimes, the "participation" is observation and reporting. Other times, it is advocacy of a position. Still other times, it is through protest, which not always is respectful or peaceful.

5) Much of the "optionality" of participation that characterised Rounds up to the Uruguay Round has disappeared.[2] In the Geneva, Annecy, Torquay, Geneva, and Dillon Rounds, technically, it was necessary for a contracting party to participate if it sought a concession, and a contracting party could seek a concession only if it held an Initial Negotiating Right (INR) or had a principal supplying interest. As a practical matter, if trade flows were small, then contracting parties tended not to exchange concessions. And, less developed countries sometimes observed from the sidelines. However, in the Uruguay Round, every contracting party had to schedule concessions on goods. In effect, no free riding was permitted.

The obvious inference from these trends, which no doubt is correct, is multilateral trade rounds have become increasingly comprehensive, time consuming, and difficult.

Section II: Tariff Negotiations Outside a Round

26–006 Before treating in some detail the rounds of multilateral trade negotiations in GATT history, it is worth appreciating there are three other venues in which tariff talks occur. These are supplementary negotiations, accession negotiations, and commitments on behalf of dependent territories.[3] While politicians, lobbying groups, and the media may on occasion give the impression "all the action" occurs in a formally declared round, in truth important developments occur in these other venues.

Between 1947 and 1957, when Article XXVIII *bis* entered into force, the GATT contracting parties established the practice of engaging in tariff negotiations outside of officially declared rounds. These talks, logically known as supplementary negotiations, led to supplementary concessions. During the 1950–51 Torquay Tariff Conference, the Contracting Parties agreed on modalities for negotiations between two contracting parties, or among more than two of the parties.[4] These modalities applied to supplementary negotiations. All contracting parties had to be notified about the time and place of proposed negotiations, and each had a right to join in the talks. The contracting party or parties initiating negotiations had to circulate lists containing requested concessions. A selective, product-by-product tariff reduction methodology was used.

[2] See Anwarul Hoda, *Tariff Negotiations and Renegotiations under the GATT and the WTO* (2001), paras H.1-4 pp.67–68.
[3] See Anwarul Hoda, *Tariff Negotiations and Renegotiations under the GATT and the WTO* (2001), paras A.9-11 pp.10–11 (2001).
[4] The modalities are published at BISD, vol.I, p.104, as cited in World Trade Organisation, Guide to GATT Law and Practice – Analytical Index, vol.2 pp.990–991 (Geneva, Switzerland: World Trade Organisation, 1995).

26–007 The second venue for out-of-round negotiations is an obvious instance. Whenever a country applies to become a member of the WTO (and, before, a contracting party to GATT), that country is asked by extant members (or contracting parties) to make tariff concessions. The process, in brief, proceeds on two tracks. First, bilateral negotiations are held between the applicant country and any member that seeks to have a deal with the applicant. Secondly, a working group—consisting of any member that would like to be part of the group—is convened at the WTO to negotiate terms of accession. The result of the first process is a series of bilateral accords between the applicant and self-selecting members. The working group takes this result and, following the MFN obligation, "multilateralises" it by creating a document containing the terms of entry for the applicant. That document provides the best tariff treatment resulting from the various bilateral accords.

Interestingly, this two track process is not spelled out in either the now-irrelevant Article XXXIII of GATT, or in Article XII of the *Agreement Establishing the World Trade Organisation* (*WTO Agreement*). These provisions do not explain how accession negotiations must be conducted. Thus, the two-track process is custom and practice, not textual law. The point, however, is that it is a venue for tariff negotiations outside of a normal round.

The third venue also is associated with accession. However, it is now the least common of the three out-of-round negotiations. The relevant GATT provision is paragraph 5(c) of Article XXVI. As its title indicates, this Article deals with the acceptance, entry into force, and registration of the GATT.

26–008 Paragraph 5(c) states:

> "If any of the *customs territories*, in respect of which a contracting party has accepted this Agreement, *possesses or acquires full autonomy in the conduct of its external commercial relations and of the other matters provided for in this Agreement*, such territory shall, upon *sponsorship* through a declaration *by the responsible contracting party* establishing the above-mentioned fact, be *deemed* to be a contracting party."[5]

This provision allows for dependent customs territories that are autonomous with respect to their trade relations to gain accession through sponsorship. This method of becoming a WTO member is far less relevant than in the decades following the Second World War, when colonial powers sponsored their dependents to become GATT contracting parties. Indeed, Professor Hoda points out this method is not carried forward into the *WTO Agreement*.[6]

The Article XXVI:5(c) route to accession sometimes is known as "succession." This label reflects the legal fact the dependent territory continues as a GATT contracting party, even after it has become entirely independent of its former colonial master. That is, the public international law doctrine of succession is applicable. To be eligible for accession under paragraph 5(c), three conditions must be present. First, the geographic entity for which accession is sought must be a distinct customs territory. Secondly, this customs territory must be fully autonomous with respect to its foreign economic policy, including all topics dealt with by GATT (but not, for example, respect to external defence or certain internal political matters). Third, the member (or contracting party) on which the customs territory is dependent must attest publicly (i.e. certify) to the second condition.

26–009 What is the relationship between accession by succession, on the one hand, and out-of-round tariff negotiations, on the other hand? During the Article XXVI:5(c) process, the dependent customs territory need not produce a separate Schedule of Concessions from

[5] Emphasis added.
[6] See Anwarul Hoda, *Tariff Negotiations and Renegotiations under the GATT and the WTO* (2001) para.A.11 p.10.

that of its sponsoring contracting party. Rather, the Schedule of the sponsor is the Schedule of the territory. Thus, deemed accession occurs, separate tariff negotiations are not needed, and all concessions agreed to and bound by the sponsor are incumbent on the territory. When the territory gains complete independence, then it retains its status as a contracting party. But, a new Schedule of Concessions is established for it, using as a starting point its existing Schedule that it inherited from its sponsor.

Section III: Emphasis on Tariff Reductions in Early Rounds

26–010 The framework for a round of multilateral trade negotiations is set out in Article XXVIII *bis*, coupled with the provisions of Article XXV on joint action. In addition, brief mention is made in Article III:2 of the *Agreement Establishing the World Trade Organisation* (*WTO Agreement*) of the supporting role played by the WTO. Still the framework is skeletal. It provides no details regarding the mechanics or procedures for conducting negotiations. Moreover, Article XXVIII *bis* was not added to GATT until October 7, 1957, following its preparation through a 1954–55 Review Session.

Not surprisingly, then, during the first three Rounds, the contracting parties followed procedures laid out in the *Charter for an International Trade Organisation* (*ITO Charter*), particularly Article 17, even though it was clearly dead letter law by the time of the second Round.

26–011 The essential features of these procedures were as follows:[7]

1) Negotiations to cut tariffs were conducted on products selected by one or more contracting parties, and the offers and counter-offers were made on a product-by-product basis.

2) A contracting party could ask for a reduction in a tariff on a product only if that party was a principal supplier of the product to the country from which it sought a concession.

3) Every contracting party had full autonomy to grant, or not grant, a concession on any particular product.

4) If a contracting party already maintained duty free treatment with respect to a product, or a low rate of duty on that product, and if it agreed to bind the tariff on that product against increase from the zero or low rate, then the other contracting parties accepted this concession as, in principle, equal to either the substantial reduction of a tariff from a high level, or the elimination of a preference.

5) Bargaining was based on reciprocity. Thus, no contracting party was obliged to offer or grant unilateral concessions.

After three Rounds of using these procedures, the contracting parties gained a comfort with them that can come only from experience. Not surprisingly, then, they crafted Article XXVIII *bis* of GATT by incorporating these features from the ITO Charter. The brief Interpretative Note to this Article makes no reference is made to the *Charter*, nor need it, precisely because of this incorporation.

26–012 The Geneva Tariff Conference of 1947 occurred in the context of finalising the GATT document itself and preparing the *ITO Charter*.[8] In 1946, the United States

[7] See Anwarul Hoda, *Tariff Negotiations and Renegotiations under the GATT and the WTO* (2001) para.B.1 pp.26–27.

[8] See Anwarul Hoda, Tariff Negotiations and Renegotiations under the GATT and the WTO para.A.2 p.25 (2001).

invited all 24 countries represented on the "Preparatory Committee for the Charter for the International Trade Organisation" to enter into negotiations to reduce tariff and other trade barriers. The United Nations Economic and Social Council appointed these countries to the Committee. As Professor Haus explains, when the United States circulated a *Suggested Charter* for the ITO in 1946, this draft

> "included two articles that would have facilitated Soviet participation. Article 28 included a variant of the quantitative import commitment inserted into many bilateral agreements with the Soviet Union in the interwar years. The clause specified that a country with a complete or substantially complete monopoly of its import trade should undertake a global import commitment, of an amount to be agreed upon, in reciprocation of the tariff concessions granted by market countries. A commercial considerations clause, designed to ensure that the increased trade arising from the import commitment be conducted in a nondiscriminatory manner, was simultaneously inserted in the *Suggested Charter* as article 26."[9]

This encouragement from the United States extended to the preparation of charters for the World Bank and International Monetary Fund (IMF),

The former Soviet Union participated in these exercises, as well as in the Bretton Woods Conference of 1944 (at which the articles of agreement for the Bank and Fund were finalised), and signed the Bretton Woods Agreement. Nevertheless, the political relationship between the allies of the Second World War deteriorated. The Soviet Union abstained from joining the World Bank and IMF, and elected not to participate in the last two conferences at which the draft *ITO Charter* was debated and completed, and never joined GATT.[10]

26–013 Accordingly, of the 24 countries on the United Nations Committee, 23 of them accepted the American invitation—the notable exception being the former Soviet Union.[11] The acceptance by 23 countries led to what became known as the first Geneva Round, which was completed in August 1947.

Why they accepted the American invitation is evident from a *Report* emerging from the Geneva Preparatory Conference:

> "*Considering that the objectives underlying the endeavour to set up the I.T.O. would be promoted if concrete action were taken* . . . to enter into reciprocal negotiations directed to the substantial reduction of tariffs and other barriers to trade . . . the governments represented on the Preparatory Committee adopted a resolution . . . regarding the carrying out of such negotiations. . . . [These governments currently are] in the final stages of negotiations [i.e. of the first Geneva Round]. . .. It is expected that the concessions resulting from these negotiations. . .will shortly be incorporated in a General Agreement on Tariffs and Trade."[12]

In brief, the 23 countries thought they would advance their shared interest in establishing an ITO, with its central mission of liberalising trade, if they commenced expeditiously

[9] Leah A. Haus, *Globalising the GATT – The Soviet Union's Successor States, Eastern Europe, and the International Trading System* (1992), 89. These two articles were not carried through to the ITO Charter, given the Soviet decision not to participate in the final two drafting conferences for the Charter. See generally,fn. 1 p.133.

[10] See Leah A. Haus, *Globalising the GATT – The Soviet Union's Successor States, Eastern Europe, and the International Trading System* (1992), 90.

[11] See Anwarul Hoda, Tariff Negotiations and Renegotiations under the GATT and the WTO para.H.1 p.67 (2001).

[12] *Report of the Second Session of the Preparatory Committee of the United Nations Conference on Trade and Employment*, United Nations Document EPCT/186 p.6 (1947) (emphasis added) (*also quoted in* John H. Jackson, *World Trade and the Law of GATT* § 10.4 fn. 7 p.218 (1969)).

to cut tariff barriers even before they finished drafting the *Charter*. (In all likelihood, some of them may have appreciated the possibility the *Charter* never would take effect.)

26–014 In the Geneva Round, the 23 countries achieved tariff reductions using a selective, product-by-product methodology, on which they had agreed at the 1946 London Preparatory Conference, and in 1947 in New York.[13] In turn, this methodology, coupled with the principal supplier rule, was drawn in large part from American practice, namely, the way in which the United States had conducted negotiations under its reciprocal trade agreements program up to 1945.[14] After all, as Professor Jackson records:

> "The General Agreement was conceived as a *product* of the negotiations, not as a framework for conducting them. The *ITO Charter* contained the framework for future negotiations."[15]

Thus, having negotiated successfully, the 23 countries logically sought to implement their trade liberalising deals, even before they finalised the *ITO Charter*. Consequently, the countries not only drafted GATT, completing it on October 30, 1947, but also agreed to its effective date as of January 1, 1948. These countries became the original GATT contracting parties. The results of the bargains on lowering tariff and other trade barriers they reached during the first Geneva Round also took effect at that time.

26–015 Following the initial GATT talks, the "Early Rounds" of multilateral trade negotiations—specifically, Annecy, Torquay, Geneva, and Dillon—focused on the reduction of tariffs.[16] During those three Rounds, i.e. until the Dillon Round, the contracting parties exchanged offers and counter-offers on a bilateral basis.[17] Moreover, high priority in the first three of these Rounds was placed on the gradual elimination of colonial-era trade preferences. The reason for commencing the 1948–49 Annecy Round was to create an opportunity for tariff negotiations between the 23 original contracting parties and 11 countries seeking accession to GATT.[18] That is, the Annecy Round dealt with the possible accession of 11 more countries as GATT contracting parties under the auspices of Article XXXIII. Of the 11 applicant countries, nine joined GATT—Denmark, the Dominican Republic, Finland, Greece, Haiti, Italy, Nicaragua, Sweden, and Uruguay.

It was in 1950, at the start of the Torquay Round, when the United States publicly declared—through a press release of the Department of State—that it would not submit the *ITO Charter* to the Senate as a treaty for its advice and consent (nor to both Houses of Congress as a Congressional—Executive agreement).[19] The small but

[13] See John H. Jackson, *World Trade and the Law of GATT* (1969) s.10.4 p.219.
[14] See John H. Jackson, *World Trade and the Law of GATT* (1969) s.10.4 p.219.
[15] See John H. Jackson, World Trade and the Law of GATT (1969) s.10.4 pp.220–21 (emphasis original).
[16] There appears to be no standard definition of "Early Rounds." One convention, followed here, is to consider the Rounds completed during the first 15 years following the entry into force of GATT on January 1, 1948, as "Early." That would mean the first five Rounds (up through the Dillon Round, which ended in 1962) are "Early."
[17] See Anwarul Hoda, Tariff Negotiations and Renegotiations under the GATT and the WTO para.B.1 pp.26–27, para.C.3 p.45 (2001). In the Annecy and Torquay Rounds, the contracting parties used the rules of Article 17(c) of the *ITO Charter*. Generally, para.B.2 p.27. Essentially, these rules stated that reduction of a most favoured nation (MFN) tariff rate on a product automatically operates as a reduction in the margin of preference on the same product, and *vice versa*, and no margin of preference could be increased.
[18] See Anwarul Hoda, Tariff Negotiations and Renegotiations under the GATT and the WTO para.A.2 p.25 (2001).
[19] See United States Department of State, *Press Release*, December 6, 1950, reprinted in 23 Department of State Bulletin 977 (1950). See also United States Senate, Committee on Finance, Hearings on the Extension of the Reciprocal Trade Agreements Act, 82nd Congress, 1st Session 1247 (1951) (discussing the decision not to submit the Charter).

growing body of contracting parties then clearly understood the GATT, to borrow Professor Jackson's phrase, "was to become an *institution considerably different* from that originally contemplated."[20] During the 1950–51 Torquay Round, the contracting parties negotiated tariff reductions among themselves and with six other countries that had applied for accession pursuant to Article XXXIII—Austria, Germany, Korea, Peru, the Philippines, and Turkey.[21] Four of the six became contracting parties at the end of the Round. Korea and the Philippines did not join until after further negotiations years later.

26–016 A noteworthy feature of the Torquay Round was the challenge posed by countries (whether existing or potential new contracting parties) that had relatively low tariffs. This challenge sometimes is called "tariff dispersion," or "tariff disparities," across countries (as distinct from the phenomenon of widely varying tariff rates maintained by one country). As observed in a 1952 study on the operation of GATT, several European countries felt themselves to be disadvantaged from the outset of the Round.[22] They had bound their tariffs in the 1947 Geneva Round and 1948–49 Annecy Round, so by the start of the Torquay Round, they had low tariffs in comparison with other countries. This earlier trade liberalisation meant they had less to offer, to induce reciprocal concessions, than higher tariff countries. The latter group refused to grant concessions they perceived as unilateral and unrequited. So, for example, high tariff countries generally avoided making major tariff cuts in exchange for prolongation by low tariff countries of bindings of duties at low rates.

Unfortunately, the Torquay Round ended without a solution to the problem of negotiations involving a mix of low and high tariff countries. The tariff cuts were neither as broad or deep as had been hoped when the talks began. France responded with a plan that, after some modifications, the CONTRACTING PARTIES adopted on October 13, 1953.[23] This "GATT Plan," as it was dubbed, set out the modalities to deal with tariff dispersion.[24]

26–017 In brief, the GATT Plan contained the following features:

1) Classification of traded products into ten categories; calculation of a "demarcation line" (in effect, a target for the average incidence of the weighted average of duties in ten European and North American countries).
2) Use of an across-the-board (not a selective, product-by-product) method to cut tariffs by a fixed rate of 30 per cent.
3) A phased reduction of tariffs to the demarcation line or below (with lower reductions, and even exemptions, for countries that already had tariffs below the line).
4) Ceiling rates on individual product categories; measurement of reciprocity on an overall basis (not in a product-by-product way).
5) Special and differential (S&D) treatment for poor countries.

[20] John H. Jackson, *World Trade and the Law of GATT* (1969), s.10.4 p.222 (emphasis added).
[21] See Anwarul Hoda, *Tariff Negotiations and Renegotiations under the GATT and the WTO* (2001) para.A.2 p.25.
[22] See ICITO, GATT in Action: Third Report on the Operation of the General Agreement on Tariffs and Trade pp.9–10 (January 1952).
[23] See *Technical Study of the French Proposal for the Reduction of Tariffs*, BISD 2nd supplement, p.67–92 (1953) (adopted October 13, 1953). The original French Plan called for an automatic, across-the-board cut of tariffs by 10 per cent (phased in over a three-year period), with a ceiling rate on each of four broad categories of products, and with exceptions to give credit to contracting parties that already had low tariffs.
[24] See Anwarul Hoda, *Tariff Negotiations and Renegotiations under the GATT and the WTO* (2001) para.B.4 pp.28–29.

Before ever trying it, the contracting parties shelved the Plan. They failed to achieve a consensus to use their 1953 Plan as the modalities for the 1955–56 Geneva Round.

In the Geneva Round, only 25 of the then 39 contracting parties agreed to engage in negotiations, and only 22 of the participating countries made concessions.[25] Many less developed countries declined to participate, and the ones that did elected not to make concession offers. Not surprisingly, the contracting parties fell back on a selective, product-by-product approach, and followed the modalities laid out in the predecessor to Article XXVIII *bis* (namely, the former Article XXIX).[26]

26–018 Worse still, because the CONTRACTING PARTIES adopted procedures whereby any two or more of them could begin talks at any time, and because several countries did not participate at all, it is more accurate to eschew the label "Round" for what really was a Tariff Conference. However, as Professor Hoda observes, the label is applied because the participants included the major trading powers, all of which exchanged concession lists.[27]

The Geneva Round was disappointing in terms of the scope of coverage of tariff reductions. It affected only US $2.5 billion in trade. The reason was the delegation from the United States Congress gave the American trade negotiating team a limited mandate (which it made nearly full use of).[28] But, in two other respects, the Geneva Round was a success. For the first time, the contracting parties recognised the importance of trade liberalisation in the agricultural sector, which (in practice) remained at the margins of the disciplines of GATT. Agricultural protectionism among developed countries was having adverse trade effects, and something had to be done.

26–019 Moreover, the contracting parties acknowledged the need to tackle the trade and development needs of less developed countries (sometimes abbreviated as "LDCs," though this acronym know is used often to stand for "least developed countries"). They memorialised their plan by publishing a report, *Trends in International Trade* – informally known as the Haberler Report (in honour of the chair of the panel of experts who wrote it, Gottfried Haberler, Professor of Economics at Harvard).

This report set out the first-ever GATT guidelines for how the contracting parties could help less developed countries. In turn, it led to a "Program for the Expansion of Trade," which was adopted by the contracting parties in October–November 1958. Pursuant to the Program, the contracting parties established three committees: Committee I, which focused on the agenda for the next Round; Committee II, which reviewed the domestic agricultural policies of each contracting party; and Committee III, which addressed the concerns of less developed countries in the world trading system.

26–020 As for the 1960–62 Geneva Tariff Conference, or Dillon Round, the American Under-Secretary of State, Douglas Dillon, is said to have proposed it because of two threats from the European Economic Community (EEC), which formed in 1957 with six member states. The Dillon Round was the first set of multilateral trade negotiations in which the EEC participated as a single entity.[29] The first threat was the common external tariff (CET)

[25] See *Plans for Tariff Reduction and Rules and Procedures for 1956 Tariff Conferences*, BISD (1956) 4th supplement, p.75 (adopted November 18, 1955); *Rules and Proced ures for the Tariff Conference Commencing in Geneva on January 18, 1956*, BISD (1956) 4th supplement, p.79; Anwarul Hoda, Tariff Negotiations and Renegotiations under the GATT and the WTO (2001) para.A.3 p.25, para.H.1 p.67.

[26] See Anwarul Hoda, *Tariff Negotiations and Renegotiations under the GATT and the WTO* (2001) para.A.3 p.25.

[27] See Anwarul Hoda, *Tariff Negotiations and Renegotiations under the GATT and the WTO* (2001) para.A.3 pp.25–26.

[28] But see John H. Jackson, *World Trade and the Law of GATT* (1969), s.10.4, p.222 (blaming the United States as "too inflexible to accept the new plans for negotiating procedures. . ...," and thus causing the fall back to the methodology of the previous Rounds).

[29] See *Programme for Expansion of Trade, First Report of Committee I, Annex I, Section VIII:C*, BISD (1960) 8th supplement, p.119 (adopted May 29, 1959).

of the EEC. Under Article XXIV:6, large-scale tariff negotiations were required of the EEC to compensate individual contracting parties for any imbalance that would result when the EEC replaced the variegated tariffs of each EEC member with a single external tariff. Thus, the first part of the Round was dedicated to renegotiating tariff with the EEC under Article XXIV:6. The balance of the Round was spent on new tariff concessions among the contracting parties.[30] During the second phase, countries applying to join GATT carried out tariff negotiations in connection with their accession.

26–021 The second threat concerned agricultural subsidies pursuant to the EEC Common Agricultural Policy (CAP). The Geneva Round and Committee III had drawn attention to trade-distorting agricultural policies. The new Dillon Round provided an opportunity to discuss these distortions. However, the problem proved too difficult. Agricultural and other politically sensitive products were, for the most part, left out of the final deal.

For three additional reasons, the Dillon Round results disappointed expectations of the contracting parties. First, effective participation was limited. Of the 37 contracting parties at the time, just 23 of them offered concessions. Secondly, nothing was done to combat non-tariff barriers, even though the rules for the Dillon Round expressly mentioned barriers under Article XI:2(c) (which has exceptions to the Article XI:1 rule against quantitative restrictions).[31] Third, tariff cuts could have been deeper. The EEC offered to slash tariffs on a linear basis. The fixed rate would be 20 per cent, though there would be some exceptions to the across-the-board cut.[32] The EEC had legal authority for this ambitious offer. The Dillon Round was the first set of multilateral trade talks conducted with Article XXVIII *bis* in force, and the contracting parties adhered to its terms. The EEC suggested they follow the first sentence of paragraph 2(a) of this Article, which empowers them to agree on the application of procedures other than a product-by-product approach. The United Kingdom matched the EEC offer. But, because of limited negotiating authority, the United States could not meet this offer. Consequently, the contracting parties stuck by the language in this sentence that authorises them to use the old-fashioned selective, product-by-product method was used.

26–022 In all of the Early Rounds, negotiations to cut tariffs were conducted on a product-by-product basis. The product-by-product method was implemented according to the principal supplier rule.[33] The principal supplier of a particular product is expected to entertain the possibility of offering concessions only on a product for which another country that also is a major supplier of that product has requested a concession. In this way, negotiations on tariff reductions for a particular product are held between pairs of principal suppliers. Other countries are kept appraised of the talks, and from time to time are brought into the negotiations. That way, all countries periodically can assess the value of concessions on the table and how those concessions would affect them.

In brief, the theory underlying the principal supplier rule is only those countries that are significant exporters of a product ought to have a right to request tariff cuts in that product. In this way, demands for tariff cuts would remain reasonable, and problems of free riding would be avoided. Once concessions on a product are agreed to on a reciprocal, mutually advantageous basis between the principal suppliers, the deal is multilateralised, by operation of the MFN obligation in Article I:1. The new, lower tariff is bound as a result of Article II:1(b). Yet, there are obvious problems with this theory as it was practiced in the early decades of GATT history.

[30] See Anwarul Hoda, *Tariff Negotiations and Renegotiations under the GATT and the WTO* (2001) para.A.4 p.26.

[31] See *Programme for Expansion of International Trade, Tariff Reduction, Second Report of Committee I, Annex A.II(b)*, BISD 8th supplement, p.p.116 (1960) (adopted November 19, 1959).

[32] See Anwarul Hoda, *Tariff Negotiations and Renegotiations under the GATT and the WTO* (2001) para.B.6 p.30, C.1 p.44, H.1 p.67.

[33] See John H. Jackson, *World Trade and the Law of GATT* (2001), s.10.4 p.220.

26–023 First, as the number of contracting parties increased, and the range of product categories expanded, the product-by-product approach and principal supplier rule became more cumbersome to implement. The method was not efficient for the organisation GATT had become. Conversely, with a large number of countries acceding to GATT, there was less fear of free riding, in the sense of benefits from tariff cuts redounding to non-members that had made no trade reforms of their own.

Secondly, the approach gradually fell victim to its own success. Having provoked significant cuts by developed countries in industrial tariffs in the late 1940s through early 1960s, there was little more headway to be made using the approach. That is, many of the important industrial product categories had been the subject of a cut.

26–024 Thirdly (and following the second point), the product-by-product approach is inherently selective, as it relies largely on the desires and efforts of principal suppliers. If no single negotiating partner is the principal supplier of a particular product, then the result may be no offer on that product is made.[34] The result is a gap in coverage of tariff cuts. A gap also can result because a product is deemed too sensitive to permit an aggressive tariff cut.

Fourthly, the approach does not address in a systematic way problems of tariff dispersion and tariff peaks (either within or among countries).

26–025 All of these shortcomings suggested a new approach would be needed for future Rounds. Yet, by way of overall impression, what might be said of the actual results of tariff cuts made during the Early Rounds? On the one hand, "[n]o reliable evaluation of the tariff reductions and other commitments made during the first five rounds of negotiations in GATT 1947 is available."[35] Systematic analyses of the outcomes appear to have commenced with the Kennedy Round, typically under the aegis of the GATT or WTO Secretariat. On the other hand, reports by these Secretariats, as well as by the United Nations Conference on Trade and Development (UNCTAD), the Organisation for Economic Cooperation and Development (OECD), and various other institutions, indicate the "the achievement during the last 50 years or so in industrial tariff reduction has been impressive. . . ."[36]

[34] For account written by a trade negotiator of the problems of the product-by-product approach and principal supplier rule that led to a linear approach in the Kennedy Round, see J. Evans, *U.S. Trade Policy* (1967) 21.

[35] Anwarul Hoda, *Tariff Negotiations and Renegotiations under the GATT and the WTO* (2001) para.J.2 p.70.

[36] Anwarul Hoda, *Tariff Negotiations and Renegotiations under the GATT and the WTO* (2001) para.J.6 p.72. See, e.g. United Nations Conference on Trade and Development (UNCTAD), The Post-Uruguay Round Tariff Environment for Developing Country Exports (1997) (a study conducted jointly by UNCTAD and the WTO).

Chapter 27

Kennedy and Tokyo Rounds (1964–79): Tariff Cutting Plus Disciplines on Non-Tariff Barriers and Remedies

Section I: Overview of Kennedy Round

27–001 The 1964–67 Kennedy Round was more ambitious and complex than any previous multilateral trade talks. By 1967, there were 76 contracting parties to GATT, though only 32 of them granted tariff concessions in this Round:[1]

1) Argentina
2) Australia
3) Austria
4) Brazil
5) Canada
6) Chile
7) Czechoslovakia
8) Denmark
9) Dominican Republic
10) EEC (then comprised of six countries)
11) Finland
12) Iceland
13) India
14) Ireland
15) Israel
16) Jamaica
17) Japan
18) Korea
19) Malawi
20) New Zealand
21) Norway

[1] See Anwarul Hoda, *Tariff Negotiations and Renegotiations under the GATT and the WTO* (2001) para.H.2, p.67.

22) Peru
23) Portugal
24) South Africa
25) Spain
26) Sweden
27) Switzerland
28) Trinidad and Tobago
29) Turkey
30) United Kingdom
31) United States
32) Yugoslavia

On many matters, the starting point or "working hypothesis for the general rate of linear reduction" for negotiations was a 50 per cent reduction in tariffs. In fact, this large reduction was achieved on many products. Indeed, the United States Trade Expansion Act 1962 gave the American negotiating team the authority to pursue an across-the-board cut of up to 50 per cent, and for some product categories an even deeper cut than 50 per cent.[2]

Section II: Linear Approach with Exceptions

27–002 Six factors made the Kennedy Round particularly noteworthy and established trends that continue to the present day. First, the negotiation process for cutting tariffs changed from the traditional product-by-product approach to an across-the-board or linear method.[3] On May 21, 1963, the Contracting Parties launched the Round by adopting a *Ministerial Resolution* calling for "substantial linear tariff reductions with a base minimum of exceptions which shall be subject to confrontation and justification" among industrialised countries for industrial products.[4] In other words, their goal was a cut of 50 per cent on all products, with precious few exceptions that had passed a rigorous test.

The Contracting Parties agreed to this goal for two reasons, as Professor Hoda explains:

[2] See 76 Stat. 877, 19 USC (1962) ss.1821(b)(1). The only exceptions to the limitation of the 50 per cent cut (i.e. items for which decreases of more than 50 per cent were permitted) seem to be for dicyandiamide and limestone, which are employed in the manufacture of cement, to which section 1821(b)(1) did not apply. See section 1823.

[3] Professor Dam argues "[t]he Kennedy Round experience suggests that rules alone cannot determine the content of tariff negotiations, particularly so long as the principle of reciprocity exercises such a powerful influence on negotiators." Kenneth W. Dam, *The GATT* (1970) 77. As a general matter, it may be observed there is a tension between reciprocity and across-the-board tariff cuts. Reciprocity entails that, with respect to trade barriers on a particular good, contracting party A treats contracting party B in the same way that B treats A. Reciprocity is less demanding, from a free trade perspective, than national treatment, which requires A to treat the goods of B in the same manner as A treats A's own goods. Contracting party A is unlikely to grant across-the-board tariff cuts on goods from contracting party B without reciprocal treatment.

[4] *Ministerial Meeting: Arrangements for the Reduction or Elimination of Tariffs and Other Barriers to Trade, and Related Matters, and Measures for Access to Markets for Agricultural and Other Primary Products*, BISD (1964), 12th supplement, pp.47–49 (adopted May 21, 1963).

> "Two main considerations led to the adoption of the linear approach. First, the item by item, request-offer method adopted in past negotiations, with its *dependence on* the extent to which the principal supplier was *willing to reciprocate* the reduction of duty in a particular product, had led to *very small reductions* which were in some cases worthless in commercial terms. Second, with the increase in the number of contracting parties, the traditional method had become increasingly *cumbersome and unwieldy*."[5]

Furthermore, the *Resolution* recommended addressing the problem of disparities in tariff levels, and called for "tariff reductions . . . based upon special rules of general and automatic application."[6]

27–003 This call in the *Ministerial Resolution* implied the break with the product-by-product methodology of the Early Rounds would not be a clean one. Indeed, it was not, and the reasons went beyond the effort to address tariff disparities. For instance, the United States Congress limited the discretion of American negotiators to engage in across-the-board reductions. In particular, Congress excluded products worth 12 per cent of all United States imports from the scope of negotiating authority.

Consequently, some product-by-product, and sector-by-sector, negotiating inevitably occurred. Professor Dam recounts this history:

> "*The linear method presupposed that all countries would reduce tariffs by the prescribed percentage on all items. If some countries excluded certain items from the scope of the linear reductions* (that is, if they tabled "exceptions" with respect to certain items), *other countries would inevitably be forced to weigh concessions received and concessions granted much as under the old product-by-product method.* But exceptions were politically inevitable. Congress had . . . tied the U.S. negotiators' hands, and it was clear that many other countries wanted to exclude certain products. Two possibilities existed for reconciling, at least partially, exceptions with the linear method, but both were rejected.
>
> One would have been to construct a list of common exceptions. This was rejected because, as a practical matter, such a list would have had to include all items excepted by any contracting party and therefore to be very long. Moreover, such a list might have been inconsistent with the linear method insofar as some contracting parties excepted items constituting a larger percentage of their imports than did other contracting parties.
>
> The alternative would have been to prescribe a certain maximum percentage of total imports (broken down perhaps by categories of imports) that might be covered by each national exceptions list. The problems associated with constructing a common exceptions list would thus have been avoided. But this alternative was rejected because it was felt that any 'quota' for exceptions would, in Parkinsonian fashion, be filled automatically, as each country sought to minimize concessions granted.
>
> The decision was made to call for 'a bare minimum of exceptions which shall be subject to *confrontation and justification*.' Since *the term 'bare minimum' was not defined*, some contracting parties treated the exception lists as bargaining devices, tabling many exceptions and then offering to reduce the number as other contracting parties did the same. Only Austria, Denmark, Sweden, and Switzerland tabled no exceptions, and their offers to make reductions without exceptions were made subject

[5] Anwarul Hoda, *Tariff Negotiations and Renegotiations under the GATT and the WTO* (2001) para.B.8, pp.30–31 (emphasis added).

[6] *Ministerial Meeting: Arrangements for the Reduction or Elimination of Tariffs and Other Barriers to Trade, and Related Matters, and Measures for Access to Markets for Agricultural and Other Primary Products*, BISD (1964) 12th supplement, pp.47–49 (adopted May 21, 1963).

to reciprocity. In the end some items were withdrawn from the 50 percent cut in order to enable certain countries to achieve reciprocity vis-à-vis the EEC."[7]

Not only was "bare minimum" left undefined, but so also the discipline of "confrontation and justification" proved somewhat weak. To be sure, contracting parties understood the phrase meant an exception had to be justified on the basis of an "overriding national interest."[8] Neither the interest of a particular domestic sector, nor the bargaining considerations of a contracting party, was supposed to suffice for an exemption from the linear cut. Yet, as Professor Dam implies, in practice these factors did result in carve outs.

27–004 Indeed, in four instances, special dispensation applied on a nation-wide basis.[9] As Professor Jackson suggests, the dispensations arose for no better reason than "certain countries decided they could not participate on a linear basis," and the rest of the contracting parties essentially acquiesced, allowing them "to participate on the basis of product-by-product offers, as before."[10] Canada got recognition as a country with a special trade structure. Because of their reliance on exports of primary agricultural products and natural resources, so also did Australia, New Zealand, and South Africa. These countries were released from the linear methodology, and permitted to make item-by-item offers. Further, for an important fifth case, the EEC, the problem of tariff disparity was handled by permitting deviation from the linear methodology. The EEC pointed out it had duties on certain items that were significantly lower than maintained by the United States and United Kingdom. In the interest of reciprocity, the EEC agreed to tariff cuts of less than 50 per cent on these product categories.

In the end, after repeatedly pushing back the deadline for completion, the talks finished in May 1967, and the Protocol embodying the results was signed on June 30, 1967.[11] The Kennedy Round negotiators did achieve an across-the-board tariff cut of 35 per cent.

As Professor Hoda discusses:

> "During the Kennedy Round, the principal industrialised countries made *tariff reductions on 70 percent of their dutiable imports, excluding cereals, meat, and dairy products*. Although the working hypothesis adopted for industrial products was for a linear cut of 50 percent, because of numerous exceptions, an *effective reduction of 35 percent* was obtained in industrialised countries for these products. The tariff reductions made by the developing countries were *highly selective* and would *not* have made a significant impact on their trade-weighted average tariff."[12]

In practice, "across-the-board" meant 60,000 products were covered by the reduction.

To be more specific, concessions made by the EEC, Japan, Sweden, Switzerland, the United Kingdom, and the United States covered 70 per cent of the dutiable imports (worth about US $26 billion) into these countries.[13] Most of their concessions (covering roughly

[7] Kenneth W. Dam, *The GATT* (1970), pp.69–70 (emphasis added).
[8] Anwarul Hoda, *Tariff Negotiations and Renegotiations under the GATT and the WTO* (2001), para.B.9, p.31.
[9] See Anwarul Hoda, *Tariff Negotiations and Renegotiations under the GATT and the WTO* (2001), para.B.10, p.31.
[10] John H. Jackson, *World Trade and the Law of GATT* (1969), s.10.5, p.225.
[11] The Uruguay Round negotiations finished on the day the trade negotiating authority of the American President expired—December 15, 1993—and the Kennedy Round package was signed on the last day of that authority. The obvious point is multilateral trade negotiations almost invariably go down to the wire."
[12] Anwarul Hoda, *Tariff Negotiations and Renegotiations under the GATT and the WTO* (2001), para.J.3, p.70 (emphasis added).
[13] See GATT Press Release (1967) 992, quoted in John H. Jackson, *World Trade and the Law of GATT* (1969), s.10.5, p.228; John B. Rehm, *Developments in the Law and Institutions of International Economic Relations: The Kennedy Round of Trade Negotiations*, 62 American Journal of International Law 2, 403 (1968).
[14] Kenneth W. Dam, *The GATT* (1970), p.77 (emphasis added).
[15] John H. Jackson, *World Trade and the Law of GATT* (1969), s.10.5, p.225.

US $18 billion of dutiable imports) were tariff cuts of 50 per cent or more, some of the concessions (covering roughly US $5 billion of dutiable imports) were tariff cuts of between 20 and 50 per cent, and some concessions (covering roughly US $4 billion of dutiable imports) were smaller tariff cuts. On some dutiable imports (worth about $11 billion), these countries granted no concessions.

27–005 Professor Dam, then, finds the results of this Round disappointing:

> "In the end, *30 percent of the dutiable imports of the major participants were left untouched by tariff reductions*, and approximately one-third of the reductions on the remaining imports were of less than the full 50 percent. Just as in earlier rounds the principle equating the binding of a low tariff with the substantial reduction of a high tariff had failed to survive intact the realities of tariff bargaining, so in the Kennedy Round *the across-the-board principle was seriously compromised*."[14]

Nevertheless, the across-the-board method of tariff reductions continues to be used in negotiations.

Section III: Partial Coverage of Agricultural Sector

27–006 Aside from the linear approach to tariff cutting, the second noteworthy feature of the Kennedy Round was the coverage of agricultural as well as industrial goods. For example, agreements were reached on grains and on chemical products. Of course, reducing tariff barriers in agricultural trade did not prove easy. As Professor Jackson recounts, "the linear approach to agricultural goods was abandoned completely."[15]

Professor Dam observes:

> "In addition to excepting individual products [from the linear method of cutting tariffs], it was decided after extensive discussions to *treat the agricultural sector specially*. This special treatment was thought to be justified by the high frequency of quantitative restrictions and other non-tariff barriers in agriculture, a circumstance that tended to make tariffs irrelevant to determining international trade flows for agricultural products. In part, the dispute about agriculture reflected a difference between the national interests of the two major protagonists, the United States and the EEC. *The United States was a major agricultural exporter, and its negotiators were committed politically to the Congress to making the successful conclusion of agricultural negotiations a condition for any concessions on industrial products. The EEC was for many agricultural products a major importer and was pursuing a conscious policy of seeking agricultural self-sufficiency*. The United States, although maintaining that the general linear rules should apply to agricultural tariffs of major significance, was successful in seeking the adoption of *'acceptable conditions of access'* as the goal of agricultural sector negotiations. 'Acceptable conditions of access' was open to the interpretation that the United States sought a *guarantee of a certain percentage share of the EEC market*, a guarantee that would have been difficult to reconcile with the linear method if not also with the most-favored-nation clause.
>
> In the end, *all agricultural products were excluded from the linear negotiations*. Cereal, meats, and dairy products were the subjects of special discussions oriented toward the creation of international commodity arrangements, and the remaining

agricultural products were dealt with through specific offers – that is to say, through *product-by-product negotiations.*"[16]

Not surprisingly, efforts to liberalise trade in agriculture continued through the subsequent Tokyo and Uruguay Rounds.

Section IV: Emergence of Japan, European Bloc, and Poor Countries

27–007 A third hallmark of the Kennedy Round was the fact that no longer was the United States the sole driving force in the negotiating rounds. Japan acceded to GATT in 1955, and the European Economic Community (EEC) was formed in 1957. During the Kennedy Round, both emerged as key players in negotiations. o this day, the United States, European Union (EU), and Japan remain dominant—and, to many participants and observers hegemonic—powers in multilateral trade discussions.

However, they are not uniquely so. Australia, Brazil, Canada, China, India, Korea, and others have joined the rank of powerful counties able to set agendas and shape negotiating outcomes in the multilateral trading system. Roughly 80 per cent of the WTO membership is comprised of developing and least developed countries. In the infrequent instances when they behave as a unified bloc, they, too, can "make" or "break" a deal. In sum, the origins of the dispersion of influence can be traced to the Kennedy Round.

27–008 Closely related to the third hallmark is a fourth one: the Kennedy Round negotiators discussed the interests of less developed countries. The *Ministerial Resolution* of May 21, 1963 launching the Round proclaimed "in the trade negotiations every effort shall be made to reduce barriers to exports of the less developed countries, but that the developed countries *cannot expect to receive reciprocity* from the less developed countries."[17] (Soon thereafter, nearly *verbatim* language would find its way into Article XXXVI:8.) Many less developed countries acceded to GATT in the early 1960s. On May 1, 1964, an International Trade Centre was created to channel information, and offer advice, to less developed countries.[18] (This Centre continues in a new incarnation under WTO auspices.) In February 1965, the Committee on Trade and Development was established.[19] (The Committee also continues to the present in its modern-day incarnation under the WTO).

During the Kennedy Round, less developed countries were treated as "nonlinear countries," meaning they participated in tariff reductions through affirmative product-specific offers. They were keenly interested in products such as cereals, dairy, and meat, and the Trade and Development Committee set up working groups to study these commodities.[20] The less developed countries did not have to table their offers until they learned about the tariff reductions that developed countries offered on agricultural products of interest to developing countries.

27–009 Many of the less developed countries, pursuant to the non-reciprocity principle, made no tariff reduction commitments. Indeed, because the negotiations among developed countries were rife with confrontation, and because so many less developed countries were involved in the negotiations, "in the end, only sixteen countries (counting

[16] Kenneth W. Dam, *The GATT* (1970), pp.70–71 (emphasis added).
[17] *Ministerial Meeting: Arrangements for the Reduction or Elimination of Tariffs and Other Barriers to Trade, and Related Matters, and Measures for Access to Markets for Agricultural and Other Primary Products*, BISD (1964) 12th supplement, 47, 48–49 (adopted May 21, 1963) (emphasis added).
[18] See John H. Jackson, *World Trade and the Law of GATT* (1969), s.10.5 fn. 11, p.226.
[19] See *Report Adopted by the Committee on Trade and Development*, BISD (1965), 13th supplement, pp.76, 77–89 (adopted March 25, 1965).
[20] See John H. Jackson, *World Trade and the Law of GATT* (1969), s.10.5 fn. 12, p.226.

each member state of the EEC separately) participated in the Kennedy Round as linear countries, while thirty-six were in the nonlinear category."[21] With respect to product coverage, less developed countries made no tariff reductions on 21 per cent of their dutiable imports, and cuts in their tariffs of less than 50 per cent on 26 per cent of these imports.[22] Less developed countries agreed to grant tariff concessions of 50 per cent or more on 49 per cent of their dutiable items, and cuts of more than 50 per cent on 5 per cent of these items.

Furthermore, during the Kennedy Round, a new Part IV entitled "Trade and Development" (Articles XXXVI-XXXVIII) was added to GATT. Under this Part, developed countries are obligated to give high priority to reducing their trade barriers to products from developing countries and eschew the erection of new barriers against such products. Article XXXVI:8 states developed countries do not "expect reciprocity" from developing countries. By no means did the major countries put into practice fully these new requirements. During the Kennedy Round, tariff concessions granted by developed countries tended to cover industrial products of potential, not actual, export interest to less developed countries.

27–010 Specifically, of the dutiable manufactured goods of actual interest to less developed countries, 24 per cent of the value of manufactured products imported by major developed countries were not subject to any tariff reduction, 29 per cent of these products were subject to reductions of less than 50 per cent, and 47 per cent were subject to reductions of 50 per cent or more.[23] By comparison, for all manufactured products, 16 per cent were subject to no tariff cut, 29 per cent to a cut of less than 50 per cent, and 55 per cent to a cut of 50 per cent or more. To the present day, the meaning and implementation of special and differential treatment for developing and least developed countries is a key source of controversy in international trade negotiations.

Section V: Taking Aim at Non-Tariff Barriers and Spotting New Issues

27–011 A fifth feature distinguishing the Kennedy Round from its predecessors was that Round negotiators in this Round worked to reduce non-tariff barriers (NTBs), as well as tariffs. To be sure, they were not the first to identify these barriers. In the 1955–56 Geneva Round, the negotiators put on the agenda "certain regulations and protection afforded through the operation of import monopolies."[24] The *Ministerial Resolution* launching the Kennedy Round spoke of "deal[ing] not only with tariffs but also non-tariff barriers."[25] Apparently, the negotiators appreciated the definition of a NTB ought not to be circumscribed to import licenses, quotas, and other quantitative restrictions. Rather, the definition should embrace abuse of trade remedies, because that abuse constricts or blocks importation of targeted merchandise.

[21] Kenneth W. Dam, *The GATT* (1970) p.73. See also John H. Jackson, *World Trade and the Law of GATT* (1969), s.10.5, p.226 (discussing negotiations among major nations).
[22] See GATT Press Release 992 (1967), quoted in John H. Jackson, *World Trade and the Law of GATT* (1969), s.10.5, p.228; John B. Rehm, *Developments in the Law and Institutions of International Economic Relations: The Kennedy Round of Trade Negotiations*, 62 American Journal of International Law 2, 403 (1968).
[23] See GATT Press Release 992 (1967), quoted in John H. Jackson, World Trade and the Law of GATT (1969), s.10.5, p.228; John B. Rehm, *Developments in the Law and Institutions of International Economic Relations: The Kennedy Round of Trade Negotiations*, 62 American Journal of International Law 2, 403 (1968).
[24] *Plans for Tariff Reduction and Rules and Procedures for 1956 Tariff Conference, Annex, Section II (Scope of Negotiations)*, BISD 4th Supp.) 80 para.4 (1956) (adopted November 18, 1955).
[25] *Ministerial Meeting: Arrangements for the Reduction or Elimination of Tariffs and Other Barriers to Trade, and Related Matters, and Measures for Access to Markets for Agricultural and Other Primary Products*, BISD (1964) 12th supplement, pp.47–49 (adopted May 21, 1963).

Accordingly, Kennedy Round negotiators established an antidumping (AD) code.[26] However, it was a plurilateral deal. Congress felt the American trade diplomats did not have delegated authority to negotiate this code, thus the United States never joined it, and the code had little practical impact.

27–012 The final and perhaps most enduring noteworthy feature of the Kennedy Round is its identification of issues that remain on the multilateral trade negotiating agenda. Agriculture products and special and differential (S&D) treatment are two examples. Reducing NTBs, and expanding the meaning of the term, are a third illustration of efforts at progressive liberalisation of trade. Still another illustration are the discussions that occurred during the Round on customs valuation, leading to an agreement on chemical products and the controversial valuation method used at the time by the United States known as the American Selling Price (ASP).[27] Modern day negotiators owe a debt of gratitude (or blame!) to Kennedy Round negotiators for putting these items squarely on the negotiating table.

Section VI: Overview of Tokyo Round

27–013 No doubt the tariff reductions achieved in the Dillon and Kennedy Rounds stimulated international trade and enmeshed the contracting parties in a growing network of economic interdependence.[28] In fact, from 1950–75, merchandise trade among industrial countries grew at an average rate of 8 per cent annually, which was double the growth rate of the gross national product of these countries. However, as impressive as the results of the Dillon and Kennedy Rounds were, more progress was needed on reducing tariff barriers on agricultural goods, managing the special problems of developing countries and—most importantly—combating the spread of non-tariff barriers (NTBs).

In early 1972, the United States, European Economic Community (EEC), and Japan called for multilateral and comprehensive GATT negotiations. This call was made in the wake of the international monetary crisis of 1971. The crisis had prompted President Richard M. Nixon to end the convertibility of the United States dollar into gold—i.e. to close the "gold window"—and abandon the fixed exchange rate system for currencies that had been established in 1944 by the *Bretton Woods Agreement*. (The *Agreement* had been negotiated in July 1944 and took effect on December 27, 1945.) The Tokyo Round of multilateral trade negotiations began in September 1973 and lasted until early 1979. As in the Kennedy Round, many tariff negotiations were conducted on a linear across-the-board basis. However, the Tokyo Round talks were even broader and more ambitious than the Kennedy Round talks. They were open to non-contracting parties and, most significantly, dealt expressly with the reduction of non-tariff barriers.

27–014 In retrospect, the Tokyo Round—if not the Kennedy Round—marks an interesting point in the history of Article XXVIII:1 *bis*. This provision clearly authorises the conduct of tariff negotiations. It does not expressly mention multilateral trade negotiations

[26] See *Antidumping Code*, GATT Doc. L/2812 (1967).

[27] See *Agreement Relating Principally to Chemicals, Supplementary Geneva Protocol*, 1967, GATT Publication L/2819; John H. Jackson, *World Trade and the Law of GATT* (1969), s.17.3, p.444, s.17.4, p.454. The Kennedy Round deal on chemicals called on Europe to reduce its tariffs on chemical products if the United States dropped the ASP valuation method.

[28] This discussion draws on Kenneth W. Dam, *The GATT* (1970), pp.72–73; *A Brief History of the GATT in* Trade Policies for a Better Future – The "Leutwiler Report," the GATT and the Uruguay Round 166 (1987); Robert E. Hudec, Enforcing International Trade Law: The Evolution of the Modern GATT Legal System 28, 159 (1993); Raj Bhala, *International Trade Law: Interdisciplinary Theory and Practice* 3rd edn (Newark, New Jersey: LexisNexis, 2008), 23–26; Abdulqawi A. Yusuf, *"Differential and More Favorable Treatment:" The GATT Enabling Clause*, 14 Journal of World Trade Law 488 (1980).

on non-tariff topics. Yet, negotiators in the Tokyo Round—indeed, in the Kennedy Round if not earlier—obviously were not inhibited by this technicality. Nor should they have been, as they had, and continue to have, the authority to negotiate any matter relevant to GATT under Article XXV:1. Accordingly, Professor Hoda observes:

> "[i]n the Tokyo Round, while tariff negotiations were important, the negotiations on non-tariff measures were given equal, if not greater, importance. No tariff conference under GATT 1947 was confined purely to tariffs and even the early rounds envisaged negotiations on quotas and the protection afforded through the operation of import and export monopolies. But it was during the Tokyo Round that a successful attempt was made to negotiate agreements on a range of non-tariff measures."[29]

Emerging from the Tokyo Round was a comprehensive package of agreements adopted by 85 contracting parties.

27–014 To be sure, not all 85 contracting parties agreed to cuts in their Schedules of Concessions. In the end, only 36 of them, including the 10-country European Community (EC), did so:[30]

1) Argentina
2) Austria
3) Australia
4) Brazil
5) Canada
6) Chile
7) Côte d'Ivoire
8) Czechoslovakia
9) Dominican Republic
10) EC (then consisting of 10 members)
11) Egypt
12) Finland
13) Haiti
14) Hungary
15) Iceland
16) India
17) Indonesia
18) Israel
19) Jamaica
20) Japan

[29] Anwarul Hoda, *Tariff Negotiations and Renegotiations under the GATT and the WTO* (2001), para.A.6, p.26.

[30] See Anwarul Hoda, *Tariff Negotiations and Renegotiations under the GATT and the WTO* (2001), para.H.3, pp.67–68.

21) Korea
22) Malaysia
23) New Zealand
24) Norway
25) Pakistan
26) Peru
27) Romania
28) Singapore
29) South Africa
30) Spain
31) Sweden
32) Switzerland
33) United States
34) Uruguay
35) Yugoslavia
36) Zaire

Still, over US $300 billion of trade was covered by tariff reductions and bindings phased in during a seven-year period.

27–015 Specifically, the weighted average tariff on manufactured goods from the nine major industrial markets declined from 7 per cent to 4.7 per cent, causing a 34 per cent decrease in customs duties collected. Professor Hoda summarises:

> "During the Tokyo Round, the level of all *industrial* duties in *industrialised* countries (EC, U.S., Canada, Japan, Austria, Finland, Norway, Sweden, and Switzerland) was reduced by *one-third if measured on the basis of customs collection*, and by about *39 percent if based on simple average rates*. In these countries, the *simple average declined from 10.4 to 6.4 percent*, and the *weighted average was reduced from 7.0 to 4.7 percent* (using import data from MFN origin in 1977, except that 1976 was used in the case of Austria, Canada, and Norway). *No comparable estimates are available for developing countries*, again [as in the Kennedy Round] because of the *selective nature of their bindings and reductions*, but a GATT Secretariat study mentions that the coverage of their tariff reductions was $3.9 billion of their imports in 1976 and 1977. As for tariffs facing imports of developing countries, the average MFN reduction on industrial products was shallower than the overall cut, about one-quarter compared with one-third. This reflected the fact that important product groups in the exports of developing countries such as textiles, clothing, footwear, and travel goods were subjected to lower than formula reduction."[31]

Put differently, the Tokyo Round cuts on industrial tariffs were similar to that achieved during the Kennedy Round, and even developing countries lowered tariffs on US $3.9 billion of their imports.

[31] Anwarul Hoda, *Tariff Negotiations and Renegotiations under the GATT and the WTO* (2001), para.J.6, p.72 (emphasis added).

Section VII: Use of Swiss Formula

27–016 How did the Tokyo Round negotiators achieve these impressive cuts in industrial tariffs? The *Ministerial Declaration* launching the Round called for the use of "appropriate formulae of . . . general application."[32] In other words, the *Declaration* envisaged an across-the-board method of some sort, not the selective, product-by-product approach of the Early Rounds. A number of contracting parties—notably, Canada, the European Economic Community (EEC), Japan, Switzerland, and the United States—proposed specific formulas, and the Swiss approach was accepted.[33]

The "Swiss Formula," as it became known, was as follows:

$$Z = \frac{(\text{coefficient})(X)}{(\text{coefficient}) + (X)}$$

That is,

$$Z = \frac{(A)(X)}{(A) + (X)}$$

In this formula, the variable "X" represents the initial rate of duty, and the variable "Z" represents the final rate of duty. The contracting parties forge an agreement on the value of the coefficient, which sometimes is abbreviated with the letter "A." There is an inverse relationship between the value of the coefficient and the reduction in tariffs, i.e. the smaller the value of the coefficient, the greater the cut.

27–017 In the Tokyo Round, Australia, Austria, the EEC, Hungary, and the Nordic countries used 16 as the value in making their tariff cut offers. Czechoslovakia, Japan, Switzerland, and the United States used 14. In general, developing countries favoured the Swiss Formula, though they argued for particularised treatment to account for their economic needs. Many of them offered concessions later in the Round, after June 1979 when the major developed countries had concluded their talks.[34]

As in the Kennedy Round, during the Tokyo Round the application of a linear formula was not truly across-the-board on industrial products.[35] There were three significant departures. First, several contracting parties simply exempted certain product categories from the application of the formula. They did so, despite the fact the Ministerial Declaration launching the Round did not refer to exceptions. Second, Canada was permitted to use an equation other than the Swiss Formula. hird, Iceland, New Zealand, and South Africa applied the product-by-product methodology.

27–018 Aside from tariff cuts, four other results of the Tokyo Round stand out. First, some reductions in agricultural tariffs occurred. However, no formula was used. Rather, the traditional, selective product-by-product approach was applied. The other three are discussed below.

[32] *Declaration of Ministers Approved at Tokyo*, BISD (1973) 20th supplement 19 (adopted September 14, 1973).
[33] See Anwarul Hoda, *Tariff Negotiations and Renegotiations under the GATT and the WTO* (2001), paras B.11-12, pp.31–32, para.C.6, p.46.
[34] See Anwarul Hoda, *Tariff Negotiations and Renegotiations under the GATT and the WTO* (2001) paras B.12, B.22, pp.32, 34.
[35] See Anwarul Hoda, *Tariff Negotiations and Renegotiations under the GATT and the WTO* (2001) paras B.12-13, pp.32–33.

Section VIII: Disciplining Non-Tariff Barriers and Remedies

27–019 A second key feature of the Tokyo Round is that agreements on reducing non-tariff barriers (NTBs) were achieved. For example, codes on customs valuation, import licensing procedures, government procurement, and technical barriers to trade, were reached. Some of these codes formed the basis, even to the extent of *verbatim* texts, for agreements reached in the Uruguay Round.

A third characteristic of the Tokyo Round, which was related to the second, was that Tokyo Round negotiators drew up accords on trade remedies. This characteristic was related to the second feature, as both represented efforts to attack barriers to trade other than tariffs. So, Tokyo Round negotiatiators approved a code on subsidies and countervailing duties (CVDs), and they revised the Kennedy Round *AD Code*. They also codified practices and procedures concerning dispute settlement and the use of trade measures to safeguard the external financial and balance of payments (BOP) positions of a contracting party.

Section IX: Enabling Clause and Generalized System of Preferences

27–020 A fourth hallmark of the Tokyo Round was that the legal basis for granting preferential trade treatment to less developed countries was made permanent. An "Enabling Clause" was agreed to that served as the legal basis for the Generalised System of Preferences (GSP) scheme offered by developed to developing countries. (The GSP is a non-reciprocal scheme whereby certain exports from beneficiary developing countries receive duty-free treatment.)

This Clause provides an MFN waiver in perpetuity:

> "Notwithstanding the provisions of Article I of the General Agreement [on Tariffs and Trade], contracting parties may accord *differential and more favorable* treatment to developing countries, without according such treatment to other contracting parties."[36]

Until the Tokyo Round, the legal basis for special GSP treatment had been a waiver of GATT obligations like MFN treatment under Article I:1.

Technically, however, the waiver provision, contained in Article XXV did not provide poor countries with certainty and predictability. That is because of its standard, which is both rigorous and subject to contextual interpretation. Paragraph 5 of Article XXV calls for a waiver only under "exceptional circumstances." This requirement could not be satisfied with respect to a general preferential scheme like the GSP that applies to a large number of developing countries. Arguably, at least, some of them suffered from "exceptional circumstances," but not all of them, and not with respect to all economic sectors. Finally, during the Tokyo Round, less developed countries were afforded more flexibility in enacting trade measures designed to meet their economic growth interests.

[36] GATT Doc. L/4903 (December 3, 1979); BISD (1980), 26th supplement, pp.203–04, paras 1–4 (emphasis added).

Chapter 28

Uruguay Round (1986–94): Birth of WTO and New Legal Texts

Section I: Industrial Tariff Reductions

28–001 Despite the impressive results of the Tokyo Round, soon after its conclusion the international economic community was faced with sluggish economic growth, rapid inflation, and high unemployment. Economists dubbed the vexing phenomenon "stagflation." Many contracting parties, including the United States, resorted to protectionist measures like voluntary export restraints (VERs). These measures were subtle but discriminating quantitative restrictions that circumvented Tokyo Round disciplines because of their voluntary nature. Not until the Uruguay Round were they banned (specifically, in Article 11:1(b) of the WTO Agreement on Safeguards.)

Moreover, some of the results of the Tokyo Round contained a built-in danger that would not be corrected until the Uruguay Round agreements were signed: free riding. The Tokyo Round codes applied only to signatory countries. Many less developed countries, for example, rejected them. Thus, a two-tier system was created—one tier of signatories, and one tier of non-signatories. Signatories had to resort to legal devices (e.g. statutory provisions in the legislation implementing the codes into domestic law) to ensure that non-signatories did not free ride on the benefits of the codes while eschewing the obligations of those codes.

28–002 Not surprisingly, then, tariff reductions were not the primary motive for launching the Uruguay Round.[1] Here, again, is an illustration of the Article XXVIII:1 *bis* authorisation to start a round of tariff negotiations being used for far wider purposes than just cutting tariffs. What, in particular, prompted trade policy makers to commence the Uruguay Round? There is no single cause. Aside from the residual problems from the Tokyo Round, among the most challenging problems faced by the world trading community after that Round were substantive issues of market access in key economic sectors. The Tokyo Round failed to deal with certain sectors adequately, or at all, in terms of providing a framework for market liberalisation. By the mid-1980s, the need for a new, even more ambitious, set of multilateral discussions was evident.

For example, the perspective of developed countries was shaped strongly by the orientation of their economies in favour of service businesses and products embodying intellectual property rights. Barriers to trade in services were a constraint on the international growth of these economies, yet services trade remained wholly outside the GATT framework. These countries also sought better IPR protection than afforded in newly industrialised countries, like Brazil, India, and Korea (and Taiwan (or, technically, "Chinese Taipei"), which acceded to the WTO on January 1, 2002), as well as in many less developed countries, such as Egypt, Indonesia, and Thailand (and China, which acceded to the WTO on December 11, 2001).

28–003 From the perspective of many developing countries, particularly net agricultural exporters, and developed country members of the Cairns Group, principally

[1] This discussion draws partly on Raj Bhala, *International Trade Law: Interdisciplinary Theory and Practice* 3rd edn (Newark, New Jersey: LexisNexis, 2008) 27–35.

Australia and New Zealand, too many contracting parties clung to various forms of protection for agricultural products. These forms included high tariff and non-tariff barriers, generous domestic support for their farmers, and significant export subsidies for their farm products.

In addition, many developing and least developed countries were concerned about the global system of quotas for textile and apparel products that existed under the 1974 Multi Fibre Agreement (MFA). These countries sought to make the economic transition from primarily agrarian economies by moving factors of production into low-value added manufacturing sectors, such as ready made garments (RMGs). To one degree or another, they were following the pattern of industrialisation laid out by W.W. Rostow in his 1960 classic work, *The Stages of Economic Growth*. While faulted for specifying a deterministic path on which the categories of development were not always clear-cut (e.g. in what stage would complex economies like those of China or India be placed?), Professor Rostow's work served to highlight the significance access to foreign markets potentially can have in advancing along the development path. The *MFA* quotas, by contrast, blocked export growth in certain textile and apparel sectors of some countries—and, not surprisingly, raised the cost of clothing to consumers in importing countries.

28–004 Certain issues cut across crude categories of "First World" and "Third World." For instance, various contracting parties sought to clarify and amplify trade remedy rules, namely antidumping duties, subsidies and countervailing measures, and safeguards. Finally, while concerns about infringement on sovereignty existed, and continue to the present, many contracting parties felt the time had come for a permanent multilateral infrastructure to promote trade liberalisation and deal with the expanding scope of international trade law and policy. In other words, it was necessary to resurrect the ITO, ultimately under a different name—WTO.

The United States had a particularly keen interest in the Uruguay Round. It was globally competitive (and in some instances dominant) in services, IP industries, and agriculture. A deal yielding significant market access for American businesses in these sectors was a Round that would be welcome. But, American interests in these sectors were not necessarily consonant with what less developed countries wanted or needed, hence a major North-South confrontation was inevitable.

28–005 The Uruguay Round was launched in September 1986 with a *Ministerial Declaration* issued by trade ministers from the contracting parties meeting in Punta del Este, Uruguay.[2] The United States successfully advocated the establishment of an agenda for this Round that was even broader and more ambitious than that of the Tokyo Round. The agenda is set forth in the *Declaration*. In contrast, in the Third WTO Ministerial Conference in Seattle, held in November–December 1999, the United States was far less successful in pushing forward what at the time was billed a "Millennium Round."[3]

Certainly, the Uruguay Round negotiators did deal with tariffs. Significantly, all contracting parties participated in the Round, in the sense that each one of them had to make offers to cut tariffs, i.e. produce a schedule of concessions on goods.[4] For many developing and least developed countries, the "grant" of a tariff concession took the form of an agreement to a ceiling binding, whereas for developed countries there were true tariff cuts. How did the negotiators achieve the cuts, in whatever form?

28–006 The *Ministerial Declaration* launching the Uruguay Round did not state whether the linear approach would be used (much less present a detailed formula), or whether the traditional item-by-item would be the methodology. However, it did speak

[2] See *Ministerial Declaration on the Uruguay Round*, BISD (1986) 33rd supplement, 19 (adopted September 20, 1986).
[3] See Jeffrey J. Schott ed., The WTO After Seattle (July 2000).
[4] See Anwarul Hoda, *Tariff Negotiations and Renegotiations under the GATT and the WTO* (2001) para.H.4 p.68.

to the problem of tariff peaks and tariff escalation, and appeared to back away from the Article XXXVI:8 non-reciprocity rule:

> "Negotiations shall aim, by appropriate methods, to reduce or, as appropriate, eliminate tariffs, including the reduction or elimination of *high tariffs* and *tariff escalation*. Emphasis shall be given to the expansion of the scope of tariff concessions among *all* participants."[5]

Switzerland proposed a formula to cut industrial tariffs essentially the same as the equation used in the Tokyo Round, i.e. the "Swiss Formula."[6]

However, the Uruguay Round negotiators never agreed on a single formula to be used for all industrial product categories. All they could agree on, which was not insignificant, was a set of guidelines, reached during the 1990 Mid-Term Review Conference in Montreal, Canada. The key points of the *Montreal Guidelines* were:

> "• The *substantial reduction or*, as appropriate, *elimination of tariffs by all participants*, with a view to achieving lower and more uniform rates, including the *reduction or elimination of high tariffs, tariff peaks, tariff escalation and low tariffs*, with a target amount for overall reductions *at least as ambitious* as that achieved by the formula participants in the *Tokyo Round*.
> • A *substantial increase in the scope of bindings*, including bindings at ceiling levels, so as to provide greater security and predictability in international trade.
> • The need for an approach to be elaborated to give *credit for bindings*; it is also recognised that participants will receive appropriate recognition for liberalisation measures adopted since June 1, 1986.
> • The *phasing of tariff reductions* over appropriate periods to be negotiated."[7]

28–007 Despite significant efforts after the Montreal Mid-Term Review, the contracting parties could not reach agreement on a single formula. That is, they gave up the effort to set a common modality, and in January 1990, they essentially turned once again to the traditional approach of making requests and offers to reduce or eliminate, and bind, industrial tariffs on a line-by-line basis.

Fortunately, the contracting parties accepted the *Montreal Guidelines*, and their subsequent discussions, implied an overall target to reduce industrial tariffs by one third, i.e. 33 1/3 per cent. Without a formula, though, each contracting party could decide how it would cut its tariffs.[8] For instance, the EC, Finland, Norway, and Sweden used a three-tiered formula the EC suggested:

1) Least developed contracting parties would not have to cut their tariffs, or only do so to the extent they felt able.
2) Developing contracting parties would reduce to a ceiling binding of 35 per cent any base (initial rate) above 35 per cent. For base rates at or below 35 per cent, developing countries would negotiate reductions bilaterally in an effort to harmonise duties.

[5] Emphasis added.
[6] See Anwarul Hoda, *Tariff Negotiations and Renegotiations under the GATT and the WTO* (2001) para.B.21 p.34.
[7] Uruguay Round Document MTN.TNC/7(MIN) p.4, quoted in Anwarul Hoda, *Tariff Negotiations and Renegotiations under the GATT and the WTO* (2001), para.B.23 p.35, para.C.10 p.49 (emphasis added).
[8] See Anwarul Hoda, *Tariff Negotiations and Renegotiations under the GATT and the WTO* (2001), paras B.17-19, B.20, B.24 pp.33–35.

3) Developed contracting parties would reduce to a ceiling binding of 20 per cent any base rate at or above 40 per cent. For base rates less than 40 per cent, if the base rate were between 30 and 40 per cent, then there would be a flat rate reduction of 50 per cent. So, for instance, if the base rate were 38 per cent, then it would be cut in half to 19 per cent. If the base rate were between zero and 29 per cent, then that base would be reduced according to the following formula:

$$R = \text{Base Rate} + 20$$

in which:

"R" stands for the per centage (rate) of reduction applied to the Base Rate.

For instance, if the base rate were 15 per cent, then the rate of reduction would be 35 per cent, implying a new tariff of 9.75 per cent (the result of 15 per cent minus 35 per cent of 15 per cent, i.e. 15–5.25 per cent).

28–008 The EC formula attacked the problem of tariff dispersion across countries by requiring deeper cuts on higher tariffs, and not exempting a priori any developed or developing contracting party.

By contrast, Japan proposed the elimination of all industrial tariffs, with developing countries subject to a less severe obligation (e.g. cutting a proportion of their tariffs). In the end, Japan joined Austria and Canada, and all three contracting parties used a formula proposed by Canada, as follows:

$$R = 32 + \frac{\text{Base Rate}}{5}$$

in which:
"R" stands for the percentage (rate) of reduction applied to the Base Rate, and R cannot exceed 38 per cent,
"Base Rate" refers to the initial tariff rate on the product in question, but with all base rates below 3 per cent to be eliminated (i.e. reduced to zero) on view that such low tariffs have only a nuisance value but no protective effect, and

The term $\frac{\text{Base Rate}}{5}$ is rounded down to the nearest whole number.

28–009 Still another formula, which Australia proposed and used, called for the elimination of any base rate of 2 per cent or less. For non-*de minimis* base rates, Australia called for deeper cuts on higher rates:

If the Base Rate exceeds 15 per cent, then:

$$R = \frac{(\text{Base Rate} - 15)\ (100)}{(\text{Base Rate})}$$

If the Base Rate exceeds 10 per cent but is less than or equal to 15 per cent, then:

$$R = \frac{(\text{Base Rate} - 10)\ (100)}{(\text{Base Rate})}$$

where in both instances:
"R" stands for the per centage (or rate) of reduction applied to the Base Rate.

For example, applying the Australian formulas, if the Base Rate were 50 per cent, then the rate of reduction (R) applied to it would be 70 per cent, yielding a new bound tariff

ceiling of 15 per cent. If the Base Rate were 12 per cent, then it would be reduced by 16 2/3 per cent, producing a new bound tariff level of 10 per cent.[9]

28–010 Even these formulas were not applied in their pure form. Norway modified the EC formula, and Austria did not apply the maximum 38 per cent rate of reduction to any product category. The adulterations are not surprising, given the range of perspectives and objectives animating in the Uruguay Round. From the perspective of different contracting parties, each formula had strengths and weaknesses. For example, contrary to Canada, the EC did not favour the elimination of low tariffs, or at least not if credit were given for such action. The EC claimed they were not mere nuisances, but rather provided a contracting party with a modicum of negotiating leverage.

What about the American methodology on cutting industrial tariffs during the Uruguay Round? As Professor Hoda writes:

> "The United States advocated the adoption of a request-and-offer approach. It argued that, after the previous rounds, the tariff regimes of countries which had participated in the formula cuts had already been substantially liberalised and little overall protection remained to justify a linear approach. Further, modern data processing techniques made it possible to conduct request-offer negotiations efficiently. Moreover, such procedures were best suited to address tariff peaks and tariff escalation, the reduction of which was an objective of the negotiations."[10]

Thus, even after the Montreal Mid-Term Review, the United States adhered to the request-offer, item-by-item method.[11] For many industrial product groups, and several industrial sectors, the United States called for the elimination of tariffs.

28–011 Accordingly, Uruguay Round negotiators considered American-inspired "sectoral proposals," also known as "zero for zero proposals," in areas such as chemicals, clothing and textiles, and non-ferrous metals. On selected products, the United States made specific reduction offers (except in two instances, namely, where the principal supplier of a product had not asked the United States for a concession, and where the United States was not negotiating with the country in the Uruguay Round and that country supplied a substantial share of imports to the American market). The United States warned it would fight free rider behaviour of some contracting parties by refining its concession offers to benefit only the contracting parties that had made serious proposals.

In the end, following not only the March 1992 "Dunkel Text," but also continuing through the last day of negotiations on December 15, 1993, what did the Uruguay Round negotiators agreed upon with respect to industrial tariffs? In brief, they achieved the following reductions:[12]

1) All developed contracting parties met the overall target percentage reduction of 33 1/3 per cent, and some of them exceeded this target. In particular, developed countries cut tariffs on industrial products they import from all sources (whether

[9] The second Australian formula as presented by Professor Hoda is different, suggesting a Base Rate of less than 10 percent. See Anwarul Hoda, *Tariff Negotiations and Renegotiations under the GATT and the WTO* (2001) para.B.24 pp.36. However, the comparison symbol may be mistakenly reversed (it states "where 10% > D < 15," yet perhaps it should read "10% < D ≤ 15").
[10] Anwarul Hoda, *Tariff Negotiations and Renegotiations under the GATT and the WTO* (2001), paras B.16, B.25 pp.33, 36.
[11] See Anwarul Hoda, *Tariff Negotiations and Renegotiations under the GATT and the WTO* (2001), paras B.26-27 pp.36–37.
[12] See GATT Secretariat, The Results of the Uruguay Round of Multilateral Trade Negotiations (November 1994); Anwarul Hoda, *Tariff Negotiations and Renegotiations under the GATT and the WTO* (2001), paras B.29-30 pp.39, J.5(a)-(e), (g)-(h) pp.70–72.

a developed, developing, or least developed country) by 40 per cent. The cut was from a pre-Uruguay Round trade-weighted tariff average of 6.3 per cent to a post-Round trade-weighted average of 3.8 per cent.

2) Developed contracting parties were slightly less generous in cutting tariffs on industrial products they import from developing and least developed countries. For industrial products imported by developed countries from developing countries, the cut was 37 per cent, from a pre-Uruguay Round trade-weighted average of 6.8 per cent to a post-Round 4.3 per cent. For such products from least developed countries, the cut was 25 per cent, from a pre-Uruguay Round average of 6.8 per cent to a post-Round average of 5.1 per cent. A few sectors explain the difference between these figures, on the one hand, and the figures on tariff cuts on industrial products from all sources, on the other hand. Developed countries reduced tariffs on clothing and textiles, fish, and fish products—all exports from developing and least developed countries—by a lower average amount than on other products.

3) Developed contracting parties agreed to extend the scope of industrial products subject to ceiling bindings. With an increase in the number of bound tariff lines from 78 to 99 per cent, virtually every industrial product traded among industrialised countries is subject to a bound rate.

4) Developed contracting parties extended the scope of duty-free treatment for industrial products from 20 per cent of these goods to 44 per cent of them.

5) Developed contracting parties agreed to reduce, but not eliminate, tariff peaks above 15 per cent in developed countries. They cut from 7 to 5 per cent the proportion of industrial products subject to a tariff peak.

6) To some extent, developing countries agreed to increase the scope of product categories subject to ceiling bindings, to reduce bound tariffs in key sectors like clothing and textiles, and to narrow gaps between bound and applied rates. Specifically, developing countries increased from 21 to 73 per cent the number of industrial tariff lines subject to bound rates, and transition economies agreed to increase this number from 73 to 98 per cent.

7) Little progress was made towards reducing or eliminating tariff escalation, i.e. the phenomenon of a higher tariff applicable to a product at a higher stage of processing a lower tariff applicable to the product in its unprocessed or semi-processed state. Measures as the absolute difference between a tariff at the higher end and at the lower end of processing, the average tariffs maintained by developed countries across all industrial products involved escalation both before and after the Uruguay Round. However, the absolute reduction in tariffs were larger for advanced products than for unprocessed products or products at early stages of production.

In sum, the Uruguay Round negotiators produced reasonably impressive results on industrial tariff cuts.

Section II: Reductions in Agricultural Tariffs

28–012 As for cutting agricultural tariffs, the Uruguay Round negotiators must be credited with achieving the first comprehensive accord on this topic. In brief, the WTO, specifically Article 4:1, and attendant documents, call for reductions on tariffs on primary and processed agricultural products. The methodology they employed (discussed below) is known as the "Uruguay Round Approach."

More specifically, the obligation to reduce agriculture tariffs is contained in Article 4:1 of the Agriculture Agreement.[13] It states simply that:

> "[m]arket access concessions contained in Schedules [of Tariff Concessions of each WTO Member] *relate to* bindings and reductions of tariffs, and to other market access commitments as specified therein."[14]

At first glance, this language seems innocuous. However, the substantive obligations to which it relates are numerical targets for cutting customs duties.

28–013 To account for variations in economic development, the Uruguay Round Approach set different targets, as well as different implementation periods, for different classes of WTO members. Developed countries committed to reduce their agriculture tariffs by an average of 36 per cent in value the six years following January 1, 1995, i.e. by January 1, 2001, in equal annual installments.[15] For 12 groups of agricultural products, developed countries cut the overall simple average by 37 per cent.[16] The range among these groups was, at the low end, a simple average tariff reduction of 26 per cent on dairy products. At the high end, it was a simple average cut of 48 per cent on cut flowers. For tropical products, which are of keen export interest to many poor countries, developed countries agreed to slash tariffs by an overall simple average amount of 43 per cent. In this product grouping, the low-end of the cut was a reduction of 37 per cent for tropical fruits and nuts. At the high end, it was a cut of 52 per cent for spices, flowers, and plants.

Developing countries agreed to reduce their duty rates by an average of 24 per cent in value (and 14 per cent in quantity) over a decade, i.e. by December 31, 2004.[17] Least

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[13] This discussion draws on Raj Bhala, *World Agricultural Trade in Purgatory*, 79 North Dakota Law Review 718–727 (2003).

[14] Emphasis added.

The term "market access concessions" refers to all market access commitments made on agriculture products during the Uruguay Round. See *Agreement on Agriculture*, Article 1(g). As the United States *Statement of Administrative Action*, prepared by the Clinton Administration, explains:

> "[i]n GATT practice, a party commits or 'binds' itself not to apply a rate of duty to a particular good that is higher than the rate specified in its schedule. This maximum specified rate is referred to as the 'bound' rate of duty."

Statement of Administrative Action, Agreement on Agriculture, *in* Uruguay Round Trade Agreements, Texts of Agreements, Implementing Bill, Statements of Administrative Action, and Required Supporting Statements, House of Representatives Document 316, 103d Congress, 2d Session, Vol. 1 pp.709, 713 (1994).

[15] See *Agreement on Agriculture*, Article 1(f) (defining "implementation period" as "the six-year period commending in the year 1995. . .."); John Croome, Guide to the Uruguay Round Agreements 54 (1999) (discussing the phase-in period for cuts).

[16] See GATT Secretariat, The Results of the Uruguay Round of Multilateral Trade Negotiations (November 1994); Anwarul Hoda, Tariff Negotiations and Renegotiations under the GATT and the WTO para.J.5(f) p.71 (2001).

[17] See John Croome, Guide to the Uruguay Round Agreements 54 (1999) (stating developing countries "could apply the reductions over a 10-year period").

This conclusion is based on Article 15:2 of the *Agreement on Agriculture*, which specifically explains "[d]eveloping country Members shall *have the flexibility* to implement reduction commitments over a period of *up to* 10 years." (Emphasis added.) Two points are noteworthy about Article 15:2. First, the italicised language indicates Article 15:2 does not require developing countries to take the full decade to cut agricultural tariffs. Second, the general definition of "implementation period," in Article 1(f), is rather misleading, unless it is read in tandem with Article 15:2. Article 1(f) says "implementation period" is "the six-year period commencing in the year 1995, *except that, for the purposes of Article 13*, it means the nine-year period commencing in 1995. . .." The italicised language creating the exception is too narrow, because Article 13 is not the only exception – Article 15:2 is another

developed countries are not obliged to make any tariff cuts.[18] Table 28-1 summarises these targets (as well as the minimum per product cuts, discussed later).[19] In brief, developing countries are expected to cut their average tariffs on agricultural imports by two-thirds that of developed countries, and are given double the amount of time to do so.

Table 28-1: Agricultural Tariff Reduction Commitments Made During Uruguay Round

Tariff Reduction Commitments	*Developed Countries*	*Developing Countries*	*Least Developed Countries*
Average Cut for All Agricultural Products	36 per cent	24 per cent	Zero
Minimum Cut Per Agricultural Product	15 per cent	10 per cent	Zero
Period for Phasing in the Cuts	6 years, from 1995–2000	10 years, from 1995–2004	Not applicable

Is it striking that any target is set for developing countries?

28–014 To adherents of Adam Smith's Law of Absolute Advantage and David Ricardo's Law of Comparative Advantage, the answer is "no." For them, even unilateral tariff reductions yield a net welfare gain to a society. That gain may be all the greater for a poor country maintaining high barriers, and may boost trade among such countries that slash their barriers.[20] Possibly, for Third World countries characterised by labour surplus, reducing barriers to agricultural trade may hasten the process of industrialisation (by making the agriculture sectors more competitive, and encouraging a shift of farm workers with zero or low marginal productivity to the industrial sector). In brief, from an economic perspective, it is beneficial for all countries, regardless of their income, to drop their barriers.

However, what the law requires is a different matter. Any obligation imposed on less developed countries to cut tariffs, demanded (however politely) in return for a cut by developed countries, offends the fundamental principle of special and differential treatment embodied in Article XXXVI:8 of GATT:

> "The developed contracting parties *do not expect reciprocity* for commitments made by them in trade negotiations to reduce or remove tariffs and other barriers to the trade of less-developed contracting parties."[21]

This principle of non-reciprocity means—or ought to mean—rich countries cut tariffs without asking, expecting, cajoling, or imposing any condition on poor countries. Lest there be any doubt about this meaning, the Interpretative Note to Article XXXVI:8,

exception. Article 13 covers domestic support and export subsidies, but does not deal with market access. Article 15:2 covers reduction commitments without limitation.

[18] See John Croome, Guide to the Uruguay Round Agreements 54 (1999) (explaining "[l]east-developed countries were not required to make reductions."). This conclusion is based on the second sentence of Article 15:2 of the *Agriculture Agreement*, and tracks its language.

[19] This Table is drawn in part from Information and Media Relations Division, World Trade Organisation Secretariat, *WTO Agriculture Negotiations: The Issues, and Where We Are Now* 11 (October 21, 2002), *posted at http://www.wto.org*.

[20] This point is pressed by (among others) Professor Jagdish Bhagwati in a variety of economic works.

[21] Emphasis added.

Ad *Article XXXVI, paragraph 8*, explains that "do not expect reciprocity" means poor countries:

> "*should not be expected*, in the course of trade negotiations, *to make contributions* which are *inconsistent with their individual development, financial and trade needs*, taking into consideration past trade developments."[22]

28–015 Evidently, some Uruguay Round negotiators forgot, ignored, or altered this meaning, at least with respect to those poor countries for which targeted "contributions" are "inconsistent" with their "needs." To be sure, it is important not to overstate the accusation. The fact negotiators imposed no tariff cut targets on least-developed countries accords fully with the non-reciprocity principle. The argument about incongruity must focus on developing countries, and appraise each such country's "needs" in relation to a 24 per cent average cut over ten years. In the final analysis, the argument likely will be valid for some, but not all, developing countries.

Just how impressive are the 36 and 24 per cent targets for cuts in agricultural tariffs under the Uruguay Round Approach, and associated with Article 4:1 of the *Agreement on Agriculture*? Double-digit tariff rate cuts of this magnitude sound ambitious. But, their substantive impact of any tariff cut is impossible to gauge without knowing the initial rates subject to reduction.

28–016 As suggested above, the levels to which a tariff rate falls depends on the level from which it fell. To take two extreme examples, suppose one WTO member's agricultural tariff rates average 50 per cent, while the average duties in a second member are 5 per cent. A 36 per cent cut in the first member's average rates translates into an 18 per cent cut, which sounds impressive, but still leaves a high average rate of 32 per cent. (Under the *Agreement on Agriculture*, if the member is a developing country, then the cut is 12 per cent, resulting in a formidable 38 per cent average rate.) As for the second member, a 36 per cent cut of a 5 per cent average duty rate yields a very low average, just 3.2 per cent. What, then, was the starting point—the base rate—for measuring the target cuts?

The answer is the tariff rate in effect on either January 1, 1995 or September 1986, depending on the nature of the rate on the agricultural product in question.[23] If the duty associated with an individual agricultural product was bound, then the base rate is the bound duty as of January 1, 1995, the date the *Agriculture Agreement* entered into force. If the duty was not bound, then the base rate is the actual duty charged in September 1986, when the Uruguay Round commenced. This distinction affords developing countries the option of binding previously unbound duties, and the Uruguay Round negotiators agreed these countries could set a bound rate that would not be subject to further tariff cuts.[24]

[22] Emphasis added.

[23] See Information and Media Relations Division, World Trade Organisation Secretariat, *WTO Agriculture Negotiations: The Issues, and Where We Are Now* (October 21, 2002) p.11 (available at *http://www.wto.org*) (setting forth these dates in the Notes to the table on Numerical targets for Cutting Subsidies and Protection); John Croome, Guide to the Uruguay Round Agreements 54 (1999) (discussing base rates). As with the targets themselves, the base rates used to calculate tariff cuts are not set forth in the *Agreement*. The failure of the negotiators to write the starting points into the text only exacerbates suspicions that the tariff cuts would be, in terms of substantive importance, less grand than the negotiators proclaimed in enthusiastic official documents like the December 1993 *Press Release*.

[24] See John Croome, Guide to the Uruguay Round Agreements 54 (1999) (discussing "ceiling bindings," i.e. maximum tariffs on agricultural products for which no bound duty rate had been set by a developing country, and which need not be reduced further).

In addition to the two scenarios mentioned above—an individual agricultural product with a bound rate, and one without a bound rate—there is a third scenario, namely, a product protected by a non-tariff barrier. As discussed below, this barrier was subject to tariffication, and the conversion of the barrier to a tariff resulted in a new base rate by which to begin tariff cuts (unless that rate was ceiling binding of a developing country). *Id.*

28–017 The point is there is an opportunity for a disingenuous binding. When converting unbound tariffs on agricultural imports into bound rates during the Uruguay Round, some developing countries decided to set bound tariff ceilings, called "ceiling bindings."[25] Yet, many of them set ceiling bindings on various agricultural imports at rates considerably above previous unbound rates, and they did not commit to declines in these rates over time.[26] To illustrate the problem, suppose the Nicaraguan pre-Uruguay Round unbound tariff on corn is 50 per cent, and it sets a bound rate of 60 per cent. Corn exporters in, for instance, Nebraska have little to cheer about (assuming Nicaragua applies the bound rate, and not some rate below 50 per cent).[27]

Critics of the *Agreement on Agriculture* charge that, overall, the initial (pre-Uruguay Round) rates are high, hence post-cut rates still are high.[28] While this criticism is fair, an "unbiased" evaluation is impossible. Once again, the end depends in part on the beginning. That is, a proper evaluation hinges on two key factors: (1) selection of a date or period "better" than January 1, 1995 and September 1986, in the sense of lower base rates being in effect; and (2) a standard to determine whether the 36 and 24 per cent targeted cuts are ambitious. On the first criterion, no doubt unsatisfied trade liberalisers could point to a date on which agriculture tariffs were low, and thus urge adoption of cuts from a low base. On the second criterion, no doubt they could call for targets more aggressive than 36 or 24 per cent. In other words, arguments about the base date and cuts from it rely on criteria, whether made explicit or left as an implicit assumption.

28–018 However, the critics have at least one point in their favour—transparency. As with the targets themselves, the base rates used to calculate tariff cuts are not set forth in the *Agreement*. The failure of the negotiators to write the starting points into the text only exacerbates suspicions that the tariff cuts would be, in terms of substantive importance, less grand than the negotiators proclaimed in enthusiastic official documents like the December 1993 *Press Release*.

The selection of a base rate to commence tariff cuts is not the only way in which to manipulate the ambitiousness of the cuts. A second clever device would be to restrict cuts to certain agricultural products. In fact, WTO members have made use of this device. For instance, on shelled groundnuts, the United States and Japan retain tariffs of 132 and 550 per cent, respectively.[29] Overall, WTO members cut tariffs by above-average amounts on flowers, oilseeds, and plants, by below-average amounts on dairy products and sugar, and by roughly average amounts on all other products.[30] As for tropical products, which

[25] See Peter Gallagher, *Guide to the WTO and Developing Countries* (2000) 42 (using this term).

[26] See Information and Media Relations Division, World Trade Organisation Secretariat, *WTO Agriculture Negotiations: The Issues, and Where We Are Now* p.11 (October 21, 2002), posted at *http://www.wto.org* (stating, in the Notes to the table on "Numerical Targets for Cutting Subsidies and Protection," that: "As a result of those [Uruguay Round] negotiations, several developing countries chose to set fixed bound tariff ceilings that do not decline over the years"); John Croome, Guide to the Uruguay Round Agreements (1999) 42 (discussing this behaviour).

[27] In many developing countries, there is a significant difference between applied and bound agricultural tariff rates. For example, one study observes that for 31 developing countries (excluding members of the Cairns Group), the simple (i.e. unweighted) applied agricultural duty is 25 per cent, compared with a bound rate of 66 percent. See Constantine Michalopoulos, Developing Countries in the WTO (2001) 85, 210.

[28] See Peter Gallagher, Guide to the WTO and Developing Countries 42 (2000) (citing a 1997 World Bank study to support the conclusion that "limited progress [has been made] in real agricultural trade liberalisation largely as a result of . . . the choice of the base period (1986–88)," and because of dirty tariffication and the use by developing countries of very high ceiling bindings).

[29] See Constantine Michalopoulos, Developing Countries in the WTO 107 (2001) (mentioning these facts).

[30] See Peter Gallagher, Guide to the WTO and Developing Countries 43 (2000) (discussing these bands). The principal types of oilseeds traded across international borders are cottonseed, groundnuts, palm, rapeseed, soybeans, and sunflower. International trade in dairy products occurs principally in

account for about one-half of all agricultural exports from developing country WTO Members, developed members agreed to a 43 per cent tariff cut—slightly above the 36 per cent average.[31] In other words, WTO members have taken advantage of the freedom any reduction commitment cast in terms of an "average" inherently allows, namely, the protection of sensitive domestic sectors with below-average reductions.

28–019 From a free trade perspective, the room for maneuver on per-product cuts is limited. With respect to both developed and developing country WTO members, Uruguay Round negotiators established minimum tariff cuts for each agricultural product. They did so to ensure a Member did not make all or most cuts on a limited range of products, but leave certain primary commodities or processed items protected with high duty rates, thereby denying market access to foreign exporters of those goods. Thus, developed countries had to reduce the tariff on each agricultural product by a minimum of 15 per cent, while the minimum cut on individual products developing countries have to make is two-thirds of the minimum cut required of developed countries, i.e. 10 per cent.[32] The same phase-in periods apply for the minimum per product reductions as are generally applicable, namely, equal installments of cuts over six years (1995–2000) for developed countries, and over a decade (1995–2005) for developing countries.[33]

Significantly, for least developed countries, no minimum product-specific tariff reduction targets exist. The *Agriculture Agreement* allows them to maintain their duty rates, and even increase their actual duty rates within their previously-agreed bindings, for as long as they remain least developed. At the same time, the obligation imposed on developing countries to make any minimum reduction hardly amounts to non-reciprocal treatment. Here, as with the 36 and 24 per cent tariff cuts, the comment can be made that developed countries are less than charitable in adhering to the mandate in Article XXXVI:8 of GATT.

28–020 The targets of 36 and 24 per cent tariff would seem to be of sufficient importance to merit express mention in the *Agreement on Agriculture*, perhaps in Article 4 itself. After all, if market access is the first of three methodologies for liberalising world agricultural trade, and if tariff reduction is the first of three measures associated with this methodology, then surely Uruguay Round negotiators would want to proclaim to the world, in the text of the *Agreement* themselves, the ambitious cuts to which they have committed. Would that incentive be greater for negotiators representing developed countries, at least those eager to show their concern for developed and least developed countries?

Yet, these figures are nowhere to be found in the *Agreement*. They are set forth in a major "*Press Summary*" issued by the GATT Secretariat at the conclusion of the Uruguay Round negotiations, in April 1994 a few days before signing of the Marrakesh Protocol.[34] They are repeated in a "*Briefing Document*" on trade and agriculture issued by the WTO in October 2002, the month before the Doha Ministerial Conference.[35] But, again, the 36

butter, cheese, and non-fat dry milk, because fresh milk cannot be stored. Sugar derived from cane is a tropical product, whereas sugar from beet is produced in temperate climates. See Chakravarthi Raghavan, Recolonisation 163, 168 (1990).

[31] See Peter Gallagher, Guide to the WTO and Developing Countries 43 (2000) (discussing this fact, and containing a table on tariff reduction commitments of developed countries, in which the highest percentage reduction commitment is on flowers, plants, and spices (52 per cent) and the lowest is on dairy products (26 per cent)).

[32] See John Croome, *Guide to the Uruguay Round Agreements* (1999) 54 (discussing minimum tariff reductions).

[33] See John Croome, *Guide to the Uruguay Round Agreements* (1999) 54 (discussing phase-in periods for minimum tariff reductions).

[34] See GATT *Press Summary*, *News of the Uruguay Round* (April 5, 1994) 8–11, *reprinted in* Raj Bhala, *International Trade Law: Theory and Practice* 2nd edn (2000) 685, 686 (stating "[t]ariffs resulting from this 'tariffication' process, as well as other tariffs on agricultural products, are to be reduced by an average of 36 percent in the case of developed countries and 24 per cent in the case of developing countries, with minimum reductions for each tariff line being required.").

[35] See Information and Media Relations Division, World Trade Organisation Secretariat, *WTO*

and 24 per cent figures are not in the place to which common sense would lead a trade lawyer.

28–021 Of course, a press release is not the document by which WTO members commit themselves to trade obligations. Rather, to find the tariff reduction targets, it is necessary to go to a side document, dated December 20, 1993, called *Modalities for the Establishment of Specific Binding Commitments Under the Reform Programme*.[36] This "*Modalities Document*" sets out the ways in which the Uruguay Round negotiators agreed to fulfil their obligations. Annex 3 of the *Modalities Document* deals with market access. Yet, even it does not mandate every developed country WTO member cut its agriculture tariffs by 36 per cent, and every developing country member do so by 24 per cent. These numbers are targets. By definition, rarely will all who aim at a target hit it, i.e. the average cut of an individual member might be less (or more) than the target. In practice, deviations have occurred. Several East Asian and Latin American developing countries agreed to relatively low bound rates on agricultural imports of less than 30 per cent, whereas many South Asian and African developing countries set high bound rates on these imports of 100–200 per cent.[37]

How are deviations from the target to be explained? Simply put, by the negotiating process during the Uruguay Round.[38] Also, by definition, a target for some or most members might not be a target for all members, i.e. some developed or developing country Members might take aim elsewhere. To take a hypothetical example, based on many give-and-take sessions with trading partners, New Zealand might agree to cut its agriculture tariffs by an average of 40 per cent (more than the 36 per cent target applicable to it), while Nicaragua might agree to cut by 20 per cent (less than the 24 per cent target applicable to it).[39] The fact the 36 and 24 per cent figures are targets, not legal obligations in the text of the *Agreement*, at least creates the suspicion the figures are "soft." That suspicion matters, particularly to farmers and processors, wherever located, looking for signs the multilateral trade negotiation process provides them with meaningful new market access opportunities.

28–022 Where, then, does each WTO member set out its specific commitments to cut agriculture tariffs? The answer is the Schedule of Concessions of the member.[40] The Schedule

Agriculture Negotiations: The Issues, and Where We Are Now p.11 (October 21, 2002), *posted at http://www.wto.org* (stating, in the Notes to the table on "Numerical Targets for Cutting Subsidies and Protection," that: "Only the figures for cutting export subsidies appear in the agreement [on Agriculture]. The other figures were targets used to calculate countries' legally binding 'schedules' of commitments."). However, even this statement is inaccurate. As explained in Section Four below, the export subsidy reduction commitments are not set forth in the *Agriculture Agreement*.

[36] See John Croome, Guide to the Uruguay Round Agreements (1999) 53—54 (discussing the 36 and 24 per cent figures, and locating them in Annex 3 paras 3–7, 14–17 of the *Modalities Document*). The *Modalities Document* is MTN.GNG/MA/W/24 and is referred to herein as the "December 1993 *Modalities Document*".

[37] See Peter Gallagher, Guide to the WTO and Developing Countries 42 (2000) (discussing these Uruguay Round bindings).

[38] See Information and Media Relations Division, World Trade Organisation Secretariat, *WTO Agriculture Negotiations: The Issues, and Where We Are Now* p.11 (October 21, 2002), *posted at* www.wto.org (stating, in the Notes to the table on "Numerical Targets for Cutting Subsidies and Protection," that: "Each country's specific commitments vary according to the outcome of negotiations.")

[39] In fact, as I learned in March 2003 at the University of Auckland, New Zealand offers duty-free treatment to all countries on agriculture products.

[40] See John Croome, Guide to the Uruguay Round Agreements 53 (1999) (stating ". . .tariff reductions are set out in the national Schedules of commitments that are attached to the Marrakesh Protocol, and governed by the protocol itself"), and fn.170 p.53 (calling Schedules "the definitive statement of each country's commitments"); *Statement of Administrative Action, Agreement on Agriculture, in* Uruguay Round Trade Agreements, Texts of Agreements, Implementing Bill, Statements of Administrative Action, and Required Supporting Statements, House of Representatives Document Number 316, 103d Congress, 2d Session, Vol.1 p.709 (1994) (explaining "[i]n many cases, the operation of these rules [on market access, domestic support measures, and export subsidies] is

is a legal document, namely, the one in which a member binds its duty rates on imported goods pursuant to Article II of GATT. Put bluntly, what was said in the December 1993 *Modalities Document* and the April 1994 *Press Summary* have little or no legal relevance.[41]

What matters, in terms of what one member can be held liable for in WTO litigation conducted according to the *Understanding on Rules and Procedures Governing the Settlement of Disputes* (*Dispute Settlement Understanding*, or *DSU*), is what the member commits to do in its Schedule.[42] The Schedule of each member is accessible, in (for example) the library of the WTO Secretariat, or from the trade ministry of the member in question. In other words, the agriculture tariff cuts to which a member commits are available, if one knows where to look. It might be said the situation is one of "transparency for those in the loop."

Section III: "Grand Bargain"

28–023 Reductions of agricultural and industrial tariffs achieved during the Uruguay Round are only part of the story of that remarkable eight years (1986–1994) of multilateral trade negotiations. The cuts occurred in the broader context of a "Grand Bargain." Essentially, the United States, European Union (EU) and other developed countries gained for their cherished services and intellectual property (IP) sectors the benefits of the *General Agreement on Trade in Services* (*GATS*) and the *Agreement on Trade Related Aspects of Intellectual Property Rights* (*TRIPs Agreement*).

In exchange, they agreed to grant developed and least developed countries improved terms of entry to their agricultural, textile, and apparel markets, on a more even playing field than before. They did so through the *Agreement on Agriculture* and the *Agreement on Textiles and Clothing* (*ATC Agreement*). Put succinctly, and setting aside the many achievements of the Uruguay Round in areas like dispute settlement and trade remedies, the Grand Bargain was better market access for services and improved IP protection in exchange for more open agricultural markets and an end to global textile and apparel quotas.

Section IV: Synopsis of WTO Agreements

28–024 Overall, in the context of this Grand Bargain, the Uruguay Round produced an array of agreements. They are listed in Table 28-2, and discussed in detail in a number of sources.[43] What is the relationship between GATT and the WTO? The technical legal answer is that GATT is one of the 13 Multilateral Trade Agreements covering goods listed in Annex 1A to the WTO *Agreement Establishing the World Trade Organisation*.

As a text annexed to the *WTO Agreement*, GATT is incorporated by reference into the

linked to particular commitments by each WTO member, contained in that WTO Member's schedule annexed to the Marrakesh Protocol to the GATT 1994," and that "[e]ach WTO Member's schedule sets forth the WTO Member's commitments regarding the access it will provide to its market for imports of agricultural products and the maximum amount of domestic support and export subsidies it will provide to agricultural products").

[41] See John Croome, Guide to the Uruguay Round Agreements 54–55 (1999) (opining the commitments in the *Modalities Document* "no longer have force, except to the extent that they may also have been reproduced in the *Agreement on Agriculture*," and that "[t]he obligations that count, and that could give rise to dispute settlement procedures if individual WTO members fail to live up to them, are the detailed commitments in each national schedule, or in the market access provisions of the *Agreement on Agriculture*.").

[42] The *DSU* is explained in a number of sources, including Peter Gallagher, *Guide to Dispute Settlement* (2002).

[43] See, e.g. World Trade Organisation, The Results of Multilateral Trade Negotiations – The Legal Texts (1999); Raj Bhala & Kevin Kennedy, *World Trade Law* (1998 with 1999 Supplement); Terence P. Stewart (ed.), *The World Trade Organisation* (1995).

web of multilateral trade rules found in that *Agreement*, and throughout the other texts listed in the Annexes. There are four such annexes, with Annexes 1, 2, and 3 containing "Multilateral Trade Agreements" that were part of the single undertaking in the Uruguay Round, and Annex 4 containing "Plurilateral Agreements" that WTO members could opt into (or not). Table 28-2 sets out these Annexes to the *WTO Agreement*, and the specific "covered" agreements contained in the Annexes.

Table 28-2: Annexes and Agreements Therein to *WTO Agreement*

Annex	*Agreement(s) in Annex*
Annex 1	**Annex 1A—Multilateral Trade Agreements on Goods** (1) GATT 1994, which incorporates by reference the 1947 GATT document. (2) *Agreement on Agriculture* (3) *Agreement on Sanitary and Phytosanitary Standards* (*SPS Agreement*) (4) *Agreement on Textiles and Clothing* (*ATC Agreement*) (5) *Agreement on Technical Barriers to Trade* (*TBT Agreement*) (6) *Agreement on Trade-Related Investment Measures* (*TRIMs Agreement*) (7) *Agreement on Implementation of Article VI of GATT 1994* (*Antidumping Agreement*" or "*AD Agreement*) (8) *Agreement on Implementation of Article VII of GATT 1994* (*Customs Valuation Agreement*) (9) *Agreement on Pre-shipment Inspection* (*PSI Agreement*) (10) *Agreement on Rules of Origin* (11) *Agreement on Import Licensing Procedures* (12) *Agreement on Subsidies and Countervailing Measures* (*SCM Agreement*) (13) *Agreement on Safeguards*
	Annex 1B—Services *General Agreement on Trade in Services* (*GATS*)
	Annex 1C—Intellectual Property *Agreement on Trade Related Aspects of Intellectual Property Rights* (*TRIPs Agreement*)
Annex 2	**Understanding on Rules and Procedures Governing the Settlement of Disputes** (*Dispute Settlement Understanding* or *DSU*)
Annex 3	*Trade Policy Review Mechanism* (*TPRM*)
Annex 4	**Plurilateral Agreements –** (1) *Agreement on Government Procurement* (*GPA*) (2) *Agreement on Trade in Civil Aircraft* Note: The *International Dairy Arrangement*, and the *Arrangement Regarding Bovine Meat*, both plurilateral agreements, have expired.

Of course, to say GATT is an "annexed" agreement and thereby incorporated by reference is to understate its contemporary importance as the Constitution of international trade.

Section V: Bitterness After Uruguay Round, Schisms Before Doha Round

28–025 As was true in September 1996 in Punta del Este when the Uruguay Round began, in November 2001 in Doha, Qatar, when the Doha Round was launched, tariff negotiations were not the primary impulse.[44] Rather, to simplify, there were two catalysts. Many agriculture-exporting countries, particularly among the developing and least developed WTO members, wanted developed countries, especially the United States, European Union (EU), and Japan, to eliminate their export subsidies for agricultural products. For them, the Grand Bargain of the Uruguay Round had broken down.

Some suspected they had been hoodwinked. They had expected more dramatic reductions of domestic agriculture support, and an end to agriculture export subsidies, pursuant to the WTO *Agreement on Agriculture*. To be sure, this expectation may have been unrealistic, particularly in light of the many detailed exceptions in that *Agreement*—for example, for Blue Box domestic support (i.e. production set-aside schemes), the exemption of food aid and export credits from the meaning of export subsidies, and the lack of an adamantine commitment to eliminate export subsidies.[45]

28–026 Many developing and least developed countries also worried about the effects on their textile and apparel industries from the end of the global quota scheme associated with the 1974 *Multi-Fibre Agreement* (*MFA*). The gist of the WTO *Agreement on Textiles and Clothing* (*ATC*) was a "suicide" (or, the better term may be "murder") clause whereby as of December 31, 2004 *MFA* quotas were phased out. Large textile and apparel manufacturing countries like China and India made smaller ones like Bangladesh and Sri Lanka worry that foreign garment companies would consolidate their operations in the larger countries. These manufacturers no longer needed to source products from many different locations to conform with the global quota scheme. Free from the distorted incentives of this scheme, they could make as much as they needed in any country. Certainly, the smaller countries had a decade (from the entry into force of the *ATC*, on January 1, 1995, to the final phase out of *MFA* quotas) to figure out how to cope, adjust to a more competitive global clothing trade, and commence diversification into other sectors. The leaders in these countries did not all use the time equally wisely. Still, the adjustment costs in the textile and apparel industries of these countries meant real, human suffering, often for millions of young women working in these industries.

For their part, developed countries were not entirely happy with the outcome of the Grand Bargain. They sought better market access for their service providers, and thus looked for improved concession offers under the *General Agreement on Trade in Services* (*GATS*). They also hoped for improved intellectual property (IP) protection in certain developing countries. A number of other issues concerned them, and—depending on the precise question—cut across simplistic "First World" and "Third World" categories.

28–027 Among these issues were clarifying antidumping (AD) disciplines, delineating the relationship between multilateral agreements on the environment and WTO accords,

[44] For a collection on various aspects of the Doha Round, see Ross P. Buckley ed., *The WTO and the Doha Round: The Changing Face of World Trade* (2003); For a discussion of the Doha Development Agenda offering the perspectives of less developed and Muslim countries, see Raj Bhala, *Poverty, Islam, and Doha*, 36 The International Lawyer 159–196 (2002).

[45] For an analysis of this *Agreement* and the exceptions to its trade liberalising provisions, see Raj Bhala *World Agricultural Trade in Purgatory*, 79 North Dakota Law Review 691–830 (2003).

reforms to the dispute settlement system, resolving at least some of the issues from the 1996 WTO Ministerial Conference in Singapore (the "Singapore Issues," namely, competition policy, customs facilitation, foreign direct investment, transparency in government procurement), and enhancing legal capacity and the rule of law in developing and least developed countries.[46] To clarify or complicate matters (depending on one's side of the debate), some academics were pushing for the Round to take on substantive authority over a wide array of non-trade or trade-related topics, and in effect become a global governance institution.[47]

Still, tariffs on both agricultural and industrial products were an issue in the Doha Round. Developed countries, and even some advocates for developing and least developed countries, pointed to the high tariffs maintained by poor countries as a reason for poor trade performance of those countries. In doing so, they may well have acted in accordance

[46] For a discussion of AD issues, see Arie Reich, *Institutional and Substantive Reform of the Anti-Dumping and Subsidy Agreements – Lessons from the Israeli Experience*, 37 Journal of World Trade 1037-1061 (December 2003); Terence P. Stewart, Amy Dwyer & Marta M. Prado, *Antidumping, Countervailing Duties, and Trade Remedies: "Let's Make a Deal"? – Views from a Domestic Practitioner*, 37 The International Lawyer 761-775 (Fall 2003).

The relationship between WTO agreements and multilateral environmental agreements (MEAs) is treated in Mark Harris, *Beyond Doha: Clarifying the Role of the WTO in Determining Trade – Environment Disputes*, 21 Law in Context 307-332 (2004) (special edition of Australian socio-legal journal entitled "Balancing Act – Law, Policy and Politics in Globalisation and Global Trade"). The intersection of the environment and services trade is explored by David Waskow, *Environmental Services Liberalisation: A Win–Win or Something Else Entirely?*, 37 The International Lawyer 777-95 (Fall 2003).

For contrasting arguments about dispute settlement reform, see Raj Bhala & Lucienne Attard, *Austin's Ghost and DSU Reform*, 37 The International Lawyer 651-76 (Fall 2003) and John Ragosta, Navin Joneja & Mikhail Zeldovich, *WTO Dispute Settlement: The System is Flawed and Must be Fixed*, 37 The nternational Lawyer 6697-752 (Fall 2003). For suggestions on improving the *DSU*, see Nikolaos Lavranos, *Some Proposals for a Fundamental DSU Reform*, 29 Legal Issues of Economic Integration 73-82 (2002).

Rule of law issues, including transparency and GATT Article X, are discussed in Warren Maruyama, *The WTO: Domestic Regulation and the Challenge of Shaping Trade*, 37 The International Lawyer 677-695 (Fall 2003). See *also Presentation Summaries and Comments, Symposium: The United States, the Doha Round and the WTO – Where Do We Go From Here?*, 37 The International Lawyer 797-833 (Fall 2003) (covering, *inter alia*, WTO institutional matters, FTAs, and investment).

[47] Labour issues were not, by design, included on the Doha Round agenda. For discussions of them, See Jill Murray, *Labour Issues in Times of Globalisation: Is the Social Clause an Appropriate Legal Response?*, 21 Law in Context 283-306 (2004) (special edition of Australian socio-legal journal entitled "Balancing Act – Law, Policy and Politics in Globalisation and Global Trade"), and Andrew J. Samet, *Doha and Global Labor Standards: The Agenda Item that Wasn't*, 37 The International Lawyer 753–59 (Fall 2003).

For an argument that non-trade concerns, such as consumer and labour rights, environmental protection, and state sovereighty should be considered in the Doha Round by allowing non-trade stakeholders to participate in the Round and increasing expertise in the WTO within these areas, See Larry A. DiMatteo *et al.*, *The Doha Declaration and Beyond: Giving a Voice to Non-Trade Concerns Within the WTO Trade Regime*, 36 Vanderbilt Journal of Transnational Law 95–160 (2003).

For an analysis of distributive concerns in the Doha Round, and a suggestion that ideals in addition to efficiency—namely, distributive values, which if emphasised would secured balanced results that maximize trading successes, as opposed to the conventional emphasis on reciprocity with a view to securing trading opportunities – See Peter M. Gerhart, *Slow Transformations: The WTO as a Distributive Organisation*, 17 American University International Law Review 1045–95 (2002).

For a proposal and response, respectively, on world government by the WTO, see Andrew Guzman, *Global Governance and the WTO*, 45 Harvard International Law Journal 303–352 (Summer 2004); John O. McGinnis & Mark L. Movsesian, Against *Global Governance in the WTO*, 45 Harvard International Law Journal 353–365 (Summer 2004).

with sound neo-classical economic theory. But, they neglected or ignored their special and differential treatment obligations under paragraphs 1 and 3 of Article XXXVIII *bis* and paragraph 8 of Article XXXVI.

28–028 As one example, consider the November 2002 proposal from the United States to eliminate all tariffs on industrial and consumer goods. The American proposal built on a proposal offered the previous month by New Zealand to do away with non-agricultural tariffs.[48] The New Zealand proposal contained no deadlines, but the American proposal called for scrapping all tariffs on all manufactured goods by 2015. In specific, the United States urged a two-phase approach, with phase one lasting from 2005–10, and the second phase from 2010–15:[49]

1) The reduction by 2010 in high tariffs on non-agricultural products. By 2010, no industrial product tariff would exceed 8 per cent. Thereafter, remaining tariffs would be reduced by 2015 to zero through equal annual reductions.

2) The elimination by 2010 of all tariffs on non-agricultural products currently below 5 per cent.

3) The accelerated elimination of tariffs in highly-traded non-agricultural products such as agricultural equipment, chemicals, civil aircraft, construction equipment, fish, paper, steel, toys, and wood.

Along with New Zealand, developed countries such as Australia, Singapore, and Taiwan, and a few developing countries, like Uruguay, backed the American proposal.[50] They did so for good reason, as the proposal embodied a certain logic.

First, 55 per cent of world trade occurs on a duty-free basis, under the auspices of one of roughly 200 free trade agreements and customs unions.[51] In contrast, by that point in the history of multilateral trade negotiations, WTO members had committed to bind only 6 per cent of trade at a tariff rate of zero. Surely, it would be economically sensible to expand the scope of duty-free treatment under WTO auspices to all industrial products.

28–029 Secondly, no doubt, less developed countries would benefit from the American proposal. Its implementation would mean greater access to developed country markets for their producers and exporters of industrial and consumer products. According to the then American Ambassador to the WTO, Linnet Deily, industrial products account for 89 per cent of exports from developing countries.[52]

Moreover, about one-half of all trade by developing countries is with other developing countries. About 30 per cent of the US $80 billion in tariffs paid on Third World exports goes to developed countries.[53] The proposal would cut that bill. Obviously, the proposal also would knock out the remaining 70 per cent of the bill, i.e. the tariffs paid on trade between less developed countries. Thus, the proposal would boost so-called "South–South," as well as North–South, trade. In doing so, it also would lower the cost of inputs

[48] See Edward Alden, *U.S. Launches Bold Plan to Abolish Most Trade Tariffs*, *Financial Times*, November 26, 2002, p.1.

[49] See Daniel Pruzin, *U.S. Plan for Scrapping Industrial Tariffs Receives Mixed Reception at WTO Meeting*, 19 International Trade Reporter (BNA) 2075 (December 5, 2002); Edward Alden, *U.S. Launches Bold Plan to Abolish Most Trade Tariffs*, *Financial Times*, November 26, 2002, p.1.

[50] See Daniel Pruzin, *U.S. Plan for Scrapping Industrial Tariffs Receives Mixed Reception at WTO Meeting*, 19 International Trade Reporter (BNA) 2075 (December 5, 2002).

[51] See Daniel Pruzin, *U.S. Plan for Scrapping Industrial Tariffs Receives Mixed Reception at WTO Meeting*, 19 International Trade Reporter (BNA) 2075–76 (December 5, 2002).

[52] See Daniel Pruzin, *U.S. Plan for Scrapping Industrial Tariffs Receives Mixed Reception at WTO Meeting*, 19 International Trade Reporter (BNA) 2075–76 (December 5, 2002).

[53] See Edward Alden, *U.S. Launches Bold Plan to Abolish Most Trade Tariffs*, Financial Times, November 26, 2002, p.1.

imported by Third World industrialists for their factories. All these benefits suggest the American proposal could have assisted less developed countries industrialise.

28–030 Unfortunately, the benefits from the November 2002 American proposal to eliminate tariffs on all non-agricultural trade are not the only items to consider. Weighted against these benefits is the fact the proposal utterly neglected Article XXXVI:8. That provision is a cornerstone of special and differential treatment. It obligates developed countries not to expect reciprocity from less developed countries when reducing trade barriers.

The non-reciprocity expectation is a rule reiterated, with an express citation to Article XXVIII *bis* (also discussed later), in the Doha Development Agenda (DDA). The mandate on market access contained in the Agenda went beyond obligating negotiators to take full account of the special needs of developing and least developed countries. The mandate also articulated as a methodology for taking these special needs into account "*less than full reciprocity* in reduction commitments, *in accordance with the relevant provisions of Article XXVIII bis of GATT*. . . and the provisions cited in paragraph 50 below."[54] The "provisions" in paragraph 50 include Part IV of GATT (Articles XXXVI, XXXVII, and XXXVIII), the *Enabling Clause* (also discussed later), and the Uruguay Round *Decision on Measures in Favour of Least-Developed Countries*.

28–031 It is no secret tariff barriers in the Third World are higher than these barriers in the First World. As of the launch of the Doha Round, the average tariff on industrial goods imposed by the United States and EU was about 4 per cent, whereas that in less developed countries is a whopping 40 per cent.[55] (As an illustration, the average tariff on industrial machinery imposed by the United States was 1.2 per cent, and by the EU 1.8 per cent. It was 35 per cent in Argentina and 36 per cent in India.[56])

Of course, it is important to distinguish between bound duties (the ceiling levels to which a country has committed in its GATT tariff schedule) and applied duties (what it actually applies to imports). Yet, here too the gap between the First and Third Worlds typically has been marked.[57] The average bound rate on industrial products imposed by the Quad countries (the United States, EU, Canada, and Japan) was 9 per cent. Among developing countries, it was 29 per cent. As for actual applied rates of duty, the range of averages among the Quad countries is 5.4 to 6.9 per cent. The range of average applied rates was considerably higher in developing countries. In Brazil, it was 14 per cent, and in India, 32 per cent.

28–032 Still, Article XXXVI:8 allows less developed countries to protect industries, many of which are infants, and to continue to obtain needed government revenue from customs duties (given the inchoate or dysfunctional income and sales tax systems in many such countries), while at the same time benefiting from tariff cuts in developed countries. The Doha Development Agenda (DDA) mandate also contemplates this course of action. The American proposal does not. Indeed, sensitive sectors in the United States—like textiles—grudgingly supported the idea only if it called for fully reciprocal cuts in tariffs.[58]

In other words, the American proposal ignored the preference built into the GATT. Not surprisingly, therefore, many Third World countries reacted sceptically. he WTO Director General, Dr. Supachai Panitchpakdi, was diplomatic in his criticism, telling the *Financial Times Deutschland*, "I am not sure that this issue would be the priority on our [i.e. the

[54] World Trade Organisation, Doha Declarations para.16 p.8 (2001) (Ministerial Declaration Adopted on November 14, 2001 (emphasis added)).
[55] See Edward Alden, *Doubts Over U.S. Plan to Scrap Tariffs*, Financial Times, November 27, 2002, p.5; *Trading Barriers*, *Financial Times*, November 27, 2002, p.14.
[56] See Edward Alden, *U.S. Launches Bold Plan to Abolish Most Trade Tariffs*, *Financial Times*, November 26, 2002, p.1.
[57] The statistics are from Daniel Pruzin, *U.S. Plan for Scrapping Industrial Tariffs Receives Mixed Reception at WTO Meeting*, 19 International Trade Reporter (BNA) 2075–76 (December 5, 2002).
[58] See Daniel Pruzin, *U.S. Plan for Scrapping Industrial Tariffs Receives Mixed Reception at WTO Meeting*, 19 International Trade Reporter (BNA) 2075–76 (December 5, 2002).

Doha Round] agenda."[59] How could it be a high priority? As the Director General rightly pointed out in November 2002, an important reason tariff rates are higher in the Third World than the First World

> "is the fact that tariffs often serve a dual purpose; they protect domestic industries from foreign competition and they are a major source of tax revenue.
>
> It follows that tariff reform can have serious revenue implications in such countries, and reductions in average tariffs depend heavily on tax reforms aimed at reducing their reliance on border taxes for revenues."[60]

28–033 The American proposal neglected the second of these two purposes. Thus, the Indian Ambassador to the WTO, K.M. Chandrasekhar, was blunt: he called the American proposal not only "radical," but also "clearly unfair."[61] He explained that in some developing countries, customs duties account for 30–40 per cent of total government revenue, whereas in the United States they account for one per cent.[62] The poor in poor countries would be harmed most by the American proposal, because the ineluctable decline in government revenue would mean slashes in education and social services expenditures from which they benefit.

The Indian Ambassador was not alone in criticising the proposal for demanding from less developed countries the largest cuts in tariffs on non-agricultural goods. Brazil, Kenya, Pakistan, the Philippines, and Malaysia all argued the proposal was inflexible in that they would not be able to protect sensitive industrial sectors.[63] Malaysia defiantly remarked it would "jealously defend" its right to retain customs duties to protect infant industries.[64]

28–034 Even Japan faulted the proposal for being impractical and unrealistic. One of its trade officials observed tariffs "are the only legitimate tool developing countries have to protect their industries under WTO rules," and asked rhetorically "Why would they want to abandon this precious tool?"[65] Conversely, it is interesting to note just how large a beneficiary from the proposal America itself would have been. Consumers in the United States would have saved US $18 billion, and the American economy would have grown by US $95 billion, or nearly 1 per cent of its Gross Domestic Product (GDP).[66]

Here, then, is another example of why it is worthwhile to examine what appear to set technical tariff negotiation provisions in Article XXVIII *bis* in a broad context that considers special and differential treatment. This treatment is called for not only in GATT itself, but also in many official pronouncements, including the November 2001 Doha Ministerial Conference Declaration. Accordingly, it is all the more astonishing the world's leading trade power, the United States, could have trotted out a proposal so manifestly inconsistent with that treatment, particularly non-reciprocity.

At the very least, the proposal was one among a number of controversies in the Doha

[59] Quoted in Edward Alden, *Doubts Over U.S. Plan to Scrap Tariffs*, *Financial Times*, November 27, 2002, p.5.
[60] Quoted in Daniel Pruzin, *U.S. Plan for Scrapping Industrial Tariffs Receives Mixed Reception at WTO Meeting*, 19 International Trade Reporter (BNA) 2075, 2076 (December 5, 2002).
[61] Quoted in Daniel Pruzin, *U.S. Plan for Scrapping Industrial Tariffs Receives Mixed Reception at WTO Meeting*, 19 International Trade Reporter (BNA) 2075 (December 5, 2002).
[62] See Daniel Pruzin, *U.S. Plan for Scrapping Industrial Tariffs Receives Mixed Reception at WTO Meeting*, 19 International Trade Reporter (BNA) 2075, 2076 (December 5, 2002).
[63] See Daniel Pruzin, *U.S. Plan for Scrapping Industrial Tariffs Receives Mixed Reception at WTO Meeting*, 19 International Trade Reporter (BNA) 2075 (December 5, 2002).
[64] Quoted in Daniel Pruzin, *U.S. Plan for Scrapping Industrial Tariffs Receives Mixed Reception at WTO Meeting*, 19 International Trade Reporter (BNA) 2075 (December 5, 2002).
[65] Quoted in Daniel Pruzin, *U.S. Plan for Scrapping Industrial Tariffs Receives Mixed Reception at WTO Meeting*, 19 International Trade Reporter (BNA) 2075 (December 5, 2002).
[66] See Edward Alden, *Doubts Over U.S. Plan to Scrap Tariffs*, *Financial Times*, November 27, 2002, p.5.

Round talks. In the spring and summer 2004, it was by no means certain the Round would succeed, and nearly a given it would not be completed by the initially scheduled date of the end of 2005. On July 16, the Director General, Dr. Supachai Panitchpakdi of Thailand, and the Chairman of the WTO General Council, Shotaro Oshima of Japan, issued a first draft for a structure to continue the Doha Round talks.

Section VI: Unsuccessful August 2004 *Framework Agreement*

28–035 At the end of July 2004, after a week of hard bargaining in Geneva, the WTO members transformed this draft into a 17 page document setting out a road map for the remaining talks. The document on which they agreed, the August 1, 2004 *Framework Agreement*, bespeaks the central role of agricultural issues in the Doha Round. Their document was supposed to be the basis for ending the post-Uruguay Round bitterness, and heal the pre-Doha Round schisms. It failed to achieve those ends, and (as discussed in subsequent Chapters), as the years wore on, the Round devolved into yet more finger-pointing and recriminations.

Nearly half of the *Framework Agreement* deals with agricultural issues, and that portion is called the "Framework for Establishing Modalities in Agriculture." The extensive coverage of these issues reflects in part their inherent complexity, and the technical details necessary to deal with them. This coverage also reflects the different interests among members.

28–036 For example, for developed countries, agriculture accounts for just 1.5 to 2 per cent of GDP (Gross Domestic Product, though that GDP in countries like the United States, EU, and Japan is huge). For these countries, the Doha Round provisions on agriculture involve policy issues about managing adjustment costs and multi-functionality. For developing and least developed countries, the share of agriculture in domestic output is far higher than single digit percentages. For many farmers, and farm-related businesses, the Doha Round provisions on agriculture may tip the balance between a modest hope for prosperity and a depressing confinement to poverty. For net food importing countries, the agriculture provisions raise a long-term concern about food security. As for the balance of the *Framework Agreement*, it addresses industrial tariffs and an assortment of other topics.

The key points of the August 2004 *Framework Agreement* were as follows.[67]

[67] The *Framework Agreement* is formally entitled World Trade Organisation, *Doha Work Programme, Decision Adopted by the General Council on August 1, 2004*. It is Document WT/L/579 (August 2, 2004), and is posted on the WTO website, *http://www.wto.org*. This summary of its terms draws from the *Agreement*, as well as Christopher S. Rugaber, *WTO Framework Marks "Historic" Changes to Farm Trade Talks, Johnson Says*, 21 International Trade Reporter (BNA) 1340 (August 12, 2004); Christopher S. Rugaber, *Zoellick, Blasting Daschle, Says Framework for Doha Will Not Hurt U.S. Farm Programs*, 21 International Trade Reporter (BNA) 1341 (August 12, 2004); Christopher S. Rugaber, *U.S. Farm Groups Criticise Brazil's Status as Developing Country in WTO*, 21 International Trade Reporter (BNA) 1342 (August 12, 2004); Christopher S. Rugaber, *U.S. Farm Groups Endorse WTO Framework Provisions on STEs, Food Aid*, 21 International Trade Reporter (BNA) 1342 (August 12, 2004); Christopher S. Rugaber, *Grassley Sees Shifts in U.S. Farm Subsidies, Rather than Reductions*, 21 International Trade Reporter (BNA) 1343 (August 12, 2004); Peter Menyasz, *Canadian Wheat Board Plans to Seek Compensation if WTO Framework Proceeds*, 21 International Trade Reporter (BNA) 1344 (August 12, 2004); Lawrence J. Speer, *French Trade Minister Proposes New Export Tax Credits for SMEs*, 21 International Trade Reporter (BNA) 1349 (August 12, 2004); *Doha Continues*, Far Eastern Economic Review, August 12, 2004, p.6; *Now Harvest It*, The Economist, August 7, 2004, pp.59–60; Gary G. Yerkey, *Farm Deal Clears Way for Broader Pact Setting Framework for Future WTO Talks*, 21 International Trade Reporter (BNA) 1304, 1305–07 (August 5, 2004); Peter Menyasz, *Trade Minister Says Canada Isolated on State Trading Enterprises*, 21 International Trade Reporter (BNA) 1305 (August 5, 2004); Gary G. Yerkey, *U.S. African Nations, Resolve Cotton Dispute*, 21 International Trade Reporter (BNA) 1306 (August 5, 2004); Christopher S. Rugaber, *Reaction to WTO Framework Mixed; Subsidy Cuts Said Unlikely to Hamper U.S.*, 21 International Trade Reporter (BNA) 1307–08 (August 5, 2004); Daniel Pruzin, *"Down Payment" Deal Helps Seal Agreement Among Major Farm Players in WTO Talks*, 21 International Trade Reporter (BNA) 1307–08 (August 5, 2004). See also Anwarul Hoda, Tariff Negotiations and Renegotiations under the GATT and the WTO para.J.6 p.72 (2001) (concerning tariff problems left after the Uruguay Round).

1) *Agricultural Market Access through Tariff Reductions*

The *Framework Agreement* called for the significant expansion of market access for agricultural products, in part by "substantial" reductions of tariffs. One device to achieve this goal was to require higher tariff cuts from countries with higher tariffs, i.e. a non-linear methodology, thereby yielding greater harmonisation in agriculture tariffs across WTO members. However, the *Agreement* was not specific on the degree of tariff cuts, and described the formula to be used to make the cuts only in general terms. All that was apparent was some kind of tiered or banded methodology will be used.

The *Agreement* also permitted members to protect "sensitive" products by self-designating those products as such. The *Agreement* lacked details on how these products were defined, how they may be protected, and for how long. However, shortly after the *Agreement* was reached, the United States indicated strongly it would designate sugar as a sensitive product. (It is one of the world's top importers of sugar.)

In at least three respects, the *Agreement* provided special and differential (S&D) treatment to poor countries. First, developing and least developed countries would have the right to designate "special" products that would be exempt from tariff reductions. In other words, beyond self-designating "sensitive" products, poor countries could select "special" products on which tariffs need not be reduced. Least developed countries would have wide latitude in this regard, and essentially will not be obligated to make tariff cuts. Secondly, the phase in period for making tariff cuts would be longer for the poor countries obligated to make cuts. Thirdly, developing and least developed countries could protect "special" products under the special safeguard mechanism established in Article 5 of the *Agreement on Agriculture*. However, the *Agreement* left to be "further specified" through negotiation the criteria for choosing a "special product" and the nature of the exemption.

The *Framework Agreement* did not appear to deal with transparency that sometimes plagued agricultural tariffs. A lack of transparency was especially likely when a WTO member maintained specific or hybrid duties.

2) *Agricultural Market Access through Tariff Rate Quota Expansion*

The *Framework Agreement* was less aggressive on expanding tariff rate quotas (TRQs) for sensitive products than an earlier draft accord. Generally, TRQs resulting from the tariffication process under the WTO *Agreement on Agriculture* led—in some developed WTO members, with respect to certain farm product categories—to high out-of-quota (or above-quota) tariff rates. If the associated quota threshold was low enough, then a high out-of-quota duty had a considerable protective effect.

The original idea in the Doha Round was to require minimum reductions in the tariff rates applicable to out-of-quota shipments of these products. At the insistence of Japan, this idea was dropped. Canada successfully prevented inclusion of a commitment to impose ceilings on above-quota tariff rates. The *Framework Agreement* affirmed market access would be enhanced by both tariff reductions and TRQ expansion. However, it wa not clear whether, how, or when TRQs will be expanded.

3) *Domestic Agricultural Support through De Minimis Subsidies*
The *Framework Agreement* called for the substantial reduction of domestic support for agricultural products and producers. However, minimal subsidies, known as *de minimis* support, were exempt from reduction obligations. *De minimis* subsidies were support that normally would be included in the Amber Box and, therefore, would be subject to reduction commitments. However, they were within defined low limits.
One limit was for product-specific support, and is up to 5 per cent of the total value of agricultural production within a low limit. The other limit was for non-product specific support, and is up to 5 per cent of the total value of agricultural production. A WTO member could take advantage of both limits (i.e. there is no trade off between them). Furthermore, to assist developing and least developed countries, *de minimis* subsidies for subsistence farmers would be exempt from reduction commitments.

4) *Domestic Agricultural Support through Blue Box Subsidies*
Regarding Blue Box subsidies, at the consistent urging of the United States, which was the chief advocate for reform of this Box, the criteria for inclusion in it could be amended to accommodate counter-cyclical payments to farmers. The United States aimed to switch its counter-cyclical payments to this Box from their current categorisation in the Amber Box, the contents of which were subject to reduction commitments on domestic support. The definition of the Blue Box in Article 6:5 of the WTO *Agreement on Agriculture* covers only those subsidy programs that require a limit on production. Thus, the Blue Box essentially was a category for production "set asides" (i.e. payments not to produce, or to limit production). The ostensible purpose of this category was to assist a WTO member in reforming its agricultural sector. In particular, supposedly it helped the EU wean its farmers off of subsidies linked to production, which historically have resulted in over-production (e.g. infamous "mountains" of butter and "lakes" of wine).
Counter-cyclical support provides farmers with payments if global commodity prices decline (thus causing the price of their crop to fall), and assures them of a minimum (or floor) price. That is, a farmer is compensated for the gap between a global price and a government-established target price, whenever the global price plummets beneath the set price. But, in the United States, this support is not contingent on a farmer agreeing to set aside part of his land and let that part lie fallow. In other words, it is de-coupled from production.
The *Framework Agreement* did not assure the Blue Box definition will be amended to eliminate the criteria relating to limits on production. Rather, it said WTO members "may have recourse" to subsidies not linked to production. As for the criteria, the *Agreement* said only that they will be subject to future negotiation. The United States sought a more firm commitment to changing the criteria to accommodate de-coupled counter-cyclical payments, but settled for a deal conditional on acceptance of other disciplines on agricultural matters.
Also regarding the Blue Box, a new spending cap would be imposed. For each WTO member, the limit would be 5 per cent of the total value of agricultural production of that member. Both the United States and EU supported this cap, as they had first proposed it in August 2003, the month before the Cancún Ministerial Conference, in a joint paper. Under the original definition of the Blue Box in the WTO *Agreement on Agriculture*, and following American farm legislation in 2002, the United States ceased to make Blue Box payments. The 5 per cent cap in the *Framework Agreement* would have allowed the United States to shift up to US $10 billion annually of subsidies into the Blue Box. In that Box, they would have been exempt from reduction commitments. Assuming a final deal on a change in the definition of the Blue Box ever occurred, then these subsidies could be counter-cyclical payments.
Finally, there was an important qualification to this cap. The *Framework Agreement* stated that "[i]n cases where a [WTO] Member had placed an exceptionally large percentage of its trade-distorting support in the Blue Box, some flexibility would be provided on a basis to be agreed to ensure that such a Member was not called upon to make a wholly disproportionate cut."

5) *Domestic Agricultural Support through Amber Box Subsidies*
The *Framework Agreement* called for "substantial reductions" in Amber Box support. It also promised WTO members with higher levels of this kind of subsidy will make deeper cuts, i.e. there was to be some degree of harmonisation of Amber Box subsidies by mandating deeper cuts from members with higher subsidy levels. The WTO *Agreement on Agriculture*, reached during the Uruguay Round, did not call for harmonising cuts. In particular, the *Framework Agreement* called for a 20 per cent reduction in Amber Box support. In this respect, the *Agreement* was more specific on the degree of cuts required in domestic support programs than it is as regards tariffs. Programs in the Amber Box, which include direct payments to farmers and price supports, are by their nature trade distorting.
Poor countries consider the commitment to a 20 per cent reduction a "down payment"—in the sense of an immediate cut—toward reducing and possibly eliminating them. Initially, the commitment applied only in the first year of any eventual Doha Round accord. Under the *Framework Agreement*, however, the down payment of a 20 per cent cut was extended to the entire life of any subsidy reduction deal. The cuts would commence in the year after Doha Round accords enter into force. The extension was backed not only by the United States and EU, but also Australia, Brazil, and India. (These five members are known as the "Five Interested Parties," or FIPs.) In addition, the United States held out the possibility of cuts on domestic support as deep as 50 per cent.
American endorsement of the 20 per cent down payment was conditional on three significant limitations. First, the United States opposed reduction commitments on domestic support on a product-specific basis. To be sure, it agreed with the concept of product-specific caps on Amber Box subsidies. But, a limitation on spending is far different from an obligation to cut spending. The United States insisted no product-specific reduction commitments enter into the *Framework Agreement*.
Secondly, and more importantly, the United States insisted on application of the 20 per cent cut to the bound level of support, not the actual level of support. (The actual level is never higher than the bound level, unless a violation occurs or an exception is permitted, and typically the bound level is considerably higher than the actual level.) That is, the cut would be applied not to actual Amber Box spending in each WTO member. Rather, it was to be made from the higher level of the bound, or permissible, spending cap to which each member has committed. The bound Amber Box level for the United States was US $19.1 billion annually, meaning the United States could spend up to that level, but its actual spending level is below this amount, at US $16.8 billion in 2000 and US $14.4 billion in 2001. Thus, the United States was unlikely to have difficulties implementing the down payment.
Thirdly, and also of great significance, the United States insisted on a cut of domestic support from a large basis for measuring this support. Thus, the 20 per cent reduction would apply to the aggregate of Amber Box subsidies, de minimis subsidies, and any subsidies that would be included in a new Blue Box.

The United States held firm on this point for reasons evident from its spending behaviour.

Across all Box categories, the bound levels for the United States summed up to about US $49.1 billion. This aggregate resulted from US $10 billion for Blue Box support (calculated according to a new limit of 5 per cent of the value of total domestic agricultural output), a further US $20 billion of *de minimis* support (calculated as the sum of US $10 billion for product-specific support and US $10 billion for non-product specific support), and US $19.1 bound Amber Box level. The 20 per cent called for by the *Framework Agreement* cut would reduce America's bound level to about US $39 billion. However, what was significant is whether the United States would have to cut actual spending to meet the US $39 billion target.

The answer was "no." The United States spent considerably less than US $39 billion in total farm support. Its Amber Box spending, again, was US $14.4 billion (as of 2001). It spent nothing on Blue Box support, as defined in the WTO *Agreement on Agriculture*, and thus would be within the proposed US $10 billion cap. Regarding de minimis subsidies, in 2000, the United States spent US $600 million on product specific support, well below the US $10 billion cap, and US $7.28 billion in non-product specific support, safely under the US $10 billion cap. In 2001, non-product specific support fell to US $6.83 billion. Consequently, as of 2000, American spending on Amber Box, Blue Box, and de minimis support totaled US $24.6 billion—well below the US $39 billion target bound level. In brief, the United States easily could have met the 20 per cent reduction commitment called for by the *Framework Agreement*, because its commitment would be to a passive cap.

This fact suggested the value of the reduction commitment is symbolic. To be fair, however, the size of the cut would have equaled or exceeded that achieved in the Uruguay Round, and would occur immediately. Moreover, the EU would have to slash more from its bound levels than the United States. As of 2004, the EU held a 3-to-1 advantage over the United States in the level of trade distorting domestic support (i.e. the sum of its Amber Box, Blue Box, and de minimis subsidy levels) it was permitted to provide. The effects of the *Framework Agreement* on the EU bound levels would have reduced the advantage to 2.4:1, indicating some harmonisation. As of 2004, the EU spent about US $25 billion in Blue Box subsidies. The EU would have had to cut that by nearly half—US US $10 billion—to satisfy the *Framework Agreement* cap of 5 per cent of the value of domestic agricultural production. In addition, the EU would have had to slash another US $20 billion from its bound levels to satisfy the *Agreement* mandate to cut 20 per cent from the combined base of Amber Box, Blue Box, and de minimis subsidies. The total reduction for the EU would be nearly US $30 billion, larger than the American cut from US $49.1 to US $39 billion.

6) *Agricultural Export Subsidies*

The *Framework Agreement* called for the elimination of all export subsidies—the most trade-distorting kind of support—on agricultural products. It does not identify by when, but instead says only that the export subsidies will be eliminated "by a date to be agreed." The WTO *Agreement on Agriculture* called for reductions in export subsidies, but not their elimination. Eliminating these subsidies would have disciplined American export credit and food aid programs, a quid pro quo on which the EU insisted in return for agreeing to phase out its export subsidies.

Among the key disciplines would have been monitoring food assistance to ensure developed countries do not abuse it to dump surplus production. The United States obtained language in the *Framework Agreement* to preserve the ability of

any member to provide food aid for humanitarian and development purposes. An earlier draft of the *Agreement* made reference to "surplus disposal." Along with many developing countries, including the Dominican Republic, Mongolia, and Sri Lanka, the United States disagreed with this term. They reasoned all food aid comes form surplus production, and were successful in eliminating the term. They successfully inserted (in the section of the agricultural annex to the Agreement dealing with export competition) as the goal of disciplines on food aid the prevention of commercial displacement. Consequently food aid is not limited—as the EU had urged—to cash grants.

7) *State Trading Enterprises (STEs)*

STEs can operate in a way that provides support to exports. Thus, the *Framework Agreement* calls for the elimination of "trade distorting practices with respect to exporting STEs including eliminating export subsidies provided to or by them, government financing, and the underwriting of losses." The *Agreement* also said "[t]he issue of the future use of monopoly powers will be subject to further negotiation." Canada, seeking to avoid modifying the structure and operation of the Canadian Wheat Board, which held a monopoly on exports of wheat from Canada, opposed these provisions of the *Agreement*. Conversely, American trade groups, such as the United States Wheat Associates and the Wheat Export Trade Education Committee (WETEC) supported efforts to break up the "single desk" approach to marketing grain.

Canada was particularly sensitive about the language concerning STEs in the *Framework Agreement* concerning "government financing" and "underwriting of losses." That sensitivity arose in part from the Canadian government loan guarantee provided to the Board for initial crop payments, and for borrowings (to be used in the event the pool of funds collected by the Board from member farmers is insufficient). It also arose because the government bailed out the Board when the Board incurred operating losses, as it did in 2003. Not surprisingly, shortly after the *Framework Agreement* was reached, the Board announced it would seek major financial compensation from the Canadian government if government guarantees were eliminated. Australia had similar concerns regarding its STE export monopolies. It had several of them, such as AWB Ltd., which used to be the Australian Wheat Board but subsequently was privatised.

Canada also sought to protect its system of supply management. In this respect, Canada was able (with Japan) to keep out of the *Agreement* a commitment on TRQs to set ceilings on tariff rates applicable to over-quota shipments.

8) *Cotton Subsidies*

The *Framework Agreement* incorporated a deal the United States struck with various African countries, including Benin, Burkina Faso, Chad, Mali, and Senegal, concerning cotton subsidies. These countries, part of the Group of 90 (G-90) developing and least developed countries, also included Rwanda, which played a leading role in the talks. The African, along with Caribbean, countries argued strenuously at the September 2003 Cancún Ministerial Conference that excessive subsidies to American cotton farmers had a serious adverse effect on their cotton farmers. The *Agreement* called for negotiations on cotton subsidies to take place in the Doha Round context "ambitiously, expeditiously, and specifically."

Without details, the *Agreement* obligated WTO members to reduce substantially export subsidies and domestic support for cotton. It also required members to expand market access opportunities for African cotton farmers. It called for negotiations on "flexibilities" to be afforded developing and least developed countries with respect to cotton trade.

The United States had sought to include the issue within the talks on agriculture, and was successful in resisting efforts to place it as separate, or "stand alone," agenda item. However, the United States could (or did) not prevent formation of a special subcommittee on cotton. The *Framework Agreement* calls for establishment of this subcommittee under the auspices of the WTO Committee on Agriculture. The purpose of the subcommittee would be to secure "appropriate prioritisation of the cotton issue independently from other sectoral initiatives [in the agriculture negotiations]." Finally, the WTO Director General would be charged with the responsibility of working with the World Bank and International Monetary Fund (IMF) "to direct effectively existing programs and any additional resources towards development of the economies where cotton has vital importance." Perhaps not surprisingly, the National Cotton Council (NCC) of the United States remained dubious about any highlighting of cotton issues.

9) *Non-Agricultural Market Access (NAMA)*

The *Framework Agreement* stated as a goal reducing or eliminating all tariff and non-tariff barriers on non-agricultural products, though its language about containing the "initial elements for future work" was a clear signal of how far away the WTO members are from that goal. The *Agreement* called for use of a non-linear formula to cut tariffs, and to apply the formula on a line-by-line basis. Higher tariffs would be cut more deeply and faster, than lower tariffs, and there would be no *a priori* exemptions from the cuts. The *Agreement* held out the possibility of eliminating entirely tariffs in certain key sectors, but does not define those sectors.

The non-linear formula also would reduce or eliminate tariff peaks and tariff escalation. Despite well over half a century of tariff cuts through multilateral trade negotiations, many developed country WTO members have tariff peaks (i.e. ad valorem duty rates above 15 per cent) in industrial sectors like clothing and textiles, footwear, and motor vehicles. Many developing country members have such peaks, too, in industrial and agricultural sectors, while other developing country members simply have high tariffs across-the-board (even in comparison with countries at comparable economic levels). Both developed and developing country members were wont to protect domestic producers in some sectors through tariff escalation.

The NAMA provisions of the *Agreement* accorded S & D treatment to developing and least developed country WTO members in four ways. First, it said application of the non-linear formula "shall take fully into account the special needs and interests of developing and least developed country participants, including through less than full reciprocity in reduction commitments." This statement suggested the members may pay some heed to the special and differential treatment afforded by Article XXVIII:3(b)-(c) *bis* and the non-reciprocity expectation of Article XXXVI:6.

Secondly, the *Agreement* exempted developing and least developed country members from having to participate in negotiations to eliminate tariffs in sectors of export interest to those countries. In other words, developed countries would have the onus of this "sectoral initiative." They would agree to make ambitious cuts, and possibly eliminate, tariffs on industrial products in which poor countries have an export interest.

Thirdly, developing country WTO members would have an extended transition period and extra flexibility to implement industrial tariff cuts. Neither the length of the extension nor the nature of the flexibility is clear.

Fourthly, under an annex pertaining to least developed members of the WTO, these countries would be exempt from cutting industrial tariffs. About a dozen

African countries objected to the criteria for qualification under the annex. But, they included members like Mauritius, which has a per capita income of US $11,000 that far exceeds that of El Salvador, Guatemala, and Mexico, none of which is considered a least developed country.

What is not clear from the *Agreement* is whether developing and least developed country WTO members would have to address their own instances of tariff peaks and tariff escalation. It is also not apparent whether they will be expected to lower ceiling binding rates so as to reduce the gap between applied and bound rates, and thereby lessen uncertainty for exporters (namely, as to possible future boosts in applied rates).

10) *Trade in Services*

The *Framework Agreement* established May 2005 as the deadline for WTO members to submit new or revised offers to open their services markets. The *Agreement* also identified service trade liberalisation as a "core" market access issue in the Doha Round, thus putting it on par with market access for agricultural products.

11) *Trade (Customs) Facilitation*

Customs facilitation, which is a diplomatic term for cutting "red tape" and the attendant costs of clearing merchandise at a port of entry, was one of the four issues identified for discussion at the 1996 WTO Ministerial Conference in Singapore. After expending considerable effort to retain these items on the agenda, and after the collapse of the September 2003 Cancún Ministerial Conference, the EU abandoned efforts to include—much less link to the talks on agriculture—the other three Singapore issues (competition policy, foreign direct investment, and transparency in government procurement).

The *Framework Agreement* said negotiations on customs facilitation will be a part of the Doha Round talks. The United States supports these negotiations. It urged the benefits could be a decrease of 5 to 15 per cent in the cost of importing and selling products in certain WTO members.

12) *Special and Differential Treatment*

The *Framework Agreement* allowed developing and least developed countries to benefit from special and differential treatment "for a reasonable period, to be negotiated." This permission was a change from earlier draft accords, in which the benefit was to expire when export subsidies had been phased out. The *Agreement* lengthens the benefit period to an indeterminate period after this phase out. As for the specific kinds of S&D treatment, they fell into two broad categories. First, least developed countries would be exempt from virtually all obligations. Second, developing countries would receive particularised exemptions from trade liberalising agriculture and NAMA commitments, sometimes in the form of extended phase-in periods as was characteristic of the Uruguay Round texts. The *Agreement* also called for recommendations by July 2005 on special and differential treatment.

However, as the WTO does not delineate "developed" from "developing" members, but allowed for self-identification, it was not clear whether larger developing countries would (or should) receive S&D treatment. Brazil was a case in point. A number of American farm groups opposed lumping Brazil together with the likes of Mali. Brazil was the top exporter of sugar in the world. In 2005, it was set to surpass the United States as the largest soybean exporter, as well as Australia as the leading beef exporter. After the United States, Brazil was the second biggest poultry exporter, with its poultry exports tripling between 1999–2003. Brazil had 420 million acres available to farm, which was roughly the amount cultivated in the United States.

28–037 While many politicians and journalists hailed the August 2004 *Framework Agreement* as "historic," that adjective must be viewed with some skepticism.

Apparently, it was in France. Shortly after the *Agreement* was reached, the French Foreign Trade Minister, Francois Loos, offered a plan in the 2005 budget bill to provide small and medium sized enterprises with export tax credits to offset their marketing and promotional expenses incurred for exports outside Europe.

28–038 True, in no multilateral trade round had negotiators ever agreed to eliminate export subsides on agricultural products. But, a deal to take action, which does not specify when or how the action will be taken, essentially is a deal to procrastinate. The WTO negotiators bought themselves more time in which to make the hard decisions of exactly how, and over what period, they will eliminate agricultural export subsidies and deal with the other key topics. Put differently, had the *Framework Agreement* been the agenda laid out in the Doha Ministerial Conference itself, or shortly thereafter, it would have been impressive—and perhaps forestalled the collapse of the September 2003 Ministerial Conference in Cancún. Seen as the work product of nearly three years after the launch of the Round, the *Agreement* is a marginal achievement.

This perspective seems all the more plausible given the limited scope of the *Framework Agreement*. On the one hand, it clearly narrows the parameters for negotiations in comparison with the state of affairs during and immediately after the Cancún Conference. It does not address squarely the full range of topics laid out in the Doha Development Agenda, suggesting a diminution in the ambition of the Round. An outstanding example is foreign direct investment (FDI). The *Agreement* forsakes efforts to negotiate rules on FDI, one of the Singapore Issues.

28–039 With respect to the all-important agricultural provisions of the *Framework Agreement*, their ambiguity may be of short-term strategic benefit, but it could be a long-term vice. For example, the lack of a deadline or phase out schedule regarding export subsidies calls into question the seriousness of the members—especially the United States and EU—to abolish them.

Likewise, the lack of hard commitments on agricultural market access allowed trade negotiators to proclaim to the world the Doha Round continued. But, their accord may be more of an agreement to disagree, and in the long term, it leaves plenty of room for protectionism. The exception for "sensitive" products in the *Framework Agreement* from market access obligations may permit Japan to retain its rice tariff of 490 per cent. That is because the *Agreement* has no criteria for how to select or treat sensitive products. The Chairman of the Agriculture Negotiations, Tim Grosser of New Zealand, had proposed a limit on the number of products a developed country WTO member can designate as "sensitive," namely, the number should closely approximate the number of products subject to TRQs. Chairman Grosser also proposed a mandatory expansion in the size of all TRQs (i.e. not only a drop in the tariff portion, but also an increase in the quota thresholds). The FIPs rejected both of these proposals. The United States proposed a tariff cap on all products designated "sensitive," but this issue remains unresolved.

The same defects exist in the *Framework Agreement* with respect to the Blue Box. The spending cap for this Box, already generous at 5 per cent of the total value of a WTO member's agricultural production, may be circumvented by the enlarged definition of that Box. The result would be developed countries shift Amber Box support into the Blue Box, and thus immunise the support from reduction commitments. The Blue Box cap also may prove parlous because of the permission for a member with "an exceptionally large percentage" (undefined) of support to avoid making a "disproportionate" (again, undefined) cut. Whether these large loopholes in the Blue Box are partly plugged with meaningful product-specific spending caps, and limits on the amount of counter-cyclical payments (possibly akin to WTO spending limits on income insurance, income safety net payments, and guarantees) is unclear.

28–040 Even the vaunted 20 per cent down payment in spending cuts seems a bit of ruse. Evidence of this possibility is the situation of the United States (discussed above). With its level of spending (in 2000) of US $24.6 billion, it need not make any "real" cuts to satisfy its promise to reduce by 20 per cent the bound level of an enlarged base (the sum of Amber Box, Blue Box, and *de minimis* support) from US $49.1 to US $39 billion. The availability of the non-trade distorting category of Green Box support makes it even less likely meaningful cuts will occur. Senator Charles Grassley (Republican-Iowa), Chairman of the Senate Finance Committee, publicly proclaimed that total American agricultural support would not decrease, but simply change form from subsidies related to production to Green Box support such as payments for environmental practices.

Ominously, even the modest success of the *Framework Agreement* stirred great controversy in key constituencies of some WTO member countries. For example, the United States was accused by its National Farmers' Union, and some members of Congress, that it conceded too much by agreeing to a specific down payment amount on domestic support cuts—20 per cent—without getting equally specific promises on cutting barriers to market access for its agricultural products. The former Minority Leader of the Senate (Tom Daschle, a Democrat from South Dakota), faulted the 20 per cent down payment as putting countercyclical payments and two other dimensions of farm support—increased loan rates and updated bases and yields—in jeopardy. The United States Trade Representative, Ambassador Robert Zoellick, and his chief agricultural negotiator, Allen Johnson, fired back with a bevy of statistics. They also trotted out their farm group supporters, namely, the 53 agriculture trade associations and agribusinesses comprising the "AgTrade Coalition." This Coalition included the American Farm Bureau Federation, the American Soybean Association, Cargill, Inc., the National Milk Producers Federation, the National Pork Producers Council, and the National Cattlemen's Beef Association.

28–041 Possibly, the August 2004 *Framework Agreement* is analogous to providing much needed-life support, and then some, to a patient. As usual, the diagnosis and prescription of *The Economist* is interesting:

> "Supachai Panitchpakdi, top man at the World Trade Organisation, touted a "'truly historic' achievement. Bob Zoellick, America's top negotiator, talked of a "milestone." *The reality is less dramatic. . . . At best, it marked the end of talks about how to negotiate – and in important areas, such as cutting industrial tariffs, it did not even do that.*
>
> So why the collective backslapping? One reason for genuine celebration is that *this deal has saved the Doha Round from near-certain collapse.* . . . The multilateral system risked being sidelined in favour of bilateral and regional trade deals. That danger has passed, at least for the moment.
>
> . . .
>
> With few numbers or dates and no products specified [regarding agriculture], *it is impossible to gauge how much reform this framework will deliver.* . . . [A]t the very least, the Geneva deal ought to stop the Europeans backsliding on their reforms and also ought to force changes to America's grotesque farm subsidies.
>
> The negotiators' sights, however, should be set much higher. They should aim for a thorough dismantling of distorting subsidies and for truly open markets in farm goods. *Given the mercantilist mindset of trade negotiations, that will only happen if barriers to industrial goods and services are also reduced, especially by big developing countries such as Brazil and India.* (The fact that lower tariffs benefit an importing economy is lost on trade negotiators.) In this area, the Geneva deal achieved less. The framework for talks on industrial goods has many *loose ends*, and the text on services does little more than tell negotiators to *try harder*."[68]

In brief, the *Agreement* might have proved a turning point in the history of multilateral trade negotiations. But, it could not have saved the Round in an expeditious manner,

[68] *A Step Forward*, The Economist, August 7, 2004, p.11 (emphasis added).

namely, bringing it to a timely conclusion (e.g. before the American President's authority to negotiate the Round expired in June 2005, or before the December 13–18, 2005 Ministerial Conference in Hong Kong).[69] The original deadline of January 1, 2005 was disposed of as impossible to meet, partly owing to thte American preoccupation in the fall 2004 with a presidential election. Alternatively, the *Agreement* might have accomplished little more than put off the date on which the Round was buried. Whatever the verdict, it was best not pronounced by the participants in the Doha Round while they were still arguing with one another.

Uncovering these kinds of criticisms leads to a large policy question about fault lines, namely, was the Doha Round a failure insofar as it did not address fundamental disequilibrating issues? Professor Lovett, in arguing (inter alia) for the United States to invoke Article XII to address its enormous, and chronic, trade deficits, identified three such fault lines:

> "The GATT 1994–WTO trade regime has three major characteristics: (i) *extensive asymmetries or unequal openness*, entrenched by the WTO's Dispute Resolution process; (ii) *strong conservative momentum* with little incentive for favoured 'protected' interests (free riders) to open themselves up or to equalise import access; and (iii) *voting in the WTO* that relies mainly upon 'one country one vote' (i.e. United Nations General Assembly voting style), so that the great majority of developing countries need not yield to pressures for greater reciprocity from nations that may be losing net market shares, real incomes, or jobs to 'emerging nations.'"[70]

28–042 Time will tell whether the GATT-WTO system, through a future set of multilateral trade negotiations, will survive, and repair, these three fault lines.

There may be two other fault lines. One might be resentment arising from the negotiating process. For many years, there has been concern about cabal-like negotiations occurring in the "Green Room" near the office of the Director General in the WTO Secretariat. During the July 2004 negotiations, some WTO members accused other members of a lack of transparency and an attempt to dominate. In particular, Canada, Chile, China, Indonesia, Japan, Malaysia, Mexico, and South Korea accused the FIPs—the United States, EU, Australia, Brazil, and India—of meeting secretly to forge a deal that would be presented *fait accompli* to the rest of the WTO membership. These critics were joined by agriculture importing countries from the Group of 10 (G–10), namely, Japan, Norway, and Switzerland (along with South Korea), which complained bitterly about a lack of consultation. The comment of the senior Swiss trade negotiator, Luzius Wasescha, hardly bode well for a copacetic atmosphere: "They [the FIPs] consider themselves the leaders of the world. They are not. They are not even able to negotiate properly [at the WTO]."[71]

[69] On August 1, the WTO members agreed to extend the Doha Round deadline for at least one year, until the Hong Kong Ministerial Conference, though within a few months after the extension, few members thought that deadline could be met and believed late 2006 to be a more realistic goal. See Frances Williams, *WTO Sets Date for Hong Kong Meeting*, *Financial Times*, October 21, 2004, p.6. It was not.

[70] William A. Lovett, *Bargaining Challenges and Conflicting Interests: Implementing the Doha Round*, 17 American University International Law Review 951, 962 (2002) (emphasis added). Professor Lovett argues the United States should consider invocation of Article XII (pp.980–86), and even withdraw from the WTO using Article XV of the *WTO Agreement* if necessary (which requires six months' notice), to correct its unsustainable structural trade imbalance. He sees freer trade as a cause of the increased American current account deficit, and as having the effect of rendering the United States too dependent on this deficit (and, conversely, making America's trading partners too dependent on their trade surpluses with the United States).Without serious action, Professor Lovett observes the possibility of a major net outflow of investment funds, a deep recession, and a dollar depreciation crisis.

[71] Quoted in Daniel Pruzin, *"Down Payment" Deal Helps Seal Agreement Among Major Farm Players in WTO Talks*, 21 International Trade Reporter (BNA) 1308, 1310 (August 5, 2004).

28–043 Interestingly, the resentment was not confined to sovereign states. Among the entities critical of the negotiating process were some non-governmental organisations (NGOs). At the Cancún Ministerial Conference, some NGOs emboldened, if not catalysed, developing and least developed countries to reject any deal on further Doha Round talks until all of the concerns of these countries were addressed satisfactorily. The *Framework Agreement* suggested these countries are willing to budge, at least if offered a credible enough deal by developed countries. The consequence was that NGOs, at least in the summer of 2004, were left on the sidelines.

A fifth fault line appearing, or widening, as a result of the August 2004 *Framework Agreement* was within the Third World. The World Bank estimated that over half of the potential economic benefits from a Doha Round deal, specifically, tariff cutting on agricultural and industrial products, would take the form of benefits to poor countries. However, that estimate presumed poor countries cut tariffs too. In other words, over half of the gains from cutting tariffs would come from poor countries slashing their own duties. Some—especially larger and better-off—developing countries appreciated this fact. Other—especially smaller, marginalised—least developed countries cling to the benefits of special and differential treatment, which obviates the need for trade reform in those countries. It also led them to focus on guaranteed access to developed country markets through preference programs. History may record that the Doha Round, and the *Agreement* in particular, was the point at which more successful developing countries broke ranks with the poorer lot.

ENVIRONMENTAL SOVEREIGNTY AND THE WTO

Trade Sanctions and International Law

Bradly J. Condon

CHAPTER 2

WTO LAW AND OTHER RULES OF INTERNATIONAL LAW

A. INTRODUCTION

WTO panels are directed to interpret the WTO agreements "in accordance with customary rules of interpretation of public international law,"[1] and, except as otherwise provided, "the WTO shall be guided by the decisions, procedures and customary practices followed by the Contracting Parties to GATT 1947 and the bodies established in the framework of GATT 1947."[2] In this chapter I will argue that the customary rules of interpretation of public international law obligate the WTO to consider the wider body of general international law in interpreting its own rules. The chapter first analyzes the key rules of the Vienna Convention on the Law of Treaties as they have been applied in WTO jurisprudence. It then argues in favor of a flexible and evolutionary approach to interpreting GATT Article XX. This is followed by an analysis of the effect of non-WTO rules on WTO law and the rules regarding conflicts between treaties.

B. THE VIENNA CONVENTION ON THE LAW OF TREATIES

The Vienna Convention on the Law of Treaties (Vienna Convention) codifies the customary rules of treaty interpretation and applies to the interpretation of WTO agreements. The key rules of treaty interpretation in the Vienna Convention are:

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[1] Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU), Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization [hereinafter WTO Agreement], *Legal Instruments—Results of the Uruguay Round*, Annex 2, 33 I.L.M. 1197 (1994) [hereinafter DSU], art. 3(2) states: "The dispute settlement system of the WTO . . . serves to preserve the rights and obligations of Members under the covered agreements, and to clarify the existing provisions of those agreements in accordance with customary rules of interpretation of public international law."

[2] WTO Agreement, art. XVI(1).

Article 31: General Rule of Interpretation

1. A treaty is to be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.
2. The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes:
   (a) any agreement relating to the treaty which was made between all the parties in connexion with the conclusion of the treaty;
   (b) any instrument which was made by one or more parties in connexion with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty.
3. There shall be taken into account, together with the context:
   (a) any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions;
   (b) any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation;
   (c) any relevant rules of international law applicable in the relations between the parties.
4. A special meaning shall be given to a term if it is established that the parties so intended.

Article 32: Supplementary means of interpretation

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

The Appellate Body has consistently taken the view that the rules of treaty interpretation in Articles 31 and 32 of the Vienna Convention have "attained the status of a rule of customary or general international law" and form "part of the 'customary rules of interpretation of public international law'."[3]

In *United States—Sections 301–310 of the Trade Act of 1974*, the Panel provided a concise description of the interpretative process under Article 31 as it has been used in the WTO context:

> Text, context and object-and-purpose correspond to well established textual, systemic and teleological methodologies of treaty interpretation, all of which typically come into play when interpreting complex provisions in multilateral treaties. For pragmatic reasons the normal usage, and we will follow this usage, is to start the interpretation from the ordinary meaning of the "raw" text of the relevant treaty provisions and then seek to construe it in its context and in the light of the treaty's object and purpose. However, the elements referred to in Article 31—text, context and object-and-purpose as well as good faith—are to be viewed as one holistic rule of interpretation rather than a sequence of separate tests to be applied in a hierarchical order. Context and object-and-purpose may often appear simply to confirm an interpretation seemingly derived from the "raw" text. In reality it is always some context, even if unstated, that determines which meaning is to be taken as "ordinary" and frequently it is impossible to give meaning, even "ordinary meaning," without looking also at object-and-purpose. As noted by the Appellate Body: "Article 31 of the Vienna Convention provides that the words of the treaty form the foundation for the interpretive process: "interpretation must be based above all upon the text of the treaty"." It adds, however, that "[t]he provisions of the treaty are to be given their ordinary meaning in their context. The object and purpose of the treaty are also to be taken into account in determining the meaning of its provisions."[4]

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[3] *United States—Standards for Reformulated and Conventional Gasoline*, WTO Doc. WT/DS2/AB/R, AB-1996-1 (1996) (Report of the Appellate Body), at 16.

[4] *United States—Sections 301–310 of the Trade Act of 1974*, WTO Doc. WT/DS152/R, (1999) (Report of the Panel), para. 7.22.

The Commentary of the International Law Commission confirms that Article 31 is a single combined operation, as the heading "General Rule" indicates.[5]

A corollary of the principle of ordinary meaning in Vienna Convention Article 31(1) is the principle of effective interpretation.[6] According to the rule of effective treaty interpretation, an interpreter is not free to adopt a reading that would result in reducing whole clauses or paragraphs of a treaty to redundancy or inutility.[7] Put another way, it is the duty of any treaty interpreter to "read all applicable provisions of a treaty in a way that gives meaning to all of them, harmoniously."[8] The International Court of Justice has generally subordinated this principle to the textual approach.[9] However, the WTO Appellate Body has invoked this principle frequently, applying it as part of the textual approach.[10] In *Japan—Alcoholic Beverages*, the Appellate Body stated:

> A fundamental tenet of treaty interpretation flowing from the general rule of interpretation set out in Article 31 is the principle of effectiveness (*ut res magis valeat quam pereat*). In *United States—Standards for Reformulated and Conventional Gasoline*, we noted that "[o]ne of the corollaries of the "general rule of interpretation" in the *Vienna Convention* is that interpretation must give meaning and effect to all the terms of the treaty. An interpreter is not free to adopt a reading that would result in reducing whole clauses or paragraphs of a treaty to redundancy or inutility."[11]

[5] [1966] Y.B. Int'l L. Comm'n, Vol. II, at 219–220. Also see Ian Brownlie, Principles of Public International Law, at 603 (6th ed. 2003).

[6] See Brownlie, *id.*, at 606.

[7] See *United States—Standards for Reformulated and Conventional Gasoline*, WTO Doc. WT/DS2/AB/R, AB-1996-1 (1996) (Report of the Appellate Body), at 23.

[8] See *Korea—Definitive Safeguard Measure on Imports of Certain Dairy Products*, WTO Doc. WT/DS98/AB/R, (1999) (Report of the Appellate Body), para. 81.

[9] Brownlie, *supra* note 5, at 606.

[10] See, for example, *United States—Standards for Reformulated and Conventional Gasoline*, WTO Doc. WT/DS2/AB/R, AB-1996-1 (1996) (Report of the Appellate Body), at 23; *Korea—Definitive Safeguard Measure on Imports of Certain Dairy Products*, WTO Doc. WT/DS98/AB/R, (1999) (Report of the Appellate Body), para. 81; *Japan—Taxes on Alcoholic Beverages*, WTO Doc. WT/DS8/10 /11/AB/R (1996) (Report of the Appellate Body), at 13; *United States—Import Prohibition of Certain Shrimp and Shrimp Products*, WTO Doc. WT/DS/AB/R, AB-1998–4 (1998) (Report of the Appellate Body), para. 121; *European Communities—Measures Affecting Asbestos and Asbestos-Containing Products*, WTO Doc. WT/DS135/AB/R (2001) (Report of the Appellate Body), para.

The Appellate Body has applied this rule of treaty interpretation to give different meanings to the term "like products" in different paragraphs of GATT Article III,[12] to interpret GATT Article XX[13] and to determine the relationship between these two articles.[14] In Chapter 5, I will apply this principle to clarify the relationship between paragraphs (b) and (g) of Article XX. In Chapter 8, I will argue that this principle requires the interpretation of Article XX(g) to give effect to the provision for not just some members, but for all of them.

1. Vienna Convention Article 31(1)

The first part of Article 31 requires that the *ordinary meaning* be given to the terms of the treaty *in their context* and in the light of its

[11] *Japan—Taxes on Alcoholic Beverages*, WTO Doc. WT/DS8/10/11/AB/R (1996) (Report of the Appellate Body), at 13 (footnotes omitted). Also see [1966] Y.B. Int'l L. Comm'n, Vol. II, at 219: "When a treaty is open to two interpretations one of which does and the other does not enable the treaty to have appropriate effects, good faith and the objects and purposes of the treaty demand that the former interpretation should be adopted."

[12] *Japan—Taxes on Alcoholic Beverages*, WTO Doc. WT/DS8/10/11/AB/R (1996) (Report of the Appellate Body) and *European Communities—Measures Affecting Asbestos and Asbestos-Containing Products*, WTO Doc. WT/DS135/AB/R (2001) (Report of the Appellate Body).

[13] *United States—Standards for Reformulated and Conventional Gasoline*, WTO Doc. WT/DS2/AB/R, AB-1996-1 (1996) (Report of the Appellate Body) and *United States—Import Prohibition of Certain Shrimp and Shrimp Products*, WTO Doc. WT/DS/AB/R, AB-1998–4 (1998) (Report of the Appellate Body).

[14] *European Communities—Measures Affecting Asbestos and Asbestos-Containing Products*, WTO Doc. WT/DS135/AB/R (2001) (Report of the Appellate Body).

object and purpose. The key point is that the ordinary meaning of the words cannot be divorced from the context in which they are used nor the purpose they aim to serve. "Ordinary meaning" does *not* require a superficial or literal reading of the treaty terms.

Lord McNair sums up the task of interpretation as, "the duty of giving effect to the expressed intention of the parties . . . as expressed in the words used by them in light of the surrounding circumstances."[15] He provides a vivid example (taken from another area of legal interpretation) of how the context can significantly alter the "ordinary meaning" of a word, at:

> A man, having a wife and children, made a will of conspicuous brevity consisting merely of the words "all for mother." No term could be "plainer" than "mother," for a man can have one mother. His widow claimed the estate. The court, having admitted oral evidence which proved that in the family circle the deceased's wife was always referred to as "mother," as is common in England, held that she was entitled to . . . the whole estate. "Mother" is, speaking abstractly, a "plain term," but, taken in relation to the circumstances surrounding the testator at the time when the will was made, it was anything but a "plain term" . . . while a term may be "plain" absolutely, what a tribunal adjudicating upon the meaning of a treaty wants to ascertain is the meaning of the term relatively, that is, in relation to the circumstances in which the treaty was made, and in which the language was used. . . . If the words used are not clear in the light of the circumstances in which they were used, it is permissible for a tribunal to examine the question whether the intention of the parties is different from that which the words in their natural and ordinary sense express.[16]

One of the approaches taken by the Appellate Body has been to first examine the context of the provision in which the language is expressed, then proceed to examine the context of the particular

[15] Lord McNair, The Law of Treaties, at 365 (1961).

[16] *Id.* at 367.

agreement in which the provision is found and lastly to examine the context of the Uruguay Round Agreements as a whole. In *European Communities—Measures Affecting Asbestos and Asbestos-Containing Products*, the Appellate Body examined the meaning of "like products" in the context of all the paragraphs of Article III in order to determine how to interpret the same provision as it was used specifically in Article III:4. In *Shrimp*, in its interpretation of the *chapeau* of Article XX, the Appellate Body stated:

> It is in the words constituting that provision, read in their context, that the object and purpose of the states parties to the treaty must first be sought. Where the meaning imparted by the text itself is equivocal or inconclusive, or where confirmation of the correctness of the reading of the text itself is desired, light from the object and purpose of the treaty as a whole may usefully be sought.[17]

This reading of Article 31 appears to equate the role of paragraph (2) with Article 32 (supplementary means of interpretation) and is inconsistent with the view that Article 31 is a single combined operation.

More recently, the Appellate Body has clarified that the starting point for ascertaining the object and purpose is the treaty itself, in its entirety, but that the object and purpose of a particular treaty term must also be taken into account.[18]

2. Vienna Convention Article 31(2): WTO Preamble as Context

Although it provides no binding right or obligation, the WTO Preamble sets out the *object and purpose* of the trade agreements and provides an overall *context* in which to interpret trade obligations

[17] *United States—Import Prohibition of Certain Shrimp and Shrimp Products*, WTO Doc. WT/DS/AB/R, AB-1998-4 (1998) (Report of the Appellate Body), para. 114.

[18] See *European Communities—Customs Classification of Frozen Boneless Chicken Cuts*, WTO Doc. WT/DS269/AB/R, WT/DS286/AB/R (2005) (Report of the Appellate Body), paras. 238–239.

and exceptions applied in cases involving the environment. It thus directly affects interpretation as part of the single combined operation of Article 31. The Preamble sets out a concise summary of the principal issues and policy objectives that shed light on the context and purpose of the WTO agreements.

The WTO Preamble incorporates the objectives of sustainable development and environmental protection on the following terms:

> Recognizing that their relations in the field of trade and economic endeavour *should* be conducted with a view to *raising standards of living*, ensuring full employment and a large and steadily *growing volume of real income and effective demand*, and *expanding* the *production* of *and trade* in goods and services, *while allowing for the optimal use of the world's resources in accordance with the objective of sustainable development, seeking both to protect and preserve the environment and to enhance the means for doing so* in a manner *consistent with their respective needs and concerns at different levels of economic development*,
>
> Recognizing further that there is a need for *positive efforts* designed to ensure that *developing countries*, and especially the least developed among them, secure a share in the growth of international trade commensurate with the needs of their economic development,
>
> Being desirous of *contributing to these objectives by* entering into reciprocal and mutually advantageous arrangements directed to the *substantial reduction of tariffs and other barriers to trade* and to the *elimination of discriminatory treatment in international trade* relations . . ." (emphasis added).

In assessing the appropriate balance to achieve and the mechanisms to employ in the (potentially) conflicting policies of global trade liberalization and global environmental protection, the issues laid out in the Preamble inform the interpretation of the WTO.[19]

[19] *United States—Import Prohibition of Certain Shrimp and Shrimp Products*, WTO Doc. WT/DS/AB/R, AB-1998-4 (1998) (Report of the Appellate Body), para. 129.

One of the fundamental objectives of the WTO is to reduce barriers to trade in order to increase global welfare through the efficient allocation of resources based on the concept of comparative advantage. Differences in the level of technological, economic and institutional development affect the ability of developing countries to implement both international trade obligations and international environmental obligations. The Preamble recognizes that levels of economic development affect the priority given to environmental protection and that improving environmental protection requires enhancing the means for doing so. This is consistent with Principle 11 of the Rio Declaration, which states:

> Environmental standards, management objectives and priorities should reflect the environmental and developmental context to which they apply. Standards applied by some countries may be inappropriate and of unwarranted economic and social cost to other countries, in particular developing countries.

The Rio Declaration represents a statement of principles reflecting the broad consensus achieved among the nations of the world in 1992, as the Uruguay Round was drawing to a close. As such, it provides evidence of the circumstances surrounding the drafting of the WTO Preamble and may be taken into account pursuant to Vienna Convention Article 32. However, it is doubtful that principles like Principle 11 that use non-mandatory language, such as "should" and "may be," could be considered "rules" of international law under Vienna Convention Article 31(3)(c).

While the WTO Preamble does not spell out methods for enhancing the ability of members to protect the environment, in the context of the WTO mandate this likely means raising incomes through gains from trade, enhancing technological capacity through technology transfer and technical assistance and institution-building through training and studies. All of these methods are features of the WTO system. The fundamental premise of the WTO system is that trade liberalization will raise incomes. Technology transfer is promoted indirectly through TRIPS. The theme of technical assistance from developed countries to developing countries is found

elsewhere in the WTO agreements. Institutional capacity-building is carried out indirectly through studies and trade policy reviews and directly through the WTO training institute, funded by developed countries.[20] The liberalization of trade in environmental technologies and services provide further means of enhancing the ability of members to improve environmental protection. All of these methods of enhancing environmental protection are in conformity with the fundamental WTO themes of trade liberalization and special treatment for developing countries. They also are consistent with Principle 9 of the Rio Declaration, which states:

> States should cooperate to strengthen endogenous capacity-building for sustainable development . . . through exchanges of scientific and technological knowledge, and by enhancing the development, adaptation, diffusion and transfer of technologies, including new and innovative technologies.

The WTO Preamble establishes a hierarchy of objectives that is reflected in both the language used and the order in which objectives are laid out. The Preamble uses distinct language for environmental protection and sustainable development. *Seeking* environmental protection only means *making an effort* in this regard.[21] Moreover, the order of appearance of this objective implies that environmental protection is secondary to the objective of raising incomes through

[20] The Doha Development Agenda Global Trust Fund was created following the WTO Ministerial Conference in Doha, in November 2001, to fund capacity-building in developing countries, primarily through training programs. See www.wto.org, Mar. 30, 2002.

[21] The *Oxford English Dictionary* definition of "seek" is "to make it one's aim, to try or attempt to (do something)." See IX OXFORD ENGLISH DICTIONARY at 389 (1978). To "try" means "to make and effort, endeavour, attempt." See XI, *id.* at 438. The Spanish version uses the term "y procurando." The French version uses the term "en vue a la fois de proteger." In *European Communities—Trade Description of Sardines*, WTO Doc. WT/DS231/R (2002) (Report of the Panel), the Panel examined the Spanish and French versions, using the DICCIONARIO DE LA LENGUA ESPANOLA and the GRAND DICTIONNAIRE ENCYCLOPEDIQUE LAROUSSE, respectively. The English, French and Spanish texts are equally authentic. See *Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations*, para. 6.

trade liberalization, in the context of the WTO mandate. In contrast, sustainable development is more closely integrated into the economic objectives set out in the Preamble. The underlying premise is that the fundamental objective of trade liberalization is consistent with the concept of sustainable development.[22] Allowing sustainable development means interpreting trade obligations to permit measures that have this aim, whether through the interpretation given to trade obligations or through the interpretation of exceptions to those obligations. The phrase "in accordance with . . . sustainable development" implies mutual adaptation and harmony of the objectives of trade liberalization and sustainable development. Mutual adaptation means that the concept of sustainable development should accommodate trade liberalization and that trade obligations should accommodate sustainable development. Arguably, this means that the interpretation of trade *obligations*, not only the *exceptions* to those obligations, should accommodate the concept of sustainable development.

In *Shrimp*, the Appellate Body gave weight to the Preamble's reference to environmental protection and sustainable development in applying these references to the interpretation of the *exception* in Article XX(g). The Appellate Body stated, "While Article XX was not modified in the Uruguay Round, the preamble attached to the *WTO Agreement* shows that the signatories to that Agreement were, in 1994, fully aware of the importance and legitimacy of environmental protection as a goal of national and international policy."[23] The Appellate Body therefore interpreted Article XX(g) in the context of contem-

[22] "In accordance with" means "the action or state of agreeing; agreement; harmony; conformity." I OXFORD ENGLISH DICTIONARY, at 62. "Agreement" means "mutual conformity of things, whether due to likeness or to mutual adaptation; concord; harmony; affinity." I OXFORD ENGLISH DICTIONARY, at 191. "In conformity with" means "in agreement, accordance or harmony with; in compliance with." II OXFORD ENGLISH DICTIONARY, at 813. The Spanish version uses the term "de conformidad con el objetivo." The French version uses the term "conformement a l"objectif."

[23] *United States—Import Prohibition of Certain Shrimp and Shrimp Products*, WTO Doc. WT/DS/AB/R, AB-1998-4 (1998) (Report of the Appellate Body), para. 129.

porary concerns about environmental protection, as reflected in modern international conventions and declarations that address environmental issues.

The concept of "context" under Article 31 is not limited to the treaty text. Under Article 31(2), non-WTO agreements may form part of the context.[24]

3. Vienna Convention Article 31(3)(b): Subsequent Practice

In *Shrimp 21.5*, the Panel appeared uncertain as to the meaning of Article 31(3)(b) of the Vienna Convention:

> Insofar as [the 1996 Report of the CTE] can be deemed to embody the opinion of the WTO Members, it could be argued that it records evidence of "subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation" . . . and as such should be taken into account in the interpretation of the provisions concerned. However, even if it is not to be considered as evidence of a subsequent practice, it remains the expression of a common opinion of Members and is therefore relevant in assessing the scope of the chapeau of Article XX.[25]

The reference in Article 31(3)(b) to "any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions" suggests that practice constitutes something less than a formal agreement on interpretation, such as that envisaged by WTO Agreement Article IX:2. Even if the 1996 Report of the CTE can be considered evidence of subsequent practice, its legal relevance in the interpretation of WTO law would depend the reasoning behind the practice.[26]

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[24] See *European Communities—Customs Classification of Frozen Boneless Chicken Cuts*, WTO Doc. WT/DS269/AB/R, WT/DS286/AB/R (2005) (Report of the Appellate Body), para. 195.

[25] *United States—Import Prohibition of Certain Shrimp and Shrimp Products, Recourse to Article 21.5 by Malaysia*, WTO Doc. WT/DS58/RW (2001) (Report of the Panel), para. 5.56.

[26] See BROWNLIE, *supra* note 5, at 605.

In *Japan—Alcoholic Beverages*, the Appellate Body found that "subsequent practice" requires a "concordant, common and consistent" sequence of acts or pronouncements which is sufficient to establish a discernible pattern implying the agreement of the parties to a treaty regarding its interpretation.[27] In *United States—Internet Gambling*, the Appellate Body clarified that establishing "subsequent practice" within the meaning of Article 31(3)(b) involves two elements:

> (i) there must be a common, consistent, discernible pattern of acts or pronouncements; *and* (ii) those acts or pronouncements must imply *agreement* on the interpretation of the relevant provision. (Emphasis in original.)[28]

Not each and every party to the treaty must have engaged in a particular practice for it to qualify as common and concordant practice.[29] The agreement of parties that have not engaged in the practice can be established from their affirmative reaction or, in some situations, from a party's lack of reaction to a practice that it has been made aware of.[30] However, reliance on subsequent practice in treaty interpretation must not interfere with the exclusive authority of the WTO Ministerial Conference and the General Council to adopt interpretations under Article IX:2 of the WTO Agreement.[31]

Article 31(3)(b) is also relevant to determining the legal effect of WTO jurisprudence. Where a panel report is adopted and results in the disputing parties conforming their practice to the conclusions and findings of the report, this provides evidence of practice establishing agreement regarding interpretation under the Vienna

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[27] *Japan—Taxes on Alcoholic Beverages*, WTO Doc. WT/DS8/10/11/AB/R (1996) (Report of the Appellate Body), at 13.

[28] *United States—Internet Gambling*, (2005) (Report of the Appellate Body), para. 192.

[29] *European Communities—Customs Classification of Frozen Boneless Chicken Cuts*, WTO Doc. WT/DS269/AB/R, WT/DS286/AB/R (2005) (Report of the Appellate Body), para. 259.

[30] *Id.*, para. 272.

[31] *Id.*, para. 273.

Convention. Where later panels follow prior panel interpretations on the same issue, this provides further evidence of practice. It is difficult to resolve the issue of what constitutes sufficient practice under the Vienna Convention. Nevertheless, where a consistent approach to interpretation emerges over several years and several cases, it is likely that future panels and the Appellate Body will continue to apply the same interpretation.

In the context of GATT 1947, Jackson argued that where a panel report is adopted and results in the disputing parties conforming their practice to the conclusions and findings of the report, this provides evidence of practice establishing agreement regarding interpretation under the Vienna Convention.[32] Where later panels follow prior panel interpretations on the same issue, this provides further evidence of practice. However, the difficult issue to resolve is what constitutes sufficient practice under the Vienna Convention.

Jackson also argued that the Council adoption of a panel report under GATT 1947 could be viewed as the equivalent of a resolution or decision by the contracting parties definitively interpreting the GATT, but doubted that this was the intention of adoption. Jackson notes that the practice of GATT parties was to treat adopted panel reports as binding on the parties, but not unadopted reports. The changes to WTO decision-making procedures introduced in the Uruguay Round do not state the legal effect of a panel report, but nevertheless indicate that the panel decisions are binding on the parties.[33] The introduction of formal mechanisms for interpretation and amendment under WTO, combined with automatic adoption of

[32] See JOHN H. JACKSON, THE JURISPRUDENCE OF GATT AND THE WTO: INSIGHTS ON TREATY LAW AND ECONOMIC RELATIONS, at 165 (2000). Also see Vienna Convention, art. 31(3)(b). In *Japan—Taxes on Alcoholic Beverages*, the Panel found that panel reports adopted by the contracting parties constitute subsequent practice in a specific case.

[33] See JACKSON, *id.* The DSU provides further that, "the first objective of the dispute settlement mechanism is usually to secure the withdrawal of the measures concerned if these are found to be inconsistent with the provisions of any of the covered agreements" (art. 3(7)) and "prompt compliance with recommendations or rulings of the DSB is essential" (art. 21(1)).

panel and Appellate Body reports, will likely affect the legal impact of panel interpretations in terms of constituting practice under the Vienna Convention.[34]

The Appellate Body indirectly addressed the issue of the legal effect of its rulings in *Shrimp*, chastising the Panel for not following the analytical sequence established by the Appellate Body in the Gasoline case:

> [W]e enunciated the appropriate method for applying Article XX. . . . [T]he analysis of a claim of justification under Article XX reflects, not inadvertence or random choice, but rather the fundamental structure and logic of Article XX. The Panel appears to suggest, albeit indirectly, that following the indicated sequence of steps, or the inverse thereof, does not make any difference. To the Panel, reversing the sequence . . ." seems equally appropriate." We do not agree.[35]

In *Shrimp 21.5*, the Appellate Body reaffirmed its view of the legal effect of panel and Appellate Body reports that it had expressed in *Japan—Taxes on Alcoholic Beverages:*

> The reasoning in our Report in United States—Shrimp on which the Panel relied was not dicta; it was essential to our ruling. The Panel was right to use it, and right to rely on it. . . . The Panel had, necessarily, to consider our views on this subject, as we . . . had provided interpretative guidance for future panels, such as the Panel in this case. . . .
>
> [I]n *Japan—Taxes on Alcoholic Beverages*, we stated that:
>
> Adopted panel reports are an important part of the GATT *acquis*. They are often considered by subsequent panels. They create legitimate expectations among WTO Members, and, therefore,

[34] See JACKSON, *id.* at 168.

[35] *United States—Import Prohibition of Certain Shrimp and Shrimp Products*, WTO Doc. WT/DS/AB/R, AB-1998-4 (1998) (Report of the Appellate Body), paras. 118–119.

should be taken into account where they are relevant to any dispute.

This reasoning applies to adopted Appellate Body Reports as well.[36]

A panel ruling does not provide an "authoritative interpretation" of a provision. While dispute panels are authorized to "clarify" provisions by applying the rules of interpretation of the Vienna Convention, interpretations by panels are not the same as interpretations under Article IX:2 of the WTO Agreement. DSU Article 3(9) makes a distinction between the provisions of the DSU and "the rights of Members to seek authoritative interpretation of provisions . . . through decision-making under the WTO Agreement." The WTO Agreement gives the Ministerial Conference and the General Council "exclusive authority to adopt interpretations" of the WTO Agreement and the Multilateral Trade Agreements.[37] Whereas a panel interpretation only binds the parties to the dispute and does not have the effect of *stare decisis*, an "authoritative interpretation" would be binding on all members in future disputes. Thus, the two avenues of interpretation have distinct legal effects.

Panel reports are adopted by the Dispute Settlement Body (DSB),[38] unless there is consensus not to adopt the report[39]—a condition that is met if no member present at the meeting of the DSB formally objects to the decision not to adopt the report.[40] While the

[36] *United States—Import Prohibition of Certain Shrimp and Shrimp Products, Recourse to Article 21.5 by Malaysia*, WTO Doc. WT/DS58/AB/RW (2001) (Report of the Appellate Body), paras. 107–109, citing *Japan—Taxes on Alcoholic Beverages*, WTO Doc. WT/DS8/10/11/AB/R (1996) (Report of the Appellate Body), 108. Regarding unadopted panel reports, the Appellate Body agreed with the Panel in the same case that, "a panel could nevertheless find useful guidance in the reasoning of an unadopted panel report that it considered to be relevant," at 15.

[37] WTO Agreement, art. IX:2.

[38] WTO Agreement, art. 2(1).

[39] WTO Agreement, art. 16(4).

[40] WTO Agreement, art. 2(4), and n.1.

DSB consists of the General Council wearing a different hat,[41] the adoption of panel reports by the DSB cannot be viewed as raising the status of a panel's interpretation to the same level as an authoritative interpretation of the General Council. Such a view would render meaningless the provisions that distinguish between panel interpretations and authoritative interpretations and that set up distinct procedures for deciding the two types of interpretation.

The scope of panel rulings are limited to "achieving a satisfactory settlement of the matter"[42] and "cannot add to or diminish the rights and obligations"[43] of WTO members. In sum, authoritative interpretations under the WTO Agreement can be more intrusive than panel interpretations with respect to the rights of the WTO members.

The Statute of the International Court of Justice sets out a hierarchy[44] of sources of international law, in Article 38(1):

> The Court, whose function it is to decide in accordance with international law such disputes as are submitted to it, shall apply:
> (a) international conventions, whether general or particular, establishing rules expressly recognized by the contesting States;
>
> (b) international custom, as evidence of a general practice accepted by law; the general principles of law recognized by civilised nations;
>
> (c) subject to the provisions of Article 59,[45] judicial decisions and the teachings of the most highly qualified publicists of the

[41] WTO Agreement, art. IV:3.

[42] DSU, art. 3(4).

[43] DSU, art. 3(2).

[44] There is growing agreement among legal scholars that the order in which these sources are listed indicates the importance to be accorded to each. Thus, the opinions of publicists would be secondary to judicial decisions in this hierarchy. See J. STARKE, INTRODUCTION TO INTERNATIONAL LAW, at 52 (5th ed. 1963).

[45] Statute of the International Court of Justice, art. 59 states: "The decision of the Court has no binding force except between the parties and in respect of that particular case."

various nations, as subsidiary means for the determination of rules of law.[46]

This provision is not directly applicable to the legal effect of different avenues of decision making in the WTO context. However, it is consistent with the view that the rulings of the WTO judiciary, while an important part of WTO law, rank below the provisions of international agreements (which includes WTO agreements and MEAs) and customary international law.

4. Vienna Convention Article 31(3)(c): Rules of International Law

In *Tuna II*, the Panel adopted the view that other international agreements could not be taken into account in interpreting the provisions of GATT, because they were,

> not concluded among the Contracting Parties to the General Agreement, and . . . did not apply to the interpretation of the General Agreement or the application of its provisions . . . practice under [the other treaties] could not be taken as practice under the General Agreement, and therefore could not affect the interpretation of it.[47]

However, the Panel in *Shrimp 21.5* adopted a different view:

> the Appellate Body, like the Original Panel, referred to a number of international agreements, many of which have been ratified or otherwise accepted by the parties to this dispute. Article 31.3(c) of the Vienna Convention provides that . . . there shall be taken into account, together with the context, "any relevant rule of international law applicable to the relations between the parties." We note that, with the exception of the Bonn Convention . . . Malaysia and the United States have accepted or are committed to comply with all of the international instruments referred to by the Appellate Body in paragraph 168 of its Report.[48]

The Appellate Body has gone beyond the immediate context of the Uruguay Round Agreements to consider the provisions of MEAs and principles expressed in documents such as the Rio Declaration.[49] While general international law is not part of the context in the narrow sense in which that term is used in the Vienna Convention, "any relevant rules of international law applicable in the relations between the parties" form part of the interpretative context that is to be taken into account in the interpretation of treaties under Article 31.

Article 31(3)(c) suggests that one goal of treaty interpretation is to ensure coherence in the interpretation of international legal obligations. The requirement to take "any" relevant rules of international law into account is not a supplementary means of interpretation, but rather a core aspect of treaty interpretation:

> 3. There *shall* be taken into account, together with the context:
> . . .
>
> (c) any relevant rules of international law applicable in the relations between the parties.

Thus, a consideration of the relationship between WTO law and other branches of international law is not an optional exercise, but rather an essential part of interpreting WTO law. However, this exer-

[46] Cahier argues that this provision should be interpreted to accord greater weight to judicial decisions than to publicists. However, he notes that, in theory, judicial decisions are not really a source of law, though they are treated as such in practice. See Philippe Cahier, *Le role du juge dans l'élaboration du droit international*, *in* JERZY MAKARCZYK ED., THEORY OF INTERNATIONAL LAW AT THE THRESHOLD OF THE 21ST CENTURY, at 353 (1996).

[47] *United States—Restrictions on Imports of Tuna*, GATT Doc. DS29/R (1994), 33 I.L.M. 839 (Report by the Panel not Adopted), para. 5.19.

[48] *United States—Import Prohibition of Certain Shrimp and Shrimp Products, Recourse to Article 21.5 by Malaysia*, WTO Doc. WT/DS58/RW (2001) (Report of the Panel), para. 5.57.

[49] See *United States—Import Prohibition of Certain Shrimp and Shrimp Products*, WTO Doc. WT/DS/AB/R, AB-1998-4 (1998) (Report of the Appellate Body), paras. 129–134.

cise cuts both ways. The interpretation of other treaties, including MEAs, must also take WTO law into account.

Support for the view that MEA provisions can influence the interpretation of WTO obligations under Vienna Convention Article 31(3)(c) can be found in the decision of the Appellate Body in *Shrimp*. The Appellate Body applied definitions of natural resources found in a variety of MEAs to the interpretation of the term "exhaustible natural resources" in GATT Article XX(g) to include living resources.[50] Moreover, the finding that the five species of turtle at issue were "exhaustible" was based on the fact that they had been listed in CITES Appendix I, which includes "all species threatened with extinction which are or may be affected by trade."[51]

Further support for the view that MEA provisions form part of the rules of international law that apply to the interpretation of WTO provisions is found in the statement of the ICJ that, "an international instrument has to be interpreted and applied within the framework of the entire legal system prevailing at the time of the interpretation."[52]

The responsibility for promoting coherence between WTO law and other rules of international law is not exclusive to the WTO judiciary. The member states of the WTO certainly have a major contribution to make in the design of not only WTO rules, but also in the design of rules contained in other treaties in which they participate. Moreover, the international judiciary in other forums needs to take WTO rules—and WTO jurisprudence—into account in the interpretation of non-WTO rules.

5. Vienna Convention Article 32: Supplementary Means

Vienna Convention Articles 31 and 32 set out a hierarchy of methods and sources of interpretation. Article 32 provides a sec-

[50] *United States—Import Prohibition of Certain Shrimp and Shrimp Products*, WTO Doc. WT/DS/AB/R, AB-1998-4 (1998) (Report of the Appellate Body), 46–51.

[51] *Id.*, para. 130.

[52] *Namibia (Legal Consequences)* (Advisory Opinion) [1971] ICJ Rep. 31.

ondary means of interpretation that, in theory, only comes into play in situations where Article 31 proves inadequate. However, there is some debate on the proper role of Article 32. For example, Jackson argues as follows:

> Under typical international law, elaborated by the Vienna Convention . . . , preparatory work history is an ancillary means of interpreting treaties. In the context of interpreting the GATT, we have more than forty years of practice since the origin of GATT. . . . Thus, . . . it is this author's view that one cannot rely too heavily on the original drafting history.[53]

> [T]he Vienna Convention . . . is generally considered to relegate preparatory history (Article 32) to a subsidiary role in interpretation, to be used only when the means specified in Article 31 do not resolve an interpretive problem.[54]

Jackson notes the case of former negotiators who have received fees from an interested party to testify as to the negotiating history based on their own experience, noting that such testimony cannot always be given full credibility.

However, Schwebel argues that Article 32 must be interpreted to give preparatory work a greater role in the interpretation of treaties than the words (particularly "confirm") would suggest. In his view, the practice of using preparatory work to either confirm or to contest the "ordinary meaning" of the treaty terms favors an interpretation that allows this practice to continue. If Article 32 may only be used to confirm, but not to contest, the interpretation that results under Article 31, then Article 32 would be redundant.[55]

In contrast to the historical context laid out in Article 32, Article 31(3) emphasizes the importance of the subsequent evolution of the

[53] JACKSON, *supra* note 32, at 426.

[54] *Id.*, at 145, n.37.

[55] Stephen M. Schwebel, *May Preparatory Work be Used to Correct Rather than Confirm the "Clear" Meaning of a Treaty Provision?*, *in* JERZY MAKARCZYK ED., THEORY OF INTERNATIONAL LAW AT THE THRESHOLD OF THE 21ST CENTURY, at 541 (1996).

law. Thus, the contemporary legal context may have greater influence than the historical context surrounding the creation of treaty obligations. Indeed, the Appellate Body has taken this approach with respect to the interpretation of GATT Article XX(g), a provision drafted over 50 years ago. In *Shrimp*, the Appellate Body stated:

> The words of Article XX(g), "exhaustible natural resources," . . . 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. . . . From the perspective embodied in the preamble of the WTO Agreement, we note that the generic term "natural resources" in Article XX(g) is not "static" in its content or reference but is rather "by definition, evolutionary."[56]

However, it is not entirely clear how "contemporary concerns of the community of nations" fit into the rules of treaty interpretation. Where such concerns are expressed in the WTO Agreement Preamble, they might form part of the context pursuant to Vienna Convention Article 31. Alternatively, where these concerns find concrete expression in treaty rules or customary principles of international law, they might qualify as relevant rules of international law under Article 31(3)(c). Finally, the contemporary concerns of nations might form part of the circumstances surrounding the conclusion of the Uruguay Round Agreements, pursuant to Article 32, and thus provide supplementary means of interpretation. However, this latter view is not compatible with the view that GATT Article XX(g) is evolutionary, since an evolutionary interpretation would go beyond the circumstances surrounding a treaty's conclusion and take into account subsequent developments in the law. However, there is some debate regarding the "evolutionary" or "evolutive" interpretation of treaties.[57]

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[56] *United States—Import Prohibition of Certain Shrimp and Shrimp Products*, WTO Doc. WT/DS/AB/R, AB-1998-4 (1998) (Report of the Appellate Body), paras. 129–130. The Appellate Body cited *Namibia (Legal Consequences) Advisory Opinion* [1971] ICJ Rep. 31, in which the ICJ stated that where concepts embodied in a treaty are "by definition, evolutionary," their "interpretation cannot remain unaffected by the subsequent development of law."

[57] See Rosalyn Higgins, *Some Observations on the Inter-Temporal Rule in International Law*, *in* Jerzy Makarczyk ed., Theory of International Law at the Threshold of the 21st Century, at 173 (1996).

6. The "Evolutionary" Interpretation of Treaties

The rule of intertemporal law sprang from the *dictum* of Judge Huber in the *Island of Palmas* case:

> A judicial fact must be appreciated in the light of the law contemporary with it, and not the law in force at the time such a dispute in regard to it arises or falls to be settled . . . the existence of the right, in other words, its continued manifestation, shall follow the conditions required by the evolution of the law.[58]

The draft Articles for the International Law Commission on the Law of Treaties extended this ambiguous doctrine to the applicability of subsequent legal evolution to interpretation of treaties—a treaty would be interpreted in the light of the law in force at the time the treaty was drawn up, but its application would be governed by the rules of international law in force at the time the treaty was applied.[59] The proposed article was not included in the Vienna Convention, which contains no such general rule. However, Higgins notes that Article 31(3) contains a "hint" in providing that "any relevant rules of international law" may be applicable, while Article 64 allows a later emergent rule of *jus cogens* to void a treaty.[60] Higgins concludes that it is preferable to focus on the intention of the parties, reflected by reference to the objects and purpose, notwithstanding judicial indications that the Huber rule is applicable to the law of treaties.

GATT 1994, which consists of GATT 1947 (as amended), "is legally distinct from the General Agreement on Tariffs and Trade,

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[58] *Island of Palmas* II R.I.A.A. 845.

[59] See Higgins, *supra* note 57, at 178.

[60] The only peremptory norms that are clearly accepted and recognized in general international law are the prohibitions of aggression, genocide, slavery, racial discrimination, crimes against humanity and torture, and the right to self-determination. See International Law Commission, *Annual Report 2001*, Chapter IV, State Responsibility, available at http://www.un.org/law/ilc/reports/2001/english/chp4.pdf, Oct. 21, 2003, at 208.

dated 30 October 1947."[61] Thanks to this legal fiction, even if the GATT must be interpreted in the light of the law in force at the time the treaty was drawn up, the relevant time frame is now arguably 1994, not 1947. This view is buttressed by the Vienna Convention interpretation rule that the object and purpose of the treaty may be gleaned, in part, from its Preamble, which was drawn up during the Uruguay Round, not in 1947. However, with respect to Article XX, there are many arguments that favor an "evolutionary" approach that permits a more flexible interpretation that can take into account both existing non-WTO rules of international law and future developments.

Vienna Convention Article 31(3) allows subsequent agreements and practice to inform treaty interpretation and, as Judge Higgins points out, "any" relevant rules of international law. Frowein notes that DSU Article 3(2) might be read as an "attempt to prevent the development of treaty rights through later evolutions," but rejects that view.[62] Pauwelyn also rejects the view that DSU Article 3(2), in explicitly confirming certain existing rules, demonstrates an intention to contract out of all other rules of international law.[63]

Article XX recognizes that GATT obligations might have to give way in order to achieve other policy goals. Article XX(b) and (g) use broad language that does not restrict the choice of policy instruments available to achieve environmental goals, but rather allows this determination to evolve over time as knowledge and conditions change. Both international law and scientific knowledge evolve over time. Both affect the interpretation and application of Article XX(b) and (g). Thus, the interpretation of Article XX involves both questions of law and questions of fact whose conclusions cannot be predetermined.

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[61] WTO Agreement, art. II(4).

[62] Jochen Abr. Frowein, *Reservations and the International Ordre Public, in* JERZY MAKARCZYK ED., THEORY OF INTERNATIONAL LAW AT THE THRESHOLD OF THE 21ST CENTURY, 403, at 404–05 (1996).

[63] Joost Pauwelyn, *The Role of Public International Law in the WTO: How Far Can We Go?*, 95 AM. J. INT'L L. 535, at 541 (2001).

Because Article XX(b) and (g) take aim at moving targets, they need to be interpreted flexibly. Environmental conditions, prevailing rules of international law and state practice need to be taken into account at the time of interpretation. Since the Article XX *chapeau* fulfills the role of preventing abuse of Article XX(b) and (g), the latter need not be interpreted in an overly restrictive manner.

One problem with this evolutionary approach to interpretation is that it leads to more ambiguity and less predictability regarding how a provision might be applied in the future. Nevertheless, there are strong arguments in favor of flexibility. Article XX(b) and (g), like the GATT Article XXI security exception, play a central role in the allocation of responsibility between national governments, the WTO and other international organizations. The shifting circumstances of both global security and global environmental concerns require a flexible approach to policy making. Moreover, the evolutionary nature of customary international law favors an evolutionary approach to interpreting such key provisions. For example, the practice of states with respect to the general international law principles of sovereign equality and non-intervention continues to evolve. Their evolution will affect the methods employed to manage the global environment and thus the range of environmental measures that might be justified under Article XX(b) and (g).

The evolution of human knowledge affects the determination of how to address environmental problems. For example, 50 years ago, banning the use of CFCs could not have been justified scientifically, because we had no knowledge of their effect on the ozone layer nor any knowledge of the impact of ozone depletion on human, animal or plant life or health. Today, we know that it is necessary to avoid using these chemical compounds because scientific knowledge has advanced to the point where we can make that determination. Thus, the very subject matter of Article XX(b) and (g) is not static. It will vary with the particular circumstances of each case and the state of human knowledge at the time the case is considered. Circumstances change.

Accepted wisdom, on which measures work best to achieve a given policy objective, changes over time; so do the policy goals. Numerous considerations from a variety of academic disciplines go

into the determination of whether to permit the consumption of a particular product and how to prevent its consumption if that is the chosen policy. Is it necessary to restrict trade in cocaine in order to protect human health? What about alcohol? What about CFCs? What about tobacco? For each of these products, the answer to the question posed depends on the era in which it is asked, scientific knowledge regarding the health effects of the product, the social and economic implications of a given policy choice and information regarding the effectiveness of one policy instrument (taxation, education) versus another (regulation, criminalization).

While there are several arguments in favor of a flexible and evolutionary approach to the interpretation of GATT Article XX, this approach is controversial. It is not entirely clear whether the Vienna Convention supports this approach or whether it envisions a stricter and more limited approach to interpretation. Moreover, this approach increases the risk that judicial decision making will alter members' obligations in a way that was not intended.

DSU Article 3(2) limits the role of the dispute settlement system to preserving the rights and obligations of the members and to clarifying existing provisions, without adding to or diminishing rights and obligations. WTO Agreement Article IX:2 gives the Ministerial Conference and the General Council exclusive authority to adopt interpretations of the WTO Agreement and the Multilateral Trade Agreements. Read together, these provisions indicate an intention on the part of the WTO members to limit the role of the WTO judiciary in the development of WTO law. Moreover, DSU Article 3(2) provides that a central goal of the dispute settlement system is to provide security and predictability to the multilateral trading system. A flexible and evolutionary approach to treaty interpretation appears to run counter to this goal.

However, DSU Article 3(2) also requires the clarification of existing provisions in accordance with the customary rules of interpretation of public international law. The Vienna Convention thus plays a central role in defining the limits of judicial interpretation. The more ambiguous provisions are, the more room the judiciary has to

resort to supplementary means of interpretation, since ambiguity is one of the conditions that permits the application of Vienna Convention Article 32. However, Vienna Convention Article 31 plays the most important role in determining the effect of non-WTO rules on the interpretation of WTO law.

C. THE EFFECT OF NON-WTO RULES ON WTO LAW

Pauwelyn defines the relationship between WTO rules and other rules of international law based on five categories:

> (1) WTO rules that add previously nonexistent rights or obligations to the corpus of international law (such as nondiscrimination principles in trade in services);
>
> (2) WTO rules that contract out of general international law (such as [the DSU with respect to] general international law on countermeasures) . . . or deviate from, or even replace, other preexisting rules of international law . . . ;
>
> (3) WTO rules that confirm preexisting rules of international law, be they of general international law (such as DSU 3.2 . . .) or preexisting treaty law (such as GATT 1994 incorporating GATT 1947 and the TRIPS Agreement incorporating parts of certain WIPO conventions);
>
> (4) non-WTO rules that already existed when the WTO treaty was concluded (on April 15, 1994) and that are (a) relevant to and may have an impact on WTO rules; and (b) have not been contracted out of, deviated from, or replaced by the WTO treaty . . . general international law . . . other treaty rules that regulate . . . the trade relations between states (such as environmental . . . conventions . . .); and
>
> (5) non-WTO rules that are created subsequent to the WTO treaty . . . and (a) are relevant to and may have an impact on WTO rules; (b) either add to or confirm existing WTO rules or contract out of, deviate from, or replace aspects of existing WTO rules; and (c) if the latter is the case, do so in a manner consis-

tent with the interplay and conflict rules in the WTO treaty and general international law.[64]

Pauwelyn argues that the reference in DSU Article 3(2) to the "customary rules of interpretation of public international law" favors the view that the interpretation of WTO rules must take into account other rules of international law.[65] He notes that this approach was confirmed by the panel in *Korea—Measures Affecting Government Procurement:*

> Article 3.2 of the DSU requires that we seek within the context of a particular dispute to clarify the existing provisions of the WTO agreements in accordance with the customary rules of interpretation of public international law. However, the relationship of the WTO Agreements to customary international law applies generally to the economic relations between the WTO members. Such international law applies to the extent that the WTO treaty agreements do not "contract out" from it. . . . [T]o the extent that there is not conflict or inconsistency, or an expression in a covered WTO agreement that implies differently, we are of the view that the customary rules of international law apply to the WTO treaties.[66]

Thus, the effect of other rules of international law on WTO law will depend in part on their consistency with WTO law, and vice versa. Achieving greater coherence between WTO law and other branches of international law is facilitated where the two are consistent.

D. CONFLICTS BETWEEN TREATIES

Neither GATT nor the WTO Agreement contain a conflicts clause that expressly determines whether GATT or MEA obligations prevail in the event of a conflict. Indeed, there is no general conflicts clause that determines the relationship between WTO law and the rest of international law. Thus, conflicts must be resolved either through reference to conflicts clauses in MEAs and other treaties or the general rules of international law regarding conflicts between treaties. Customary international law is binding on all WTO parties, but treaties can only bind their parties (*pacta tertiis nec nocent nec prosunt*).

[64] Pauwelyn, *id.*, at 540–41.

[65] Pauwelyn, *id.*, at 542–43.

[66] *Korea—Measures Affecting Government Procurement*, WTO Doc. WT/DS163/R (2000) (Report of the Panel), para. 7.96.

In general international law, where there is no conflicts clause that determines which treaty prevails in case of a conflict, there is a presumption that the later treaty prevails over an earlier treaty on the same subject. The presumption flows from the idea that the countries would be aware of the earlier treaty when they created the later treaty, and that their intention would therefore be to have the later treaty take precedence in the event of any inconsistency. However, another presumption is that the more specific treaty is intended to prevail over the more general one. Both presumptions are methods of determining the intention of the parties to a treaty.

The presumption that the later treaty prevails does not work well in the modern multilateral context for two reasons. First, the relevant date for each state is the date it consented to be bound by the treaty.[67] This is problematic where new states accede on an ongoing basis, since the determination of which treaties prevail will vary from one state to the next depending on their date of accession. For example, both the WTO and CITES continue to add new members. Second, the content of the rules of many multilateral treaties continues to evolve over time.[68] For example, the WTO uses waivers, formal decisions and amendments to alter obligations, such as TRIPS obligations on patents. Pauwelyn uses the term "continuing treaties" to refer to such treaties where the appropriate date of acceptance of treaty obligations is difficult to determine. He argues persuasively that when continuing treaty norms are involved, applying the later-in-time rule may not make sense and could lead to arbitrary solutions.[69]

[67] See Pauwelyn, *supra* note 63, at 546.

[68] *Id.*

[69] See *id.*

Of course, treaties may be interpreted so as to avoid conflicts. For example, the broad language of GATT Article XX provides a way to avoid conflicts between GATT and other branches of international law. However, WTO members have not resorted to WTO dispute settlement to challenge their obligations under MEAs. As long as WTO members that are parties to MEAs resolve disputes over MEA trade measures under the MEA, there will be no need to resolve potential conflicts between MEA and WTO obligations. Moreover, as I will argue later in this book, WTO jurisprudence permits WTO-MEA conflicts to be resolved in a satisfactory manner. Recent developments in WTO jurisprudence regarding the interpretation of GATT Article XX should discourage WTO challenges to MEA trade obligations. Strengthening dispute settlement mechanisms in MEAs would encourage MEA members to continue the practice of resolving MEA issues under the MEA, rather than under the WTO.

Some have argued for the creation of a new global forum for environmental issues. These proposals can be divided into three categories. In the first category are proposals to create some form of global environmental organization.[70] In the second category are proposals to introduce a joint trade-environment regime as part of the WTO, for example in the form of an agreement modeled upon the TRIPS agreement.[71] In the third category are those who prefer to work with existing institutions, taking the view that it is not necessary to create new institutions to resolve largely theoretical issues.[72] In addition to the political difficulty involved in the first two categories, the current level of cooperation between United Nations environmental agencies, MEA secretariats and the WTO suggest that the latter view is the better view.[73]

[70] See, for example, Daniel C. Esty, *The Value of Creating a Global Environmental Organization*, Env't Matters, June 2000, at 13.

[71] See, for example, Chantal Thomas, *Trade Related Labor and Environment Agreements?*, 5 J. Int'l Econ. L. 791 (2002).

[72] See, for example, Sanford E. Gaines, *The Problem of Enforcing Environmental Norms in the WTO and What To Do About It*, 26 Hastings Int'l & Comp. L. Rev. 321 (2003).

[73] See Gary Sampson, *Is there a need for restructuring the collaboration among the WTO and UN Agencies so as to harness their complementarities?*, 7 J. Int'l Econ. L. 717 (2004).

The content of MEAs and the practice of parties to them should influence the choice of forum. For example, the practice of signatories to CITES has been to address the issue of trade bans imposed by CITES within the CITES framework, not the WTO. For example, CITES imposes a ban on trade in elephant ivory. Four African nations with healthy elephant populations have sought to have the ban lifted to allow them to sell stockpiles of ivory.[74] Even though these nations are members of the WTO, they have not sought recourse before the WTO where they might challenge the ban as a violation of GATT Article XI. Indeed, in the 30 years since CITES was opened for signature, none of its trade provisions have been challenged as inconsistent with either GATT or WTO obligations.

The practice of resolving differences regarding the application of CITES trade restrictions under CITES, rather than at the WTO or GATT, may not constitute subsequent practice within the meaning of the Vienna Convention that would influence the interpretation of the jurisdiction of the WTO over MEA disputes. The reasons for the practice may relate more to politics or the availability of resources to bring such disputes before the WTO.

With respect to the relationship between different WTO agreements, the practice of the Appellate Body suggests that where two agreements apply simultaneously, a panel should normally consider the more specific agreement before the more general agreement. In *European Communities—Trade Description of Sardines*, the Panel followed the practice set out by the Appellate Body in *European Communities—Regime for the Importation, Sale and Distribution of Bananas*, which stated that the Panel "should" have applied the Licensing Agreement first because this agreement deals "specifically, and in detail" with the administration of import licensing procedures. The Appellate Body

[74] Alanna Mitchell, *Proposed ivory sale may harm elephants*, available at http://www.globeandmail.com, (Toronto), June 18, 2002. Botswana, Namibia, South Africa and Zimbabwe applied for a change in the rules at the convention secretariat in Geneva. The request to bring back a limited ivory trade was scheduled for consideration at a two-week conference of CITES in Chile in November 2002.

noted that if the Panel had examined the measure under the Licensing Agreement first, there would have been no need to address the alleged inconsistency with Article X:3 of the GATT 1994.[75] However, where there is a conflict between the WTO Agreement and a Multilateral Trade Agreement, the former prevails.[76]

The sequence of analysis of provisions within one agreement is also important, since an improper sequence may be considered an error of law. In *Shrimp*, for example, the Appellate Body considered the sequence of analysis important in examining whether the American measure was justifiable under Article XX of the GATT 1994. It held that the Panel erred by looking at the *chapeau* of Article XX and then subsequently examining whether the American measure was covered by the terms of Article XX(b) or (g) because "[t]he task of interpreting the chapeau so as to prevent the abuse or misuse of the specific exemptions provided for in Article XX is rendered very difficult, if indeed it remains possible at all, where the interpreter . . . has not first identified and examined the specific exception threatened with abuse."[77] However, the sequence need not follow the order of appearance of provisions in a particular agreement. Rather, the correct sequence is based on logic and whether a different sequence would produce a different result.[78]

[75] See *European Communities—Trade Description of Sardines*, WTO Doc. WT/DS231/R (2002) (Report of the Panel), para. 7.15 and *European Communities—Regime for the Importation, Sale and Distribution of Bananas*, WTO Doc. WT/DS27/AB/R (1997) (Report of the Appellate Body), para. 204.

[76] WTO Agreement, art. XVI:3.

[77] *United States—Import Prohibition of Certain Shrimp and Shrimp Products*, WTO Doc. WT/DS/AB/R, AB-1998-4 (1998) (Report of the Appellate Body), para. 120. See also *European Communities—Trade Description of Sardines*, WTO Doc. WT/DS231/R (2002) (Report of the Panel), para. 7.17 and *United States—Tax Treatment for "Foreign Sales Corporations,"* WTO Doc. WT/DS108/AB/R (2000) (Report of the Appellate Body), para. 89.

[78] See for example *European Communities—Trade Description of Sardines*, WTO Doc. WT/DS231/R (2002) (Report of the Panel), para. 7.19, where the Panel decided to analyze the *Agreement on Technical Barriers to Trade*, WTO Agreement in the following order: art. 2.4, 2.2, 2.1 and then art. III:4 of the GATT 1994.

The effect of other rules of international law on the interpretation of WTO provisions will depend on whether the other rules are binding on all WTO members (for example rules that reflect customary international law) or the parties to the dispute (as in *Shrimp 21.5*). Thus, it is not possible to say that all non-WTO sources of international law must be taken into account in the interpretation of WTO agreements.[79]

E. CONCLUSION

A consideration of the relationship between WTO law and other branches of international law is an essential part of interpreting WTO law. WTO law forms part of the general body of international law. The opinions of the WTO judiciary influence the development of international law. Thus, other sources of international law need to be taken into account in interpreting WTO provisions, particularly international legal obligations that are binding on all WTO parties or that are binding on the parties to a dispute. The WTO judiciary has accepted this state of affairs. However, in subsequent chapters, I will argue that the WTO judiciary needs to consider the relevant rules of international law on a more systematic basis, in order to promote greater coherence between WTO law and other branches of international law. Promoting coherence now will prevent future conflicts between WTO law and other rules of international law.

In later chapters, I will show that the interpretation of Article XX in the *Shrimp* cases is generally consistent with the relevant rules of international environmental law and general international law, even though the latter was not explicitly taken into account in the rulings. I will argue that, in future, these rules should be taken into account explicitly in order to maintain consistency and coherence between WTO law and the other branches of international law. This will prevent deviations that might create divergence, rather than coherence.

[79] See generally, Pauwelyn, *supra* note 63.

ESSENTIALS OF WTO LAW

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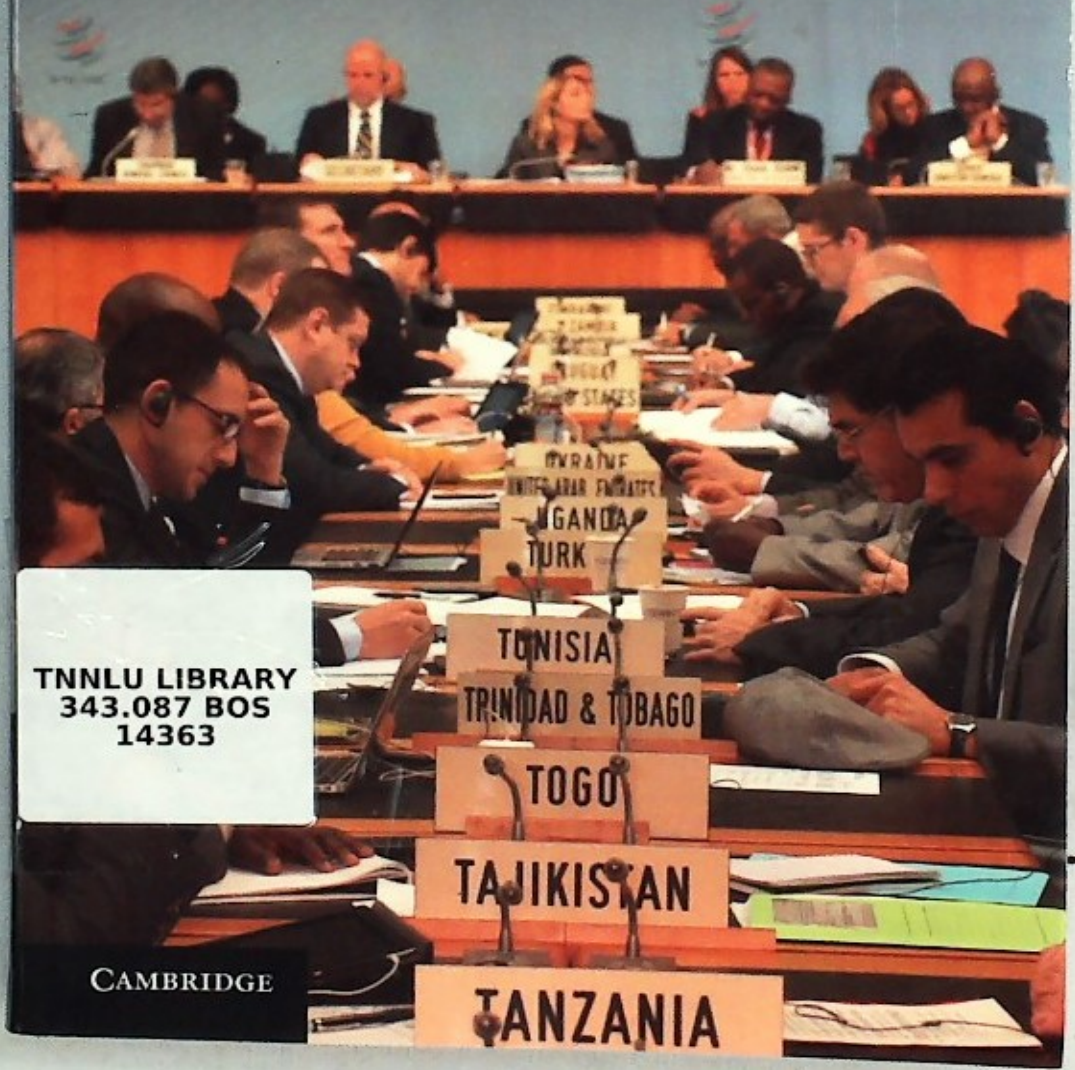

CAMBRIDGE

Chapter 7

The institutional aspects of the WTO

7.1 Introduction

The World Trade Organization (WTO) was established under the WTO Agreement and became operational on 1 January 1995. The WTO Agreement was signed on 15 April 1994 in Marrakesh, Morocco, by the countries and customs territories that had participated in the Uruguay Round of multilateral trade negotiations (hereinafter the Uruguay Round) from 1986 to 1993. The establishment of the WTO is seen by many as the most important result of the Uruguay Round. Although the WTO is the youngest of the major international intergovernmental organizations, it is arguably among the most influential international organizations in these times of economic globalization.

The origins of the WTO lie in the General Agreement on Tariffs and Trade of 1947 (GATT 1947), which had functioned for almost fifty years as a de facto international organization for trade. At the end of the 1940s, the international community had not succeeded in establishing an international organization for trade alongside the newly created international economic organizations, namely the World Bank and the International Monetary Fund (IMF). Although the Havana Charter establishing an 'International Trade Organization' was

concluded in 1948, it never came into force because of the refusal of the US Congress to approve this agreement. The GATT 1947, which was conceived as a multilateral agreement for the reduction of tariffs and other barriers to trade, and not as an international organization, gradually and very pragmatically, took on the central tasks of the 'stillborn' International Trade Organization. The decisions, procedures and customary practices of the GATT 1947 still guide the WTO (Article XVI:1 of the WTO Agreement).

The GATT 1947 had much success with regard to the reduction of customs duties, particularly on industrial products. However, it was less successful in reducing non-tariff barriers to trade. During the Uruguay Round, the conviction gradually grew that the international community needed a fully fledged international organization to efficiently guide and regulate the increasingly complex trade relations between countries. This conviction, championed by Canada, the European Union (EU), and Mexico but not by the United States, finally led to the establishment of the WTO.

7.2 Objectives

Pursuant to the Preamble of the WTO Agreement, the ultimate objectives of the WTO are:

- the increase of standards of living;
- the attainment of full employment;
- the growth of real income and effective demand; and
- the expansion of production of and trade in goods and services.

However, it is clear from the Preamble that, in pursuing these objectives, the WTO must take into account the objective of sustainable development and the needs of developing countries. These preambular statements contradict the contention that the WTO is only about trade liberalization without regard for the sustainability of economic development, environmental degradation and global poverty. The WTO agreements must be read in the light of the objectives set out in the Preamble.

> In *US – Shrimp (1998)*, the Appellate Body stated: '[The language of the Preamble to the WTO Agreement] demonstrates a recognition by WTO negotiators that optimal use of the world's resources should be made in accordance with the objective of sustainable development. As this preambular language reflects the intentions of negotiators of the WTO Agreement, we believe it must add colour, texture and shading to our interpretation of the agreements annexed to the WTO Agreement, in this case, the GATT 1994'.

7.3 Functions

The primary function of the WTO is to provide the common institutional framework for the conduct of trade relations among its Members. More specifically, the WTO, as set out in Article III (and Article V) of the WTO Agreement, has been assigned the following broad functions:

- to facilitate the implementation, administration and operation of the WTO agreements, as well as to further the objectives of these agreements;
- to be a forum for the negotiation of new trade rules;
- to settle trade disputes between its Members (see Chapter 8);
- to review the trade policies of its Members; and
- to cooperate with other international organizations and non-governmental organizations.

In addition, although not explicitly mentioned in the WTO Agreement, the WTO undisputedly has the function of giving technical assistance to developing-country Members.

Each of these functions is discussed briefly next.

7.3.1 Facilitation of the implementation of the WTO agreements

The function of facilitating the implementation, administration and operation of the WTO agreements and furthering their objectives is an essential function of the WTO. It involves most of its bodies and takes up much of their time.

> An example of what this function of 'facilitating' implementation entails is found in Article 12.2 of the SPS Agreement, pursuant to which the SPS Committee has created a mechanism whereby Members may raise at each regular meeting of the SPS Committee the specific

trade concerns they have with regard to other Members' sanitary or phytosanitary measures. The multilateral discussion of these concerns may lead (and frequently does lead) to revision of the relevant measure or to the provision of technical assistance to comply with the measure. In this way, trade concerns can be addressed without recourse to dispute settlement.

7.3.2 *Negotiations*

A second function of the WTO is to provide a forum for negotiations among WTO Members on new trade rules. Before the WTO was established, multilateral trade negotiations were conducted in specially convened, time-limited rounds of negotiations, covering a wide variety of issues. The WTO now provides for a permanent forum for negotiations among its Members, in which each trade issue can be negotiated separately on its own merits.

Examples of trade agreements negotiated in the framework of the WTO include the amendment of the provisions of the TRIPS Agreement regarding compulsory licensing, to ensure access to essential medicines; the amendment of the Agreement on Government Procurement to extend its coverage; the accession of thirty-three countries to the WTO; and the adoption of the Information Technology Agreement.

Although it was initially thought that specially convened rounds of negotiations would no longer be necessary, it soon became apparent that, for multilateral negotiations on trade liberalization to be successful, the political momentum and opportunity for package deals brought by old GATT-style negotiation rounds is needed. Members therefore agreed at the Doha Ministerial Conference of 2001 to launch a new round of multilateral trade negotiations, commonly known as the 'Doha Round', with an ambitious agenda. The Doha Round initially adopted a 'single undertaking' approach, meaning that there is no agreement on anything until there is agreement on everything. However, in view of several missed deadlines and repeated deadlocks in the negotiations on core issues, Members decided to abandon the 'single undertaking' approach and advance negotiations in areas where progress was possible. At the Bali Ministerial Conference in December 2013, twelve years after the start of the Doha Round, agreement was reached on a limited number of issues on the negotiating agenda, including trade facilitation, public stockholding for food security purposes and issues relating to preferential treatment of least-developed countries (LDCs). Subsequently, in November 2014, WTO Members adopted the Agreement on Trade Facilitation, to be inserted into the WTO Agreement and to enter into force once two-thirds of Members have completed their domestic ratification process. On the many remaining issues on the agenda of the Doha Round, and in particular on non-agricultural market access (NAMA), trade in agricultural products and trade in services, the negotiations continue.

7.3.3 *Dispute settlement*

A third and very important function of the WTO is the administration of the WTO dispute settlement system. The prompt settlement of disputes under the WTO agreements is essential for the effective functioning of the WTO and for maintaining a proper balance between the rights and obligations of Members (Article 3.2 of the DSU). Chapter 8 examines the basic principles, institutions and procedures of the WTO dispute settlement system.

7.3.4 *Trade policy review*

A fourth function of the WTO is to administer the WTO Trade Policy Review Mechanism (TPRM). Under the TPRM, the trade policies and practices of all WTO Members are subject to periodic review by the Trade Policy Review Body (TPRB) (see Section 7.4) on the basis of a report by the Member under review and a report by the WTO Secretariat. These reports, together with the minutes of the meeting of the TPRB and the concluding remarks by the TPRB Chair are published shortly after the review. The TPRM aims to achieve greater transparency with regard to the trade policies and practices of Members and to contribute to improved compliance by Members with their WTO obligations. The TPRM may serve to 'shame' a Member into complying with its WTO obligations or publicly support its WTO-consistent (but domestically contested) policies. Trade policy review reports can be found on the WTO website and are a very useful source of information on the trade policies and practices of WTO Members.

7.3.5 *Cooperation with other organizations*

A fifth function of the WTO is cooperation with other organizations. Article III:5 of the WTO Agreement requires the WTO to cooperate with the IMF and the World Bank in order to ensure coherence in global economic policy. The WTO has given effect to this obligation through concluding cooperation agreements with the IMF and the World Bank. The WTO is also required to cooperate with other international organizations that have responsibilities related to those of the WTO (Article V:1 of the WTO Agreement). The WTO has made arrangements for cooperation with many international organizations, including United Nations Conference on Trade and Development (UNCTAD), World Intellectual Property Organization (WIPO) and the World Health Organization (WHO). About 140 international organizations have observer status with WTO councils or committees, and the WTO likewise participates in the work of many international organizations.

Furthermore, as allowed by Article V:2 of the WTO Agreement, the General Council has made appropriate arrangements for consultation and cooperation with non-governmental organizations (NGOs). Although NGOs have no role in WTO decision-making, a significant improvement in the relationship between the WTO and civil society has been achieved through pragmatic initiatives by the WTO Secretariat, including regular briefings for NGOs on the work of the WTO, symposia and public fora, dissemination of NGO position papers to WTO Members and the general public, the setting up of an NGO centre at ministerial

conferences and improved access to WTO documents through faster derestriction.

7.3.6 Technical assistance to developing countries

A sixth function of the WTO is the provision of technical assistance to developing-country Members to allow them to integrate into the world trading system and to reap the benefits of international trade. Although this task is not explicitly stated in the WTO Agreement, its importance is emphasized in the Doha Ministerial Declaration of December 2001.

> In paragraph 38 of the Doha Ministerial Declaration of 2001, WTO Members stated, 'We confirm that technical cooperation and capacity building are core elements of the development dimension of the multilateral trading system ... We instruct the Secretariat, in coordination with other relevant agencies, to support domestic efforts for mainstreaming trade into national plans for economic development and strategies for poverty reduction'.

Several WTO agreements provide for technical assistance to developing-country Members by other Members or by the WTO. Technical assistance provided by the WTO is funded mainly from the Doha Development Agenda Global Trust Fund, to which Members make voluntary contributions. These activities include e-learning courses, regional

trade policy courses, advanced trade policy courses held in Geneva, the 'WTO reference centres' in developing countries, the 'Geneva Week' to update developing-country Members with no permanent representation in Geneva on recent developments at the WTO, technical support missions to specific developing-country Members, and support for research and teaching in developing-country Members on WTO law and international trade. At the Hong Kong Ministerial Conference in December 2005, the WTO launched the Aid for Trade Initiative to mobilize resources to address the trade-related capacity constraints faced by developing and least-developed countries and coordinate the aid for trade given by national, regional and international donors and organizations.

7.4 Institutional structure

The WTO has a complex institutional structure with numerous permanent and temporary bodies to carry out its tasks (Article IV of the WTO Agreement). This institutional structure is illustrated in Figure 7.1.

At the highest level is the Ministerial Conference (Article IV:1 of the WTO Agreement). The Ministerial Conference consists of representatives at ministerial level of all WTO Members. It is in session for only a few days every two years. The Ministerial Conference is competent to make decisions on *all* WTO matters. It has further explicitly been granted specific powers, including adopting authoritative interpretations of the WTO agreements, granting waivers of WTO obligations, adopting amendments to the WTO

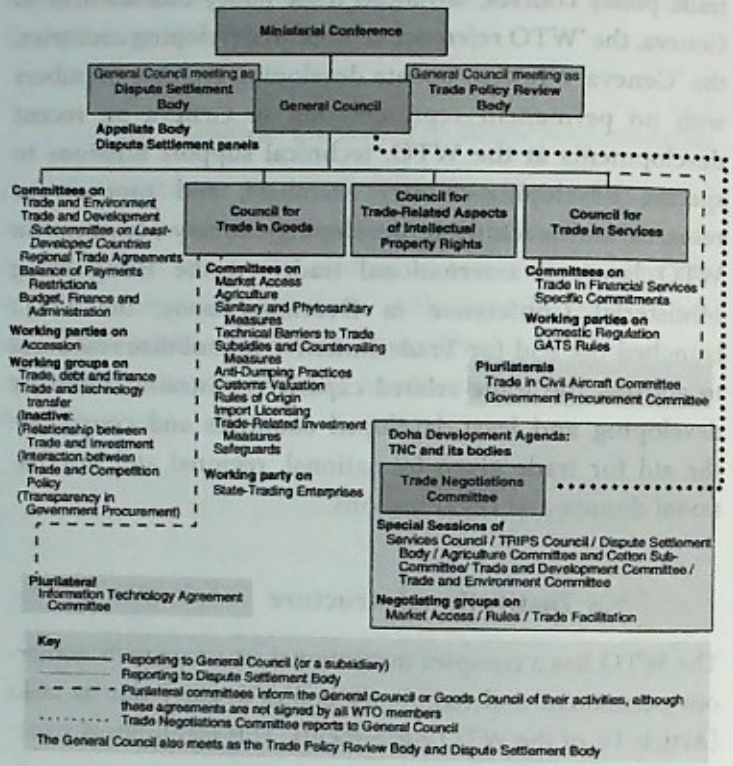

Figure 7.1: WTO Structure (source: WTO website)

agreements, making decisions on accession to the WTO, appointing the WTO Director-General and adopting staff regulations.

At the second level, there is the General Council (Article IV:2 of the WTO Agreement). The General Council exercises all the powers of the Ministerial Conference in

between its sessions. It consists of ambassador-level diplomats of all WTO Members. The General Council normally meets every two months in Geneva. The General Council has two alter egos, namely, the Dispute Settlement Body (DSB) and the Trade Policy Review Body (TPRB). When the General Council convenes to discharge its responsibilities relating to dispute settlement (see Chapter 8), it convenes as the DSB, which has its own chairperson and its own procedural rules. When the General Council convenes to discharge its responsibilities relating to the review of a WTO Member's trade policies (see Section 7.3.4), it convenes as the TPRB, which also has its own chairperson and procedural rules. The DSB and the TPRB meet more frequently than does the General Council.

The Ministerial Conference and the General Council are supported by the Council for Trade in Goods (CTG), the Council for Trade in Services (CTS) and the Council for Trade-Related Aspects of Intellectual Property Rights (TRIPS Council) (Article IV:5 of the WTO Agreement). These specialized Councils, on which all WTO Members are represented, are responsible for overseeing the functioning of the multilateral agreements on trade in goods, the GATS and the TRIPS Agreement, respectively. They meet as often as necessary.

The institutional structure of the WTO further comprises around thirty-five permanent and thirty ad hoc bodies. The permanent bodies include the Committee on Trade and Development, the Committee on Regional Trade Agreements and the Committee on Trade and Environment. In addition, all but one of the multilateral agreements on trade in goods establish a committee to carry out functions relating to the

implementation of the relevant agreement, for example the Committee on Technical Barriers to Trade (TBT Committee) (see Section 6.2.3) and the Committee on Subsidies and Countervailing Measures. The ad hoc bodies are mainly Working Groups on accession and negotiating bodies established especially for the Doha Round negotiations. The Doha Round negotiations are supervised by the temporarily established Trade Negotiations Committee (TNC), which reports to the General Council.

Every year, there are hundreds of meetings of WTO councils, committees and working parties that take place at the WTO headquarters in Geneva. It is nearly impossible for developing countries with no or a limited diplomatic representation in Geneva to attend all the meetings in which issues of importance to them are discussed. Furthermore, the often very technical and/or complex legal nature of the trade issues discussed at WTO meetings creates significant challenges for Members' representatives to the WTO.

Unlike other international organizations with a large membership, the WTO does not have an executive body composed of a limited number of representative WTO Members to facilitate the process of negotiation and decision-making. Instead, all WTO bodies are composed of representatives of all 162 WTO Members, making negotiations in these bodies very difficult and time-consuming. Furthermore, the WTO does not have a permanent body through which the 'dialogue' between the WTO and civil society representatives, such as national parliamentarians, employee and employer organizations, environmental organizations and human rights organizations, can take place.

The institutional structure of the WTO also includes non-political, independent, judicial or quasi-judicial bodies and, in particular, the ad hoc dispute settlement panels and the permanent Appellate Body (see Section 8.5).

The WTO is serviced by its Secretariat based in Geneva, which is responsible for the smooth functioning of the organization. Its main tasks are to provide technical and professional support to the various WTO bodies, to provide technical assistance to developing countries, to monitor and analyze developments in world trade, to provide information to the public and the media, to advise governments of countries wishing to become Members of the WTO and to provide administrative and legal assistance to dispute settlement panels. Note that the Appellate Body has its own Secretariat, separate from the WTO Secretariat.

The Secretariat is headed by the WTO Director-General, who is appointed by the Ministerial Conference. The appointment of a new Director-General is typically a contentious process. New procedures were adopted in 2009 to facilitate the appointment process. The current WTO Director-General is Roberto Azevêdo, previously Ambassador of Brazil to the WTO and other international economic organizations in Geneva.

The WTO Secretariat staff and the Director-General are independent and impartial international officials. They may not seek or accept instructions from any government or any authority external to the WTO (Article VI:4 of the WTO Agreement).

WTO Members often emphasize that the WTO is 'a Member-driven' organization. The Members – and not the

Director-General or the WTO Secretariat – set the agenda, make proposals and take decisions. The Director-General and the WTO Secretariat have no autonomous policy decision-making powers. They act mainly as an 'honest broker' in or a 'facilitator' of the political decision-making processes in the WTO.

The WTO Secretariat is of limited size (less than 650 regular staff as compared to 12,335 regular staff of the World Bank) and possesses limited financial resources (a budget of about US$ 195 million in 2014, as compared to the World Bank's administrative budget of US$2.6 billion in the same year). Nevertheless, a WTO Director-General with vision and drive can play an important role by building consensus among WTO Members on particular agreements or decisions.

7.5 Membership

Since the accession of the People's Republic of China in December 2001, the WTO can be regarded as a universal organization. Its 162 Members account for 99.5 per cent of the world's population and about 98 per cent of all international trade.

This section will examine the current membership of the WTO, the accession process and the obligations and rights of membership.

7.5.1 Current membership

As stated, the WTO has 162 Members at present (i.e. as of 1 December 2015). This membership is very diverse.

Three-quarters of WTO Members are developing countries. There is no WTO definition of a 'developing country'. Instead, developing-country status is largely based on self-selection by Members. Developing countries may rely on the special and differential treatment provisions in various WTO agreements and may receive technical assistance. One-fifth of WTO Members are least-developed countries (LDCs). The WTO recognizes as LDCs those countries that have been classified as such by the United Nations. Additional special and differential treatment is provided for in WTO agreements for LDC Members.

It is noteworthy that not only States but also separate customs territories with full autonomy in the conduct of their external commercial relations – such as Hong Kong, China; Macau, China; and Chinese Taipei – can be, and are, Members of the WTO. Equally noteworthy is that both the European Union (before 2010 referred to as the European Communities) and all twenty-eight Member States of the European Union are Members of the WTO (Article XI:1 of the WTO Agreement). In practice, it is the European Commission that speaks and acts for the European Union and all its Member States in WTO matters (except in the Budget Committee).

WTO Members organize themselves, formally and informally, into various groups and alliances around common interests or positions. For example, previously, the Cairns Group of nineteen agriculture-exporting countries and currently the G-20 group of developing countries have been influential in the negotiations for the liberalization of agricultural trade. Other coalitions include the G-90 group

representing the interests of the poorest Members and the 'Cotton-Four' group of West African countries that campaign against the policies of the European Union and United States that distort trade in cotton. Groups of WTO Members have also emerged to allow negotiations in smaller groups, to permit compromises to be reached or to break deadlocks. Previously the 'Quad', composed of the United States, the European Communities, Canada and Japan, was at the core of all negotiations. Currently, reflecting the new geopolitical reality and the growing economic importance of certain developing-country Members, the Quad has been replaced by the G-5, consisting of the United States, the European Union, China, Brazil and India. Without agreement among these key Members, no progress can be made in WTO negotiations. Furthermore, in recent years, a large group of developing countries, including Argentina, Venezuela, Chile, Peru, Mexico, Thailand, the Philippines, Indonesia, Malaysia, Turkey and Pakistan, often acting as part of a coalition or alliance, has gained significantly in influence in WTO decision-making and negotiations. The WTO is clearly no longer the 'rich man's club' it was in its early days.

7.5.2 Accession

The WTO Agreement initially provided for two ways to become a WTO Member. First, Contracting Parties to the GATT 1947 could become 'original' Members of the WTO by accepting the terms of the WTO Agreement and the multilateral trade agreements and by making concessions and commitments for trade in goods and trade in services,

respectively (Article XI:1 of the WTO Agreement). This method was only available at the time of and shortly after the establishment of the WTO.

Second, a state or separate customs territory can negotiate accession to the WTO by accepting the terms of the WTO Agreement and the multilateral trade agreements and negotiating the terms of accession with the current WTO Members (Article XII of the WTO Agreement). This way of becoming a Member is open indefinitely.

Accession to the WTO is typically a long and difficult process.

> China's accession negotiations lasted fifteen years and those of Russia eighteen years. The shortest accession process has been that of Kyrgyzstan, lasting two years and eleven months.

There are four main phases in the accession process. First, the applicant state or customs territory has to submit a report or 'memorandum' on its trade and economic policies. A working party of all interested WTO Members is established to examine, on the basis of this report and other information, the WTO-consistency of the applicant's laws, regulations and administrative procedures.

Second, candidates for membership must bring their national laws, regulations and administrative procedures into conformity with their obligations under the WTO agreements. Current WTO Members will often have very specific concerns and demands in this respect and will carefully

monitor whether these concerns and demands are addressed. Candidates for membership also have to negotiate a 'ticket of admission' in the form of market access concessions. When they join the WTO, new Members immediately benefit from all the gains in market access achieved by existing WTO Members. In return, they must 'pay' for this benefit by offering access to their own markets to WTO Members. The 'price' of this ticket of admission depends on the level of economic development of the acceding country and is the subject of the accession negotiations. Since different WTO Members have different trade interests, these negotiations are necessarily bilateral. However, the outcome of these negotiations is 'multilateralized' (i.e. it applies equally to all WTO Members) due to the most-favoured-nation (MFN) treatment obligation (see Sections 2.2 and 2.3).

The third stage of the accession process entails the drafting of the 'terms of membership' in the working party report, the draft Protocol of Accession and the draft Goods and Services Schedules of the candidate, containing its market access concessions and commitments. It is possible that, to secure accession to the WTO, a candidate for membership must accept additional ('WTO-plus') obligations or limited ('WTO-minus') rights. This will be reflected in the Protocol of Accession.

> For example, China undertook the 'WTO-plus' obligation to eliminate export duties on all its products, except those listed in Annex 6 to its Protocol of Accession (paragraph 11.3 of the Protocol of Accession of China),

> whereas most other WTO Members are not subject to such an obligation. In addition, China had to agree to WTO-minus rights in the form of a twelve-year transitional product-specific safeguard mechanism, under which other WTO Members could, more easily than under the normal rules on safeguards, restrict Chinese exports that caused or threatened to cause market disruption (paragraph 16 of the Protocol of Accession of China).

The final stage of the accession process is the 'decision stage', in which the General Council or the Ministerial Conference decides on the application for membership. If the application is approved, the candidate becomes a WTO Member thirty days after it has deposited the instrument of ratification of its Protocol of Accession.

> To date, thirty-three accessions have been successfully completed. At this moment, twenty-one countries are negotiating their accession to the WTO.

7.5.3 Membership obligations and rights

Article XVI:4 of the WTO Agreement requires every Member to ensure that its laws, regulations and administrative procedures comply with the obligations of the WTO agreements. However, in exceptional circumstances in which it is very difficult or impossible for a Member to comply with its

obligations, it may be granted a time-limited waiver from specific obligations by the Ministerial Conference or the General Council (Article IX:3 of the WTO Agreement).

There are several well-known examples of waivers granted to WTO Members. These include the waiver from the obligations under Articles I, IX and XIII of the GATT 1994 that was granted to a group of Members allowing them to ban trade in 'blood diamonds' (i.e. diamonds sold to fund conflicts in Africa) under the Kimberly Process. Another notable example is the waiver from the obligations of Article 31(f) and (h) of the TRIPS Agreement granted to WTO Members that produce essential medicines, under compulsory licences, for export to those Members that lack sufficient domestic capacity to manufacture these medicines themselves.

In addition to the possibility to be granted a waiver from certain WTO obligations, WTO law also provides the possibility for a Member to 'opt out' of the application of WTO rules with respect to another Member (Article XIII of the WTO Agreement) for political, economic or other reasons. The non-application clause may only be invoked at the time either of the two Members involved becomes a WTO Member and no later. The decision to 'opt out' must be notified to the General Council or Ministerial Conference before it takes a decision on the accession of the Member involved. The 'opt-out' possibility has been of limited practical importance to date.

The non-application clause has been invoked only eleven times to date. Seven of these were 'opt outs' by the United States with regard to former communist countries acceding to the WTO. Most recently, in 2011, the United States invoked the non-application clause when the Russian Federation was acceding to the WTO. In response, Russia did likewise. These opt-outs have all been revoked. In addition, Turkey invoked the non-application clause with regard to Armenia, and El Salvador did so with regard to China. The latter two 'opt-outs' are the only ones currently still in force.

In recognition of the particular difficulties that developing-country Members may face in participating in international trade, most WTO agreements provide for special and differential treatment (S&D treatment) of these Members. These S&D treatment provisions include those that (1) grant transitional periods to developing-country Members to comply with certain WTO obligations, (2) allow greater flexibility to developing-country Members in making commitments or using policy instruments, (3) encourage the granting of technical assistance to developing-country Members, (4) aim at increasing the trade opportunities for developing-country Members and (5) provide that developed Members should safeguard the interests of developing-country Members. However, because most S&D treatment provisions are either couched in hortatory terms or contain only 'best-endeavour' obligations, they are not easily enforceable.

An example of a S&D treatment obligation of 'best-endeavour' is that at issue in the *EC – Approval and Marketing of Biotech Products (2006)* dispute. In this dispute, Argentina relied on the S&D treatment provision contained in Article 10.1 of the SPS Agreement, which provides that, in the preparation and application of SPS measures, 'Members shall take account of the needs of developing country Members'. Argentina argued that the European Union had not taken account of the great economic impact of its restrictions on importation and sale of biotech products on Argentina. This impact was due to Argentina's status as the world's largest developing-country producer of biotech products and its economic dependence on agricultural exports. The panel, however, held that the obligation 'to take account' of developing-country needs entails only the obligation 'to consider' these needs and does not prescribe any result to be achieved.

With one exception of minor importance, the WTO Agreement does not provide for the possibility to expel Members from the WTO. There is no procedure to expel even Members that systematically violate their WTO obligations or that are guilty of gross violations of human rights or acts of aggression.

Members can unilaterally withdraw from the WTO under Article XV:1 of the WTO Agreement. Withdrawal applies to all the multilateral trade agreements – it is not possible to withdraw from certain of these agreements and not others. The withdrawal takes effect six months after the

notification of the decision to withdraw has been received by the WTO Director-General. No Member has made use of the withdrawal possibility to date.

7.6 Decision-making procedures

In terms of Article IX:1 of the WTO Agreement, WTO Members must first try to take decisions by consensus. A decision is considered to be taken by consensus if no Member present at the meeting when the decision is taken *formally* objects to the proposed decision. In other words, an express objection is needed to prevent a decision being taken. No voting occurs. Each Member has veto power, but Members generally refrain from blocking a consensus unless significant national interests are at stake. A certain degree of deference to economic power occurs.

In theory, when a decision cannot be taken by consensus, it may be taken by majority voting. The required majority varies with the subject matter of the decision. In general, a simple majority is sufficient for a decision to be adopted. However, certain special decision-making procedures are provided for in respect of particular decisions.

For example, a three-fourths majority of the Members is required to adopt an authoritative interpretation of a WTO agreement and to adopt a waiver of WTO obligations (Article IX:3 of the WTO Agreement). For decisions on accession, a two-thirds majority of the Members is required (Article XII:2 of the WTO Agreement).

Each WTO Member has one vote, except for the European Union, which has as many votes as it has Member States (currently twenty-eight). When the European Union exercises its voting right, the European Union Member States, which are all full Members of the WTO (see Section 7.5.1), may not participate in the voting. In practice, however, this matters little, because the WTO very seldom resorts to voting. WTO decisions are made almost exclusively by consensus.

Although the consensus requirement renders decision-making by the WTO difficult and susceptible to paralysis, decision-making by consensus is at the heart of the WTO system and is regarded as a fundamental democratic guarantee. It is also a guarantee of the presence of sufficient economic and political support for the decision to ensure its implementation.

In the early years of the WTO, developing-country Members objected to their marginalization in WTO negotiations and decision-making. As noted earlier, at present, progress can no longer be made in WTO negotiations without the agreement of China, India and Brazil, all members of the G-5. More generally, whereas many other developing-country Members still lack the resources and expertise to participate effectively in WTO negotiations and decision-making, they have increasingly been able to make their voices heard and their concerns considered in WTO negotiations and decision-making. To large extent, this has been the result of the systematic coordination of positions and the pooling of resources and expertise in groups, coalitions and alliances of developing-country Members with common interests. This welcome development does, however, also have a drawback.

The active and effective participation in WTO negotiations and decision-making of a larger number of developing-country Members with very different economic and trade interests has made it more difficult than ever before to reach consensus.

7.7 Status and budget

The WTO has legal personality and must be granted by its Members the legal capacity, privileges and immunities needed to carry out its functions (Article VIII of the WTO Agreement). The WTO is not part of the UN 'family', but is a fully independent organization. However, it maintains a close working relationship with several UN agencies and bodies (see Section 7.3.5).

The WTO has a rather modest budget compared to other international organizations. In 2014, its total budget amounted to 197 million Swiss Francs. The Financial Regulations, adopted by the General Council, provide that the contribution of each WTO Member to the WTO budget is established on the basis of that Member's international trade (both imports and exports) in relation to the total trade of all Members. Thus, contributions depend on each Member's share in global trade. With respect to Members of which the share in international trade is less than 0.015 per cent, a minimum contribution of 0.015 per cent to the WTO budget is required. The largest contributors to the WTO budget are the Member States of the European Union because their share is calculated taking into account both intra-European Union trade and trade between the European Union and third

countries. The European Union itself does not contribute to the WTO budget.

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Guide to WTO and GATT

Economics, Law and Politics

Autar Krishen Koul

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SATYAM LAW
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Chapter 32

WTO, Trade and Investment

1. THE BACKGROUND

International trade and investment are co-related and the last decade has seen a dramatic increase in foreign direct investment (FDI), defined as ownership and control of a business or a part of a business in another country. Foreign direct investment is usually distinguished from portfolio investment, where a foreign actor purchases securities in a domestic company solely to earn a financial return, without any intent to own, control or manage the domestic firm.1 Foreign direct investment generally takes one of the three forms; (a) an infusion of new equity capital such as a new plant or joint venture; (b) reinvested corporate new plant or joint venture; and (c) net borrowing through the company or affiliates.

According to UNCTAD Investment Report 1998, the global FDI stock, a measure of investment underlying international production increased fourfold between 1982 and 1994; over the same period it doubled as a percentage of world gross domestic products to 9 per cent. In 1996, the global FDI stock was valued at $3.2 trillion. Its rate of growth over the past decade (1986-96) was more than twice that of fixed capital formation, indicating an increasing internationalisation of production systems. The worldwide assets of foreign affiliates, valued at $ 8.4 trillion in 1994 also increased more rapidly than world gross fixed capital formation. Unlike the two previous investment booms in 1979-81 and 1987-90 (the first one being led by petroleum investments in oil producing countries and the second one being concentrated in the developed world), current boom is characterised by considerable developing-country participation on the inflow side, although it is driven primarily by investments originating in just two countries—the United States and the United Kingdom.

In recent years many developing countries in pursuit of liberalising and globalising their economies have moved to dismantle many explicit barriers and disincentives (such as limits on the percentage of an enterprise that can be foreign owned and on repatriation of profits), ownership by foreigners has become of increasing concern in

[1] N. Grimwade, International Trade: New Patterns of Trade, Production and Investment 144 (London: Routledge, 1989).

some industrialised countries, especially in the United States, that traditionally complained about illiberal attitudes elsewhere towards foreign investment.[2] Further, the increased investment in Japan, by nationals of other industrialised countries, especially the United States, has focused attention on a range of domestic policies and practices in Japan that (including competition policies that provide few constraints on domestic gross ownership of enterprises) supposedly create obstacles to foreigners wishing to acquire business assets there.[3]

The issue of foreign investment is closely linked with the role of multinationals in the global political economy. Multinational corporations are being considered as powers unto themselves, capable of buying and intimidating governments, or at least with the capacity to spread production and other functions around the globe so as to exploit regulatory differences between states taking advantage of one country's cheap labour, another's tax heaven, and yet another's favourable rules on intellectual property, and perhaps creating a race to the bottom.[4] Others view the multinational corporations as a logical and desirable extension of the inherent logic of corporate advantage, combining the benefits of organising production within a single firm with the gains from free trade.

The controversy over foreign investment has surrounded measures that aim not to exclude investment but to direct it in a manner that benefits the economic development of the host country. In fact, measures aimed at challenging foreign investment to benefit the economies of host countries actually challenge two of the major assumptions that have traditionally underpinned hostility to foreign investment and the multinational firm: first, that foreign investment is necessarily harmful to development; and second the developing countries are powerless to determine the way in which foreign firms exploit their productive resources. Also of significance are incentives to attract foreign investment, such as tax holidays or subsidies.[5] Indeed incentives are often used in conjunction with export performance or local sourcing requirements, and may have the effect of offsetting some or all of the disincentive effects of such restrictions or conditions on foreign investment.[6] From the perspective of neo-colonial economic theory, a world free of restrictions on the movement of goods, services and capital, any measure that distorts the global allocation of productive resources would reduce the world welfare.

[2] E. Graham and M. Ebert, 'Foreign Direct Investment and the U.S. National Security:Fixing Exon-Florio' (1991) (14) 245 World Economy; See also, R Kuttner, The End of Laissez Faire: National Purpose and the Global Economy After the Cold War, (New York: Knopt, 1991).

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[4] A.K. Koul, 'Multinational Corporations; Bonanza or a Source of illusion for the Developing Countries Economies', (2), 10-30 Review of Contemporary Law, Brussels (1981); See also A. Rugman, Inside the Multinational, The Economics of Internal Markets (New York: Columbia University Press, 1981).

[5] See A.J. Easson, 'The Design of the Incentives for Direct Investment; Some Lessons from the ASEAN Countries', International Business of Tax Law Programme, (University of Toronto, 1993).

[6] OECD, Investment Incentives and Disincentives (Paris: OECD, 1989).

However, within the GATT, the focus of attention has been on investment measures that have direct effects on trade in goods, such as measures that require or encourage foreign owned firms to discriminate between domestically produced and imported inputs in production in the host country (local content requirements) as well as measures that require that a certain percentage of a foreign firm's output be exported. The investment provisions of the Uruguay Round of Final Act would subject some investment measures with direct effects on trade to more explicit results against existing GATT norms.

2. THE HAVANA CHARTER

The Havana Charter for International Trade Organisation (ITO) 1947, provided in a very scant manner, provisions on the encouragement of the international flow of capital for productive investment (Article 1:2) and in Article 11(1)(b), 'no Member shall take unreasonable or unsuitable action within its territory injurious to the rights or interests of nationals of other Members in the enterprise, skill, capital, arts or technology which they have supplied'. Whereas Article 12 (Chapter III) entitled, 'International Investment for Economic Development and Reconstruction', which stated, *inter-alia*, that:

> 'The members recognise that international investment, both public and private, can be of great value in promoting economic development and reconstruction and consequent social progress... member has the right to take any appropriate safeguards necessary to ensure that foreign investment is not used as a basis for interference in internal affairs or national policies to determine whether and to what extent and upon what terms it will allow future foreign investment...'.

It was further recognised that the international flow of capital will be stimulated to the extent that members afford nationals of other countries opportunities for investment and security for existing and future investments. A member has the right to determine whether and to what extent and upon what terms it will allow foreign investment; to prescribe and give effect on just terms to requirements as to the ownership of existing and further investment; and to give due regard to the desirability of avoiding discrimination as between foreign investments.[7]

The Havana Charter, therefore, encouraged investment but recognised sovereignty of countries to regulate investment. It is fair to suggest that in the negotiations of ITO when a provision requiring member states to make just compensation for property taken into public ownership, subject to various exceptions was dropped from the final version of ITO as adopted at Havana, very little was achieved in arriving at international law of investment at the international trade level.

[7] See UN Conference on Trade and Employment, held at Havana, Cuba from 21 November 1947 to 24 March 1948, Final Act and Related Documents (Lake Success, N.Y. Interim Commission for the International Trade Organisation, 1948), UN Doc. E/Conf. 2/78); See also Clair Wilcox, A Charter for World Trade, 145-46 (1949).

3. MULTILATERAL DISCIPLINES ON INTERNATIONAL INVESTMENTS: PRE-URUGUAY ROUND/WTO

A. BITS and NAFTA

Prior to the WTO Agreement on Trade-Related Investment Measures, there was no multilateral agreement comprehensively dealing with investment issues. However, trading parties commonly enter into so-called bilateral investment treaties (BITS) in which the core issues on the conditions of foreign investment, the standards of compensation in cases of expropriation, and investor remedies are often incorporated in investment state arbitration mechanisms.[8]

Between 1959 and the end of the year 2001, more than 1100 bilateral investment treaties were concluded between developed and developing countries and a substantial number between developing countries *inter se*. Of the 1100 treaties, more than 800 have been concluded since 1987. Overall 155 countries were parties to BITs, covering every continent.[9]

At the regional level EC/EU integration process has emphasized complete liberalisation of investment and free movement of capital as one of the 'fundamental economic freedoms' agreed by member states of the Union.[10]

North American Free Trade Agreement (NAFTA) liberalised investment and movement of capital between Mexico, the United States and Canada and is modeled on the BITS in many ways and as such the principles governing investment in BITS are same as contained in NAFTA.

The essential normative order for investment in BITS is to promote greater economic co-operation between the parties and to encourage the flow of private capital and create conditions conducive to such flow.

(i) The Contents of BITS

The general requirement in the BITS is to provide that neither party shall mandate, as condition for the establishment, acquisition, expansion, or operation of a covered investment satisfying any of the six performance requirements:

(a) to achieve a particular level or percentage of local content or to give a preference to products of services of domestic content, or source;

(b) to limit imports in relation to a particular volume of production, exports, or foreign exchange earnings;

(c) to export a particular level or percentage of products or services;

[8] See generally, Richard B. Lillich and Burns Weston eds, The valuation of Nationalised Property in International Law(Weston eds. 1972); Richard B. Lillich, The Protection of Foreign Investment: Six Procedural Issues (1956).

[9] The figures are based on the Collection of BITS by the International Centre for the Settlement of Investment Disputes, (ICSID).

[10] George Berman, Roger J. Goebel, William J. Davey, and Eleanor M. Fox, European Union Law,451 (2002).

(d) to limit sales in the party's territory in relation to a particular volume or value of production, exports, or foreign exchange earnings;

(e) to transfer technology to a national company in the party's territory; or

(f) to carry out a particular type, level or percentage of research and development in the party's territory.

(ii) Fair and Equitable Treatment

The BITS provides fair and equitable treatment as required under international law and hence no discrimination is allowed in respect of nationality or origin for matters such as access to local courts and administrative bodies, applicable taxes, and administration of governmental regulations. Also a minimum international standards of behaviour is required for treatment of foreign investors even if no discrimination is palpable.[11]

(iii) Full Security and Protection

BITS requires that the host governments should provide full security and protection to the investor, his property and person and also to defend these rights of the investor against any violations.[12]

(iv) Expropriation

BITS contains provisions on expropriation, which is lawful and not inconsistent with the BITS provided, (i) it is carried out for a public purpose; (ii) it is not-discriminatory; (iii) it is carried out in accordance with due process; and (iv) it is accompanied by payment of compensation—in some treaties as qualified by the word 'just', 'prompt', adequate and effective compensation.[13] Many of these treaties also speak of 'expropriation' or nationalisation, 'of expropriation direct or indirect', or 'expropriation' 'nationalisation', of expropriation 'direct' or 'indirect' etc.

(v) Compensation

The compensation criteria adopted in most of the BITS centers round the words 'prompt', 'effective' and 'adequate' compensation. Adequate compensation is defined as 'market value' or 'fair market value' before the expropriation/nationalisation took place and is supposed to exclude any change in value occurring because the plan to expropriate had become known before the actual measure being undertaken. The typical example of adequate compensation can be found in BITS between Japan and China of 1988 which specifically incorporated that the compensation 'shall be such as

[11] Metalclad Corporation vs. United Mexican States, Final Award, 30 Aug. (2000), para. 99 ICSID case No. ARB (AF) 197/1.

[12] Asian Agricultural Produces Ltd. vs. Republic of Sri Lanka, Award of 27 June, (1990), paras. 85-6; 30 I.L.M. 577 (1991), 41 CSID Rep. 246. (1997).

[13] See Andreas F. Lowenfeld. International Economic Law, Ch. 15, (Oxford University Press 2000).

to place the nationals and companies in the same financial position as that in which the nationals and companies would have been if expropriation, nationalisation or any other measures, the effects of which would be similar to expropriation or nationalisation... had not been taken. Such compensation shall be paid without delay. It shall be effectively realised and freely transferrable at the exchange rate in effect on the date used for the determination of the amount of compensation'.[14]

Prompt compensation means that interests accruing from the date of nationalisation shall be paid and included in any agreement. Some agreements, including the U.S. Model Agreement, states that interest shall be paid at 'a commercially reasonable rate' for the currency in which the compensation is paid. Some BITS refer expressly to the London Interbank Rate (LIBOR).

Effective means is a form usable by the investor. The currency of payment must be freely usable or convertible into freely usable currency, without restrictions on transfer. Market bonds are acceptable, provided their actual value, as contrasted with their nominal value are acceptable, is equal to the compensation determined to be payable.

'Market value', 'Fair market value' or 'Just Compensation' or 'Genuine Value' are essentially synonymous and have been highly controversial for the reason that to determine these values, it is the specificity of the investment which will have to be carefully looked into to arrive at any of the above values. In the case of shares traded on a stock exchange, the price of shares on the relevant date may be taken to determine the market value of the investments. In cases of investment for large mining manufacturing units, it may be difficult to arrive at 'just compensation' for the fact that there may not be a willing buyer to determine the value. If the enterprise has a record of earnings over a representative period, negotiators or tribunals may attempt to arrive at going concern value i.e., the present value of future earnings.[15] When an investment is expropriated or destroyed before it has been able to establish an earnings, or when it has failed to make a profit in the period prior to the nationalisation or destruction, arbitral tribunals tend to be skeptical about the claims of prospective earnings, and base their awards on the actual funds invested in the enterprise.

(vi) Dispute Settlement

The settlement of disputes in the BITS is by way of arbitration which normally is taken under the International Centre for the Settlement of Investment Disputes (ICSID), provided both the home and host states are parties to the ICSID Convention. ICSID Convention 1966 is a convention for the settlement of investment disputes within the World Bank.[16] Many of the recent BITS provide alternatives to ICSID arbitration particularly for arbitration under UNCITRAL rules, and in some treaties for arbitration

[14] Article 5(3) of the Agreement Concerning the Encouragement and Reciprocal Protection of Investment Between Japan and China, done at Beijing 27 Aug. 1989. Reproduced in 28, 1. L.M. 575 (1989).
[15] *Supra* note 13, pp. 476-493.
[16] See 575 U.N.T.S.159, entered in force 16 Oct. (1966).

under the auspices of International Chamber of Commerce or under purely ad-hoc arbitration if agreed by the parties to the dispute. The arbitral proceedings under BITS and NAFTA are purely confidential, and participation by non-governmental organisations or other *amicus curie* has not been allowed.

4. THE MULTILATERAL INVESTMENT GUARANTEE AGENCY (MIGA)

The negotiating history of the Multilateral Investment Guarantee Agency (MIGA) reveals that the World Bank was interested in launching a multinational agency that would 'enhance the flow of capital and technology for productive purposes' to developing countries by improving the conditions for direct foreign investment and reducing and insuring against the political risks of such investment.[17] The World Bank's Board of Governors approved the MIGA Convention in 1985 which came into force in 1988.[18] By the end of 2001 MIGA had 22 industrial and 132 developing countries as members.

(i) Risks Covered

The risks covered under MIGA extend to the eligible investors who can purchase insurance against risks of inconvertibility of local currency, expropriation, breach of contract, and war and civil disturbance, including politically motivated acts of sabotage or terrorism.[19] To be an eligible investor, a person must be a national of a member country other than the host country, a corporation organised or established in such a country, or if it is incorporated in the host country, a corporation the majority of whose capital is owned by nationals of member countries. State enterprises are also eligible provided they are engaged in commerce. Eligible products can include new investments, as well as expansion, modernisation, restructuring, and privatisation of existing investments, and in some circumstances loans made or guaranteed by holders of equity in the enterprise in question.[20]

(ii) MIGA and Investment Climate

As the MIGA Convention is adhered by more than 150 states, both developed and developing, and in terms of the objectives of the MIGA i.e., to encourage the flow of investment for productive purposes among member countries as well as in guaranteeing the investment including the availability of fair and equitable treatment and legal protection for the investment, it is sufficiently clear that a uniform climate for investment across the member nations has been evolved.

[17] For a detailed history, See, Ibrahim Shihata, MIGA and Foreign Investment: Origins, Operations, Policies and Basic Documents of the Multilateral Investment Guarantee Agency (1988).
[18] Convention Establishing the Multilateral Investment Guarantee Convention, 1508 U.N.T.S. 99.
[19] Article 11, MIGA.
[20] Article 13, MIGA.

The MIGA has a dual role of satisfying itself that appropriate investment conditions are available in the host country as well to encourage the amicable settlement of disputes between the investors and the host countries. The Agency has also to endeavour to conclude agreements with developing member countries, and in particular with prospective host countries. The Agency, with respect to investment guaranteed by it, has to provide treatment at least as favourable as that agreed by the member concerned for the most favoured investment guarantee agency or state in an agreement related to investment. Such agreements are to be approved by special majority of the Board, which shall promote and facilitate the conclusion of agreements, among its members, on the promotion and protection of investment.[21]

MIGA Convention requires the agency to encourage developing countries to enter into BITS and join ICSID Convention or to adopt other criteria of an investor-friendly legal regime. MIGA Convention goes further that in case no protection is assured under the laws of a host country or a BIT, the Agency will issue a guarantee only after it reaches agreement with the host country pursuant to Article 23(b)(ii), in which investments guaranteed by the host country will receive MFN treatment.

MIGA Convention has adopted a fairly broad definition of 'expropriation and similar measures' and is clear that the focus is on the loss to the investor, not on the gain to the host government by proclaiming that, 'any legislative action or administrative action or omission attributable to the host government has the effect of depriving the holder of a guarantee of his ownership or control of, or a substantial benefit from his investment, with the exception of non-discriminatory measures of general application which the governments normally take for the purpose of regulating economic activity in their territories'.[22]

Finally, MIGA covers 'any repudiation or breach by the host government of a contract with the holder of a guarantee, when (a) the holder of a guarantee does not have recourse to a judicial or arbitral forum to determine the claim of repudiation or breach; or (b) a decision by such a forum is not rendered within such a reasonable period of time as shall be prescribed in the contracts of guarantee pursuant to the Agency's regulations; or (c) such a decision cannot be enforced'.[23]

In sum, this World Bank Convention has improved the investment climate and has encouraged trans-border investments as a vehicle of world economic growth.

5. THE INTERNATIONAL CONVENTION ON THE SETTLEMENT OF INVESTMENT DISPUTES BETWEEN STATES AND NATIONALS OF OTHER STATES AND INTERNATIONAL CENTRE FOR SETTLEMENT OF INVESTMENT DISPUTES (ICSID)

The World Bank's efforts for settling investment disputes not between states, but between private parties on one side and host states on the other hand, under the

[21] Article 23, MIGA.
[22] Article 11(a)(11), MIGA.
[23] Article 11(a)(iii), MIGA.

auspices of an institution which could act as a neutral empire led to the coming into force, the Convention on the Settlement of Investment Disputes between States and Nationals of other States.[24] The Convention established the International Centre for Settlement of Investment Disputes (ICSID) within the World Bank.

Under the ICSID Convention, both host and home country of the investor have to be parties of the Convention. The Convention is open to all member states of the World Bank, and with approval of its Administrative Council by a two thirds vote, to any other state party to the Statute of the International Court of Justice (ICJ).[25] In order for the Convention to be applicable, a given investment dispute must be the subject of a consent to arbitrate under the auspices of ICSID, which may be given in an investment agreement at the time the project in question is undertaken, or in an *ad-hoc* agreement after the dispute arises however, a consent once given is not subject to revocation.[26]

Article25(2)(b) of the ICSID Convention defines 'National of Another Contracting State' to include not only a foreign corporation or other juridical entity but also 'any juridical person, which, because of foreign control, the parties have agreed should be treated as a national of another Contracting State for the purposes of the Convention. Article 26 provides that, unless otherwise stated, consent of the parties to arbitration under the Convention shall be deemed to exclude any other remedy. A contracting state may make a reservation to require the exhaustion of local administrative or judicial remedies, but typically host states have not done so. Correspondingly, home states of an investor are precluded from giving diplomatic protection or bringing an international claim in connection with a dispute subject to the Convention.[27]

An arbitral tribunal under the ICSID Convention consists of three persons, one selected by each party to the dispute, (i.e., the host state and the investor) and the presiding arbitrator selected either by the parties or, if they cannot agree, by the chairman of ICSID, who is *ex officio*, the President of the World Bank. The pattern of choosing an arbitral tribunal follows the pattern of other international commercial arbitration except that Article 39 provides that the majority of arbitrators shall be nationals of states other than the host state or the home state of the investor.

(i) The Working of the Convention

By the year 2001, 149 states had signed the ICSID Convention and about 80 disputes relating to investment had been submitted to ICSID for arbitration or conciliation, 51 cases had been decided either by final award or by settlement in the course of the proceedings and 30 cases were in progress.

The Tribunal decides a dispute in accordance with such rules of law as may be agreed upon by the parties. In the absence of an agreement, the Tribunal applies the

[24] 575 U.N.T.S. 159 entered into force 16 Oct. 1966.
[25] Article 67, ICSID Convention.
[26] Article 25(1), ICSID Convention.
[27] Article 27(1), ICSID Convention.

law of the Contracting State party to the dispute (including its rules of conflict of laws) and such rules of international law as may be applicable.[28]

The Tribunal first looks at the law of the host state and that law would in the first instance be applied to the merits of the dispute. Then the result would be tested against international law. That process would not involve the confirmation or denial of the host states law, but may result in not applying it where that law, or action taken under that law violated international law.[29] There are four situations where an ICSID tribunal would have occasion to apply international law, i.e., (i) where the parties have so agreed; (ii) where the law of the host state calls for the application of international law, including customary international law; (iii) where the subject-matter or issue is directly regulated by international law, for instance a treaty between the host state and the home state of the investor; (iv) where the law of the host state or action taken under that law violates international law.

6. MULTILATERAL AGREEMENT ON INVESTMENTS (MAI)

The Multilateral Agreement on Investment (MAI) negotiations started as early as 1995 by a decision of a Ministerial Council of the OECD.[30] The OECD, a Paris-based inter governmental organisation for developed countries was interested in establishing a strong discipline on investment at the multilateral level in which integration of developed and developing countries investment interests would have been globalised.

A. Notable Features of the MAI Rules

The OECD Ministerial Council after the 1995 agreed that MAI should become 'a state-of-the-art agreement,[31] which meant that all recent achievements in existing investment frameworks should be integrated in MAI. MAI's approach essentially was to liberalise investment, remove barriers to investment, and provide protection against expropriation and measures diminishing its value, and institute a dispute settlement system. The MAI negotiations although could not materialise into an international treaty and failed in 1998, yet the substantive issues continue to have a bearing on the open ended trade policies of the WTO as MAI could become part of the WTO legal regime. The issues can broadly be categorised as under:

(a) although investment creates jobs, foreign firms can, it is alleged, exert too much influence on the economic sectors of the host countries, specially in developing countries, unless they are subject to some controls;

[28] Article 42 (1), ICSID Convention.
[29] Aron Brouchs, 'The Convention on the Settlement of Investment Disputes', 136 Recueil de cours 33 [Hague Academy of International Law (1972)].
[30] Ministerial statement of the Multilateral Agreement on Investment, Paris 17-26 May, 1997, 45 SG/COM/NEWS (97).
[31] OECD, A Multilateral Agreement on Investment, Report by the Committee on International Investment and Multinational Enterprises (CIME) and the Committee on Capital Movements and Invisible Transactions (CIMT), 65 OECD/GD/(95) (Paris 1995).

(b) there are fears that investment liberalisation can lead to economic crisis, when in times of trouble, foreign investors may pull their money out of the host country; and

(c) the investment liberalisation is opposed because it is feared that multinational companies will use foreign direct investment to exploit workers in low-wage countries with inadequate labour standards.[32] It was further contended that the companies will invest in countries with low environmental standards and use their influence to attack efforts in these countries to improve environmental standards on the basis of earlier attempt to do so.[33]

The issues surrounding the dead MAI cropped up once again at the Ministerial Conference of WTO at Fourth Session at Doha, 2001 and agreed to undertake negotiations on trade and investment beginning in 2003[34] and continued at its third formal meeting since the Doha Ministerial Conference. The Working Group completed its review of the issues set out at Doha, the definite action is, however still awaited.

7. POST URUGUAY ROUND; WTO AGREEMENT ON TRADE RELATED INVESTMENT MEASURES; TRIMS

A. Uruguay Round Negotiations

Investment was a major issue during the Uruguay Round Negotiations. The negotiations in the context of GATS, TRIPS, Government Procurement and Subsidies as well as MAI and discussions at the WTO Working Group on Trade and Investment, have demonstrated that many countries continued to have concerns with providing right of establishment to foreign investment and consider it important to maintain flexibility in their economic and development policies. All multilateral negotiations on this subject since the Havana Charter have been marked by the reluctance to subject investment policies to international rules and disciplines. Although, Doha Declaration of 2001 of WTO kept investment issue alive on the WTO agenda, it cannot be ignored that a lot of negotiations have taken place in this sector as far back as Havana Conference/ Charter and at the UN fora, notably the Commission on Trans-national Corporations (UN Commission on TNCS),[35] as well as the Tokyo Round Preparatory Committee

[32] See generally, Kenneth W. Dam, The Rules of the Global Game,175(2001); Michael J. Trebilcock and Robert Howse, The Regulation of International Trade, 363 (2nd ed.,1999).
[33] Matalclad Corporation vs. United Mexican States, 40 I.L.M. 36 (2001) in which damages were awarded when company investment was in hazardous waste treatment facility approved by the Federal Government of Mexico which was latter blocked by local Mexican authorities; See also, Environmentalists' letters on MAI, 13 Feb. 1997 reprinted in Inside U.S. Trade, 21 Feb. 1997 Article 12-13.
[34] See generally, Yoshi Kodama, 'the Multilateral Agreement on Investment and its Legal Implications for Newly Industrialising Economies', 32(4) JWT 22-39 (1998).
[35] A.K. Koul, 'The Code of Conduct on Transfer of Technology; An Analysis in Legal Prespective', 141-162 Foreign Trade Review, (1985).

for the GATT Ministerial Meeting[36] which finally led to the negotiations of trade-related investment measures of WTO as a result of Uruguay Round Negotiations, 1994.

Indeed, the Final Act of the Uruguay Round contains a number of provisions dealing with issues relating to investment liberalisation and protection. The bulk of such protections are found in two chapters of the Final Act of the Agreement on Trade-Related Investment Measures (TRIMs), and the GATS. A number of other chapters on the Final Act, namely the Agreement on Subsidies and Countervailing Measures, TRIPS and the Understanding on Rules and Procedures Governing the Settlement of Disputes, also contain provisions relevant to assessing the Uruguay Round's treatment of investment.

B. TRIMs Negotiations

While the TRIMs were negotiated under the Group of Negotiations on Goods (GNG) two basic issues cropped up, i.e., (i) whether the disciplines developed in this area should be limited by existing GATT articles especially Articles III and XI of GATT or expanded to develop an investment regime, and (ii) whether all or some of the TRIMs should be prohibited or should be dealt with on a case-by-case basis demonstration of direct and significant restrictive and adverse effects on trade. In the TRIMs negotiations, certain developed countries such as Japan and United States were interested to negotiate new rules with respect to various aspects of investment policy, notably incentives and performance requirements. The proposals of United States and Japan were to the effect that not only international investment legal regime should be established but it should also allow multinational corporations a freedom to invest in full climate of freedom and least restrictions.

The United States enumerated the effects of TRIMs under categories such as; (a) prevent, reduce or divert imports by limiting the sale, purchase and use of imported products; (b) restrict the ability to export by home and third country producers; and (c) artificially inflate exports from a host country thereby distorting trade flows in world markets.[37] Therefore, the TRIMs had adverse trade effects and this was a sufficient reason to make a case for applying general principles and disciplines to control them under Articles III and XI of GATT. It was further alleged that a number of regulatory performance requirements adopted by governments of host countries have trade distorting and inhibiting effects, such as, requirements for local content, export performance, trade balancing, domestic sales, manufacturing, product mandating, remittance restrictions, technology transfers, licensing and local equity.

The EC proposals[38] focused on measures that had a direct and significant restrictive impact and a link to GATT rules identifying eight TRIMs that met the criterion of being directed at the exports and imports of a company with the immediate

[36] Report of The Consultative Group of Eighteen, Doc. No. L5210, reprinted in GATT BISD 28th Sept. 75-76 (1982).
[37] See submission by the U.S., Doc. MTN. GNG/NG12/W/1, W/2, W/4, W/5, W/6, W/11, W/14, W/ 15 and W/24.
[38] See submission by the EC, Documents MTN. GNG/NG 12.

objective of influencing its trading patterns, (local content, manufacturing, export performance, product mandating, trade balancing, exchange restrictions, domestic sales, and manufacturing limitations concerning components of the final product).

The developing countries position in the negotiations was little ambivalent. On the one hand, the developing countries asked for strict adherence to the mandate and for limiting the negotiations exercise to the effects of investment measures that had a direct and significant effect on trade[39] and on the other hand, to maintain maximum flexibility in respect of investment policies including remittance restrictions, technology transfer requirements, local equity requirements, licensing requirements, incentives to achieve economic growth, trade expansion, industrial, social and developmental objectives.

The developing countries proposals went further by asking for *effects test* wherein evidence based on case-by-case examination of investment measures should be established to find out whether a direct and significant adverse effect on trade existed. In other words, a clear *link* would need to be demonstrated between the measure and the alleged effect; and if such a link was established, the nature and impact on the interests of the affected party would need to be assessed and appropriate ways and means would have to be found to deal with the demonstrated effects, including in relation to the treatment accorded when development aspects outweigh the adverse trade effects.[40]

The rationale for the above proposals by the developing countries lies in the fact that they use a combination of investment incentives and performance requirements to pursue a variety of development objectives such as, to orient resource allocations to sectors considered to have a particular growth potential; to build up a viable domestic private sector; to promote vertical integration; to attract foreign technologies or export oriented investment; or to improve access to major markets and export marketing capacities. In many cases, since policy instruments to ensure free domestic competition are not sufficiently effective or enforceable *vis-a-vis* multinational corporations, investment measures are relied upon to correct market distortions created by these multinationals. In the present climate of globalisation, in which international competitiveness and liberal foreign direct investment are *sine-qua-non* for any development effort of the developing countries, and in absence of sufficient official aid, the developing countries are continuously in need of private investment which *per se* is in the hands of multinational corporations, the multinationals corporations obviously favour investment in the countries with the least number of restrictions.

8. TRIMS: AN ANALYSIS

TRIMs Agreement acknowledges explicitly that certain measures governing the treatment of investment have restrictive or distortive effects on trade. The Agreement, which applies only to investment measures related to trade in goods, provides that no signatories shall apply any TRIMs inconsistent with Articles III (National Treatment) and XI (General Elimination of Quantitative Restrictions) of GATT 1994. To this end,

[39] Doc. MTN. GNG/Ng12/4, pp. 11-12.
[40] See Submission by Malaysia, Singapore, India, Mexico and Bangladesh-MTN.GNG/NG12/W/ 13,17,18,19 and 21.

an illustrative list of TRIMs deemed to be inconsistent with the above Articles is appended to the Agreement. This list covers the following types of prohibited TRIMs:

(i) Those that require particular levels of local sourcing by an enterprise (i.e., local content requirements);

(ii) Those which restrict the volume or value of imports which an enterprise can buy or use to the volume or value of products it exports (i.e., trade balancing requirements);

(iii) Those that restrict the volume of imports to the amount of foreign exchange inflows attributable to an enterprise; and

(iv) Those which restrict the exportation by an enterprise of products, whether specified in terms of the particular type, volume or value of products or of a proportion of volume or value of local production.

Prohibited practices under the TRIMs Agreement include both those that are mandatory in nature and those 'with which compliance is necessary to obtain an advantage'. While the Agreement does not define the term 'advantage' (suggesting some potential overlap with provisions on prohibited subsidies found in the Agreement on Subsidies and Countervailing Measures), it is understood to cover all forms of advantages (including those that are tax related) and is thus more encompassing than the term subsidies.

The Agreement comprises of eleven Articles with one Annex.

A. National Treatment and Quantitative Restrictions

The Preamble of the Agreement recognised the fact that liberalisation of world trade requires facilitation of investment across international frontiers for the purposes of increasing economic growth of all trading partners including the less developed countries, that there was a need to balance the investment measures which have trade restrictive or distorting effects within the parameters of GATT. The coverage of the Agreement relates only to the trade in goods. The members to the GATT 1994 are obligated not to apply any TRIM which is inconsistent with the provision of Article III or Article XI of GATT 1994. An illustrative list of TRIMs that are inconsistent with the obligation of national treatment provided for in paragraph 4 Article III of GATT 1994 and the obligations of general elimination of quantitative restrictions provided for in paragraph 1 of Article XI of GATT 1994 is contained in Annex I of this Agreement. The phrase 'investment measures' as reflected in the Agreement indicates that the TRIMs Agreement is not limited to measures taken specifically in regard to foreign investment. Nothing in the TRIMs Agreement suggests that the nationality of the ownership of enterprise subject to a particular measure is an element in deciding whether that measure is covered by the Agreement. Since TRIMs Agreement is basically designed to govern and provide a level playing field for foreign investment, measures relating to internal taxes or subsidies cannot be construed to be a trade related investment measure. Internal taxes or advantages are only one of the many types of advantages which may be tied to a local content requirement which is a principal focus

of TRIMs Agreement. TRIMs Agreement is not concerned with subsidies and internal taxes as such but rather with local content requirements, compliance with which may be encouraged through providing any type of advantage. Nor in any case, internal measure would necessarily not govern the treatment of foreign investment.[41]

In examining whether the measures in question are investment measures, the Panel on Indonesia-Autos[42] reviewed the legislative provisions relating to the measures. The Panel concluded that the measures were 'aimed at encouraging the development of local manufacturing capability for finished motor vehicles and parts and components in Indonesia and that 'there is nothing in the text of the TRIMs Agreement to suggest that a measure is not an investment measure simply on the ground that a member does not characterise the measure as such, or on the grounds that the measure is not explicitly adopted as an investment regulation'.

In examining whether the measures at issue in the dispute were trade-related, the Panel on Indonesia-Autos held that the local content requirements were necessarily trade related. If these measures are local content requirements, they would necessarily be 'trade-related' because such requirements, by definition, always favour the use of domestic products over imported products, and therefore affect trade. An examination whether these measures are covered by Item (1) of the Illustrative list of TRIMs Annexed to the TRIMs Agreement, which refers among other situations to measures with local content requirements, will not only indicate whether they are trade related but also whether they are inconsistent with Article III: 4 and thus in violation of Article 2.I of the TRIMs Agreement.[43]

B. Exceptions[44]

All exceptions under GATT 1994 are applicable, as appropriate, to the provisions of TRIMs Agreement.

TRIMs Agreement is a full fledged agreement in the WTO system. The TRIMs Agreement and Article III: 4 of GATT 1994 prohibit local content requirements that are TRIMs and therefore cover the same subject. But when the TRIMs Agreement refers to 'the provisions of Article III, it refers to the substantive aspects of Article III', i.e., ten paragraphs of Article III are referred to in Article 2.I of the TRIMs and not the application of Article III in the WTO context as such. Thus, if Article III is not applicable for any reason not related to the disciplines of Article III itself, the provisions of Article III remain applicable for the purposes of TRIMs Agreement. This view is reinforced by the fact that Article 3 of the TRIMs Agreement contains a distinct and explicit reference to the general exceptions to GATT. If the purpose of the TRIMs agreement were to refer to Article III as applied in the light of other (non-Article III) GATT rules, there would have been no need to refer to general exceptions.[45]

[41] Indonesia—Certain Measures Affecting the Automobile Industry, Panel Report, 23 July 1998, DSR 1998: VI, para. 14.73.
[42] *Ibid.*
[43] *Ibid.*
[44] Article 3.
[45] *Supra* note 41, para. 14.60-14.61.

Moreover, it has to be recognised that the TRIMs Agreement, in addition to interpreting and clarifying the provisions of Article III where trade-related investment measures are concerned, has introduced special transitional provisions including notification requirements. This reinforces the conclusion that the TRIMs Agreement has an autonomous legal existence, independent from that of Article III. Consequently, since the TRIMs Agreement and Article III remain two legally distinct and independent sets of provisions of the WTO Agreement, we find that even if either of the two sets of provisions were not applicable the other one would remain applicable.46

The Panel on Indonesia-Autos[47] found that the tax and tariff benefits contingent on meeting local requirements under the Indonesian car programmes constituted 'advantages' within the meaning of the Chapeau of paragraph 1 of the illustrative list of TRIMs and as a result were inconsistent with Article 2.I of the TRIMs Agreement.[48]

C. Developing Country Members[49]

Article 4 of the TRIMs conceives of concessions to less developing countries to deviate temporarily from the obligations as set out in Article 2 of the Agreement to the extent and in such manner as provided in Article XVIII of GATT 1994, the Understanding on the Balance-of-Payments provisions of GATT 1994 and the Declaration on Trade Measures Taken for Balance-of-Payments Purposes adopted on 28 November, 1979 permit the member to deviate from the provisions of Article III and XI of GATT 1994.

D. Notifications and Transitional Arrangements[51]

The TRIMs Agreement requires the mandatory notification of all non-conformity TRIMs covered by the Illustrative list[52] and maintained at the national or sub-national levels and calls for their elimination over transition periods which vary according to member's levels of economic development i.e., two years in the case of developed countries from entry into force of the WTO; five years for the developing countries, and seven years for the LDCs.

The Council for Trade in Goods has been authorised to extend the transition period for elimination of TRIMs for a developing or a LDCs member which demonstrates particular difficulties in implementing the provisions of TRIMs Agreement that may include developmental, financial and trade needs also.

It is also obligatory on members not to modify the terms of any TRIMs which the member has notified to the Council on Trade in Goods as such a modification would increase the degree of inconsistency with the provisions of Article 2 of the

46 *Ibid.* 14.62-14.63.
47 *Ibid.*
48 *Ibid*, para. 14.91-14.92.
49 Article 4.
50 BISD 265/205-209.
51 Article 5.
52 Annex I of the Agreement.

TRIMs Agreement. The members are allowed to apply during the transition period the same TRIMs to a new investment in cases (i) where the products of such investments are like products to those of the established enterprises; and (ii) where necessary to avoid distorting the conditions of competition between the new investment and the established enterprise. Any TRIMs so applied to a new investment shall have to be notified to the Council for Trade in Goods.

E. Transparency[53]

The TRIMs Agreement obligates the members to comply with their commitments on transparency and notification in Article X of GATT 1994, in the undertaking on 'Notification' contained in the 'Understanding Regarding Notification, Consultation, Dispute Settlement and Surveillance of 28 November, 1979 and in the Ministerial Decision on Notification Procedure as adopted on 15 April, 1994. Each member is further obligated to notify the Secretariat of the WTO, of publications in which TRIMs may be found including those applied by regional and local governments and authorities within their territories.

It is further incumbent on the members to accord sympathetic consideration to request for information, and afford adequate opportunity for consultation, on any matter arising from TRIMs Agreement raised by another member. No member is required to disclose information in conformity with Article X of the GATT 1994 if such disclosure would impede law enforcement or otherwise be contrary to the public interest or would prejudice the legitimate commercial interests of particular enterprises, public or private.[54]

The TRIMs Agreement established a Committee on Trade-Related Investment Measures whose membership is open to all members. The Committee elects its own chairman and vice-chairman and meets once a year and otherwise at the request of any member. The Committee has to carry out the responsibilities assigned to it by the Council for Trade in Goods. The Committee affords members an opportunity to consult on any matters arising or relating to the operation and implementation of TRIMs Agreement. The Committee further monitors the implementation of TRIMs and reports to the Council of Trade in Goods annually.

9. CONSULTATION AND DISPUTE SETTLEMENT[55]

The consultations and disputes arising out of TRIMs Agreement are to be decided in accordance with the provisions of Article XXII and XXIII of GATT, 1994 as elaborated and applied by the Dispute Settlement Understanding of the WTO.

The Panel in EC—Bananas III dispute, examined the import licensing procedures of the European Communities under GATT Licensing Agreement and the TRIMs

53 Article 6.
54 Article 7.
55 Article 8.

Agreement. The Panel found that the allocation of import licences to a particular category of operators was inconsistent with Article III: 4 of GATT 1994.[56]

In Indonesia—Autos case, the European Communities and the United States claimed that the Indonesian 1993 car programme, by providing tax benefits for finished cars incorporating a certain percentage value of domestic parts and components, and for customs duty benefits for imported parts and components used in cars incorporating a certain percentage of value of domestic products, violated the provisions of Article 2 of the TRIMs Agreement and Article III: 4 of GATT 1994. The Panel on Indonesia—Autos found that the tax and tariff benefits contingent on meeting local requirements under the Indonesian car programme constituted 'advantages' within the meaning of Chapeau of paragraph 1 of the illustrative list of TRIMs and as a result were inconsistent with Article 2.1 of the TRIMs Agreement.[57]

In Canada—Autos case, the complainant raised claims pertaining to conditions concerning the levels of Canadian value added and the maintenance of certain ratio between the net sales value of vehicles produced in Canada and net sales value of vehicles sold for consumption in Canada. These claims were based upon both Article III: 4 of the GATT 1994 and the TRIMs Agreement. The Panel found that certain requirements concerning domestic value added were inconsistent with Article III: 4 of GATT 1994.[58]

In the India—Measures Affecting Automotive Sector, Complaint by the European Communities and the United States,[59] it was contended that India applied certain measures by way of local content and export balancing requirements were violative of Articles III, XI of GATT and Article 2 of the TRIMs Agreement. The Panel held that India's Auto Policy, 1997 was inconsistent with its obligations under TRIMs. Consequently, India has eliminated all such inconsistencies in its new Auto-policy.

10. REVIEW BY THE COUNCIL FOR TRADE IN GOODS[60]

Article 9 provides for review of the TRIMs Agreement by the Council of Trade in Goods five years after the WTO was established, i.e., in January 1995 and propose to the Ministerial Council, the necessary amendments and also in course of the review, the Council for Trade in Goods was to consider whether the Agreement should be complemented with provisions on investment policy and competition policy. The

[56] European Communities—Regime for the Importation, Sale and Distribution of Bananas, Panel Report, WT/DS 27/R ECU and Corr. I, Adopted 6 May, 1999, DSR 1999: 11.
[57] Indonesia—Certain Measures Affecting the Automobile Industry, Panel Report,adopted 23 July, 1998, DSR 1999: VI; Indonesia Certain Measures Affecting the Automobile Industry-Arbitration under Article 21.2(c) of the DSU, 7 December, 1998, DSR 1998: IX.
[58] Canada—Certain Measures Affecting the Automobile Industry Panel Report, WT/DS/39/R, WT/DS/42/R, Adopted 19 June, 2000 as modified by the Appellate Body Report WT/DS/139/ARB/R,WT/DS/42/AB/R.
[59] WT/DS/46/R, (2000) and WT/DS175/R (2000); For India's Policy in this respect, See WT/TPR/ 100 (2002).
[60] Article 9.

Council for Trade in Goods, accordingly launched a review of the operation of the TRIMs Agreement.[61] However, the review awaits an outcome till date.

11. INADEQUACIES OF THE TRIMS AGREEMENT

The TRIMs Agreement suffers from a number of limitations, chief among which are:

(i) that the Agreement makes a arbitrary decision of measures affecting trade in goods and services;

(ii) that the list of prohibited measures is very limited as compared, for example, to the more comprehensive ban on performance requirements found in the investment chapter (Article 11) of the NAFTA;

(iii) that it essentially codifies existing GATT jurisprudence, e.g., the 1984 panel on the administration of Canada's Foreign Investment Review Act. (FIRA); and

(iv) that it grants members the right to temporarily deviate—in effect enjoy a waiver from GATT obligations to which they are already bound.

Despite the above limitations, the TRIMs Agreement has made a number of useful contributions such as:

(a) specific investment-related disciplines in multilateral trading system;

(b) transparency that is to result from the obligation to notify the existing non-conforming TRIMs, an obligation that would automatically extend to all TRIMs added in future to the illustrative list;

(c) the legal certainty provided by the obligations to eliminate notified TRIMs at the end of agreed transition period; and

(d) the acknowledgement that heightened policy interrelations in the field of trade, investment and competition will likely warrant more encompassing future work on investment and competition policy within the multilateral trading system.

12. ILLUSTRATIVE LIST[62]

TRIMs that are inconsistent with the obligations of national treatment provided for in Article III of GATT 1994 include those which are mandatory or enforceable under domestic law or under administrative rulings, with which it is necessary to obtain an advantage, and which require;

(a) the purchase or use by an enterprise of products of domestic origin or from any domestic source, whether specified in terms of particular products, in terms of volume or value of products, or in terms of proportion of volume, or value of its local production; or

[61] G/C/M/41, Section 7.
[62] Annex. 1 of TRIMs.

(b) that an enterprise's purchase or use of imported products be limited to an amount related to the volume or value of local products that it exports.

TRIMs that are inconsistent with the obligation of general elimination of quantitative restrictions provided for in paragraph 1 of Article XI of GATT 1994 include those which are mandatory or enforceable under domestic law or under administrative rulings with which it is necessary to obtain an advantage, and which restrict:

(a) the importation by an enterprise of products used in or related to its local production generally or to an amount related to the volume or value of local production that it exports;

(b) the importation by an enterprise of products used in or related to its local production by restricting its access to foreign exchange to an amount related to the foreign exchange inflows attributable to the enterprise; or

(c) the exportation or sale for export by an enterprise of products, whether specified in terms of particular products, in terms of volume, or value of products, or in terms of a proportion of volume or value of its local production.

13. CONCLUSION

Although in the last four decades, national and international legal policies and rules concerning trade and investment have repeatedly changed, the investment and its varieties have also undergone substantial transformation in its magnitude and content. In the national laws and policies, the trends towards liberalisation and increased protection to investment have gathered strength and the controls and restrictions have been relaxed in many countries. Non-discriminatory treatment after admission of investment either by way of FDI or portfolio is becoming the rule rather than an exception. Guarantees of non-expropriation and the free transfer of funds are increasingly growing. Therefore, the WTO TRIMs Agreement is welcome. However, the short falls of the Agreement, as pointed above need to be rectified.

Chapter 33

WTO and Competition Policy

1. INTRODUCTION

As the tariffs have lost much of their importance, customs barriers worldwide are lessening, and increasing attention is being paid to the effects of anti-competitive markets and uneven application of competition laws on international trade. Litigations as reflected in recent high profile cases such as Kodak,[1] and U.S. Pipe and Tube industry[2] under Section 301 of the U.S. Trade Act of 1974,[3] demonstrate that there is a tremendous recognition within national governments and international organisations that application of competition law across the borders promotes international trade.[4]

The international community in WTO has identified competition policy as one of the new generation of trade issues to be addressed. Paragraph 20 of the Singapore Ministerial Declaration established a Working Group on Trade and Competition Policy. The Working Group has based its work on written contributions by members and on oral statements, questions and answers by members in the Group. The Singapore Declaration encouraged the Working Group to undertake its work in co-operation with UNCTAD and other appropriate inter-governmental fora, including IMF and IBRD to work out the theoretical dimensions of the competition policy in international trade.

A substantial issue of competition policy veers around the application of WTO principles of national treatment,[5] most favoured nations principle[6] and transparency and their significance in any competition policy. In the context of globalisation, the importance of the above principles can hardly be doubted as these principles are the core principles to be focused in any competition policy. The competition policy and law of member governments have to be transparent and fairly and uniformly applied,

[1] See, Eastern Kodak Files 301 Petition Seeking Access for U.S. Film in Japan, 12' Int'l Trade Rep. (BNA) 881-92 (May 24, 1995).
[2] See, Section 301 Petition Alleged Unfair Korean Steel Practices, 12 Int'l Trade Rep (BNA) 967, 978 (June 7, 1995).
[3] 19USC S. 2411 (1988).
[4] See, e.g., U.S. Trade Representative, 1995 National Trade Estimate Report on Foreign Trade Barriers 2 (1995).
[5] Article III, GATT 1994.
[6] Article I, GATT 1994.

and the WTO principles of transparency, fair trade and most-favoured nations cannot be overlooked for long by the member nations in their competition policies and laws.

Further, there is an intrinsic relationship in the GATT/WTO jurisprudence, that the competitive opportunities of members must be allowed in all fields of economic endeavour, be it goods, services and economic enterprises. The competition policy and laws of the members of WTO have to avoid distortions in the competitive process so that the international trade is not distorted for seeking undue market access. The competition policy may also provide a mechanism of addressing certain kinds of discriminatory policies and arrangements perpetuated by member governments to deny equal access and competitive opportunities to foreign competitors. The importance of fair trade and equal opportunity can best be achieved if the competition policy and law is universally modelled so that the nationality of an enterprise is subservient to international rules of competition.

As the WTO is based on transparency in the trade practices of member governments, the transparency in the competition policy is highly desirable both from the trade interests of public and private enterprises so that the competition policy and law are known in advance, uniform, impartial, reasonably administered and provide legal redressal. Generally, a number of instances are cited as anti-competitive practices which have restrictive or discriminatory effects which, *inter alia*, include collective boycotts of foreign goods, exclusionary actions by professional bodies or associations, abuses of dominant positions of enterprises intended to prevent the entry of new competitors, price fixing mechanisms, export import cartels and market sharing arrangements.

2. ARTICLES VIII & IX OF GATS[7]

Articles VIII and IX of the General Agreement on Trade in Services 1994 (GATS) do reflect the concern of WTO members of competition policy and law, although concerning the trade in services only, yet may be true in the case of trade in goods also as the trade in goods is intertwined with trade in services. Article VIII of the GATS provides how monopolies and service suppliers have to conform to the members obligations under Article II (Most-Favoured Nations Treatment)[8] and specific commitments.[9] Every Member, therefore, has to accord *unconditional and immediate* treatment to the services and service suppliers of all members on a *most favoured nations* basis subject to exemptions in financial services, maritime transport services and basic telecommunications.[10]

Further, the monopoly power of the enterprise acting directly or through affiliates for supplying of services should not be abused in a manner which is inconsistent with the specific commitments of a member. The GATS provides a mechanism of Council

[7] Annex. IB of Agreement Establishing World Trade Organisation.
[8] Article II of GATS.
[9] Articles XIX and XX of GATS.
[10] Annex. to Article II, Exemption, Article XXIX of GATS.

for Trade in Services[11] who can oversee if a monopoly is abusing its power, and can ask the member to whom the monopoly belongs to supply information of such abuse. Any monopoly rights granted by a member to a service provider shall have to notify to the Council of Trade in Services after the GATS comes into force. There is an inbuilt mechanism in Article VIII of overseeing the abuse of monopoly of service providers in cases where a member may authorise to establish a small number of service suppliers and substantially prevent competition among those suppliers in its territory. The essence of the Article VIII is that monopolies and exclusive service suppliers whether existing or likely to be established should not be allowed to distort trade and should act fairly and on a most favoured nation's basis.

Article IX[12] on the other hand, recognises that certain business practices of member nations of WTO in the service sector have likely impact of restraining competition and restraining trade in service sectors. It, therefore, recognises that members should enter into consultations in the eventuality of an allegation of unfair business practices and eliminating the same. The Article imposes responsibility on members to give a sympathetic consideration and supply relevant non-confidential information of the alleged practice and other information to find a satisfactory resolution of the unfair practice.

Article XVI of GATS[13] goes further and provides that for market access, besides providing most-favoured nations treatment, the member is forbidden both in entire territory or on regional basis, limitation on the number of service suppliers whether in the form of numerical quotas, monopolies, exclusive service suppliers or the requirements of an economic needs test; or on the total quantity of service output expressed in terms of designated numerical units in the form of quotas or the requirement of an economic needs test; limitation on the total number of natural persons that may be employed in a particular service sector, or that a service sector may employ and who are necessary for, and directly related to, the supply of a specific service in the form of numerical quotas, or the requirement of an economic needs test; measures which restrict or require specific types of legal entity or joint venture through which a service supplier may supply a service; and limitations on the participation of foreign capital in terms of maximum percentage limit on foreign share-holding or the total value of individual or aggregate foreign investment.

The above list of limitations illustrates as to how market access in the service sector can be allowed to function which have trade maximising effects.

3. THE ELEMENTS OF COMPETITION LAW

A. Harmonisation – A Regional Economic Experience

Taking a clue from, harmonisation of competition policies in regional economic groupings such as European Union (EU), the Australian New Zealand Closer Economic

[11] Article XXIV of GATS 1994.
[12] Article IX of GATS 1994.
[13] Article XVI of GATS 1994.

Relations Agreement (ANZCERTA), and the North American Free Trade Agreement (NAFTA), which have directly or indirectly dealt with the issue of harmonising competition laws and practices among their members, harmonisation of competition laws and policies should occur at three different levels;

(a) Harmonising Substantive Law,

(b) Harmonising Procedural Requirements such as notification of Mergers and Acquisitions, and

(c) Harmonising Enforcement Practices.

(a) Harmonising Substantive Law

In most regional economic arrangements, involving industrialised countries, economic integration has occurred only after member nations have adopted competition laws and policies that are generally consistent *inter se* the region. After NAFTA came into existence, its members such as Mexico and Canada established a new legal regime based on economic efficiency and open market competition.[14] There are significant differences between U.S. competition law and the new Mexican legal regime, but the thrust of the new law is more or less similar to U.S. law. The new Mexican law, for instance, prohibits 'absolute' monopolistic practices such as price-fixing and agreements to restrict output, divide markets, or rig bids and treats such practices as unlawful.[15] Certain relative practices such as retail price maintenance, tying exclusive dealing contracts are unlawful if they unduly impede competition.[16] These practices are in line with U.S. and Canadian practices, the thrust of these practices is to conform to the concept of competition law at a broader level.

So far as EU competition law and policy is concerned, the EU competition policy, *inter se*, is highly evolved and any future integration of other members in EU has to comply with EU competition law. The substantive law on competition policy in the Treaty of Rome created a new competition policy that applies to all EU members.[17] The basic standards are set out in Article 85 dealing with regulations on restrictive agreements, and Article 86 dealing with restrictions on the abuse of a dominant position. Article 90 requires, subject to limited exceptions, that competition rules of the EU apply to public undertakings also and to undertakings that enjoy 'special or exclusive right'. Article 92 prohibits any aid granted by a member state or through state resources in any form whatsoever that distorts or threatens to distort competition. The competition law of EU and its application to member states existing or new entrants is complex and evolving. As a general rule, the EU law applies to all activities that have an appreciable effect on commerce within the EU.[18] Accordingly, if EU law prohibits

[14] Richard O. Cunningham & Anthony J. Rocca, 27 Law and Policy in International Business, 879-901 (1996).
[15] Allam Van Fleet, Mexico's Federal Economic Competition Laws: The Dawn of a New Anti-Trust Era, 64 Anti trust LJ, 183, 192-193 (1995).
[16] *Ibid.* at 193-194.
[17] See EEC Treaty, Arts 85-94.
[18] See generally, Hans Smit & Peter E. Herzog. The Law of European Community (1995).

a practice that appreciably affects commerce among EU members, but national law in the state where that conduct occurs permits the conduct, EU law would generally be applied by the national court. On the other hand, if EU law permitted a practice, but national law prohibited it, the more restrictive national law could apply, although the national court might decide to rely on EU standards to arrive at a just decision.[19]

To promote the uniform application of EU Competition Law, a supranational Court was established under the Treaty of Rome.[20] Article 177 obligates national courts to request an advisory opinion from the European Court of Justice (ECJ) on an application of EU competition law provisions arising under either the Treaty (e.g., Arts. 85 and 86), directives by the Council of Ministers, or decisions by the European Commission. The ECJ also has jurisdiction over cases brought against the Commission and the Council of Ministers for failure to carry out their responsibilities under EU law, as well as appellate jurisdiction over cases decided in the Court of First Instance, including cases involving competition claims.

The European Free Trade Association (EFTA) created in 1960 as an alternative to European Economic Community by members of Austria, Denmark, Norway, Portugal, Sweden, Switzerland, (Finland, Liechtenstein and Iceland joined EFTA subsequently), created a general competition policy similar to that created by the U.S. Sherman Act, under the EFTA Convention.[21] The EFTA Convention in Article 15 obligates the members not to enter into agreements which have, as their object or result, the prevention, restriction, or distortion of competition within the Areas of Association and not to allow unfair advantage of a dominant position within the Area of Association. These types of anti-competitive conduct were declared to be incompatible with the EFTA Convention to the extent that they frustrated the benefits expected under the Convention.

Unlike the Treaty of Rome, however, the EFTA Convention did not prohibit the practices covered by Article 15, nor are Article 15 standards automatically incorporated into the national law of member states. Accordingly, private firms could not seek recovery for violations of Article 15, nor could enforcement agencies prosecute persons within their territory for specific violations of Article 15. The EFTA Convention thus created a framework for competition law and policy within which individual members maintained more discretion than in the EU.

The North American Free Trade Agreement (NAFTA), as already said, provides for harmonisation of competition policy and even Canada has revised its competition law in 1986 increasing its emphasis on civil enforcement prior to its joining Canada—US Free Trade Agreement.[22] The basic provision in Article 1501 of NAFTA provides that 'parties shall adopt or maintain measures to prescribe anti-competitive business conduct and take appropriate actions with respect thereto'. Additionally, Article 1502

[19] Rupert M. Bondy, United Kingdom in World Antitrust Law and Practice, 25 (James J. Garrett ed. 1995).
[20] EEC Treaty, Art. 177.
[21] For Sherman Act, see 15 U.S.C Ss. 1-7 (1994).
[22] See generally, Glen G. MacArthur & Joan E. Neal, in James J. Garrett Ed, (1995).

permits a NAFTA party to designate monopolies but also impose limitations on the ability of those monopolies to engage in discriminatory or predatory conduct.

In the other EU Agreements more specifically with Bulgaria, the Czech Republic, Hungary, Poland, Romania and the Slovak Republic (so called Europe Agreements entered between EU and the above Eastern European countries during 1991-93), creates a substantive competition standard applicable to trade between the Eastern European countries and the EU on the same legal analogy as that of EEC Treaty in Articles 85 to 95, i.e., prohibition on concerned practices, abuse of dominant position, applying basic competition law standards to public entities and prohibition of public aid that distorts competition. The Agreements establish separate Association Councils that are responsible for developing plans for implementing the new competition law standards. Implementation of the basic standards is scheduled to occur within three years from the date of entry into force of the agreements.[23]

From the standpoint of harmonisation of substantive competition law as provided in the regional economic groupings as discussed above, it can be inferred that the competition policies in these grouping is not uniform and there is a need to constitute a common and uniform regime which would prevent nations in these groupings to subvert competition laws in more than one way to favour domestic industries. There are possibilities of exclusionary conduct by monopolies or the pervasive use of vertical restraints by firms with market power to exclude unwanted competition from firms in other nations. The nations whose competition law is based on permissive or discretionary standards in these areas, its domestic industries might be able to erect trade barriers that defeat the purpose underlying the regional economic integration.

(b) Harmonising Procedural Requirements

Harmonisation of procedural requirements for the purposes of competition policy in the context of regional trade arrangements is sought in the area of state approval of mergers and acquisitions. As the structural reorganisation of regional markets is a major objective, regional arrangements usually result in cross-border investments[24] and where state approval or review procedures differ among the member states, uncertainties, costs and delays may discourage the cross-border transactions. Therefore, the harmonisation of merger controls and acquisitions may be done either by creating parallel procedures or by establishing direct enforcement cooperation or by creating single merger control entity.

The procedural harmonisation may also take place in the areas of service of process, discovery, or reciprocal enforcement of court judgments. This harmonisation is useful for private enforcement through litigation as well as for governmental agencies who are vested with power to brook the competition law violations that are directed towards the state.

[23] Europe Agreement Establishing an Association Between the European Communities and Their Member States and the Republic of Poland, Dec. 16, 1991, 1993 O.J. 2 (L348).
[24] See generally, Bela Balassa, The Theory of Economic Integration, 96-98 (1961).

The harmonisation of procedural matters in EU goes to the extent that European Commission has to be notified of certain mergers, acquisitions and joint ventures meeting the definition of 'concentration' that have a community dimension.[25] National competition law generally does not apply to these transactions.

NAFTA makes no attempt to harmonize procedural rules such as those pertaining to mergers or acquisitions. The European Agreements which were signed between EU and Bulgaria, the Czech Republic, Hungary, Poland, Rumania and the Slovak Republic from 1991 to 1993, do not contain any provisions for coordinating procedures governing merger notifications and review. Nor do the agreements contain specific provisions governing the type or degree of cooperation between competition law authorities or other enforcement provisions.

(c) Harmonising Enforcement Practices

The enforcement of existing competition law by the agencies of the governments in a regional co-operation setting is very important as the co-ordination in enforcement may result in more tangible results than efforts to fine tune the substantive law. The harmonisation of enforcement practices at the bottom requires sacrificing some element of sovereignty, and it is only EU which provides extreme example of enforcement co-ordination and to an extent a sacrifice of sovereignty, in the creation of a supernational enforcement authority. It is the European Commission of the EC which is responsible for enforcing the European competition law throughout the EU.

Director General for competition, the branch of the commission in charge of the competition law enforcement, has the authority to conduct investigations anywhere in the EU.[26] A private party with a legitimate interest in a particular matter may apply to the commission to initiate an investigation. In addition, national competition authorities may enforce EU competition law, so long as the commission has not already initiated investigations with respect to the same matter.

NAFTA so far as enforcement co-ordination is concerned provides that the parties will 'cooperate on issues of competition law enforcement policy, including mutual assistance, notification, consultation, and exchange of information relating to the enforcement of competition laws and policies in the free trade area'. Also parties shall consult from time to time about the effectiveness of measures undertaken by each party.[27] In addition, NAFTA created a dispute resolution procedure that contemplates consultations, review by the Free Trade Commission (consisting of cabinet level-representatives) and referrence to arbitral panel. Disputes arising under the general competition provisions in Article 1501 (i.e., the parties' general agreement to prescribe anti-competitive conduct) are specifically excluded from these dispute resolution procedures.

[25] Council Regulation (EEC) 4064/89 of 21 December 1989.
[26] Council Regulation 17/62 Implementing Articles 85 and 86 of the EEC Treaty.
[27] Article 150 NAFTA, Dec. 17, 1992 US-Canada-Mexico, 32, ILM. 663.

4. WTO AND INTERNATIONAL LAW OF COMPETITION POLICY

It is necessary to conceive and develop a uniform law of competition and policy at the international level in which the anti-monopolistic practices may have to be defined in a rigorous manner and member nations must not be allowed to experiment or apply different competition law systems. Secondly, state sanctioned export cartels, which most industrialised countries authorise in the form of export association providing some degree of limited anti-trust exemptions for exports, should be subjected to the scrutiny of international rules and if possible prohibited. The other areas which need to be legislated internationally are the predatory or discriminatory pricing system which creates trade barriers and state subsidies and the conduct of state monopolies. Bid rigging conspiracies by domestic firms have the potential to significantly raise contract costs or reduce output. Price fixing by domestic competitors and re-sale price maintenance could have trade distorting effects. Group boycotts may constitute a significant trade barrier to firms from other members.

The outbound effects of restraints include price-fixing, price predation by a monopolist in one country directed at firms in another country, or price discrimination between internal and export markets. These outbound restraints are most obvious sources of trade distortions and need to be harmonised, although the 'effects test' as developed by the U.S. and EU courts have to a great extent curbed the effects of these trade distortion methods.[28]

Predatory pricing and price discrimination raise special issues. To the extent that these practices affect only domestic trade, they are generally subject to regulation under domestic competition laws. In many cases, however, domestic laws may not apply to these practices to the extent that they occur outside the country where the effects are felt. For example, the U.S. Robinson Patman Act, which prohibits price discrimination, applies only where the 'commodities are sold for use, consumption, or resale within the United States'.[29]

Many commentators have urged that anti-dumping laws should be replaced by harmonised standards relating to price predation and the basic argument is that dumping often is the result of market power created by entry barriers that protect domestic industries from external competition. Monopoly profits accumulated by these industries allow them to 'dump' products in other markets to establish market power in those other markets. If entry barriers in international trade are reduced that make dumping possible, dumping is less likely to occur. Furthermore, if international competition law among member states is enforced, any abuses of market power that do occur through predatory or discriminatory pricing can be challenged under the general international competition law of WTO.

So far as exclusionary practices that create market barriers are concerned, most competition laws recognise the basic principle that exclusionary conduct by firms that have market power should be prohibited. In the NAFTA countries, for example, Canadian law permits Canadian authorities to prohibit exclusive dealing arrangements

[28] Hartford Fire Insurance Co. V. California, 113 Sct. 2891, 2909 (1993).
[29] 15 U.S.C S.13 (a) (1988 & Supp.1993).

that impede entry of competitors into the market.[30] Similarly U.S. law prohibits exclusive dealing by firms with market power if the effect of those arrangements is to significantly restrain competition; and the Mexican law treats exclusive marketing dealings arrangements as 'relative monopolistic practices that can be prohibited if used by firms with substantial market power'.[31]

State subsidies and other forms of state assistance to domestic industries are an obvious source of market distortions. Subsidies can have outbound effects (e.g., by allowing exporters to suppress prices in export markets) and inbound effects (e.g., by depressing domestic prices to a level that effectively bars entry by foreign producers). In addition, state mandated price controls or export restraints may artificially depress domestic prices and thereby create market barriers. Other forms of government regulation, such as in the area of standard setting, may promote or authorise anti-competitive conduct or exclude competitors from other countries. Government procurement practices may favour domestic entities. State monopolies and state owned entities also require special attention because of their potential to distort competition.

Internationalisation of competition laws and policy goes back to 1992 when Sir Leon Brittan, European Commissioner in charge of External Relations for the European Union, gave a call for such a measure at Davos World Economic Forum. European Commission accordingly appointed a Group of Experts who submitted a report in 1995 and suggested that international initiative should be built upon a foundation of agency to agency co-operation, including bilateral agreements with positive comity; that rules should require transparency and non-discrimination; and that at a latter stage, states should agree to proceed to adopt common minimum rules for transactions and conduct of international dimensions, with a system of dispute resolution.

The above initiatives were carried to the WTO in 1996 at the Singapore Ministerial Meeting; that an initiative on trade and competition should be launched as a result WTO Working Group was established to study the interaction between trade and competition policy in order to gain a better understanding on the issues surrounding restrictive business practices and international trade. The Working Group focused on two topics: (1) ways to promote co-operation and communication among WTO members on competition policy, and (2) the contribution of competition policy in achieving WTO objectives, including the promotion of international trade.[32]

In anticipation of the WTO Ministerial Conference at Doha in November 2001, the European Union, Canada, Japan and others proposed that competition issues be included on the agenda of the next round of trade negotiations. The Doha Ministerial Declaration provides that the member states will undertake negotiations on competition policy after the Fifth Session of the Ministerial Conference (held in 2005), subject to explicit consensus on the modalities of negotiations. In the 'interim, the Working Group was to focus on clarifications of 'Core Principles', including transparency,

[30] See, ABA Report on the Competition Dimensions of NAFTA (July 20, 1994)
[31] *Ibid.* 534.
[32] See, Report (1998) of the WTO Working Group on the Interaction Between Trade and Competition Policy to the General Council, WTO Doc. WT/WGTCP/2 (Dec. 8, 1998).

non-discrimination and procedural fairness, and provisions on hard-core cartels; modalities for voluntary co-operation; and support for progressive reinforcement of competition institutions in developing countries through capacity building.[33]

There is a growing literature on internationalisation of anti-trust, spanning from the days of International Trade Organisation of Havana Charter, 1947 down to the establishing of a WTO Working Group on competition policy in 1998.

Chapter V of the Havana Charter specifically dealt with 'Restrictive Business Practices' and addressed competition policy directly by stating: 'Each Member shall take appropriate measures and shall cooperate with the Organisation to prevent, on the part of private or public commercial enterprises, business practices affecting international trade which restrain competition, limit access to markets, or foster monopolistic control, whenever such practices have harmful effects on the expansion of production or trade and interfere with the achievements of any of the other objectives set forth in Article I.[34]

This clearly demonstrates that competitive effects of certain business practices that existed in 1940's relative to today are reflective of the co-relationship between restraints of domestic markets to international trade restrictions. In addition, Article 46 of ITO, in paragraph 3,[35] prohibited the following practices:

(a) fixing prices, terms and conditions to be observed in dealing with others in the purchase, sale or lease of any product;

(b) excluding enterprises from, or allocating or dividing, any territorial market or field of business activity, or allowing customers, or fixing sales quotas or purchase quota;

(c) discriminating against particular enterprises;

(d) limiting production or fixing production quotas;

(e) preventing by agreement the developing or application of technology or intervention whether patented or unpatented;

(f) extending the use of rights under patents, trademarks or copyrights granted by any member to matters which, according to its laws and regulations, are not within the scope of such rights, or to products or conditions of production, use or sale which are otherwise not the subjects of such grants; and

(g) any similar practices which the Organisation may declare, by majority of two-thirds of the members present and voting, to be restrictive business practices.[36]

From the year 1947 when the ITO failed to come into existence and a stop-gap arrangement GATT 1947 replaced the failed ITO, there have been consistent efforts at the GATT in its earlier eight rounds to draw attention to the competition policy and

[33] WTO Ministerial Declaration 14 Nov. 2001, para. 23-5, WT/MIN (01/DEC/1 (20 Nov. 2001).
[34] Havana Charter, Chapter V, Article 46.
[35] *Ibid.*
[36] Clair Wilcox, A Charter for World Trade (1949).

unfair business practices. However, no substantial progress was ever allowed to be made for addressing the issues arising out of the competition across the nations. Recently, there is a growing literature dealing substantially with as to how internationalisation of antitrust has a bearing on globalisation, market integration, the limits of national law, and the challenges posed by supra-national agreement.[37] It is being said that competition policy poses problems of how to reconcile trilemma—economic integration, management, and national sovereignty, which is a challenge to the WTO for working out an international law of competition and policy.

Any future effort at the WTO level should provide provisions which require members to keep markets free of commercial restraints that unreasonably block their markets. One way of keeping the markets of member nations of WTO free is that nations should adopt and enforce national competition laws. It is also necessary that for avoiding problems of indeterminate legal standards, the law of the country in which the exclusionary restraint operates could be designated as the applicable law, as long as it is a credible law that prohibits unreasonable blocking restraints.

WTO should develop international standards and rules wherein the trans-border cartels are prohibited and provide mechanism for discovery and enforcement against the nationals of the states that have been injured by the cartels. WTO should also prohibit governmental measures which often facilitate cartels and market access restraints either by providing subsidies or otherwise.

There are other areas which need to be addressed by the WTO such as; pre-merger notification systems to be rationalised by creating obligations of mutual recognition or use of a common clearing house, systems clashes would be alleviated by an agreed framework for modulating disputes, i.e., choice of law, states could be required to count costs outside as well as within their borders in assessing alleged anti-competitive conduct, at least in the case of clashes of jurisdiction; in general, states could be encouraged to analyse competitive problems in view of the total market impact, not merely their national interest; GATT principles of non-discrimination, as established in the service sector, against non-nationals and transparency could usefully apply to competition rules and their enforcement; and finally bilateral co-operation with suitable amendments could be multilateralised.

There is every possibility given the wherewithal of the WTO that competition law can be globalised so that national blinders are removed.[38]

[37] See D. Tarullo, 'Norms and Institution in Global Competition Policy' 94 Am. J. Int'l. 478 (2000) and E. Fox, 'Towards Antitrust and Market Access', 91 Am. J. Int'l (1997).
[38] Andreas E. Lowenfeld, International Economic Law, 340-383 (Oxford University Press, 2002).

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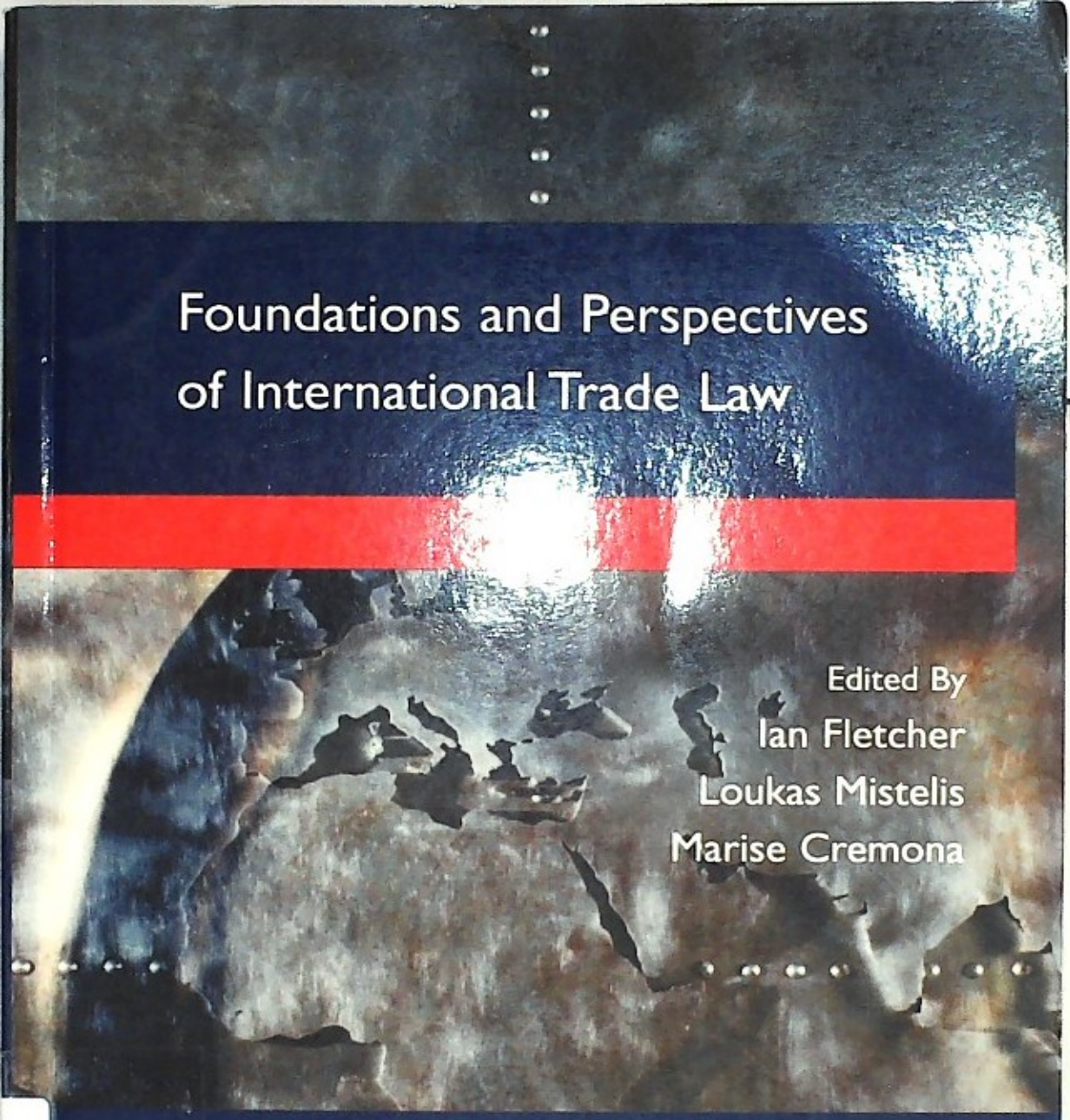

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THE RISE AND FALL OF THE MULTILATERAL AGREEMENT ON INVESTMENT: LESSONS FOR THE REGULATION OF INTERNATIONAL BUSINESS

PETER T. MUCHLINSKI[1]

10–001 Clive Schmitthoff was a scholar of immense range within the field of commercial law. Among his many achievements he is recognised, perhaps above all, as a pioneer in the study of international trade law. However, he also numbers among the earliest legal writers on questions relating to the regulation of multinational enterprises (MNEs).[2] Indeed, he was among the first to see the law relating to international trade and foreign investment law as two parts of a single continuum.[3] It is, therefore, fitting that a symposium on law

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[2] See, for example, *Schmitthoff's Export Trade* (London, Stevens, 9th ed., 1990, 10th ed., 2000,) part Two; "Multinationals in Court" [1972] JBL 103; "The Multinational Enterprise in the United Kingdom" in H.R. Hahlo, J. Graham South and Richard W. Wright (Eds) *Nationalism and the Multinational Enterprise* (Leiden, Sijthoff, 1977) chap. 4; "The Wholly Owned and Controlled Subsidiary" [1978] JBL 218.

[3] Foreign direct investment by MNEs can be seen as an alternative to export sales by such firms in the supply of an overseas market. Equally about one third of all international sales transactions are now carried out between affiliates of the same multinational group. See generally J.H.Dunning *Multinational Enterprises and the Global Economy* (London, Addison-Wesley, 1993) Chapters 2, 3 and 14; UNCTAD *World Investment Report 1996* Part Two.

and trade named for Professor Schmitthoff should also contain within it a dimension concerned with the regulation of MNEs. Accordingly, it is the aim of the present paper to offer a contribution that addresses some of the main contemporary issues in this area. These have become particularly prominent in recent times at the multilateral level, with the rise and fall of the draft Multilateral Agreement on Investment (MAI), negotiated unsuccessfully under the auspices of the OECD, and with the opposition to the adoption of multilateral investment rules on the part of the developing countries and civil society groups at the WTO Seattle Ministerial in November 1999.[4] Despite the failure of the Seattle Ministerial, the British Government and the European Commission continue to favour the adoption of multilateral investment rules by the WTO, as part of a comprehensive round of negotiations that would not only consider trade and investment but also include competition policy, government purchasing, industrial tariffs, labour rights and the environment.[5] However, even if investment does not appear on any future negotiating agenda, the issues raised by the MAI will continue to influence developments in bilateral and regional investment negotiations. Therefore, an understanding of its shortcomings is useful in a more general context.

10–002 In the course of the conference on which this volume is based, certain central themes had emerged. These concerned, first, the harmonisation of private law through international agreements; secondly, how proper institutions for the regulation of international business could be built, so that they could act as "human" institutions that have a relevance and sensitivity to the concerns of all stakeholders in the global economy and not only to narrow commercial and corporate interests; thirdly, the rise of the WTO as a new institution and the direction in which it should be developing; and, finally, the continued significance of the conflict of principles between national sovereignty and the transfer of regulatory powers to international economic institutions. These themes emerged mainly in relation to discussions concerning the regulation/deregulation of international trade, as is reflected in other papers in this volume. However, it would be wrong to assume that they are confined to this sphere of international business regulation. The field of foreign direct investment (FDI) regulation encounters similar issues, as the present paper hopes to demonstrate. The story of the rise and fall of the MAI is one in which all of the above–mentioned themes have played a greater or lesser part. Each theme will now be considered in turn.

1. Harmonisation of private law

10–003 This theme is the one in which the divergence between trade and investment is the greatest. The majority of international trade agreements deal with the

[4] On which see John Vidal "secret world of WTO deal makers" *The Guardian* December 3, 1999 pp.1–2.

[5] See Clare Short "Lifting One Billion People out of Poverty: The Role of Trade and Investment" a speech given at UNCTAD X Bangkok, February 16, 2000 (DFID); EC Commission "EC Approach to Trade and Investment" April 2000, http://www.europa.eu.int/comm/trade/miti/invest_en.htm.

harmonisation of private contractual rules so as to put in place a genuinely transnational specialised private law by which trade transactions can be governed. This may occur through the adoption of existing customs and practices, that may already be enshrined in standard form contracts, or through the development of new norms.[6] This is not an aim shared by International Investment Agreements (IIAs). Such treaties do not seek to harmonise private law relationships. Their focus is on the harmonisation of standards of treatment for foreign investors and their investments and on the creation of an international legal obligation on the part of the contracting states to pay heed to those standards in the future development of national regulation. IIAs are concerned, therefore, more with public regulatory law than with private law.

10–004 On the other hand, there is a broader similarity between trade agreements and IIAs in that, through the creation of a more uniform and predictable legal order for the conduct of international business, both types of agreements seek to reduce transaction costs for business. In this sense both private and public law regimes may require a degree of harmonisation across national legal systems. Furthermore, it would be wrong to assume that all international trade agreements deal with private law issues alone. A public law element in the field of international trade regulation clearly arises from, for example, the GATT, the General Agreement on Trade in Services or the North American Free Trade Agreement (NAFTA). Indeed, the regulation of international trade by such agreements materially affects the conduct of FDI, given the close economic relationship between these forms of international business activity. Thus, while the specific subject matter of harmonisation agreements in international trade and in IIAs may not coincide, they do form complementary parts of an integrated system for the effective regulation of international business, a phenomenon that straddles private law and public law, contract and corporation. The MAI would have contributed to this type of harmonisation if it had been adopted. This remains a significant reason why the idea of a future multilateral agreement on investment has not been laid to rest.

2. Development of "human" international economic institutions

10–005 This theme embodies a major issue underlying the story of the MAI. The building of an institutional system for the harmonious regulation of FDI has proved to be highly problematic. The failure of the MAI is only the latest episode in a much longer process. Demands for international business protection, and also for its regulation in the public interest, are far older than might be imagined.[7] The starting point for discussion is the concept of

[6] See Roy Goode "Usage and its Reception in Transnational Commercial Law" 46 ICLQ 1 (1997); P.T. Muchlinski "Global Bukowina" Examined: Viewing the Multinational Enterprise as a Transnational Law-making Community" in Gunther Teubner (ed.) *Global Law Without a State* (Aldershot, Dartmouth Publishing Company, 1997) p.79 at pp. 86–87, John Braithwaite and Peter Drahos *Global Business Regulation* (Cambridge, Cambridge University Press, 2000) chap. 7.

[7] See further P.T. Muchlinski "A Brief History of Regulation" in Sol Picciotto and Ruth Mayne (eds.) *Regulating International Business: Beyond Liberalisation* (London, Macmillan Press/Oxfam, 1999) p. 47.

international minimum standards of treatment for aliens and their property, developed in the nineteenth century by the major Western European powers and the United States.[8] Two principles in particular stand out: first, the property of foreigners could not be taken without due process of law and without prompt, full and effective compensation; secondly, contractual relations entered into between host states and private foreign investors were to be accorded the utmost respect, requiring the preservation of the bargain even where its terms proved to be disadvantageous to the host state.

These principles were challenged by a number of political and associated **10–006** legal developments. Thus, the independence movement in Latin America in the nineteenth century gave rise to the Calvo doctrine. This influenced Latin American resistance to international minimum standards in the late nineteenth and much of the twentieth centuries, on the basis that foreign investors were entitled to treatment no better than that accorded to domestic investors. Secondly, the rise of socialism and its delegitimation of private property rights helped to undermine the accepted Western views of the sanctity of contract and property. Thirdly, the decolonisation movement in Europe after the First World War and Africa and Asia after the Second World War, led to greater demands for economic self-determination and, with it, a reinforcement of the state's sovereign right to regulate national economic policy within its borders. The result of these challenges was to generate uncertainty as to the content of customary international law in the field of foreign investment. This uncertainty was reinforced in the early 1970s by the demands for greater control over national economic policy made by the developing countries under the New International Economic Order. However, one area has remained certain, in that all states have accepted the right to control the entry and establishment of foreign investors into the territory of the receiving state unless the latter is bound by treaty to accord such rights to investors.[9]

Amid such growing uncertainty attempts have been made, since the late **10–007** 1920s to develop an agreed international code for the regulation of foreign investor/host state relations.[10] These can be divided between attempts to conclude a binding international investor protection convention, and attempts to reconcile the interests of investors for protection and the interests of states to control investors in the national interest.

In the first category, there were numerous unsuccessful initiatives under- **10–008** taken by the League of Nations between 1929 and 1930. However, the most influential initiative came from private sector interests in the United Kingdom and Germany which led, in 1959, to the conclusion of the "Abs-Shawcross" draft convention. This convention was taken up by the then Organisation for European Economic Cooperation (OEEC now OECD) for consideration. It led to the OECD Draft Convention on the Protection of

[8] See C. Lipson *Standing Guard: Protecting Foreign Capital in the Nineteenth and Twentieth Centuries* (Berkeley, University of California Press, 1985).

[9] See further UNCTAD *Admission and Establishment* UNCTAD Series on issues in international investment agreements (New York and Geneva, United Nations, 1999) pp. 7–14.

[10] For examples see Muchlinski *op.cit.* n. 7 *supra* or P.T. Muchlinski *Multinational Enterprises and the Law* (Oxford, Blackwell Publishers, 1999, Revised Paperback Edition) pp. 573–75.

Foreign Property of 1962.[11] However, this draft was never adopted, due to opposition from the less developed South European member countries. In 1967 the Council of the OECD, by a resolution adopted on October 12, 1967, commended the draft convention to Member States as a model for bilateral investment protection treaties and as a basis for ensuring the observance of the principles of international law which it contained. Such bilateral treaties—of which there are in excess of 1,300—have been highly influential in the development of investor protection standards, and may be regarded as a significant source of such standards for the MAI.[12] Alongside the abortive attempt to adopt the Convention, the OECD also initiated a policy on the progressive liberalisation of capital flows under the Codes of Liberalisation of Capital Movements and Current Invisible Operations of 1961.[13] These instruments committed the members to the progressive removal of barriers to the conduct of cross-border capital transactions as specified in the Liberalisation Lists appended to each Code. Of particular importance to the future development of the MAI was the introduction, in 1984, of a right of establishment into the Code on Capital Movements.[14] This was based on a prohibition against the maintenance or introduction of regulations or practices in relation to the granting of licences, concessions or similar authorisations, including conditions or requirements attached to such authorisations, which would affect the operations of enterprises by raising special barriers or limitations with respect to non-resident as compared to resident investors, and which had the intent or effect of preventing or significantly impeding inward direct investment by non-residents.

10–009 More recent developments that have also played a part in providing sources for MAI provisions include the NAFTA, which exemplifies the North American model of investor promotion and protection, with its distinctive feature of including pre-entry as well as post-entry protection for foreign investors, the 1994 Energy Charter Treaty (ECT), an experiment in multilateral standard setting for trade and investment in a specific industrial sector and the 1994 WTO Agreements dealing with investment related issues, namely, the General Agreement on Trade in Services (GATS), the Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPs) and the agreement on Trade Related Investment Measures (TRIMs). In addition, there have been some notable institutional developments aimed at furthering the protection of investors adopted under the auspices of the World Bank. These include the 1965 Washington Convention on the Settlement of Investment Disputes Between States and Nationals of Other States, which provided a model for the dispute settlement provisions of the MAI, and the 1985 Multilateral Investment Guarantee Agency Convention.

10–010 In the second category, the most significant historical example is the

[11] 1-2 ILM 241 (1962–63).
[12] See further UNCTAD *Bilateral Investment Treaties in the Mid-1990s* (New York and Geneva, United Nations, 1998).
[13] Code on the Liberalisation of Current Invisible Operations OECD/C(61)95; Code on the Liberalisation of Capital Movements OECD/C(61)96, periodically re-issued with updated country schedules.
[14] *ibid.* Annex A.

Charter of the International Trade Organisation, Havana, Cuba, of March 24, 1948.[15] The Charter contained a number of provisions relevant to the regulation of foreign investment by corporations, including proposals for the control of restrictive business practices, provisions protecting the security of foreign investments and an assertion of the right of capital importing states to control the conditions of entry and establishment for inward investment. This caused widespread opposition to the Havana Charter among business interests and led to its demise when the United States and other signatory states did not ratify it.[16]

More recently, in the 1970s, numerous negotiations commenced for the **10–011** adoption of codes of conduct for MNEs. International organisations began to accept the legitimacy of claims by capital-importing states for greater control over the conditions of entry and establishment and over the subsequent conduct of foreign investors within their territory. The balancing of the interests of private foreign investors and those of the host state, first attempted in the abortive Havana Charter, became the basis for these new codes of conduct for MNEs. The most significant initiative was the UN Draft Code of Conduct on Transnational Corporations.[17] It was never adopted. Nonetheless its contents continue to inform the debate on how corporate responsibility issues should be formulated in IIAs.[18] More successful was the ILO initiative which led to the adoption, in 1977 of the ILO Tripartite Declaration of Principles Concerning Multinational Enterprises and Social Policy.[19] Equally, in 1976 the OECD Guidelines for Multinational Enterprises were adopted. These contain the most comprehensive set of responsibilities for MNEs but are not legally binding. They should be read alongside the OECD Declaration on International Investment and Multinational Enterprises which contains references to national treatment and international law. These guidelines have recently been revised.[20] Finally, mention should be made of the 1992 World Bank Guidelines on the Treatment of Foreign Investment. These guidelines are aimed at investor protection but, significantly, they accept the right of host states to control the entry and establishment of foreign investors.[21]

The history of discussions regarding the rights of investors and their pro- **10–012** tection has raised a number of hitherto unresolved issues concerning multilateral investment rules: should these tend towards investor protection alone, or towards a balance between protection and regulation; should they be binding or voluntary; should investors be offered privileged treatment based

[15] The investment related provisions of the Charter are reproduced in UNCTAD *International Investment Instruments: a Compendium Vol.I.* (New York and Geneva, United Nations, 1996) pp.3–13 (hereafter "Compendium").
[16] See Lipson *op.cit.* n. 8 at pp. 86–87.
[17] See UNCTAD *Compendium Vol.I. op.cit.* n. 15 at pp. 161–80.
[18] See for example WTO *1998 Report of the Working Group on the Relationship Between Trade and Investment to the General Council* WTO Doc.WT/WGTI/2 December 8, 1998 especially at pp. 51–62 paras 191–225.
[19] See UNCTAD *Compendium Vol.I. op.cit.* n. 15 at pp. 89–103. See too the ILO *Declaration on Fundamental Principles and Rights at Work* (Geneva, ILO, 1998).
[20] See OECD *Guidelines for Multinational Enterprises* June 27, 2000, http:// www.oecd.org/daff/investment/guidelines/newtext.htm.
[21] See UNCTAD *Compendium Vol.I. op.cit.* n. 15 at pp. 247–255.

on international minimum standards or only the same treatment as national investors? It has been argued that these debates have been overcome by events, in that the contemporary environment is more suited to the successful creation of a new multilateral regime for investor protection, as a result of shifts towards liberalisation, privatisation and the recognition of the utility of inward direct investment by transnational corporations as a source of capital and technology.[22] The MAI is undoubtedly a product of this conviction.[23] According to the Report of the Committee on International Investment and Multinational Enterprises and the Committee on Capital Movements and Invisible Transactions:

> "The MAI would build on the achievements of the present OECD instruments, consolidating and strengthening existing commitments under the Codes of Liberalisation and the 1976 Declaration and Decisions on International Investment and Multinational Enterprises. The aim of the negotiations is to conclude an agreement incorporating roll-back, standstill, national treatment and non-discrimination/most favoured nation (MFN) as well as new disciplines to improve market access and to strengthen the basis of mutual confidence between enterprises and states. The liberalization obligations would be complemented by provisions on investment protection. The obligations under the agreement would need to be reinforced by effective dispute settlement procedures . . . The agreement would be comprehensive in scope, covering all sectors under a broad definition of investment focusing mainly on [foreign direct investment]. The MAI would aim to raise the level of existing liberalisation based on a "top-down" approach under which the only exceptions permitted are those listed when adhering to the agreement and which are subject to progressive liberalisation."[24]

10–013 Thus, the draft MAI was based on earlier models of binding investor protection standards leading it to be crafted as an investor and investment protection and promotion agreement, similar in type to the first category of agreements and instruments mentioned above. Although the OECD Guidelines for Multinational Enterprises were to be included as a non-binding Annex, thereby offering some indication of what types of obligations MNEs had towards the states in which they operated, this essential quality of the MAI could not be disputed. It would prove to be a major cause of the failure of the negotiations.

10–014 At the outset, significant obstacles to the successful conclusion of such an instrument were identified.[25] Of the many obstacles encountered in the negotiating process the following are worthy of highlighting: the negotiating environment, the contents of the draft MAI and other "deal breakers" that were added to the negotiations as they progressed. These introduce, in turn, aspects of the third and fourth themes identified at the beginning of the paper. Thus the problem of the negotiating environment is linked to the wider issue of the WTO as an emerging regulatory institution. Indeed, the fact that the OECD was chosen over the WTO as the forum for the MAI negotiations

[22] See Thomas Waelde, "Requiem for the New International Economic Order: The Rise and Fall of Paradigms in International Economic Law" in N.Al. Nauimi and R. Meese (Eds) *International Legal Issues Arising Under the United Nations Decade of International Law* (The Hague, Kluwer, 1995) p. 1301.
[23] See OECD *Towards Multilateral Investment Rules* (Paris, OECD, 1996) at p. 9. and *ibid.* William Witherill "Towards an International Set of Rules for Investment" at pp.17–30.
[24] *ibid.* at pp.10–11.
[25] See Guy de Jonquieres, "Rocky road to liberalisation" *Financial Times* April 10, 1995 p. 17

offers significant insights into the perceived problems of using the WTO as a location for the pursuit of multilateral investment rules. Furthermore, the disagreements over the contents of the MAI, and over the other "deal breakers", shed light on how the conflict of principles between national sovereignty and the development of multilateral rules, that aim to constrain such sovereignty, is no nearer resolution than in earlier times.

3. The WTO as an emerging institution and the negotiating environment of the MAI in the OECD

10–015 The origins of the OECD negotiations can be traced back to United States initiatives in 1991 which called for the OECD to engage in the discussion of a wider investment instrument. This was supported by the Business and Industry Advisory Committee to the OECD in 1992. The United States wanted the OECD to adopt a "state-of-the-art" investment agreement with high standards of liberalisation, investor protection and dispute settlement procedures.[26] Equally, calls for the institution of negotiations for a multilateral agreement on investment came from the European Commission which, in 1995, argued for the establishment of a "level playing field" for direct investment.[27] The then EU Trade Commissioner, Sir Leon Brittan, also gave weight to such a programme. He favoured a binding code which would be negotiated in, and subsequently administered by, the WTO.[28] The attraction of the WTO was threefold: first, it covered a large number of states, including developing countries; secondly, it possessed a binding dispute settlement procedure that could give the proposed code real legal force and, thirdly, the EU had direct negotiating rights on behalf of its members before that organisation. Notwithstanding EU preferences for the WTO, and the discussion among OECD ministers in 1996 of a possible link between the OECD negotiations and the WTO at some unspecified future time, the MAI negotiations remained centred on the OECD. This may be explained by the fact that there would have been only limited backing for similar negotiations in the WTO. Indeed when the issue was mooted at the 1996 WTO Singapore Ministerial Meeting it was opposed by a group of developing countries led by Egypt, India, Malaysia and Uganda.[29] To counter the inevitable criticism that the OECD based negotiations were unrepresentative, the MAI was envisaged as a free-standing international treaty open to all OECD Members and the European Communities and to accession by non-OECD Member countries.[30] Members would have to persuade developing countries to accept the new disciplines and to sign up to the MAI. Thus from the outset the negotiating environment was lacking in a comprehensive and representative body of states. This was somewhat strange

[26] Elisabeth Smythe, "Your place or mine? States, international organizations and the negotiation of investment rules" 7 *Transnational Corporations* pp.85 at p. 101–102 (1998).
[27] EC Commission, "A Level Playing Field for Direct Investment World-Wide" COM(95) 42 final, March 1, 1995.
[28] See "Brittan wants WTO rules for investment" *Financial Times* January 19, 1995, p.4. and Sir Leon Brittan "Investment liberalisation: the next great boost to the world economy" 4 *Transnational Corporations* p. 1. (1995).
[29] See David Henderson, *The MAI Affair: A Story and its Lessons* (London, RIIA, 1999) p. 16.
[30] OECD *op.cit.* n. 23 at p. 11.

given that the main reason for adopting a MAI was to improve market access and investor protection in developing countries, the very group that was not represented by the OECD membership.

10–016 Thus, it may be said that the WTO, as a truly multilateral institution, with members from all geographical and political regions of the world, may be an unruly horse to control. It will not always offer a forum before which support for progressive liberalisation and sovereignty reduction can be guaranteed. This concern lay behind the American preference for the OECD. However, as things turned out, even that organisation, with its overwhelmingly developed market economy membership, could not bring about an investor and investment protection oriented multilateral agreement, given the degree to which national sovereignty would have to be limited to achieve the American objective of "state-of-the-art" protection. To this question we now turn.

4. National sovereignty and international regulation

4.1 The content of the MAI

10–017 The draft MAI consisted of 12 major sections: the general provisions and preamble; scope and application, treatment of investors and investments, investment protection, dispute settlement, exceptions and safeguards, financial services, taxation, country-specific exceptions, relationship with other international agreements, implementation and operation and final provisions.[31] It is not possible to give a detailed analysis of all the outstanding negotiating questions in this paper. Instead, the emphasis will be on the key controversies which remained unresolved during the negotiations, and which may be said to have contributed to their failure. These are: the scope of the definition of "investor" and "investment"; the extension of investor protection to the pre-entry stage and exceptions to this; the nature and content of the non-discrimination standard which lay at the heart of the draft MAI and was expressed through the national treatment and most favoured nation standards; the scope of the prohibition on performance requirements; the applicable rules on expropriation; and the proposed dispute settlement provisions which would have given MNEs direct rights to bring claims against signatory states.

4.1.1 The definition of "investor" and "investment"

10–018 It is usual for an IIA to begin with a scope and definition clause. In this the draft MAI was no different. However, the proposed formulation of the above

[31] OECD *Multilateral Agreement on Investment*: Consolidated Text (Final Version, April 24, 1998) DAFFE/MAI/NM (98) rev.1.http.//www.oecd.org/daf/cmic/mai/negtext.htm.; OECD *Commentary to the Negotiating Text* (Final Version, April 24, 1998). For analysis of the principal provisions see: A.Fatouros "Towards an international agreement on foreign direct investment? 10 ICSID–FILJ 181 (1995); F. Engering "The Multilateral Investment Agreement" 5 *Transnational Corporations* 147 (1996); Sol Picciotto "A Critical Assessment of the MAI" in Picciotto and Mayne (eds) *op.cit.* n. 7 at p. 82, *ibid.* "Linkages in international investment regulation: the antinomies of the draft Multilateral Agreement on Investment" 19 U.Pa.J.Int'l.Econ.L. 731 (1998); UNCTAD *Lessons From the MAI* UNCTAD Series on issues in international investment agreements (New York and Geneva, United Nations, 1999); S. Canner "The Multilateral Agreement on Investment" 31 Cornell.ILJ. 657 (1998).

terms was extremely wide. Thus "investor" included not only nationals but permanent residents, as well as legal persons or other entities constituted or organised under the applicable law of a Contracting Party. "Investment" was defined in terms of, "every kind of asset owned or controlled, directly or indirectly, by an investor . . ." followed by an illustrative, though not exclusive, list that covered both equity based and contractual assets. These included *inter alia* construction contracts, loans, claims to money or performance, intellectual property rights, concessions and licences and property related contractual rights such as leases or mortgages.[32]

10–019 Although there was broad support for an asset based definition, certain delegations argued for the exclusion of portfolio investment and others found it difficult to accept an open definition.[33] There was also concern over the extent of coverage given to investments indirectly owned or controlled by investors of a party. Indirect ownership of investments located outside a MAI country by investors from a MAI country would be covered as would investments located in a MAI country owned and controlled by an investor located in a non-MAI country. This approach would permit MNEs to manage their capital flows in a flexible manner utilising their transnational network of affiliates as they saw fit. On the other hand, some delegations favoured a denial of benefits clause which would exclude investors who lacked a substantial business presence in a MAI country from the protection of the Agreement.[34] In the event many issues remained unresolved and text refers to further work being needed in the areas of indirect investment, intellectual property, concessions, public debt and real estate.

4.1.2 Extension to pre-entry protection

10–020 The draft MAI would require the progressive liberalisation of rights of entry and establishment. This was in line with the policy of the OECD Codes on Liberalisation and followed the precedent set by NAFTA and in bilateral investment treaties (BITs) negotiated by the United States and, more recently, Canada.[35] Historically, states have reacted differently to such proposals. While advocating greater liberalisation for outward investment, many states may prefer to restrict the flow of inward investment for protectionist purposes. Economic unions, such as the EU, may want the right to liberalise faster for internal investors than for investors from outside the economic union.[36] Federal states may encounter internal political objections from

[32] MAI Consolidated Text *ibid.* at p. 11.
[33] UNCTAD *Lessons From the MAI, op.cit.* n. 31 at p. 11.
[34] Commentary to the MAI Negotiating Text *op.cit.* n. 30 at pp. 6–7.
[35] See UNCTAD *Admission and Establishment*, *op.cit.* n. 9 at pp. 23–28. Other regional investment agreements have followed this approach albeit with variations such as transitional periods (see MERCOSUR Decision 11/93 in UNCTAD *Compendium Vol.II.op.cit.* n. 15 at p.513, ASEAN Framework Agreement on the ASEAN Investment Area 1998 see UNCTAD *Compendium Vol IV*. (New York and Geneva, United Nations, 2000, forthcoming) p. 227) or side agreements (see Energy Charter Treaty Article 10(2)–(4) in UNCTAD *Compendium Vol.II. op.cit.* n. 15 at p. 555).
[36] See further text at n. 66–68 *infra*.

federal sub-divisions to the effect that a MAI could curtail their local competence and discretion in formulating inward investment policy.[37] A similar problem could confront local authority initiatives.[38] Developing countries in particular may prefer to exercise caution in relation to inward investment and thus to retain screening powers on entry, so as to protect indigenous infant industries from excessive competition on the part of powerful MNEs. Indeed most BITs, with the exception of the abovementioned U.S. and Canadian models, follow an investment control approach, based on the right of the receiving state to regulate the entry of foreign investors in accordance with national laws and regulations, and do not contain entry and establishment rights.[39]

10–021 Clearly, rights of entry and establishment would not be accepted without significant exceptions. Many restrictions on the rights of foreign investors may be regarded as entirely legitimate, the most obvious examples being restrictions based on public health, order or morals or on strategic and defence grounds. Indeed the draft MAI contained provisions embodying such general exceptions. In addition, it gave to contracting states the right to enter country-specific exceptions.[40] In the event numerous country-specific exceptions were put forward by states, resulting in what some have called a "swiss cheese" agreement, with more "holes" than the negotiators originally expected. This has been explained on the ground that many exceptions taken by states were mere bargaining counters to be discarded on the gaining of concessions.[41] However, the large number of exceptions may in fact be an effect of the "top-down" approach taken in the MAI.

10–022 The extension of rights of entry and establishment can be achieved in an IIA in one of two basic ways: by stating the right and allowing exceptions thereto—the "top-down" approach favoured in the MAI draft—or by giving states the discretion to open up specific sectors as and when they feel ready to do so—the "bottom-up" approach. This is the approach taken in the GATS in that contracting states are not bound to offer entry and establishment rights to investors from other contracting states.[42] Rather, by Articles XVI and XVII of that Agreement, they are given the discretion to specify which sectors will be subject to market access rights, and the extent to which full national treatment will apply. This approach may be more attractive to states that are hesitant to enter into broad commitments regarding entry and establishment. The "top-down" approach of the MAI, by contrast, places liberalisation of entry conditions at the heart of the agreement, leaving less choice to contracting states. In the event the only sure course of action may

[37] Such concerns led one delegation to propose an additional clause ensuring that where a sub-federal entity offers more favourable treatment to its investors and investments as compared to that offered by other sub-federal entities the more favourable treatment should be extended to foreign investors and investments under the national treatment standard: see MAI Consolidated Text *op.cit.* n. 31 at p. 129.

[38] See R. Nurick *The MAI. Potential Impacts on Local Economic Development and Poverty Issues in the UK* (Oxfam, March 1998); World Development Movement "The impact of the multilateral agreement on investment on local government in the UK" (1998).

[39] See UNCTAD *Admission and Establishment op.cit.* n. 9 at p. 18.

[40] See MAI *Consolidated Text op.cit.* n. 31 at pp. 77–80 and 90.

[41] See UNCTAD *Lessons From the MAI op.cit.* n. 31 p. 12.

[42] General Agreement on Trade in Services 1994, 33 ILM 44 (1994).

be to lodge extensive general and country-specific exceptions so as to preserve existing national regulations, and hence host country discretion, over entry and establishment. The result is often an unwieldy agreement in which the exceptions serve to complicate its scope and interpretation. NAFTA is a case in point.[43] Furthermore, once country-specific exceptions have been made, in the absence of a transitional period within which such exceptions must be removed, the effect of the agreement may be to entrench them, thereby defeating the aim of progressive liberalisation. Even if a transitional period exists, it is quite likely that, in practice, it will be extended where the contracting states do not feel ready to espouse full liberalisation. Indeed, this issue continued to be a matter of discussion with no final agreement being reached on how the MAI would achieve its avowed aim of "rollback" on non-conforming country-specific measures.[44]

10–023 In this respect IIAs may be different from international trade agreements. A general commitment to market access for goods and services traded across borders offers less of an inroad into national sovereignty than a positive commitment to give rights of entry and establishment to foreign investors. The latter involves agreement to a right that permits the entry of aliens onto the territory of the receiving state, not merely goods or services of foreign origin. This has far greater political and social consequences for the receiving country. The latter is therefore likely to seek a preservation of its discretion to control the entry of aliens in the public interest. It is for this reason that the "top-down" approach of the MAI may be harder to sell on a political level than the "bottom-up" approach of the GATS, especially to developing countries, where sensitivity to foreign domination of the economy may be especially great.

4.1.3 Non-discrimination

10–024 The non-discrimination provision in the draft MAI concerned both national treatment and most-favoured-nation treatment (MFN), which, respectively, would have ensured treatment for foreign investors "no less favourable" than that received by national investors or investors from other countries, whichever was the more favourable to the investor. The most controversial issue was the extension of the non-discrimination standard to rights of entry and establishment. As noted above, this led to considerable time and energy being devoted to the issue of exceptions. Other problems that were not resolved concerned the scope of the non-discrimination standard itself. At the outset it is worth noting that the two aspects of non-discrimination were discussed as a combined standard. This may have led to an overemphasis on national treatment issues, which are inherently more sensitive than issues relating to the MFN standard. In particular, as noted by a recent UNCTAD study on MFN treatment, "exceptions to national treatment are more frequent than exceptions to MFN. This reflects the fact that countries find it

[43] See M.Gestrin and A.Rugman "The North American Free Trade Agreement and foreign direct investment" 3 *Transnational Corporations* 77 (1994); *ibid.* "The NAFTA investment provisions: prototype for multilateral investment rules?" in OECD *Market Access After the Uruguay Round* (Paris, OECD, 1996) p. 63.

[44] See *Commentary on the MAI Negotiating Text* (as of April 24, 1998) p. 60.

more difficult to treat foreign and domestic investors equally than to provide for equal treatment among investors from different home countries. Furthermore, there may be special situations in which a privileged treatment of domestic enterprises can be justified."[45] It may have been better to discuss each standard in a separate provision, so as to ensure that MFN would not be overwhelmed by national treatment issues. Indeed this is the approach of the GATS where MFN is a general obligation under Article II, while national treatment is an optional obligation under Article XVII.

10–025 As regards the content of the non-discrimination standard, two closely related questions had to be answered: first, what were the factual situations in which the standard applied and, secondly, what technique of comparison should be adopted in order to determine when foreign investors or their investments were being discriminated against. As to the first issue, the draft MAI referred to, "establishment, acquisition, expansion, maintenance, use, enjoyment and sale or other disposition of investments"[46] This formulation was considered by several delegations to be a comprehensive one whose terms were designed to cover all activities of investors and their investments for both the pre- and post-establishment phases. Other delegations favoured a closed list of investment activities covered by the non-discrimination standard. Others objected to this approach on the grounds that, while such a list has the advantage of certainty, it could omit elements that were of importance to the investor.[47] A related issue concerned whether or not to include a qualifying phrase "in like circumstances". No agreement was reached on its inclusion. Some delegations thought that national treatment and MFN implicitly provided the comparative context for determining whether a measure unduly treated foreign investors and their investments differently and that the inclusion of the words was unnecessary and open to abuse. Other delegations thought that the comparative context should be indicated, following the practice of the OECD National Treatment Instrument, some BITs and NAFTA.[48] As to the second question, the formulation adopted in the MAI Negotiating Text included the phrase "no less favourable treatment".[49] This opens the possibility for treatment that may be in practice more favourable for foreign, as compared to national, investors and investments, as where, for example, the treatment of national investors falls below international minimum standards.[50] In this light there was discussion as to whether the "same" or "comparable" treatment approach should be used. However, the majority of delegates considered that this would unacceptably weaken the standard of treatment from the investor's viewpoint.[51]

[45] UNCTAD *Most-Favoured-Nation Treatment* UNCTAD Series on issues in international investment agreements (New York and Geneva, United Nations, 1999) at p. 31.
[46] MAI Consolidated Text *op.cit.* n. 31 at p. 13.
[47] Commentary to the MAI Negotiating Text *op.cit.* note 44 at p. 11.
[48] *ibid.*
[49] MAI Consolidated Text *op.cit.* n. 31 at p. 13.
[50] See UNCTAD *National Treatment* UNCTAD Series on issues in international investment agreements (New York and Geneva, United Nations, 1999) at p. 37.
[51] Commentary on the MAI Negotiating Text *op.cit.* n. 44 at p. 10.

4.14 Performance requirements

10–026 The MAI would have made the imposition of performance requirements as a condition of entry and establishment subject to extensive prohibitions. In particular, it would have prohibited: trade-related requirements dealing with the ratio of export sales to total sales, domestic content and local purchasing rules and ratio of local sales to exports; transfer of technology requirements, except where imposed under competition laws; location of headquarters requirements; requirements to supply goods or services to a specific region or the world market exclusively from the host country; local research and development targets; mandatory employment of nationals; establishment of a joint venture with domestic participation; and minimum and maximum levels of foreign equity participation. Trade related performance requirements would have been absolutely prohibited, while the other categories could be allowed where they were linked to advantages granted in connection with an investment in the territory of the host contracting party. All of these policies entail a discretion in economic planning that might be used to favour national investors. Indeed performance requirements can be justified as a means of ensuring fair competition between MNEs and local firms in the domestic market, particularly in developing countries.[52] This was one of the issues picked up by NGOs who feared that the MAI could weaken such regulatory discretions to the disadvantage of the host state. Furthermore, delegations treated the matter with caution given the absolute nature of the obligations and the complexity of the matters at issue.[53] The controversial nature of these matters is further emphasised by the fact that the related issue of incentives was postponed for discussion after the adoption of the MAI. Had this been included on the agenda, the very right of a sub-national authority with constitutional powers over investment matters to offer incentives would have been put into question.[54] This would have been politically impossible to justify especially in countries with powerful sub-national entities such as the United States and Canada.

4.1.5 Provisions on expropriation

10–027 The MAI provision on expropriation sought to include the international minimum standards that had become commonplace in BITs. However, its scope was to prove controversial in that it covered not only direct but indirect takings.[55] This approach could cause significant problems for countries with strong regulatory regimes as any act of regulation which limits the capacity of an investment to make profits could be seen as an indirect taking

[52] See Picciotto "Linkages in International Investment Regulation" *op.cit.* n. 31 at p. 751.
[53] UNCTAD *Lessons From the MAI op.cit.* n. 31 at p. 16.
[54] *ibid.* p. 17.
[55] According to the Consolidated Text, "A Contracting Party shall not expropriate or nationalise directly or indirectly an investment in its territory of an investor of another Contracting Party or take any measure or measures having equivalent effect . . . except for a purpose which is in the public interest on a non-discriminatory basis . . . in accordance with due process of law . . . accompanied by payment of prompt, adequate and effective compensation . . . " *op.cit.* n. 31 at p. 57.

of property. This caused much discussion leading to the proposal that an interpretative note be added to the text explaining that the expropriation provision does not, "establish a new requirement that Parties pay compensation for losses which an investor or investment might incur through regulation, revenue raising and other normal activity in the public interest undertaken by governments."[56]

10–028 On the other hand, the provisions on taxation make clear that the provisions on expropriation will apply to taxation measures that amount to outright or "creeping" expropriation but not if the measure is, "generally within the bounds of internationally recognised tax policies and practices."[57]

4.1.6 Dispute settlement provisions

10–029 These were among the most controversial aspects of the MAI. The draft contained a chapter on dispute settlement covering both state-to-state and investor-state disputes.[58] The latter in particular gave rise to difficulties. It would have granted to foreign investors special rights to challenge national decisions concerning the observance of the substantive provisions of the MAI. This approach to dispute settlement is not new. It has become a standard feature in IIAs. For example, most BITs contain an investor-state dispute settlement provision that usually encourages amicable settlement, with third party settlement, such as arbitration before an international arbitral body, as a last resort. Similar provisions can be found in NAFTA, MERCOSUR and the Energy Charter Treaty.[59] However, the NGOs saw this provision—and similar formulations in other IIAs—as giving foreign investors special privileges enabling them to neutralise legitimate national laws and regulations by claiming before an international tribunal that they violated the protective standards of the IIA. Much was made of the recent case brought by the Ethyl Corporation against Canada under the dispute settlement provisions of NAFTA, where Ethyl claimed that a Canadian law banning the importation into Canada of the gasoline additive MMT, violated its rights as an investor under that agreement. This case was eventually settled in July 1998 with Canada lifting the import ban and paying $13 million to Ethyl.[60] The NGOs saw this case as an example of how the provisions of NAFTA could be used to invalidate a measure based on environmental concerns.[61] Similar objections were made by one delegation, while others voiced

[56] See MAI Consolidated Text *op.cit.* n. 31 at p. 144. Significantly this formulation is to be found in the Annex containing the package of proposals for text on environment and labour.

[57] *ibid.* at p. 87.

[58] See MAI Consolidated Text at pp. 63–76.

[59] See UNCTAD *Lessons From the MAI op.cit.* n. 31 at p.19. On investor state dispute settlement generally see P.T. Muchlinski *Multinational Enterprises and the Law op.cit.* n. 10 Chap. 15.

[60] The case is reported in relation to the jurisdictional issues under NAFTA: see 38 ILM 700 (1999).

[61] Another case that has received similar attention concerns the US Metalclad Corporation's claim under NAFTA against Mexico see M. Nolan and D. Lippoldt "Obscure NAFTA Clause Empowers Private Parties" *The National Law Journal* April 6, 1998 p.B8. On the other hand in the NAFTA case of *Robert Azantan and others v. United Mexican States*, ICSID Case No.ARB (AF/97/2) award of November 1, 1999 14 ICSID Review-FILJ 538 (1999), it was held that the NAFTA dispute settlement mechanism must operate within the limits of international law, and so a mere breach of contract by the host state could not of itself give rise to a violation of NAFTA in the absence of a further violation of international law. This should prevent the NAFTA mechanism from being used by investors in any but the most serious cases of alleged violations of their rights.

opposition to the extension of the dispute settlement procedure to the pre-establishment phase.[62] Numerous unresolved questions remained after the negotiations had finished including the question of the role of local remedies, the scope of reservations and of the principle of unconditional prior consent to the MAI system.[63] A number of delegations were left feeling that much work was still needed on dispute settlement.

4.2 Other "deal breakers"

10–030 The preceding discussion has centred on the main areas of disagreement within topics that could be regarded as part of the conventional content of IIAs. In this section a number of further issues are considered. They all share the common features of going beyond this conventional content and of being highly controversial, but yet incapable of being excluded from the agenda due to the insistence of one or more delegations that had a special interest in the matter. By contrast other issues that could have raised serious controversies, namely, taxation, intellectual property and incentives, were either left out after initial debates or reserved for future discussion.[64]

10–031 Four such "deal-breakers" were introduced onto the agenda: in the light of the controversy over the Helms Burton Act, the issue of the extraterritorial application of investment related national laws and of the establishment of international disciplines to deal with the use of confiscated foreign owned property; the regional economic integration organisation (REIO) exception to the non-discrimination standard; the "cultural industries" exception; and labour and environmental standards.

4.2.1 New disciplines on the treatment of illegally confiscated property

10–032 In the course of MAI negotiations the U.S. tried to introduce new disciplines concerning the rights of owners of illegally expropriated property to pursue claims against its current owners. This emerged out of the controversy generated by the Helms-Burton Act[65] which sought to recover claims concerning property owned in Cuba by U.S. nationals, taken at the time of the Cuban revolution, and which was now owned by firms from other countries, mainly

[62] See UNCTAD *Lessons From the MAI op.cit.* n. 31 at p. 19.

[63] See Commentary to the MAI Negotiating Text *op.cit.* n. 44 at pp. 38–9.

[64] Taxation was carved out of the MAI, except in relation to expropriation and transparency commitments, so as to avoid clashes with double taxation agreements; intellectual property discussions were left at the stage that a separate provision excluding the application of the non-discrimination standard beyond the scope of existing commitments in intellectual property conventions would be inserted into the MAI, and incentives would have been discussed after the adoption of the MAI. See MAI Consolidated Text *op.cit.* n. 31 at pp. 87–9, 50–2 and 46–8.

[65] The Cuban Liberty and Democratic Solidarity Act 1996 U.S. Public Law 104–114, March 12, 1996, 35 ILM 357 (1996). Also of significance in generating this debate was the Iran Libya Sanctions Act 1996 U.S. Public Law 104–172, August 5, 1996, 35 ILM 1273 (1996).

Europe, Canada and Mexico. In May 1998 an understanding was reached on these issues between the U.S. and EU leaders, though with significant restrictions as to its scope. In the end two alternative country-specific proposals for new drafts existed, one on conflicting requirements and one on secondary investment boycotts. The first would prevent a Contracting Party from prohibiting outside its territory an investor from another Contracting Party from acting in accordance with that other Contracting Party's laws, regulations or express policies unless these were contrary to international law. The second would prohibit the Contracting Parties from taking measures that impose liability on investors or investments of investors from another Contracting Party, or to prohibit, or impose sanctions for, dealing with investors of another Contracting Party, because of investments an investor of another Contracting Party makes, owns or controls, directly or indirectly, in a third country in accordance with the regulations of such third country.[66]

4.2.2 The REIO Exception

10–032 The non-discrimination provision of the MAI had the potential to create a "free rider" problem. By relying on that provision, MAI contracting states could enjoy the benefits of a regional economic integration organisation (REIO), whose membership consisted of parties to the MAI, without being members of that organization. To deal with this problem, it was proposed by the EU that a REIO exception be included in the MAI.[66] There remained considerable disagreement as to the scope of such a clause at the time negotiations were suspended. Some delegations thought that this proposal struck at the very objectives of the MAI, which included the gaining of market access to REIOs on a par with access by investors from the member countries of such organisations. On the other hand, as the EU had argued, membership of such organisations carried with it additional obligations which non-members did not carry, such as, for example, the acceptance of majority voting, and extended to areas not covered by the MAI, for example recognition of diplomas. To extend the benefits of membership to non-members in such circumstances would be very difficult.[68]

4.2.3 The cultural industries exception

10–033 This exception would preserve the right of a Contracting Party to take any measure to regulate investment of foreign companies, and the conditions of activity of these companies, in the framework of policies designed to preserve and promote cultural and linguistic diversity.[69] This exception was championed by France and Canada, in particular, who feared an "Americanisation" of global media industries. It was strongly opposed by U.S.

[66] MAI Consolidated Text *op.cit.* n. 31 at pp. 122–7.
[67] See MAI Consolidated Text op.cit. n. 31 at pp 118–9. See further J.Karl "Multilateral investment agreements and regional economic integration" 5 *Transnational Corporations* p. 19 (1996).
[68] See UNCTAD *Lessons From the MAI op.cit.* n. 31 at pp. 14–15.
[69] See MAI Consolidated Text *op.cit.* n. 31 at p. 128.

media interests. The issues remained unresolved at the time the MAI negotiations were suspended.

4.2.4 Labour and environmental standards

Initially, the MAI was not to have included these matters. However, in **10–034** response to extensive lobbying by NGOs and trade unions,[70] some general provisions were included in the preamble and an additional labour and environment clause was proposed by the Chairman of the Negotiating Conference in Annex 2 to the Draft Agreement.[71] This concentrated on the need for a balanced relationship between the MAI disciplines and other areas of public policy and on the avoidance of unintended consequences of normal regulatory practices. In particular, it was noted that the inclusion of the "in like circumstances" formulation in the non-discrimination provision would address the problem of "*de facto*" discrimination where a measure, not specifically aimed at foreign investors or investments, would have the practical effect of treating them less favourably as compared to domestic and/or other foreign investors or investments. The principal aim was to ensure that the MAI did not inhibit normal non-discriminatory governmental regulatory activity in these areas. Another aspect of this issue was the proposed inclusion of a "no lowering of standards" clause which would have ensured that countries could not use a lowering of labour environment or health standards as incentives for inward investment.[72] However, the precise content of that clause was never agreed upon and it remained subject to many drafting alternatives.

5. Analysis: lessons for the future

The problems described above proved fatal to the aim of concluding the MAI. **10–035** On October 14, 1998 the French Prime Minister, Lionel Jospin, stated that France would take no further part in the negotiations, on the ground that the MAI, as currently formulated, represented an unacceptable threat to national sovereignty.[73] A week later, on October 22, the senior representatives of the OECD Members and the European Commission convened in the Executive Committee of the Special Session of the OECD in Paris. They announced that they would now proceed with further consultations on the controversies that the negotiating process had raised, thereby effectively ending the negotiations on the MAI.[74]

[70] On which see further Henderson *op.cit.* n. 29 at pp. 22, 27–8; Nick Maybey "Defending the Legacy of Rio: The Civil Society Campaign against the MAI" in Picciotto and Mayne (eds) *op.cit.* n. 7 p. 60.
[71] See MAI Consolidated Text *op.cit.* n. 31 at pp. 140–145.
[72] *ibid.* at p. 54.
[73] "France quits investment accord talks" *Financial Times* October 15, 1998 p.5; Henderson *op.cit.* n. 29 at pp. 30–1. For the full debate see Assemblee Nationale, Session Ordinaire de 1998–99, 8eme jour de séance, 18eme séance, 1ere séance du Mardi Octobre 13, 1998, http://www.assemblee-nationale.fr/2/cra/2aa.htm.
[74] OECD News Release Paris, October 23, 1998 "Chairman's Statement Under Secretary of State Stuart Eizenstat (USA) Executive Committee in Special Session". The negotiations were formally ended in a further informal OECD Meeting in December 1998: Henderson *op.cit.* n. 29 p. 32.

10–036 There is much debate on the actual causes of this failure. The political opposition to the Agreement generated by the NGO community undoubtedly made a significant contribution. However, the principal reason lies in the conception of the agreement as a pure investor and investment protection instrument. This made it an anachronism from the start. The MAI was based on fundamental misconceptions as to the nature of transnational economic interactions in an era of increased privatisation and de-regulation at the national level. Thus it started from the false premise that governmental power to control business had to be curtailed. It lived in a world dominated by old political agendas signified by the "right/left" axis of Cold War politics, in which the principal concerns of foreign direct investors were to preserve existing investments in recently decolonised and/or increasingly politically assertive host countries.

10–037 The new political environment no longer places "right/left" issues of ownership and control at centre stage. Rather there has been a transformation in political discourse which challenges not the legitimacy and value of free private enterprise as such, but its legitimacy as a polluter, an abuser of market power, a corruptor of state officials, an exploiter of workers and a potential accomplice to violations of fundamental human rights. Thus, the correct starting point should have been an acknowledgement that, in this new investment environment, new regulatory issues, of the kinds listed above, emerge.[75] It was the complete failure to address these new questions that undermined the MAI, based as it was on models of IIAs that were, in effect, a response to increased state intervention and control over the national economy through nationalisations and highly interventionist national economic plans. In the light of the foregoing, a number of conclusions can be drawn.

10–038 As to the negotiating process, any future multilateral initiative must be made more representative in terms of the participating countries. The active involvement of developing countries and countries in transition is essential. The developing countries in particular must come fully armed to the negotiating table. The UNCTAD programme on issues in IIAs seeks to achieve this purpose. It involves regional seminars for developing country officials, the publication of specialised issues papers as guides to negotiators and ongoing analysis of the development implications of IIAs, focused on the concept of "flexibility for development".[76] Furthermore, to counter the perceived lack of a civic input into the original negotiations, provision should be made for representatives of civil society to be officially involved in the negotiations as advisers and not merely as observers. However, the ultimate responsibility for concluding binding rules must rest with governments as the only legitimate and accountable representatives of their populations.[77] As to venue, the WTO continues to be

[75] On which see further the interesting paper by A.A.Fatouros "International Investment Agreements and Development – Problems and Prospects at the Turn of the Century" in G. Hafner, G. Loibl, A. Rest, L. Sucharipa-Berman and K. Zemanek (Eds) *Liber Amicorum Professor Seidl-Hohenveldern – in Honour of his 80th Birthday* (The Hague, Kluwer Law International, 1998) p. 115.

[76] See *UNCTAD UNCTAD's Work Programme on International Investment Agreements. From UNCTAD IX, Midrand (1996), to UNCTAD X, Bangkok (2000)* (New York and Geneva, United Nations, 2000); UNCTAD *International Investment Agreements: Flexibility for Development* UNCTAD Series on issues in international investment agreements (New York and Geneva, United Nations, 2000).

[77] See Henderson *op.cit.* n. 29 at pp. 57–60.

mentioned as a possibility, given its wide membership. However, some groups have expressed caution given its commitment to free trade. They would welcome a more pluralistic venue, possibly within the UN. Another alternative might be to establish a specialist negotiating forum, composed of inputs from the WTO, UNCTAD and other relevant intergovernmental organisations.

As to content, the draft MAI was criticised as displaying an imbalance 10–039
between investor rights and responsibilities and prompted NGOs, unions, consumer groups and others to campaign for the introduction of tougher responsibilities for investors in the MAI. This may entail a binding section on investor responsibilities which, while covering many of the same issues, would go beyond the mere appending of the OECD Guidelines for Multinational Enterprises in a non-binding Annex. Numerous NGO proposals for a code based on such an approach have been formulated, and may be useful as a guide to negotiators.[78]

Secondly, with further awareness of the need for "flexibility for develop- 10–040
ment", the very structure, objectives, substantive rules and modes of implementation and monitoring of future multilateral investment rules should ensure that there is a balance between the protection of investors with the interests of countries, especially developing countries. Such future rules must avoid falling into the pitfall of the MAI, which recognised only the "legal symmetry" of the contracting parties, thereby assuming that all countries were formally equal under the law of the Agreement. However, with the active participation of developing countries, such "legal symmetry" cannot co-exist with the reality of "economic asymmetry" without resulting in the exposure of developing countries to the risk of damaging competition from often stronger foreign investors, including MNEs. Thus, the very structure, content and organisation of the agreement should aim at a minimisation of "economic asymmetry" through provisions that ensure respect for the legitimate development needs of countries. This may require the introduction of transitional provisions, commitments to co-operation and technical assistance provisions.[79]

Thirdly, the failure of the MAI shows that even the developed countries 10–041
cannot agree on a "fast-track" liberalisation agreement. The major lesson is that negotiation of a MAI-type agreement is not a zero-sum game with either full liberalisation or full protectionism as the possible outcomes. Perhaps the inevitable result will be an agreement with some liberalisation and some protectionism, much like the current example of NAFTA. One way around this, as noted above, could be to abandon the MAI's commitment to liberalisation coupled with "negative lists" of exceptions and to adopt the more cautious approach of selective liberalisation whereby a country "opts-in" to liberalisation by specifying the sectors in which it is willing to accept such disciplines while leaving non-specified sectors outside the agreement.

Fourthly, linkages with other issues such as labour standards, human 10–042
rights, environmental protection, competition, taxation and intellectual property will have to be tackled to ensure that future multilateral investment

[78] See examples in UNCTAD *International Investment Agreements: A Compendium Vol.V.* (New York and Geneva, United Nations, 2000); and Amnesty International UK Business Group *Human Rights Guidelines for Companies* (London, Amnesty International, 1998).

[79] For a detailed discussion and illustrative examples see UNCTAD *Flexibility op.cit.* n. 76.

rules do not interfere in a way that undermines existing international obligations of states in these areas.[80] In this regard, a new debate has arisen among NGOs. On September 15, 1999 a new group of academics and NGOs from developing countries issued a "statement Against Linkage".[81] This calls for the de-linking of environmental and labour questions from any future multilateral rules on investment, and their remaining within specialised bodies such as the ILO, on the principal ground that these constitute no more than hidden protectionism by developed countries against developing countries that may have lower standards in these areas. This position has been vigorously opposed by, among others the International Confederation of Free Trade Unions.[82] However, given the existence of a Trade and Environment Working Group in the WTO, and the growing concern over corporate responsibilities generated by Western NGOs, it is likely that this wider agenda will remain within that organisation.

10–043 Finally, certain wider implications of the lessons from the failure of the MAI should be highlighted. First, the lessons of the MAI go further than the WTO. Numerous bilateral investment agreements continue to be negotiated as do new regional investment agreements, a notable recent example being the ASEAN Framework Agreement on an ASEAN Investment Area of 1998.[83] The scope and development of such IIAs needs to reflect the experience gained under the MAI and to create a new generation of agreement types, which are more development oriented, and more sensitive to environmental and social issues. Secondly, as regards the United Kingdom's policy in this area, the Government itself asks the question whether there is a high priority for action on investor protection rules based on non-discrimination given the existing network of bilateral investment agreements.[84] On the other hand the Government believes that there is scope for action to create a single, transparent non-discrimination framework that preserves the right of governments to pursue their social, environmental and economic objectives.[85] Should the Government pursue such an objective it is crucial that it carries a truly representative voice into negotiations. To this end it may be necessary to establish improved systems of policy development, which build upon the informal networks already in existence, and which take account not only the views of civil society but also, in particular, of local and regional interests.

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[80] See further Picciotto "Linkages in International Investment Regulation.." *op.cit.* n. 31.

[81] Third World Intellectuals and NGOs Statement Against Linkage (TWIN-SAL) September 15, 1999. This can be accessed through the Consumer Unity and Trust Society of India website: http://www.cutsjpr@jp1.dot.net.in.. This initiative has been strongly influenced by the thinking of one of the Statement's signatories, Jagdish Bhagwati, on which see further "Free trade, 'fairness' and the new protectionism: some reflections on an agenda for the WTO" (London, Institute of Economic Affairs Occasional Paper 96, April 1995).

[82] ICFTU "Enough Exploitation is Enough: a Response to the Third World Intellectuals and NGOs Statement Against Linkage" (February 2000).

[83] See n. 35.

[84] See DTI *International Investment: The Next Steps* July 21, 1999 para. 12.

[85] *ibid.* para. 45.

CHAPTER 11

MULTILATERAL AND BILATERAL APPROACHES TO THE INTERNATIONALISATION OF COMPETITION LAW: AN EU PERSPECTIVE

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1. Introduction

> "In today's liberalised world the Community cannot be without an external dimension to its competition policy."[2]

> "The WTO should begin negotiations on a basic framework of core principles and rules on domestic competition law and policy and its enforcement."[3]

1.1 The EU and multilateral trade

11–001 The European Union, in discussing EC trade policy, regularly emphasises the complementarity of its multilateral, regional and bilateral dimensions. In July 2000, in presenting its trade policy statement to the WTO's Trade Policy Review Body, the EC Commission claimed that "in terms of trade, the EU has a global vocation", a vocation which was to be realised both by using the full potential of the multilateral system and by strengthening links with individual trading partners. Its Introductory Statement on behalf of the EU the Commission emphasised three elements of EU policy, based on this "global vocation": support for the multilateral trading system, strengthened bilateral and regional relations, and the need for the WTO to respond to the challenges posed by globalisation and the concerns of civil society.

> "Firstly, there is no substitute for a strong multilateral trading system. It is only in the respect of its rules that the multifaceted commercial relations between countries can truly prosper. Secondly, in terms of trade, the EU has a global vocation. It is therefore natural for it to use the full potential offered by the MTS and to deepen its trading links with a number of partners around the world. Thirdly, the WTO must take on the challenges of today or it will be disregarded and become irrelevant. Taking into account these challenges there is no other choice for us but to embark on a new round of multilateral trade negotiations."[4]

11–002 The Commission contrasts the "threat of unilateralism" and its "destructive potential for international trade" with the deepening of bilateral relations and "trade enhancing" bilateral agreements which "underpin and are mutually supportive" of the multilateral trading system.[5]

11–003 In the preparation of the EU's negotiating position prior to the Third WTO Ministerial Conference in Seattle and in its public contributions to the post-Seattle debate, the EU has also recently needed to address the future development of the multilateral trading system, represented in particular by the WTO, the part to be played by the EU in this process, its own bilateral

[2] Commission Communication of June 17, 1996, "Towards an International Framework of Competition Rules', COM (96) 284, at section I(b). See also Jacquemin, "The International Dimension of European Competition Policy" (1993) 31 JCMS 91; Bourgeois, "Competition Policy and Commercial Policy" in Maresceau (ed.) The EC's Commercial Policy after 1992: The Legal Dimension (Kluwer 1993); Devuyst, "The International Dimension of the EC's Antitrust Policy: Extending the Level Playing Field" (1998)3 EFA Rev 459.

[3] Conclusions of the General Affairs Council (GAC) in preparation for the WTO Ministerial Conference in Seattle, October 26, 1999.

[4] Trade Policy Review Mechanism, EU Policy Statement, European Commission Brussels, July 19, 2000, D (2000) at p. 16.

[5] *ibid.* at pp.6, 8 and 17.

preferential relations, and the relationship between them. Here the emphasis has been on the importance of the multilateral trading system, and on the priorities and role of the EU in the development of that system. In its conclusions on the preparation of its position for Seattle (which represent the Council mandate for negotiations), the Council "reaffirmed the importance it attaches to the primacy of the multilateral trading system and of its basic principles as guarantees against protectionism and unilateralism."[6] The EU stance, as a regional trade bloc committed to many regional agreements, is one of support for the multilateral trading system and for trade liberalisation whether achieved globally or regionally.

11–004 This general policy orientation has since Seattle focused on the need for a comprehensive new round of negotiations.[7] In the EU's view, a new round is needed not just in order to achieve a greater degree of trade liberalization. It is also necessary to "update the rule-book" as Commissioner Lamy put it recently in Tokyo:

> "Trade liberalisation is generally a very good thing, and not just for business. Within that, multilateral liberalisation, and the MFN principle, is generally recognised to be the most efficient mechanism for this. But it is not, in and of itself, sufficient in this era. So we need a Round which does more than just tackle market access. We need a Round which updates the WTO rule-book."[8]

11–005 The Commissioner includes in this updating process, the need to develop a framework of rules governing foreign direct investment and competition and to re-examine the interface between trade rules and multilateral environment agreements. The trade and environment interface and the attempt to negotiate a multilateral agreement on investment are considered in chapters 9 and 10 of this volume. This chapter will take the third area mentioned by Lamy, the international dimension of competition policy; we will examine this vast subject from the particular perspective of the EU, and the distinctive combination of multilateral and bilateral initiatives in the development by the EU of a policy that reaches beyond the borders of the Community itself. It is in fact a field where a concerted attempt has been made to combine bilateral with multilateral initiatives, and even to multilateralise existing bilateral models. In this, EU policy not only demonstrates a wide variety of approaches and techniques, but can be seen as an example of the interaction between multilateral and bilateral strategies for achieving the twin objectives of underpinning increased market access with an agreed minimum level of regulatory control, and the reduction in costs represented by regulatory convergence.

[6] Conclusions of GAC, October 26, 1999; these were of course adopted prior to Seattle but were subsequently confirmed by the Informal Trade Council in March 2000.

[7] The four key elements of a New Round sought by the EU are market access, new rules (covering *inter alia* competition and investment), sustainable development and a response to the concerns of civil society (notably environment and consumer issues).

[8] "Strengthening the Multilateral System", speech by Pascal Lamy to the Foreign Correspondents" Club, Tokyo, July 18, 2000; http://europa.eu.int/comm/trade/speeches_articles/spla29_en.htm.

1.2 The international dimension of competition policy

11–006 At the multilateral level, the EU has been an active participant in the debate over the need for, and possible shape of, an international framework of competition rules which would complement the TRIPS agreement on intellectual property rights within the WTO framework. In its bilateral relations, moreover, provisions on competition policy are now an inevitable accompaniment to trade commitments. These contractual provisions range from those with candidate States, such as the central and eastern European States and Turkey, to agreements with trading partners much further afield, such as Mexico or South Africa. They range from competition provisions within wider free trade or customs union agreements to specific sectoral agreements on co-operation in the enforcement and application of competition rules; and from agreements with developing countries, such as the Cotonou Convention with the ACP (African, Caribbean and Pacific) States, to agreements with industrialised States such as the USA or Canada. The remarkable spread of this external dimension to the EU's competition policy acts as a counterpoint to its rhetoric at the multilateral level, and the EU's experience bilaterally and regionally has influenced the position it takes in multilateral fora.

11–007 There is an additional element to this multidimensional approach to international competition issues. The multilateral and bilateral dimensions to EU policy should also be seen in relation to its unilateral dimension. The latter includes the application of what we may call "domestic" EU competition law to undertakings operating from outside the EU itself,[9] as well as the adoption of autonomous trade protection measures directed at anti-competitive activity under the anti-dumping or trade barriers Regulations. It is not possible in this chapter to enter into a discussion or assessment of the extra-territorial scope of domestic EU competition law; we will just note that while speaking in general terms, and avoiding specific reference to competition policy, EU statements have stressed the synergy between multilateral and bilateral approaches, in contrast to the threat to the multilateral trading system posed by unilateralism.[10] Trade protection measures such as anti-dumping legislation are of course covered by existing WTO rules, and the relationship between such measures and an effective and non-discriminatory competition policy has been one of the issues exercising the WTO Working Group on Trade and Competition Policy, established in 1996. More broadly, the development of a multilateral framework for competition raises questions as to the extent to which it could—or should—be used as a method of constraining the use of autonomous measures of both competition and trade policy.

[9] See Robertson and Demetriou, "But that was in another country . . ." [1994] ICLQ 41; Torremans, "Extraterritorial Application of EC and U.S. Competition Law" (1996) 21 ELRev. 280. This aspect of EU policy will not be discussed further in this chapter.

[10] On unilateralism in the context of international trade more generally, see the Symposium "Unilateralism in International Trade: What Place Can it Have in Light of the Emerging Multilateral Regime?" in 11 EJIL (2000) 249, and especially Bernhard Jansen, "The Limits of Unilateralism from a European Perspective" 11 EJIL (2000) 309.

1.3 External Community competence in matters of competition policy

Before going on to examine the multilateral and bilateral aspects of EU policy, we should briefly address the preliminary issue of competence. External competence (for example, to conclude agreements) in matters of competition policy is not expressly granted in the EC Treaty. Competence derives from two sources. **11–008**

First, where competition clauses form part of an agreement for which express powers have been granted in the Treaty, that treaty provision may provide a sufficient basis for the competition dimension of the agreement. For example, where the competition clause is ancillary to trade provisions, concerned with the effect of anti-competitive distortions on trade between the parties, then express common commercial policy competence under Article 133 EC will provide an adequate basis for the agreement; the free-trade agreements with the EFTA States of the 1970s are an example of this. It is also possible to envisage competition forming part of an agreement concluded under Article 181 EC on development co-operation. The Court has held, in relation to the scope of this provision: **11–009**

> "In order to qualify as a development co-operation agreement for the purposes of [Article 181] of the Treaty, an agreement must pursue the objectives referred to in [Article 177]. . . . those are broad objectives in the sense that it must be possible for the measures required for their pursuit to concern a variety of specific matters. . . . the fact that a development co-operation agreement contains clauses concerning various specific matters cannot alter the characterisation of the agreement, which must be determined having regard to its essential object and not in terms of individual clauses, provided that those clauses do not impose such extensive obligations concerning the specific matters referred to that those obligations in fact constitute objectives distinct from those of development co-operation."[11]

Secondly, competence may be implied from internal powers, either directly from the Treaty itself or via secondary legislation.[12] In its second Opinion on the draft EEA, the Court of Justice said: **11–011**

> "It follows from the Court's case law . . . that the Community's authority to enter into international agreements arises not only from an express attribution by the Treaty, but also from other provisions of the Treaty and measures taken pursuant to those provisions by the Community institutions. Consequently, the Community is empowered, under the competition rules in the EEC Treaty and measures implementing those rules, to conclude international agreements in this field."[13]

The Court also expressly confirmed that this power includes the possibility of competence-sharing jurisdictional rules, providing these do not "change the nature of the powers of the Community".[14] The competition provisions EEA are in fact a case of indirect implied powers; the EEA was concluded **11–012**

[11] Case C-268/94 *Portugal v. Council* [1996] E.C.R. I-6177, at paras 37-39. The Treaty Article numbers have been changed to reflect the renumbering introduced by the Treaty of Amsterdam.

[12] The doctrine of implied external competence has been developed by the Court of Justice, in case 22/70 *Commission v. Council* (AETR) [1971]E.C.R. 263;[1971] C.M.L.R. 335, and subsequent cases including *Opinion 2/91 (re ILO Convention)* [1993] E.C.R I-1061.

[13] *Opinion 1/92 (draft Treaty on EEA, No.2)* [1992] E.C.R I-2821 at paras 39–40.

[14] *ibid.* at para 41; see further text at n. 87.

on the basis of Article 310 EC, as an association agreement. Association agreements may include "commitments towards non-member countries in all the fields covered by the Treaty",[15] including competition policy.

11–013 External competence could be implied from the competition provisions of the Treaty and thus form part of an association agreement. The Court's statement in this case on implied external competence in the competition field is also illustrated by the Agreement between the EC and USA on competition.[16] It was ultimately concluded on the basis of Articles 83 and 308 EC; Article 83 grants a legislative competence to the Council of Ministers in the field of competition in order to give effect to the principles set out in Articles 81 and 82, but without explicit mention of external agreements. Article 308 EC was necessary, according to the Preamble of the concluding Decision, because the agreement included matters covered by the Merger Regulation (Regulation 4064/89) which is itself based on Article 308 EC. So here powers were implied from a Treaty Article directly and from secondary legislation (the Regulation). This Agreement is also of interest because it was originally concluded by the Commission; the Commission argued that it had competence to do so under Article 85 EC (then Article 89) which gives the Commission the task of ensuring the application of Articles 81 and 82 EC. However, in an action brought by France challenging the legality of the Commission Decision concluding the Agreement, the Court of Justice held that the doctrine of implied powers could not be used to justify Commission competence in this case.[17] *Community* external competence could be derived by implication from the Treaty provisions on competition but this does not imply specific institutional allocation of power. This must be derived from the specific Treaty Article dealing with the procedure for negotiating and concluding international agreements, Article 300 EC, which establishes that agreements must be concluded by the Council of Ministers. A new Decision concluding the Agreement had to be adopted by the Council of Ministers on the basis of Articles 83 and 308 together with Article 300 EC. The Court's judgment highlights the fact that (whatever the internal Treaty-based rules about institutional competence) it is the European Community itself which has legal personality (Article 281 EC) and which therefore enters into international obligations with the possibility of incurring liability at an international level.[18] The binding nature of the Agreement in international law was thus not put in question by the annulment of the Commission Decision concluding the Agreement for the Community.

11–014 Having established Community competence, we need to consider whether this is exclusive or not, whether it precludes the possibility of Member State action in the field. Where the competition clause of an agreement is simply ancillary within a trade agreement based on Article 133 EC, then competence will be exclusive.[19] Competence under the development co-operation

[15] Case 12/86 *Meryem Demirel v. Stadt Schwäbisch Gmünd*. [1987]ECR 3719; [1989] I.C.M.LR. 421, at para. 9.
[16] EC - USA Agreement on competition 1991 [1995] O.J. L 95/45.
[17] Case C-327/91 *France v. Commission* [1994] E.C.R I-3641; [1994] 5 C.M.L.R. 517.
[18] *ibid.* at paras 24–25.
[19] See, for example, *Opinion 1/78 (Agreement on Natural Rubber)* [1979] E.C.R 2871.

provisions of the treaty, in contrast, is shared (although this does not mean that every agreement concluded under Article 181 EC must be mixed[20]). Where, competence is based on implied powers then competence is shared, as it is internally.[21] In discussing the possibility of a multilateral competition agreement the Commission makes the point:

> "As competition is not an exclusive Community competence, international cases might involve either the Community (if trade between Member States were affected) or a single Member State (if it alone were affected). A framework of rules would have to take account of both cases, while preserving the unity of Community action in the trade field."[22]

11–015 The Member States are under a duty, in exercising their competence in this field, not to prejudice the application of Community competition rules;[23] and were an agreement to be concluded on a mixed basis (jointly by the Community and Member States) the duty of co-operation would apply:

> "... where it is apparent that the subject-matter of an agreement or convention falls in part within the competence of the Community and in part within that of the Member States, it is essential to ensure close co-operation between the Member States and the Community institutions, both in the process of negotiation and conclusion and in the fulfillment of the commitments entered into. That obligation to co-operate flows from the requirement of unity in the international representation of the Community."[24]

11–016 A practical application of this principle can be seen in the joint submissions made by "the EC and its Member States" to the WTO Working Group on Trade and Competition Policy.

2. The multilateral dimension to EU policy: trade and competition

11–017 The WTO is by no means the only multilateral forum in which the development of international competition policy has been debated; the OECD and UNCTAD have engaged in their own initiatives, as well as the varied regional approaches of NAFTA, the FTAA and of course the EU itself.[25] Nevertheless the wide—and wide-ranging—membership of the WTO, and the increased attention paid in the last decade to the relationship between trade policy and regulatory policy, has meant that the work of its Working Group on Trade and Competition Policy has provided a focus for policy debate bringing together both industrialised and developing countries.

[20] Case C-268/94 *Portugal v. Council* [1996] E.C.R I-6177. A mixed agreement is concluded jointly by the Community and the Member States.
[21] Case 14/68 *Wilhelm v. Bundeskartellamt* [1969] E.C.R 1; [1969] C.M.L.R. 100.
[22] Commission Communication of 17 June 1996, "Towards an International Framework of Competition Rules', COM (96) 284.
[23] Article 10 EC and case 14/68 *Wilhelm v. Bundeskartellamt* [1969] E.C.R 1, at para 4.
[24] *Opinion 1/94 (re WTO Agreement)* [1994] E.C.R I-5267, para. 108.
[25] Initiatives outside the WTO framework include for example the draft UN Convention on Restrictive Business Practices in 1953, the 1967 OECD Recommendations on Co-operation on Anti-competitive Practices Affecting International Trade, last revised in 1995, the 1998 OECD Recommendation on Hard Core Cartels, and the work of UNCTAD and its Intergovernmental Group of Experts, in particular the (non-binding) Set of Multilaterally Agreed Equitable Principles and Rules for the Control of Restrictive Business Practices, adopted by the UN General Assembly in December 1980 (UN Doc. A/35/48 (1980)).

11–018 Although the role of competition policy in international trade does not as such form part of the "built-in agenda" for a New Round of trade negotiations,[26] it has in practice been on the agenda for some time. Indeed the abortive Havana Charter of 1947 contained a separate chapter on restrictive business practices and the issue of a possible international anti-trust agreement has been considered within GATT structures more than once since. Aspects of existing GATT law are designed to support fair competitive conditions on both import markets (Article III for example) and export markets (Article VI for example), although focused on public rather than private conduct. As WTO attention has shifted from border controls to beyond-the-border trade restrictions, and in particular the regulatory environment in which imported products are marketed and out-of-state businesses must operate, competition policy implications arise from a number of provisions in the Uruguay Round package of Agreements (such as GATS[27] and TRIPS[28]), as well as subsequent agreements (such as the Agreement on Telecommunications Services). An institutional framework for further discussion was provided when the Singapore Ministerial Conference in December 1996, the first after the coming into force of the Uruguay Round Agreements, established a Working Group "to study issues raised by members relating to the interaction between trade and competition policy, including anti-competitive practices, in order to identify any areas that may merit further consideration in the WTO framework."[29]

2.1 The rationale for an international approach to competition policy

11–019 In October 1999 the EU's Council of Ministers adopted a set of Conclusions on the planned Millennium Round negotiations, a position statement which established a negotiating mandate for the Commission. This wide-ranging and ambitious agenda was based on four "broad objectives":

> "strengthening the WTO rules-based system, promoting the further liberalisation of trade, improving the integration of developing countries into the multilateral trading system, addressing the interface between trade and related issues and policies."[30]

11–020 For the EU, the trade and competition issue relates to all four of these objectives. The Council puts its support behind a new agreement on competition:

> "The WTO should begin negotiations on a basic framework of binding core principles and rules on domestic competition law and policy and its enforcement. The WTO principles of transparency and non-discrimination would provide key foundations for the development of such core principles and rules. The WTO should also aim at developing common approaches on anti-competitive practices with a significant impact on international trade and investment as well as on the promotion of international co-operation. The development dimension should also be at the centre of the considerations of such a multilateral framework by combining possible transitional periods together with technical assistance and flexibility in the rules."[31]

[26] The "built-in" agenda includes those items for which further negotiations are provided within the Uruguay Round Agreements themselves, for example agriculture under Art.20 of the Agreement on Agriculture. Art.9 of the TRIMS Agreement (one of the Annex 1A Agreements on Trade in Goods) provides for a review of that Agreement within five years of its entry into force by the Council for Trade in Goods, including consideration of "whether the Agreement should be complemented with provisions on investment policy and competition policy."

[27] See Arts VIII and IX of GATS.

[28] See Arts 8, 39 and 40 of TRIPS. Smith, "A Long and Winding Road: TRIPS and the Evolution of an International Competition Framework" (1999) JIEL 435.

[29] Singapore Ministerial Declaration, WT/MIN(96)/DEC/W, December 13, 1996, para. 30.

[30] Conclusions of General Affairs Council on the preparation for the Third WTO Ministerial Conference, October 26, 1999, at para. 3.

11–021 The link between international trade and competition based on liberalization and market access is well known to those familiar with the EC Treaty's approach to public and private barriers to cross-border trade. The market access argument is essentially that in spite of different perspectives[32] both international trade law and competition policy serve the same objective of open markets, and that the fundamental WTO principle of non-discrimination is intended to ensure equality of competitive opportunity as between products (and companies) of different national origin.[33] Competition policy is necessary to prevent prohibited public barriers to trade being replaced by anti-competitive private business practices. This argument has been sharpened by the fact that the growing membership of the WTO includes state trading (or non-market economy) countries, such as China, bringing the interface between trade liberalisation, state trading activities and competition into relief. However, there is a broader pragmatic rationale for an internationalised approach to competition policy: anti-competitive practices such as international cartels or international mergers which affect more than one State lead to simultaneous investigation and enforcement activity by more than one national competition authority, and jurisdictional and enforcement conflicts between authorities.

11–022 These essentially institutional problems are increasing with the growth of both national competition laws and the globalisation of business.[34] Combined with differences between national policies, they also increase compliance costs for companies involved in cross-border business.[35] Pitofsky, Chairman of the

[31] Conclusions of General Affairs Council on the preparation for the Third WTO Ministerial Conference, October 26, 1999, at para. 11(d).

[32] Tarullo points out that trade and competition authorities often have very different perspectives, which although sometimes complementary may conflict; in particular trade negotiators tend to pursue the interests of their own national businesses: Tarullo, "Competition Policy for Global Markets" (1999) JIEL 445 at 446. This issue is also discussed in the 1998 Report of the WTO Working Group on the Interaction Between Trade and Competition Policy to the General Council, December 8, 1998, WT/WGTCP/2, section C.1.(a).

[33] See the submission from the EC and its Member States to the WTO Working Group on Trade and Competition Policy, on "The relevance of fundamental WTO principles of national treatment, transparency and most favoured nation treatment to competition policy and vice versa", April 12, 1999, WT/WGTCP/W/115, section I.

[34] 82 countries have some kind of competition law and 24 are in the process of drafting or enacting such a law: Pitofsky, "Competition Policy in a Global Economy" (1999) JIEL 403, at 403.

[35] Melamed identifies three types of problem: competition problems with similar effects in several countries, such as international cartels; problems where the effects are felt in one country but much of the evidence is located in another (for example, export cartels), and cases where the effects are different for different countries, including the market access cases. Melamed, "International Co-operation in Competition Law and Policy: What can be Achieved at the bilateral, Regional and Multilateral Levels" (1999) JIEL 423 at 424. The Report of the Group of Experts, "Competition Policy in the New Trade Order: Strengthening International Co-operation and Rules", Brussels, July 1995, identifies similar problems, although they (writing from an EU perspective) also include the problem of some competition authorities' extension of jurisdiction and lack of attention to

U.S. Federal Trade Commission, emphasises the burden of divergent regulatory norms in words which reflect the confidence of a dominant model:

> "[I]nconsistent anti-trust enforcement and divergence of anti-trust rules from country to country, at least where they are unfair, unwise or enforced in a discriminatory manner, create an unlevel playing field on which firms must operate in international competition, and these are a burden on international commerce."[36]

11–023 This analysis would seem to suggest support for an international approach to competition policy from both national authorities and international business interests. It is not so simple. The need for a separate "horizontal" agreement on competition in addition to specific sectoral measures is still strongly contested, as well as its putative content. In particular, is an international competition code required, or rather a basic framework for procedural co-operation between national authorities? If a code, should this be compulsory or voluntary, how detailed should its fundamental principles be, and how should it be enforced? The three reports so far produced by the WTO Working Group on Trade and Competition Policy reflect this contention, and in particular whether the Working Group should examine all aspects of competition policy as they may affect trade, or focus primarily on aspects of the trade and competition relationship traditionally within the scope of the WTO, such as anti-competitive conduct of government or state origin, and the importance of the basic WTO disciplines of transparency, MFN and national treatment for the application of competition policy.[37]

11–024 The arguments in favour of some form of new horizontal competition agreement are, predictably but justifiably, based not only on the need for international business to be able to enter open competitive markets, but also on the need for developing and emerging economies to protect themselves against the abuse of monopoly power, whether domestic or imported.

> "The more economies are integrated into the global system the more they need competition rules to control the power of global businesses in their markets. It is argued that the absence or inappropriate enforcement of competition rules can create barriers to trade. That is certainly true. A commitment by WTO members to a common set of competition law principles would be a helpful way of addressing both issues. Countries also need to have measures to control restrictive business practices in order to reap the full benefits of trade liberalisation."[38]

11–025 The 1998 Report of the WTO Working Group on Trade and Competition Policy also reflects the complementarity of competition policy and economic development. Competition law may be adopted as part of a package with trade liberalisation, foreign investment regimes and other economic reforms

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their partner's interests. See also Tarullo, "Competition Policy for Global Markets" (1999) JIEL 445 at 447-450; while not denying their significance, especially in the medium-longer term, Tarullo argues that these problems are still "of limited scope and urgency".

[36] Pitofsky, "Competition Policy in a Global Economy" (1999) JIEL 403, at 404.

[37] The Working Group has to date produced three reports to the General Council: November 28, 1997, WT/WGTCP/1; December 8, 1998, WT/WGTCP/2; October 11, 1999, WT/WGTCP/3.

[38] Lord McIntosh of Haringey, HL Deb, April 19, 2000, col 787; cited in House of Lords Select Committee on the European Communities, Tenth Report, June 13, 2000 "The World Trade Organisation: The EU Mandate after Seattle" at para. 184; see http://www.parliament.the-stationery-office.co.uk/pa/ld199900/ldselect/ldeucom/76/7601.htm.

such as privatisation and deregulation; in such cases "competition policy would act as a catalyst for economic reform and development based on market-oriented principles."[39] As the EU's Group of Experts Report points out, the absence of a functioning competition policy may result not only in less efficient market development but also the risk of being subjected to the extraterritorial application of third countries' competition laws by agencies which will not share the same policy interests.[40]

11–026 The EU Commissioner for Trade, Pascal Lamy, has linked the economic development arguments with the need to address the concerns of civil society over the legitimacy, transparency and responsiveness of the WTO system:

> "Essentially, we want to fix some basic rules in the WTO so that all countries around the world start to think competition, start to put in place a basic infrastructure of competition law and policy, agreed principles, and mechanisms for co-operation between competition authorities. It's a development issue as much as a trade issue."[41]

> ". . . Surely, if we are to counter accusations that the WTO is the lap-dog of the multinationals, what better way than by starting to work on ensuring fair competition and a level playing field for all, large and small?"[42]

11–027 This objective of ensuring fair play through competition rules forms part of a rule-based approach to trade liberalisation:

> "Indeed, a Round has to update the WTO rules across the board: not to bring us towards some utopian dream of global government, but to start to impact on global governance, in other words predictability, stability, transparency in the rules, and rule-making capacity, of the global institutions"[43]

11–028 In the discussion over possible multilateral approaches to trade and competition policy, four options[44] have emerged:

- a multilateral agreement containing mandatory (minimum) standards for competition legislation, including enforcement;
- a sectoral approach: including specific competition provisions in sectoral agreements such as the Telecommunications Agreement;

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[39] Report of the Working Group on the Interaction Between Trade and Competition Policy to the General Council (1998), December 8, 1998, WT/WGTCP/2, sect.C I.(a).

[40] Report of the Group of Experts, "Competition Policy in the New Trade Order: Strengthening International Co-operation and Rules", Brussels, July 1995.

[41] Commissioner Pascal Lamy, Speech to United States Council for International Business, New York, June 8, 2000.

[42] Commissioner Pascal Lamy, Speech to Confederation of Indian Industries, March 6, 2000, cited in House of Lords Select Committee on the European Communities, Tenth Report, *op.cit.* at n. 37 at para 184.

[43] "Strengthening the Multilateral System", speech by Pascal Lamy to the Foreign Correspondents" Club, Tokyo, July 18, 2000; http://europa.eu.int/comm/trade/speeches_articles/spla29_en.htm.

[44] One might add the theoretical option of the establishment of an international competition authority with direct enforcement powers (a European Commission writ large), but even the Commission, in its 1996 Communication, does not see this as a "feasible option for the medium term": Commission Communication of June 17, 1996, "Towards an International Framework of Competition Rules', COM(96) 284, at section III.

- a multilateral framework that does not specify or require individual members to introduce any comprehensive competition law, but merely prescribes principles to be followed if a member wishes to introduce competition law.
- a plurilateral framework, such as the existing Agreement on Government Procurement, which contains mandatory rules but which does not form a compulsory part of any New Round package of commitments.

11–029 In addition, there are those who take the view that formal agreements on competition are only really feasible at a bilateral level between countries with similar approaches, expectations and levels of enforcement infrastructure. On this view, multilateral fora such as the WTO Working Group on Trade and Competition Policy are best suited to exchanges of views and experiences with the aim of gradually building convergence but without the immediate objective of an international "competition code" in any sense.

2.2 The EU position

11–030 Since the conclusion of the Uruguay Round, the European Union position, in contrast to that of the USA, has been moving towards support for a comprehensive agreement on competition, which would include "core principles and rules" as well as provisions on co-operation. In fact the rationale for the EU's position can be traced back considerably further; it derives from a sense that the EU's open approach to the external dimension of the internal market demands a degree of reciprocity from its partners. In 1988 the Commission, in seeking to categorise the 1992 single market programme as the creation of "partner Europe" rather than "Fortress Europe", stated that the Community's aim would be "to strengthen the multilateral system in accordance with the two principles of balance of mutual advantage and reciprocity".[45] A strengthening of competition policy was included as one element of this strategy although the focus was here on the international dimension of domestic EC policy rather than on developing new international rules.

11–031 In July 1995 the consultative Report of a Group of Experts commissioned by the European Commission was published.[46] In his introduction to the report, the then Competition Commissioner Karel van Miert reflects this view: open markets require effective competition policies, and the EU will look for reciprocity not only in the opening of markets but also in the development of competition principles and rules. The Report itself was not intended to represent EU policy in any formal sense, but has undoubtedly influenced its direction, particularly in its recommendation that that policy should move forward on both the bilateral and multilateral fronts in parallel:

[45] Commission paper, "Europe a world partner: the external dimension of the single market", Bull.EC 10-1988 p.10.

[46] "Competition Policy in the New Trade Order: Strengthening International Co-operation and Rules", Report of the Group of Experts, Brussels, July 1995. The Group of Experts included Commission officials (participating "on a personal basis") and external experts including Frédéric Jenny, now Chair of the WTO Working Group on Trade and Competition Policy.

deepening existing forms of co-operation through bilateral agreements, and at the same time developing a multilateral framework which would adopt many of the ingredients already included in bilateral agreements. In its follow-up Communication to the Council in June 1996, the Commission examines the case for the adoption of international competition rules from both a competition and a trade perspective. From both perspectives, the element of reciprocity is important, linked to equal conditions of competition and equality of market access:

> "The Community interest is to seek the same commitment to competition enforcement from our partners in their markets as we apply to operators, irrespective of their origin, on ours."[47]

11–032 The Commission agreed with the Group of Experts that bilateral and multilateral policies would be "complementary and mutually supportive", while stressing that in its judgement, bilateral co-operation agreements alone will not be sufficient; such agreements

> "remain limited in scope and in effect. In scope, because although increasing, only the EU and a limited number of countries which are very actively involved in enforcing competition policies, have entered such agreements; and, in effect, because these agreements do not contain substantive rules or principles."[48]

11–033 These 1996 proposals, although then described by the Commission as "modest" and incremental, now seem ambitious. It stresses the need for binding commitments, covering the adoption of domestic competition structures and common rules, co-operation between competition authorities and dispute settlement procedures. The Commission shares the view of the Group of Experts that the greatest scope for progress lies in a plurilateral agreement; a plurilateral framework, initially based on groups of countries where strong regional co-operation already exists[49] would allow for evolution in terms of geographical and substantive coverage and enforcement.[50] In more immediate terms, the Commission recommended that the Council's conclusions in preparation for the Singapore WTO Ministerial Meeting in December 1996 should support the creation of a WTO Working Group with a remit to explore the development of an international framework of competition rules. Following this Communication, an informal meeting of trade ministers in Dublin in September 1996 included as one of the Community's "key priorities" the need for the WTO "to broaden at Singapore its work-programme to adapt itself to new realities of the world economy in particular on investment

[47] Commission Communication of June 17, 1996, "Towards an International Framework of Competition Rules', COM(96) 284, at section I(b).

[48] *ibid.*, at section I(e).

[49] For example, NAFTA, EU (and the countries of central and eastern Europe) and Australia-New Zealand, however a viable plurilateral agreement should also include at least Japan and other Asian industrialized states. Apart from the EU and its Member States only 10 states are signatory to the plurilateral Government Procurement Agreement, although this does include the USA, Canada and Japan.

[50] COM(96) 284 at section IV(a). Report of the Group of Experts (see n. 31) at para. IV.1. In their view, a network of bilateral agreements will not in themselves produce a level playing field, but would make conclusion and operation of a plurilateral agreement easier: *ibid.* at para. IV.3.

and competition"[51] and the decision to approve the final text of the Ministerial Declaration was taken at a special session of the General Affairs Council in Singapore. The Ministerial Declaration established the Working Group on Trade and Competition Policy, although (unsurprisingly) with a generalised remit to "identify any areas that may merit further consideration", rather than a specific mandate to explore the possibility of a common framework of rules such as the Commission had envisaged.

11–034 As we have seen, discussion within the Working Group reflects the very different perspectives of the WTO members as to both the desirability and feasibility of such a framework. Although the 1996 Communication still forms the basis of Community policy, the Community position has also become more nuanced since 1996, in the course of a number of internal Commission policy papers and Communications to the Working Group from the Community and Member States, in which the Community builds the case for a multilateral framework of rules.[52] The Council's negotiating mandate for the Seattle Ministerial Conference in Seattle reaffirmed the EU's support for the inclusion of competition in the agenda for a new round of negotiations, with the three-part aim of agreeing a "basic framework of core principles and rules", developing "common approaches" on certain key anti-competitive practices, and the promotion of international co-operation.[53] As a Commission discussion paper in March 1999 admitted,[54] a strategy for building support for this agenda was needed, and part of this strategy has been to emphasise the "development-friendly" aspects of these objectives, not only the benefits of an effective competition policy for development but also flexibility, transitional periods and technical assistance in the implementation of internationally agreed rules.

11–035 Although the EU would still like to see an agreement on competition,[55] it is not looking for agreement on detailed and specific substantive rules, which would amount to a form of minimum harmonisation on the EU model, still less the creation of some form of international agency with investigative or enforcement powers. Rather, it stresses the flexibility of "core principles" and "common approaches":

[51] Presidency Conclusions reflecting the outcome of the informal meeting of trade ministers in Dublin on September 19, 1996, para. 3; included in Annex to Conclusions of the General Affairs Council meeting of October 1, 1996.

[52] See for example, Commission Discussion Paper of March 19, 1999 on Trade and Competition, prepared in the run-up to the Seattle Ministerial Conference in December 1999; Communication from the European Community and its Member States to the Working Group on Trade and Competition Policy, "Impact of Anti-competitive Practices on Trade", February 23, 1998; Communication from the European Community and its Member States to the Working Group on Trade and Competition Policy, "The contribution of competition policy to achieving the objectives of the WTO, including the promotion of international trade", July 12, 1999, WT/WGTCP/W/130. We cannot analyse each one of these dozen Communications in this chapter; for texts, see: http://europa.eu.int/comm/trade/miti/compet/contrib.htm

[53] Conclusions of GAC in preparation for the WTO Ministerial Conference in Seattle, 26 October 1999. See text at n. 30 *supra*.

[54] Commission Discussion Paper on Trade and Competition, March 19, 1999.

[55] See in particular, the submission from the EC and its Member States to the WTO Working Group on "A Multilateral Framework Agreement on Competition Policy", September 25, 2000, WT/WGTCP/W/152.

> "The EU approach has aimed at dispelling the myth that there is no middle way between the development of a hard and fast rule and the total absence of multilateral disciplines. . . . rather than seek to establish "minimum common standards" we have advocated a flexible approach based on the need to develop common approaches in relation to anti-competitive practices with a significant impact on international trade and investment."[56]

The flexibility of common approaches, using agreed assessment criteria, would allow scope for development, so that as convergence increases, consensus on rules can evolve. These will be underpinned by core principles relating to the formulation of a domestic system of competition law and its enforcement which, the Commission has argued, can be drawn from existing WTO principles, including transparency, non-discrimination and procedural fairness.[57] The third strand of this strategy is international co-operation, seeking to build on existing bilateral co-operation (whether informal or formalised in bilateral agreements), to resolve jurisdictional conflicts and to provide an institutional structure to share information, experience and good practice and provide technical assistance and advice.[58] **11–036**

Finally, the difficult question of dispute settlement would need to be resolved. The existence of a credible dispute settlement procedure is one reason the Commission puts forward for preferring the WTO to (for example) the OECD as a forum for the development of a competition agreement.[59] Nevertheless, the Commission also resists any idea that international dispute settlement should be open to private parties; the criteria for an effective domestic competition policy should include scope for private party challenge to a competition authority's decision, but dispute settlement under any new agreement should (in the Commission's view) remain intergovernmental.[60] The Community envisages an agreement that would impose obligations on the State parties, requiring enactment of domestic legislation, but which would not directly create rights or obligations for private parties.[61] Others are sceptical as to the suitability of the WTO as a forum for resolving the problems of competition policy.[62] Even if WTO-based dispute settlement **11–037**

[56] Commission Discussion Paper on Trade and Competition, March 19, 1999.

[57] See further the submission from the EC and its Member States to the WTO Working Group on "The relevance of fundamental WTO principles of national treatment, transparency and most favoured nation treatment to competition policy and vice versa", April 12, 1999, WT/WGTCP/W/115.

[58] This would encompass negative and possibly also positive comity; negative comity involves taking the interests of other states into account, positive comity involves one authority agreeing to investigate on request from another: see discussion at n. 74 below.

[59] Commission Communication of June 17, 1996, "Towards an International Framework of Competition Rules', COM (96) 284.

[60] This approach reflects the current position in relation to anti-dumping measures.

[61] Submission from the EC and its Member States to the WTO Working Group on "The relevance of fundamental WTO principles of national treatment, transparency and most favoured nation treatment to competition policy and vice versa", April 12, 1999, WT/WGTCP/W/115. The unstated implication is that private parties, as well as being denied recourse to the WTO dispute settlement procedure, would not be able to enforce the envisaged agreement in national courts. This would have to be read in the light of the so-called "*Nakajima* principle": see case C-69/89 *Nakajima* [1991] E.C.R. I-2069, and most recently, case C-149/96 *Portugal v. Council* [1999]E.C.R I-8395.

[62] See Tarullo, "Competition Policy for Global Markets" (1999) JIEL 445 at p.450-452 for a clear analysis of the difficulties inherent in using WTO mechanisms for enforcing even a limited code.

were limited to ensuring that members' domestic competition laws complied with the agreed framework of "core principles and common approaches", difficult issues would arise where a dispute ultimately challenged the legitimacy of approach or a decision of a national authority in a specific case.[63]

11–038 After Seattle, the Community's position was confirmed by the Informal Trade Council in March 2000 and in position papers since then the Community has reaffirmed its support for a multilateral agreement on competition based on core principles applying to domestic competition law and policy, international co-operation and support for the reinforcement of competition institutions in developing countries.[64] A core principles approach "does not imply harmonisation", providing instead a basis for convergence.[65] The five core principles identified by the Community in September 2000 as a basis for discussion are:

- the existence of a competition authority possessing sufficient enforcement powers;
- domestic competition law to be based on the principle of non-discrimination on grounds of the nationality of firms;
- transparency as regards the legislative framework, including any sectoral exclusions;
- guarantees of due process; and
- agreement that "hard-core" cartels should be treated as a serious breach of competition law.[66]

11–039 The Community does not see this multilateral initiative, even if successful, as replacing its bilateral and regional commitments; it predicts complementarity and synergy between the different levels and modes of co-operation. It is certainly true that we can trace a two-way process here: on the one hand, the Community has been influenced in the development of its multilateral strategy and proposals by its experience of bilateral and regional agreements; on the other, the establishment of a common approach and core principles at a multilateral level will feed into bilateral agreements, providing a basis for further and perhaps more detailed commitments. Given that provisions on competition policy are now an almost indispensable feature of the Community's bilateral agreements this synergy is important. In the next section, we will turn to examine the Community's bilateral approaches to competition policy before, in the final section, drawing some conclusions as to the way in which the multilateral and bilateral interact.

[63] The Commission is clear that there should be no review of individual decisions but suggests exploration of the possibility of a panel review in cases of an alleged "pattern of failure" to enforce competition laws in cases affecting the interests of other Members: Commission Discussion Paper on Trade and Competition, March 19, 1999.

[64] Submission from the EC and its Member States to the WTO Working Group on "A Multilateral Framework Agreement on Competition Policy", September 25, 2000, WT/WGTCP/W/152.

[65] *ibid.* at p.5.

[66] "Hard-core" cartels are "generally understood to be agreements among actual or potential competitors involving price fixing, bid rigging, output restrictions or customer allocation and market divisions." *ibid.* at p.8.

3. The bilateral dimension to EU policy: from co-operation to harmonisation

There is no single model for a competition clause in a Community agreement. As a general initial classification we can identify three basic types. 11–040

First, provision for co-operation between national (or Community) competition authorities, including provision for negative and positive comity; such measures may appear as a free-standing agreement on competition co-operation or within a wider trade or association agreement. 11–041

Second, provisions which are concerned with competition in the context of trade between the contracting parties; such clauses will be included in agreements designed to liberalize trade between the parties and are designed to prevent private actors distorting competitive conditions in a liberalized market. 11–042

Third, measures essentially concerned with substantive and/or procedural standard-setting, or even harmonisation, within domestic legal systems; these clauses will form part of a wider agreement designed to establish closer relations with the Community and will often have a development dimension; as such they are accompanied by provision for technical assistance in developing regulatory capacity. It will be noticed that these different types of clause (which are of course not mutually exclusive) address the three different types of international competition problem identified both by the Commission and by the WTO Working Group.[67] 11–043

3.1 Bilateral co-operation agreements

Bilateral co-operation agreements have been concluded by the EC with both the USA[68] and Canada.[69] These are agreements specifically dealing with competition policy, and are the most fully worked-out examples of co-operation agreement, but there are also co-operation provisions in other agreements, notably the European Economic Area Agreement, the Europe Agreements and the customs union Decision of the EU–Turkey Association Council. In the case of the Europe Agreements and Turkey, provisions for the implementation of co-operation on competition policy between the EC and the 11–044

[67] See text at n. 35 *et seq.* As summarised by the Commission, these are first, anticompetitive practices which impact on more than one market and which may therefore give rise to jurisdictional problems and the need for co-operation between national authorities; secondly, anticompetitive practices which hinder market access, whether or not the result of inadequate competition law or enforcement; and thirdly, anticompetitive practices the effects of which are felt on a third country market; see Commission Discussion Paper on Trade and Competition, March 19, 1999.

[68] EC – USA Agreement on competition 1995 O.J. L95/45; EC - USA Agreement on the application of positive comity principles in the enforcement of competition laws 1998 O.J. L173/26.

[69] Agreement between EC and Canada regarding the application of their competition laws 1999 O.J. L175/50.

respective associated states were to be adopted by Decision of the relevant Association Council. There is no bilateral agreement between the EU and Japan, but regular bilateral meetings are held to discuss competition issues and the possibility of an agreement has been discussed. Co-operation with other industrialised states such as Australia and New Zealand takes place within the framework not of a formal agreement, but of the OECD recommendation of 1986 which is limited to notification and exchanges of information.[70]

11–045 Two basic objectives underlie bilateral co-operation agreements such as that between the EC and the USA: co-operation in the implementation of the law (for example, co-operation in merger control to ensure that incompatible conditions are not imposed by the different authorities) and co-operation in the avoidance or management of disputes (including jurisdictional conflicts and positive comity provisions).[71] In principle, these agreements may establish a framework for an evolutionary process, developing from the simple exchange of non-confidential information, to more intensive co-operation including positive comity and even exchanges of confidential information. The EC – USA relationship is an example of evolution, with the 1998 agreement on positive comity building on the positive comity provision in the 1991 agreement.

3.1.1 The EC – USA Co-operation Agreements

11–046 The 1991 agreement covers notification and exchanges of information[72] co-operation in enforcement including the possibility of co-ordination,[73] and negative and positive comity.

11–047 Negative comity, essentially a self-restraint provision in relation to the extra-territorial application of competition law, seeks to avoid conflict by requiring each party to take account of the "important interests" of the other and an "appropriate accommodation" of competing interests.[74]

Under the provision on positive comity in the 1991 agreement, each party may request the other party to initiate investigative and enforcement action where it believes that its interests are adversely affected by anti-competitive practices in the other party's territory.[75] The provision does not impose any obligation, either on the requested agency to act, or on the requesting agency to refrain from acting itself.

11–048 The 1998 agreement elaborates on the application of these positive comity principles; in particular it is agreed that the requesting agency will normally suspend or defer its own enforcement activity during the continuation of enforcement procedures by the requested agency, while recognising that

[70] See n. 25.
[71] The agreement between the EC and Canada (see *supra* n. 69) mirrors the EC – USA Agreement of 1991. The Report for 1999 of the WTO Working Group on the Interaction between Trade and Competition Policy contains a useful discussion of the different aims and types of co-operation; Report of October 11, 1999, WT/WGTCP/3.
[72] EC – USA Agreement on competition 1995 O.J. L95/45, Arts II and III.
[73] *ibid.* Art. IV.
[74] EC – USA Agreement on competition 1995 O.J. L95/45, Art VI.
[75] *ibid.* Art. V.

sometimes action by both parties may be appropriate.[76] These clauses have two connected aims: to ensure that anticompetitive conduct with a cross-border dimension does not thereby escape the enforcement agencies, and to achieve the most effective and efficient allocation of resources between the parties.[77] In its annual Report on the operation of the EC – USA agreement covering 1998, the Commission says that the agreement on positive comity is "an important development, since it represents a commitment on the part of the European Union and the United States to co-operate with respect to antitrust enforcement in certain situations, rather than to seek to apply their antitrust laws extraterritorially."[78] Provisions of this type (as opposed to simpler information exchange provisions) clearly require a high degree of trust between the parties, which may need building up over a period of dialogue and co-operation. The Commission Report for 1998 describes this relationship:

> "In all cases of mutual interest it has become the norm to establish contacts at the outset in order to exchange views and, when appropriate, to co-ordinate enforcement activities. The two sides, where appropriate, seek to co-ordinate their respective approaches on the definition of relevant markets, on possible remedies in order to ensure that they do not conflict, as well as on points of foreign law relevant to the interpretation of an agreement or to the effectiveness of a remedy. Co-operation under this heading has involved the synchronisation of investigations and searches."[79]

11–050 As the quotation illustrates, the Commission is generally positive as to the effectiveness of the co-operation agreement. One of the major constraints has proved to be confidentiality of information. Neither the 1991 nor the 1998 agreements alter the existing laws of either party as far as confidential information is concerned. The Commission is under a duty of confidentiality under Regulation 17/62 and the agreement makes it clear that neither party may be required to disclose information where disclosure would be prohibited by the law of that party.[80] On the conclusion of the 1998 agreement the Commission made a Statement on Confidentiality of Information, in which it points out:

> "Article VII of this Agreement states that existing laws remain unchanged and that the Agreement must be interpreted consistently with those existing laws. This Agreement therefore cannot permit either of the Parties" competition authorities to do any act they do not already have the power to do. One consequence of this is that the Commission may only provide information to the U.S. authorities where it is consistent with Community law to do so."[81]

[76] EC – USA Agreement on the application of positive comity principles in the enforcement of competition laws 1998 O.J. L173/26, Arts III and IV.
[77] *ibid.* Art. I(2).
[78] Commission Report to the Council and European Parliament on the operation of the EC – USA competition agreement, April 2, 1999. See also Reports on 1995-96, COM (96) 479 final; on 1996, COM (97) 346 final and 1997, COM (98) 510 final.
[79] Commission Report to the Council and European Parliament on the operation of the EC – USA competition agreement, April 2, 1999 at p.2.
[80] Regulation 17 O.J. English special edition Series-I (59–62) p. 87, Art 20 (for consolidated version, see http://europa.eu.int/eur-lex/en/consleg/pdf/1962/en_1962R0017_do_001.pdf); EC – USA Agreement on competition 1995 O.J. 95/45, Art. VIII, together with an exchange of interpretative letters, and EC – USA Agreement on the application of positive comity principles in the enforcement of competition laws 1998 O.J. L173/26, Art. V.
[81] The Statement on Confidentiality of Information is quoted in the Commission's Report for 1998, April 2, 1999, p.6.

11–051 In practice this means that the consent of the undertaking concerned is needed. This may well be forthcoming as it is in the undertaking's own interest that the investigation proceeds efficiently on both sides of the Atlantic; in its Report for 1998 the Commission refers to the Microsoft case, where Microsoft agreed to the exchange of confidential information between the Commission and the Department of Justice. However, in the nature of things, such consent is less likely to be forthcoming in cartel cases. The Report of the Group of Experts in 1995 recommended increasing the level of bilateral co-operation, both in extent—the conclusion of similar agreements with more countries, including Japan[82]—and depth—with greater use of positive comity and provision for the exchange of confidential information.[83] Certainly the exchange of confidential information is much more likely to be agreed in the context of a bilateral agreement between domestic authorities that know and trust each other: the Commission has said that it would be premature to include exchange of confidential information in the co-operation provisions of a putative multilateral agreement. This example illustrates that while it will be possible to multilateralise the principle of co-operation, some of the more intensive forms of co-operation are difficult to translate from the bilateral to multilateral level.

3.1.2 Co-operation in the European Economic Area Agreement

11–052 Co-operation also forms one aspect of the extensive competition provisions in the EEA. These provisions are based on two initial decisions: first, that in spite of the overall objective of homogeneity there would be a two-pillar approach to competition enforcement within the EEA, encompassing the EC Commission and the (newly-created) EFTA Surveillance Authority;[84] and second that each individual case would be subject to investigation by one only of these two authorities. This meant that in addition to provisions for practical co-operation designed to underpin homogeneity, there was a need for clear jurisdictional rules. The EEA contains both. Article 58 provides that the Commission and the EFTA Surveillance Authority will co-operate in accordance with Protocols 23 and 24, with a view to "uniform surveillance" throughout the EEA, and the promotion of homogeneous implementation, application and interpretation of the agreement. Protocol 23 (co-operation in cases falling under Article 53 and 54 EEA, that is the equivalents of Articles 81 and 82) and Protocol 24 (co-operation in relation to control of concentrations under Article 57 EEA) cover exchanges of notification, documents and other information, mutual assistance, consultation and rights of representation at hearings. Significantly, both Protocols allow for the exchange of confidential information. In addition, Article 110 EEA provides for the mutual enforcement of decisions of the Commission, the European Court of Justice and the EFTA Surveillance Authority and EFTA Court.

[82] The Joint Conclusions on the Economic and Trade Partnership at the EU–Japan Summit held in Tokyo on July 19, 2000 look forward to a future bilateral agreement on competition policy.
[83] See n. 46.
[84] See Protocol 21 on the Implementation of Competition Rules Applicable to Undertakings, and Agreement between EFTA States on establishing EFTA Surveillance Authority and EFTA Court [1994] O.J. L344/1.

11–053 The jurisdictional rules in the EEA agreement are designed so as not to give rise to "any transfer of powers to the EFTA Surveillance Authority and the EFTA Court" from the Community institutions.[85] The overall effect of Articles 56 EEA is that all "mixed" cases (these are cases where both Article 81 EC and Article 53 EEA may apply) will fall within the jurisdiction of the EC Commission unless there is no appreciable effect on trade within EC. In addition, the EC Commission has jurisdiction in cases where there is no affect on trade between the EU Member States (so Articles 81 will not apply) but trade is affected between one Member State and one or more EFTA States, subject to a turnover threshold.[86] Similarly in cases of abuse of a dominant position, Article 56(2) EEA provides that cases are to be decided by the authority in whose territory a dominant position is found to exist; if the dominant position is present in both, the jurisdictional rules applicable to Article 53 apply, so that in cases where there is an appreciable effect on trade between the EU Member States, the EC Commission will have jurisdiction. In *Opinion 1/92*, the Court of Justice accepted that these provisions do not encroach on the Community's existing powers, and more importantly, that the Community had competence to enter into competence allocation agreements of this type:

> ". . . the Community may accept rules made by virtue of an agreement as to the sharing of the respective competences of the Contracting Parties in the field of competition, provided that those rules do not change the nature of the powers of the Community and of its institutions as conceived in the Treaty."[87]

11–054 The EEA therefore goes considerably further than the co-operation agreements with the USA or Canada, in its provisions on rights of representation, confidential information, and jurisdiction. They reflect the aim of the EEA to produce a "homogeneous European Economic Area"[88] with two competition authorities developing in parallel policy based on substantially identical rules in the context of a highly integrated market.

3.1.3 Co-operation in other agreements

11-055 It might have been expected that similar jurisdictional rules would be incorporated into the implementing rules on competition policy adopted by the Association Councils within the framework of the Europe Agreements.[89] However, these implementing rules instead adopt a comity-based approach,

[85] Summary of the Commission's request for an opinion, *Opinion 1/92* [1992] E.C.R. I-2821.
[86] Where the turnover of the undertakings concerned within the EFTA States represents more than 33% of the combined EEA turnover, then the EFTA Surveillance Authority will have jurisdiction unless trade between EU Member States is affected: Art. 56(1)(b) and (c). The concepts of "undertaking" and "turnover" are dealt with in Protocol 22. The Commission claims this jurisdiction as an "entirely new power": summary of the Commission's request for an opinion, *Opinion 1/92* [1992] E.C.R. I-2821.
[87] *Opinion 1/92* [1992] E.C.R. I-2821, at para. 41.
[88] Art.1(1) EEA.
[89] Europe Agreements have been concluded with ten Central and Eastern European States (Hungary, Poland, Romania, Bulgaria, Slovakia, Czech Republic, Estonia, Latvia, Lithuania and Slovenia). These implementing rules were to be adopted by the Association Council within three years of the entry into force of the Agreements; see, for example, the Europe Agreement

recognising that there will be overlapping jurisdiction between the EC Commission and national authorities in the Associated States. To take the Polish rules as an example:

> "The competencies of the Commission and the AMO [Polish Antimonopoly Office] to deal with these cases shall flow from the existing rules of the respective legislation of the Community and Poland, including where these rules are applied to undertakings located outside the respective territory. Both authorities shall settle the cases in accordance with their own substantive rules."[90]

11-056 Cases under the Agreements which may affect both the Community and the market of the Associated State and which may fall under the competence of both competition authorities shall be dealt by both the Commission and the relevant competition authority in accordance with the co-operation and co-ordination provisions.[91] Notification, consultation and comity (positive and negative) and the provision of information (subject to confidentiality in the same way as within the agreements with the USA and Canada) are all covered. In cases where the such procedures do not lead to a "mutually acceptable" solution, the Association Council may act as a forum for an exchange of views and may make recommendations, but these will be "without prejudice to any action under the respective competition laws in force in the territory of the Parties."[92] Again, therefore, the Commission does not cede any competence.

11-057 Other agreements, including those with less-developed economies, also contain provision for co-operation and comity. The Euro-Mediterranean Association Agreements that have been concluded with (so far) Tunisia, Morocco, Israel, Jordan and Egypt contain provisions on competition policy very similar to the Europe Agreements and it is likely that the implementing rules will follow the same pattern. The so-called "Global Agreement" with Mexico signed in 1997 provided that:

> "The Joint Council shall establish mechanisms of co-operation and co-ordination among their authorities with responsibility for the implementation of competition rules. Co-operation shall include mutual legal assistance, notification, consultation and exchange of information in order to ensure transparency relating to the enforcement of competition laws and policies."[93]

11–058 In March 2000, the EC-Mexico Joint Council adopted a Decision (which came into force on July 1, 2000) for the implementation of trade aspects of the Global Agreement which included provision for co-operation in competition.[94]

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with Poland 1993 O.J L348/2, Art.63(3) and Decision 1/96 of the Association Council adopting the implementing rules 1996 O.J. L208/24. For an effective critique of the implementing rules, see Van den Bossche, "The International Dimension of EC Competition Law: The Case of the Europe Agreements" (1997) 18 E.C.L.R. 24

[90] Decision 1/96 of the EU – Poland Association Council adopting the implementing rules 1996 O.J. L208/24, Arts.1

[91] *ibid.*, Art.2.

[92] *ibid.*, Art.9.

[93] Economic Partnership, Political Co-ordination and Co-operation Agreement between the EC, its Member States and the United Mexican States 1997 O.J. C350/6, COM (97) 527, Art 11.

[94] The Global Agreement itself is not yet in force; however, the Interim Agreement on Trade came into force in July 1998, and Decision 2/2000 of the Joint Council of the Interim Agreement

Under Article 39 of this Decision, a "mechanism of co-operation" between the authorities of the Parties with responsibility for implementation of competition rules is established, and the details of this mechanism are set out in an Annex which covers the usual co-operation issues such as notification, exchanges of information (subject to confidentiality), co-ordination of enforcement and comity.[95] One aim of this co-operation, apart from underpinning the free-trade objectives of the Decision, is to promote mutual understanding of the parties" competition laws and to "clarify differences", and to that end mutual technical assistance will include training, seminars and joint studies.[96] Technical assistance is also included in the Trade, Development and Co-operation Agreement with South Africa, signed in 1999, along with provision for exchange of information and positive and negative comity.[97]

11-059 It is noticeable that each of these agreements or Decisions, containing provisions for co-operation and comity, post-date the specific Agreement of 1991 with the USA. Although there are still very few specific bilateral agreements on competition policy, therefore, there is a real sense in which this Agreement has provided a model for structuring co-operation in the context of a wider trade or association agreement.

3.2 Competition in trade agreements

3.2.1 Competition and free trade

11–060 However, the agreements that have been mentioned in the previous section have, as well as co-operation clauses, additional elements which reflect their purpose as trade agreements. Behind the EU's championing within the WTO and its Working Party of core principles and common approaches to competition policy lies a key development in its own bilateral trade policy: the recognition that an increased emphasis on reciprocal free trade leads to the need for a regulatory dimension to its external policy.[98] And for the reasons already discussed, competition policy is regarded as a centrally important dimension to the regulatory framework needed to support trade liberalisation. Both the market access and developmental aspects of this issue are relevant here: an adequate competition policy helps to create a fully competitive open market, helps to prevent the often fragile markets of emerging economies from being subverted by anticompetitive practices from private

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on Trade and Trade-Related Matters brought into effect the free-trade provisions of the agreement, including competition policy, and came into force on July 1, 2000. See also Communication from the Commission to the Council and the European Parliament accompanying the Final Text of the Draft Decisions by the EC – Mexico Joint Council, January 18, 2000, COM (2000)9.

[95] Annex XV to Decision 2/2000 of the Joint Council of the Interim Agreement on Trade and Trade-Related Matters.

[96] Annex XV, Art. 9.

[97] Trade, Development and Co-operation Agreement between the EC, its Member States and South Africa 1999 O.J. L311/3, Arts. 38, 39 and 40.

[98] For a discussion of the increased emphasis on reciprocal free trade, see Cremona, "Flexible Models: External Policy and the European Economic Constitution" in de Búrca and Scott (eds.) Constitutional Change in the EU: From Uniformity to Flexibility? (Hart Publishing 2000).

undertakings (domestic or foreign) and provides a secure and friendly regulatory environment for prospective inward investors. This, at least, is the theory and helps to explain both why the EU has been keen to include competition among the "trade-related" provisions of new agreements, and why the other parties to such agreements have accepted their inclusion.

11-061 The condemnation of anticompetitive conduct where it affects the trade between the parties to a preferential trading agreement is not new. The free trade agreements with the EFTA States, now largely superseded by the EEA (or by accession to the EU) contain provisions on competition. The still extant 1972 free trade agreement with Switzerland, for example, which is typical of these early trade agreements, links together in its stated aims the promotion of bilateral trade between the Community and Switzerland, the provision of fair conditions of competition for trade between the Contracting Parties, and its contribution to the harmonious development and expansion of world trade.[99] It then declares certain anticompetitive activities "incompatible with the functioning of the Agreement in so far as they may affect trade between the Community and Switzerland".[1] Three types of conduct are specified, corresponding to Articles 81, 82 and 87 of the EC Treaty: restrictive agreements and concerted practices, abuse of a dominant position, and state aids. A very similar provision is found in the Europe Agreements and Euro-Mediterranean Association Agreements.[2] There is, however, one interesting development. The Swiss Agreement uses language which echoes the relevant EC Treaty articles; a Declaration made by the EC at the time of its conclusion states that in the context of "the autonomous implementation of Article 23(1) of the Agreement" the EC will "assess any practices contrary to that Article on the basis of criteria arising from the application of the rules of Articles 85, 86, 90 and 92 of the Treaty establishing the European Economic Community" (now Articles 81, 82, 86 and 87 EC). This explicit reference to the EC Treaty is not incorporated into the Agreement itself, however, and applies only to the Community. The later Europe and Euro-Mediterranean Agreements refer explicitly to "assessment on the basis of criteria arising from the application of the rules" of the specific EC Treaty provisions. This change, as we shall see in the next section, reflects the degree to which the Associated States are prepared to adopt a framework of competition rules aligned to those of the Community. The EEA and the Decision establishing a customs union with Turkey go even further: they both include more elaborate provisions which substantively copy the competition rules of the EC Treaty. In the former case, this is an aspect of the intended homogeneity of the EEA; in the case of Turkey the provisions reflect the high degree of integration represented by a customs union.

11-062 The substantive equivalence between the EC Treaty rules and those in the EEA and the Turkey customs union Decision has another important dimension. Anticompetitive activities are not only declared to be "incompatible"

[99] Free Trade Agreement with Switzerland, OJ English special edition Series-I 72 (31.12) L300 p.190, Art 1.
[1] *ibid.*, Art 23.
[2] See for example, Europe Agreement with Poland, Art.63(1) and Euro-Mediterranean Agreement with Tunisia, Art 36(1).

with the proper functioning of the agreement, they are *prohibited*; and in both cases restrictive agreements are "automatically void".[3] This of course has important implications for the enforcement of the rules. Enforcement under the bilateral free-trade agreements of the 1970's with the EFTA States (which provide for incompatibility but no prohibition) was effectively limited to intergovernmental enforcement through the Joint Committee procedure set up by the agreements; direct enforcement by private parties was not envisaged, and enforcement by respective domestic agencies depended on both the status of the Agreement within each national system and its jurisdictional rules as far as competition was concerned.

11–063 In practice, for the Community, the extra-territorial application of its own competition law was more effective than the procedures in the free-trade agreements. One of the most significant aspects of the EEA for the Community, therefore, was the inclusion of directly enforceable competition rules, together with a regional enforcement agency (the EFTA Surveillance Authority) and Court. The Turkey customs union Decision, like the EEA, contains a firm commitment on the part of Turkey to establish an enforcement agency capable of directly enforcing the prohibition in the Decision.[4] On this point, the Europe Agreements adopt essentially the same approach as the early free-trade agreements: a declaration of the incompatibility of anticompetitive conduct, together with implementing rules under which, as we have seen, enforcement is the responsibility of the competition authority of each Party, exercising its jurisdiction on the basis of "the existing rules of the respective legislation of the Community and [the Associated State], including where these rules are applied to undertakings located outside the respective territory."[5] The requirement to adopt implementing rules pre-supposes the existence of a functioning competition authority but there is no specific obligation to create such a body.

11–064 Other trade agreements contain competition clauses, which may be more generalised statements of principle. The free-trade Decision of the EU – Mexico Joint Council simply states that the parties "undertake to apply their respective competition laws so as to avoid that the benefits of this Decision may be diminished or cancelled out by anticompetitive activities."[6] Similarly, the Partnership and Co-operation Agreement with Russia provides that the parties "agree to work to remedy or remove through the application of their competition laws or otherwise, restrictions on competition by enterprises or caused by State intervention insofar as they may affect trade between the Community and Russia."[7] The Trade, Development and Co-operation Agreement with South Africa uses a declaration of incompatibility similar to that found in the Free Trade Agreement with Switzerland, covering

[3] EEA, Art. 53(2); Decision 1/95 of the Association Council on implementing the final phase of the customs union with Turkey, Art. 32(2).
[4] Decision 1/95 of the Association Council on implementing the final phase of the customs union with Turkey, Art. 39(2)(b).
[5] See n. 90.
[6] Annex XV to Decision 2/2000 of the Joint Council of the Interim Agreement on Trade and Trade-Related Matters, Art. 1(1).
[7] Partnership and Co-operation Agreement with Russia 1997 O.J. L327/1, Art. 53(1).

restrictive agreements and abuse of market power.[8] In an Annex, it is agreed that the Community will use criteria arising from the application of Articles 81 and 82 EC, including secondary legislation, and South Africa will use criteria arising from the application of the rules of South African competition law.[9] Enforcement will be by the respective competition authority, with the possibility of consultation within the Co-operation Council; each Party is under an obligation to introduce, if necessary, laws for the implementation of the competition clause.[10]

3.2.2 Competition policy and anti-dumping

11-065 One further aspect of the link between trade and competition policy made in these agreements should be mentioned: the relationship between competition policy and anti-dumping measures. While anti-dumping is essentially a trade measure, it is (at least in theory) a response to anticompetitive conduct on the part of the exporting undertaking. It is one way, enshrined in the GATT 1994, in which States are able to deal with one of the trade and competition problems: that of conduct in one State which has anticompetitive effects in another. This being the case, it is possible to argue that where there is an effective inter-State (and intra-State) competition policy there is no need for anti-dumping measures. Most of the agreements we have examined so far do not make this connection; the most they do is to provide for prior consultation before unilateral anti-dumping action is taken.[11] However there are three interesting exceptions.

11-066 The first is the EEA. As a direct result of the broader acceptance by the EFTA parties of the *acquis communautaire* and in particular of the competition policy of the European Community, anti-dumping measures will generally not be applicable in trade between EC states and EFTA states, any more than they are possible within the EC itself.[12] Anti-competitive practices, such as predatory or discriminatory pricing or illegal state aid should be dealt with by the EC Commission and EFTA Surveillance Authority within their respective jurisdictions, thus rendering retaliatory measures unnecessary. The link with the *acquis communautaire* is made clear in Protocol 13, applicable to this provision. Under the first paragraph of the Protocol, the application of Article 26 is limited to areas in which the *acquis communautaire* is fully integrated into the Agreement. The Community's common commercial policy towards third countries is, however, one area which is *not* integrated into the EEA. Consequently, problems may arise where third country origin products that are subject to (for example) EC anti-dumping measures, are imported indirectly into the EC via an EFTA party. In such a case, anti-dumping measures may be imposed as an anti-

[8] Trade, Development and Co-operation Agreement between the EC, its Member States and South Africa 1999 O.J. L311/3, Art. 35.
[9] *ibid.*, Annex VIII.
[10] *ibid.*, Arts. 36 and 37.
[11] See, for example, Euro-Mediterranean Agreement with Tunisia, Arts 24 and 27; Free Trade Agreement with Switzerland, Arts 25 and 27.
[12] Art. 26 EEA.

circumvention measure at the border between the EC Member State and EFTA state.[13]

11–067 The second example is the Turkey customs union Decision. In spite of its extensive competition provisions, and in spite of the fact that the Community's anti-dumping Regulation is one of the measures to be implemented by Turkey as part of its alignment to the Community's external commercial policy, the Turkey customs union Decision does not go as far as the EEA in abandoning anti-dumping in trade between the Community and Turkey. The Additional Protocol of 1970, which sets out the details for the transitional stage for the establishment of the customs union, contains procedures for the implementation of anti-dumping measures and these are preserved by the customs union Decision of 1995.[14] However, the Decision does give the Association Council the power to review the application of trade defence instruments at the request of either party, during which

> "the Association Council may decide to suspend the application of these instruments provided that Turkey has implemented competition, State aid control, and other relevant parts of the acquis communautaire which are related to the internal market and ensured their effective enforcement, so providing a guarantee against unfair competition comparable to that existing inside the internal market."[15]

11–068 Two points are notable here; first, the staged nature of the customs union implementation; unlike the EEA, this was to be achieved over a period of time allowing for the adjustment of Turkish legislation and policy.[16] Secondly, the need for anti-dumping and other trade defence measures is linked not only to competition policy but also to other elements of the internal market *acquis communautaire*. This suggests that although competition policy provides support for market liberalization, market-opening measures which provide the foundation for the internal market are themselves, in an international context, supportive of an effective competition structure.

11–069 Thirdly, we turn again to the Europe Agreements. These association Agreements have less ambitious aims as far as immediate economic integration is concerned, and preserve anti-dumping mechanisms subject to consultation procedures. However, the Commission has stated that in the case of full and effective application of competition rules by and within Associated State, it may be possible to regard anti-dumping measures as no longer necessary. This statement, made in July 1994 in a Communication that was designed to prepare the way for the major decisions on accession strategy taken by the European Council at Essen in December 1994, was also a response to criticism from the central and eastern European States over the

[13] Protocol 13, para. 2. Complex anti-circumvention rules mean that even products manufactured in an EFTA state may be covered, if the components or parts have been imported from a third country in order to circumvent the anti-dumping origin rules applicable to the finished product.
[14] Additional Protocol to the Association Agreement, of November 23, 1970, Art. 47; Decision 1/95 of the Association Council on implementing the final phase of the customs union with Turkey, Art. 44(2).
[15] Decision 1/95 of the Association Council on implementing the final phase of the customs union with Turkey, Art. 44(1).
[16] See Arts. 8-10 of Decision 1/95 on technical barriers to trade for another example of this staged approach.

continued use of anti-dumping measures by the EU against their exports. Emphasising the priority to be given to competition policy and State aids control in the prospective programme of harmonisation, the Commission's language is very close to that incorporated into the Turkish customs union Decision the following year:

> "Once satisfactory implementation of competition policy and state aids control, together with the application of those parts of Community law linked to the wider market, has been achieved, the Union could decide to progressively reduce the use of commercial defence instruments for industrial products for the countries concerned, since it would have a level of guarantee against unfair competition comparable to that existing inside the Internal Market."[17]

11–071 As a unilateral statement, this does not of course have the status of Article 44 of Decision 1/95; it nevertheless shows that in Community thinking at the time the link between competition and anti-dumping was well established, as well as illustrating the Community strategy towards the central and eastern European States based on incentives targeted at those countries managing to achieve goals set by the Community institutions.

In 1995 the Group of Experts also addressed the link between competition and anti-dumping in the context of strengthened bilateral co-operation, concluding that

> "Co-operation between competition authorities will not in the foreseeable future make it possible to relinquish trade protection instruments. However, as the effectiveness of co-operation increases, instances of conflict likely to lead to the use of these instruments will decrease."[18]

11–072 In its 1996 Communication, the Commission expressed the view that from an economic perspective anti-dumping measures are less efficient than the development of domestic law in dealing with the problem of inadequate regulation of competition on export markets, because they tackle the effect of the anti-competitive behaviour but not its root cause in the export country.[19] We are here moving towards the attempt to build the core principles of domestic competition policy into bilateral agreements, alongside provisions which focus on inter-party trade.

3.3 Standard-setting and harmonisation

11–073 Devuyst has pointed out that the EC has been "very active in extending its own competition policy model to countries that do not yet have a tradition in the enforcement of antitrust rules. The instrument used to achieve this goal has been linkage with preferential and non-preferential trade agreements."[20]

[17] Commission Communication, "Follow up to 'The Europe Agreements and Beyond: A Strategy to Prepare the Countries of Central and Eastern Europe for Accession', July 27, 1994, COM(94) 361 final, section B(ii) p.7.
[18] "Competition Policy in the New Trade Order: Strengthening International Co-operation and Rules", Report of the Group of Experts, Brussels, July 1995, at para. IV.2.1.
[19] Commission Communication of June 17, 1996, "Towards an International Framework of Competition Rules", COM (96) 284 at section 1(c).
[20] Devuyst, "The International Dimension of the EC's Antitrust Policy: Extending the Level Playing Field" (1998)3 EFA Rev. 459 at 469.

The rationale for this policy is in many ways similar to the arguments used by the EU in support of an international competition agreement, centred on the role of competition policy in developing and emerging economies.

3.3.1 The development of domestic competition law

This rationale does not, of course, in itself require use of the EU's own model of competition policy. The agreements in which approximation to the EU model is found are those which envisage a high degree of economic integration with the EU and in particular agreements with the Community's own near neighbours: the EEA, the Europe Agreements with the countries of central and eastern Europe, the Decision on the customs union with Turkey, the Euro-Mediterranean Agreements, and the Partnership and Co-operation Agreements (PCAs) with the countries of the former Soviet Union. Other agreements will commit the parties to an effective domestic competition policy but without reference to the EU standard: the free trade Agreement with Mexico, the new Partnership Agreement between the African, Caribbean and Pacific States and the EU (the Cotonou Convention), the Trade, Development and Co-operation Agreement with South Africa. **11–074**

The Cotonou Convention exemplifies this latter approach. The provision on competition policy starts with a statement of principle; the Parties: **11–075**

> "agree that the introduction and implementation of effective and sound competition policies and rules are of crucial importance in order to improve and secure an investment friendly climate, a sustainable industrialisation process and transparency in the access to markets."[21]

Then follow two commitments; a commitment to implement national and regional rules and policies regulating anticompetitive agreements and abuse of a dominant position (the terminology reflects Articles 81 and 82 EC but without an explicit reference); and a commitment to support and assistance including "assistance in the drafting of an appropriate legal framework and its administrative enforcement with particular reference to the special situation of the least developed countries."[22] This Convention is essentially a framework convention and is designed to be followed by regional agreements moving towards WTO-compliant reciprocal free trade; it is likely that the new agreements will contain more detailed provisions on competition. As we have seen, the Trade, Development and Co-operation Agreement with South Africa contains a declaration of the incompatibility with the Agreement of certain anticompetitive activities; this is supported by a commitment to adopt the "necessary laws and regulations" within three years.[23] **11–076**

The EEA regime is very different. Here the need was not to establish national competition authorities in the individual EFTA states, but to set up an EFTA Surveillance Authority that would fulfil the competition policy functions of the EC Commission for the EFTA States as a **11–077**

[21] Cotonou Convention, Art. 45(1).
[22] *ibid.* Art 45(3).
[23] Trade, Development and Co-operation Agreement with South Africa, Art. 36; for the incompatibility clause see n. 8.

group.[24] The "two-pillar" system was designed so that as far as possible it would mirror the EC system:

> "It was decided that the same competition rules and policies had to apply throughout the EEA. It was felt that this situation even called for identical and largely parallel enforcement structures and procedures in the Community and in the EFTA countries."[25]

11–078 As with the EU Member States, there is no obligation in the EEA requiring the implementation of any specific model of *national* competition law; rather, the EEA competition rules apply in the EFTA States, enforced by the EFTA Surveillance Authority and EFTA Court. The key to the system are thus the jurisdictional and co-operation rules applicable to the EC Commission and EFTA Surveillance Authority.[26]

3.3.2 Approximation of laws

11–079 In other Association and Partnership Agreements with emerging economies —those closer to the EU—we begin to see provision for the approximation of laws with reference to Community standards, and competition is normally among the areas of law included.[27] The competition provisions in the non-preferential PCAs do not use the terminology of Articles 81, 82 or 87 in their reference to anticompetitive practices, but the approximation of laws provision makes reference to Community law. The PCAs with the "non-European" states such as Kazakhstan contain a provision on legislative co-operation, including competition, under which the partner state is to "endeavour to ensure that its legislation will be gradually made compatible with that of the Community". The Parties also agree "to examine ways to apply their respective competition laws on a concerted basis in such cases where trade between them is affected."[28] In the PCA with Russia, the parties "shall ensure that they have and enforce laws addressing restrictions on competition by enterprises within their jurisdiction"[29] and "rules on competition" are among the areas covered by the approximation of laws provision: "Russia shall endeavour to ensure that its legislation will be gradually made compatible with that of the Community".[30]

11–080 The Europe Agreements also include competition among the areas of law which are to be approximated to Community norms.[31] Here, approximation is expressly linked to integration; the Agreement with Poland, for example, states:

[24] See Stragier, "The Competition Rules of the EEA Agreement and their Implementation" [1993] 1 ECLRev 30; Diem, "EEA Competition Law" [1994] 5 ECL Rev. 263.
[25] European Commission, 22nd Report on Competition Policy (1992).
[26] See text at n. 84 *et seq.*
[27] The Euro-Mediterranean Agreements have only a general approximation clause, specifying that co-operation will aim at helping the Associated State to bring its legislation closer to that of the Community in the areas covered by the Agreement: see, for example, Euro-Mediterranean Agreement with Tunisia 1998 O.J. L97/2, Art. 52.
[28] PCA with Kazakhstan 1999 O.J. L196/1, Art. 43.
[29] PCA with Russia 1997 O.J. L 327/1, Art. 53.
[30] PCA with Russia, Art. 55.
[31] Europe Agreement with Poland, Art. 69.

> "The Contracting Parties recognize that the major precondition for Poland's economic integration into the Community is the approximation of that country's existing and future legislation to that of the Community. Poland shall use its best endeavours to ensure that future legislation is compatible with Community legislation."[32]

11–081 We have already seen that competition has been prioritised as an area of implementation by the Commission,[33] and that the rules implementing the inter-State trade competition provisions of the Europe Agreements pre-suppose a functioning domestic competition authority in the Associated States.[34] Indeed, the implementing rules appear in some respects to pre-empt the approximation process by applying aspects of EC competition law, even though the underlying principle of the rules is that each competition authority is to apply its own legislation. In the Polish rules, for example, "the competition authorities shall ensure that the principles contained in the block exemption Regulations in force in the Community are applied in full" in applying the competition provisions of the Agreement.[35] Difficulties on the Polish side caused by the Community rules are to be resolved through consultation within the Association Council, "having regard to the approximation of legislation as provided for in the Europe Agreement".

11–082 In practice, the approximation provisions in the Europe Agreements themselves are now part of the larger pre-accession process. The Commission's White Paper of 1995 on the Preparation of the Associated Countries of Central and Eastern Europe for Integration into the Internal Market has a section on competition policy which gives an analysis of EU competition policy, including state aids, merger control, restrictive agreements and abuse of a dominant position, and the rules relating to state monopolies and public undertakings. The White Paper indicates the infrastructure conditions which are a necessary precondition for the operation of competition law, and sets out recommendation for the first stage of implementation.[36] Competition (both substantive law and administrative ability to apply to *acquis*) is included in the Commission's regular reports on progress in compliance with the accession criteria, which includes the ability to assume the obligations of membership. To take just one example, the report on Poland in October 1999 concluded:

> "Poland has achieved a reasonable level of alignment in the field of *antitrust* and *mergers*. Amendments to the Law on Counteracting Monopolistic Practices have entered into force in January 1999 and have improved the situation. Further alignment in particular regarding block exemptions remains to be completed. . . . Poland should establish a legal and regulatory framework for the control of state aids to ensure full compliance with the *acquis* in order to prepare for the competitiveness of the internal market. The need for an effective public aid control and enforcement system remains an urgent priority for Poland."[37]

[32] *ibid.*, Art. 68.
[33] See text at n. 17.
[34] See text at n. 89.
[35] Decision No 1/96 of the EU - Poland Association Council 1996. O.J. L208/24, Art.6.
[36] Commission White Paper on the Preparation of the Associated Countries of Central and Eastern Europe for Integration into the Internal Market of the Union", May 3, 1995, COM (95) 163 final, chap. 3.
[37] Regular Report from the Commission on Progress towards Accession: Poland, October 13, 1999, section B.3.1.

11–083 Similar regular reports are now produced by the Commission with respect to Turkey, now accepted as a candidate State.[38] This process takes place within the context of the customs union Decision of the EC-Turkey Association Council which, as we have already seen, contains extensive provisions on competition policy as it affects trade between the parties. However, competition also features as part of the programme of approximation of laws, "with a view to achieving the economic integration sought by the Customs Union;" Turkey was to pass a competition law modelled on that of the EC (including block exemption regulations and "the case law developed by the EC authorities") and establish a competition authority before the entry into force of the customs union, and adapt its State aids to Community rules and guidelines.[39] The provisions for state aid control are of interest; they have to accommodate the fact that while not a Member State, Turkey's position within the customs union requires a degree of State aid control which could not be provided by a national agency. The solution has been to provide for notification by Turkey to the EC Commission of proposed State aid in the same way as an individual EU Member State. The Commission may then "raise objections" against an aid which it would have deemed unlawful if granted by a Member State; if Turkey cannot accept the Commission's view, the case may be referred to arbitration. On the other side, Turkey may raise objections within the Association Council to aids granted by EU Member States, in which case the matter, if not resolved within the Association Council, may be referred by the Council to the Court of Justice. The system thus avoids the Commission issuing individual decisions binding on Turkey, while giving it a role together with international forms of dispute settlement. It is too early to tell whether this system will work in practice. In October 1999, the Commission's regular report on Turkey's progress in meeting the accession criteria concluded:

> "As far as the implementation of *anti-trust* rules is concerned, the situation remains satisfactory. However, progress still remains to be made in order to finalise the approximation on the *acquis* as foreseen in the customs union Decision. Regarding *state aid*, information on Turkey's state aid schemes have already been submitted to the Commission. Their conformity with EC rules still needs to be discussed between the Commission and the Turkish authorities."[40]

11–084 In the case of the candidate States, approximation has a clear goal, and the regular reports by the Commission (although not part of the regime instituted by the agreements themselves) provide an effective practical incentive towards implementation. Substantive commitments made by other States are much less easy to enforce and may not have much more practical effect than aspirational statements of intent. It is perhaps ironic, if understandable, that whereas a certain political dimension has become a prerequisite for economic

[38] See Conclusions of the European Council, Helsinki, December 1999.
[39] Decision 1/95 on the Customs Union between the EU and Turkey, Art 39. Turkish legislation on competition has been adopted, see Law No. 4054 on Protection of Competition Official Gazette 22140, December 13, 1994; Law No. 97/9090 on Appointment of the Competition Board Official Gazette 22918, February 27, 1997. See WTO Secretariat Report and government policy statement for WTO Trade Policy Review Body in October 1998, available at http://www.wto.org/wto/reviews/turkey.htm.
[40] Regular Report from the Commission on Progress towards Accession: Turkey, October 13, 1999, section B.3.1.

integration agreements, the economic and institutional infrastructure necessary to support economic liberalisation does not yet form part of the "essential elements" of most agreements.[41]

4. Conclusion

In the previous section we have examined three different types of competition clause in the Community's bilateral agreements: co-operation clauses, dealing with procedural and jurisdictional issues; substantive clauses which focus on supporting the inter-State trade liberalisation envisaged by the agreement; and approximation clauses, with or without reference to the Community standard, which seek to ensure the existence of functioning competition law at the domestic level. To what extent are any of these models likely to prove helpful in the debate over a putative multilateral agreement on competition? 11–085

The rationale for adoption of the Community model of competition policy in the agreements with candidate states is linked to their need to adopt the *acquis communautaire* as part of the pre-accession process (even where the negotiation of the Agreement pre-dates the formal membership application). The rationale is clear, although the suitability of the Community model (especially its detailed rules beyond the "hard core cartel", such as those on vertical restraints) for emerging economies some distance from accession may be questioned. It is necessarily even more questionable for countries outside the accession process, such as the Euro-Mediterranean Partnership States of the Maghreb and Mashreq, or the States of the former Soviet Union with Partnership and Co-operation Agreements. 11–086

As the Commission now recognises, any commitment to substantive standards of competition law at a multilateral level would have to be based on more generally applicable (and more generalised) principles. It is also the case that Community competition rules have been developed within the context of the treaty's market integration objectives and the development of purely domestic policy will not necessarily require the same balance of objectives: 11–087

> "Community competition policy therefore, unlike competition policy of Member States or our trading partners, has not only had to take account of the need for a system of undistorted competition but also the market integration objective."[42]

This history and context does however make Community experience valuable in identifying priorities for a competition policy designed to underpin a trade liberalisation agreement. If the adoption of a multilateral agreement containing even core principles to be applied in a domestic context is a distant and possibly unrealistic prospect, it may be more possible to achieve consensus on competition principles as they affect inter-state trade. The 11–088

[41] The new Cotonou Convention includes the principles of a market economy among those contributing to the agreement's objectives, without giving them "essential element" status: "The Parties recognise that the principles of the market economy, supported by transparent competition rules and sound economic and social policies, contribute to achieving the objectives of the partnership." Cotonou Convention, Art. 10(2).
[42] Commission Green Paper on Vertical Restraints in EC Competition Policy COM(96) 721 at p. 1.

"incompatibility clauses" of the Community's trade and association Agreements provide a precedent which could in principle be translated into a multilateral context. However the inclusion of norms affecting the conduct of private parties in an essentially inter-State Agreement is still problematic. The ineffectuality of these clauses in the Community's free-trade Agreements of the 1970s, as well as the contentious operation of GATT-based anti-dumping, bear witness to the difficulty of enforcing this type of trade rule. We have earlier touched on the difficulties of WTO dispute settlement in this context.[43] It will in practice be essential to combine even this level of agreement on substantive principles with some form of agreement on co-operation, and it is this aspect of Community bilateral policy which appears to offer most prospect of success at the multilateral level.

11–089 It is clear that the EU is committed to maintaining, and developing, its bilateral co-operation policies. Nevertheless, the Commission is emphatic that a bilaterally-based policy is insufficient to deal with international competition issues and the needs of the developing and emerging economies. The conclusion of bilateral agreements between each of the over eighty (and rising) countries with competition authorities is inconceivable and would be unworkable:

> "The costs of administering such a complex network would be prohibitive for all competition authorities. Therefore, if co-operation is to develop exclusively at the bilateral level, the interests of competition authorities in developing countries or in small economies are likely to be neglected."[44]

11–090 In contrast, the Commission argues, multilateral commitments play a useful role in reinforcing the position of domestic agencies and "contribute to the spread of a 'competition culture'".[45] Support for a multilateral agreement is, however, by no means universal, either within the WTO Working Group or among commentators. In 1998 the Working Group reported on discussion on the levels at which co-operation could take place:

> "It was suggested, further, that it was desirable to discuss institutional linkages between trade and competition policy, and the feasibility and desirability of expanded co-operation in competition law enforcement, at three levels. First, within individual countries, much would be gained through closer institutional linkages and dialogue between institutions responsible for trade policy and competition law enforcement. Second, at the regional level, a significant strengthening of co-operative approaches to competition law enforcement, coupled with selective substitution of competition law for existing trade instruments, could be envisioned. At the multilateral level, a more cautious and gradual approach was warranted. Consideration could be given to two elements: (i) the fostering of shared understanding and voluntary convergence through the sharing of national experiences, legislation and jurisprudence; and (ii) deliberations on possible basic standards to be incorporated in Members' competition legislation."[46]

[43] See text at n. 63.
[44] Submission from the EC and its Member States to the WTO Working Group on "A Multilateral Framework Agreement on Competition Policy", September 25, 2000, WT/WGTCP/W/152, at p. 3.
[45] *ibid.*
[46] 1998 Report of the WTO Working Group on the Interaction Between Trade and Competition Policy to the General Council, December 8, 1998, WT/WGTCP/2, section C.1.(a).

It is noticeable that the possibilities of multilateral action set out by the Working Group do not explicitly include a binding agreement, although "deliberations on possible basic standards" may ultimately lead to such an agreement. This is consistent with the Working Group's role; as the Commission points out: **11–091**

> "the decision on whether to launch negotiations on competition is essentially political in nature, and as such, does not correspond to this Working Group, whose mandate is exploratory and analytical; the elements of a possible future WTO agreement on competition could only be determined as a result of multilateral negotiations and, on the basis of input from all WTO members."[47]

A "cautious and gradual approach" is also favoured by commentators. The suggestion is that an evolutionary approach, whereby the practice of co-ordination and co-operation may lead to "slow but steady convergence of review and mutual respect"[48] and the "evolution of common views",[49] is likely to be more successful than an immediate attempt to reach agreement on common principles. This informal convergence has the advantage of flexibility compared with an international code.[50] "We should . . . resist the temptation to codify principles that may well be either too vague to be useful or, if precise, unsuited to the disparate interests involved and unlikely to pass the test of time and experience."[51] **11–092**

We have already seen how the bilateral agreement on co-operation between the USA and the EU has served as a model for co-operation clauses in other Community bilateral agreements. Could a bilateral agreement such as this serve as a model for a multilateral agreement? Not all aspects of such an agreement are equally easy to multilateralise. Co-operation ranges from exchanges of ideas and policy, through technical assistance, to case-specific enforcement assistance. Case-specific enforcement assistance is likely to remain bilateral for the present; it requires trust, and relatively similar legal systems and economic experience.[52] Co-operation at the level of exchanges of information (excluding confidential and maybe even case-specific information) and technical assistance is likely to be more feasible at a multilateral level, but would not by themselves go far to address the problems of international competition that have been identified. However, it may serve to build up confidence, and more importantly capacity, so as to provide a basis for more ambitious initiatives. **11–093**

Apart from the negotiating weight of the Community, no doubt one reason for the widespread direct or indirect reference to EC competition rules **11–094**

[47] Submission from the EC and its Member States to the WTO Working Group on "A Multilateral Framework Agreement on Competition Policy", September 25, 2000, WT/WGTCP/W/152, at p. 1.
[48] Pitkofsky, "Competition Policy in a Global Economy" (1999) JIEL 403, at p. 407, referring to the effect of the co-operation agreement between the USA and EU However, Pitkofsky also cautions, "procedural co-operation does not lead ineluctably to common attitudes or approaches." *ibid.* at 406.
[49] Melamed, "International Co-operation in Competition Law and Policy: What can be Achieved at the bilateral, Regional and Multilateral Levels" (1999) JIEL 423 at 425. See also Tarullo, "Competition Policy for Global Markets" (1999) JIEL 445 at 446.
[50] Pikofsky, *ibid.* n. 48 at p. 411.
[51] Melamed, *ibid.* n. 49 at p. 433.
[52] Frédérik Jenny, cited by Melamed, *ibid.* n. 49 at p. 432.

in the Community's bilateral agreements, reflected in the language chosen to describe anticompetitive conduct, lies in the absence of any internationally agreed set of norms. In this, competition policy differs, for example, from Intellectual Property protection, where it is common to define bilateral obligations by reference to lists of multilateral Conventions, including the TRIPS Agreement.[53] From the Community perspective, then, an international agreement on competition containing not only co-operation provisions but also core principles would offer the advantage of a model which could be used in negotiation, especially with countries with no long-term reason to adopt the Community's own model. We have here the potential for a two-way interaction, as multilateral regulatory standards influenced by the EU's own laws themselves provide a model for the development of EU policy commitments in a bilateral context. For this purpose, the international agreement would not need to be all-encompassing or contain mandatory standards. The EU position within the WTO Working Group now puts stress not on an attempt at mandatory harmonisation but on agreement on core principles with the emphasis on those principles which are already accepted within the WTO, such as non-discrimination and transparency.

11–095 A plurilateral agreement, or even one which sets out an agreed but optional framework for a national competition policy, would provide a reference point for bilateral interlocutors. At the same time, the Community has a clear interest in influencing the content and approach of the (plurilateral or multilateral) core principles. Such influence is not only the direct result of the Commission's position papers and participation in the WTO Working Group; it is also assisted by the growing number of non-Member States having already agreed, at a bilateral level, to principles of competition policy which reflect the EU approach. In this way, bilateral commitments help to build multilateral consensus.

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[53] For example, see the Agreement with South Africa on Trade, Development and Co-operation, Art. 46.

ELGAR ADVANCED INTRODUCTIONS

Advanced Introduction to

INTERNATIONAL TRADE LAW

Michael J. Trebilcock

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11 Trade and investment

11.1 Introduction

Foreign direct investment (FDI) (which is the focus of this chapter) should be distinguished from portfolio investment. FDI typically involves some form of effective control and active management of assets in host countries, while portfolio investment typically involves passive investments in enterprises or government bonds in host countries. Over the last several decades, there has been a dramatic increase in FDI around the world, much of it between developed countries, but increasingly developing countries have been major recipients of FDI, including countries such as China, and in some cases have themselves become exporters of FDI (again, China is a prominent example).[1] More than 40 per cent of world FDI inflows are directed to developing countries. FDI flows to developing countries now exceed foreign aid flows by a factor of about 5 to 1.[2]

In their early post-independence years, many former colonies viewed FDI with skepticism, and in some cases outright hostility, as it was perceived to be a new form of economic imperialism (reflected in dependency theories of development that were influential in many developing countries in the 1950s and 1960s). More recently, many developing countries have come to see FDI as having at least the potential for making significant contributions to their economies – as a source of investment in infrastructure, as a source of technology transfers and spillovers, as a source of investment in human capital and skills upgrading, as a source of investment in major natural resource extraction projects, and as a major source of local employment in low-wage,

1 See generally, Americo B. Zampetti and Pierre Sauvé, "International Investment", in Andrew T. Guzman and Alan O. Sykes (eds), *Research Handbook in International Economic Law* (Cheltenham, UK: Edward Elgar, 2007).

2 UNCTAD, "Assessing the Impact of the Current Financial and Economic Crisis on Global FDI Flows", 19 January 2009.

low-skilled manufacturing activities.[3] Foreign direct investment can substitute for or complement trade, depending on context and application. In this respect, it is useful to distinguish between horizontal and vertical FDI.[4] If, for example, a manufacturer in North America wishes to access China's market to sell its products, it can export its products from North America to China or set up a replica manufacturing facility in China to service domestic customers in the Chinese market (horizontal FDI). Where host countries have large protected domestic markets, FDI may be the most effective way of accessing these markets behind prevailing tariff walls – particularly the case with host countries with large growing populations and hence significant potential demand for the goods or services that foreign investors can produce. In this case, FDI is a substitute for trade. In the case of vertical FDI, foreign investors are able to expand their opportunities for international trade in goods or services by accessing lower cost inputs (for example, natural resources or low-cost labour) in host countries and hence gain a comparative advantage in export markets. For example, a North American manufacturer may choose to set up foreign subsidiaries or affiliates to manufacture components for its products and export these components to its parent company in North America for incorporation in the final products. In this case, FDI and trade are complements.

In principle, the theory of comparative advantage should apply as much to international movements of FDI as to international trade in goods or services – capital is likely to gravitate to where its marginal productivity is greatest. If unqualified, this presumption would suggest the case for an international regime that facilitates the free movement of FDI, and constrains countries from adopting domestic policies designed either to encourage it – for example, through subsidies, tax breaks, or tax incentives – or to discourage it – for example,

3 See, for example, Theodore Moran, "Enhancing the Ability of Developing Countries to Attack and Harness FDI for Development", in Theodore Moran (ed.), *Harnessing Foreign Direct Investment: Policies for Developing Countries* (Washington, D.C.: Brookings Institute Press, 2006); Theodore Moran, Edward Graham and Magnus Blomstrom (eds), *Does Foreign Direct Investment Promote Development?* (Washington, D.C.: Peterson Institute, 2005); OECD Report, *Foreign Direct Investment for Development: Maximizing Benefits, Minimizing Costs* (Paris: OECD, 2002). For recent analysis of the benefits of FDI in developed and developing countries see Theodore Moran, *Foreign Direct Investment and Development: Launching a Second Generation of Policy Research: Avoiding the Mistakes of the First, Reevaluating Policies for Developed and Developing Countries* (Washington, D.C.: Peterson Institute, 2011).

4 See Elhanan Helpman, *Understanding Global Trade* (Cambridge, M.A.: Harvard University Press, 2011), chapter 6.

through regulations pertaining to local sourcing, minimum export requirements, restrictions on exports, trade balancing requirements that restrict the value or volume of imports to the value or volume of exports, technology transfer requirements, and so on. In fact, many countries have adopted a wide range of domestic policies that either encourage or restrict FDI either generally or, more commonly, in particular sectors.

Restrictions on FDI may be motivated by a range of concerns. First, there are likely to be concerns about foreign investors acquiring domestic firms where the nature of the activities in question raise national security issues – concerns that have been exacerbated by the rapid growth of Sovereign Wealth Funds.[5] Foreign investors who control these assets may have access to sensitive national security technology or information. Second, while there are few inherent legal constraints on the application of domestic jurisdiction to the activities that foreign investors engage in within a particular country, there may be significant practical constraints in the effective application of domestic laws where the bulk of the firm's assets, many of its senior personnel, and much of the information about its activities and decision-making are located abroad. Third, there may be concerns about attempts by home country governments to enforce their laws in foreign jurisdictions through foreign subsidiaries of home country parent corporations, that is, extra-territorial application of home countries' laws. Fourth, there may also be concerns that foreign subsidiaries will be managed in such a fashion as to reflect home country bias in business decisions, for example purchasing inputs from home country affiliates or using personnel from home country or other affiliates rather than local personnel, perhaps in some cases motivated by a desire to appear to be a "good corporate citizen" in the home country in order to maximize political influence in that jurisdiction. Fifth, there may be concerns that foreign investors will seek to protect their investments in specialized technology and know-how by restricting access to them by domestic firms or individuals in the host country, hence reducing the benefits of technological spillovers and human capital enhancements in the host country. Sixth, there may be cultural and political sovereignty concerns with permitting FDI in certain sectors, such as the print and electronic media.

5 See Jackie Van Der Meulen and Michael J. Trebilcock, "Canada's Policy Response to Foreign Sovereign Investment: Operationalizing National Security Exceptions", (2009) 47:3 *Canadian Business L.J.* 392.

Foreign direct investors, in turn, are likely to confront their own set of concerns in contemplating investments in a foreign country. These may include political and policy instability (including macroeconomic stability). Where investments are sunk, subsequent governments may have incentives to behave opportunistically towards foreign direct investors that lack direct political voice in host countries by unilateral *ex post facto* re-specification of the terms on which the initial investment was made. Other concerns include weak protection of private property rights (including intellectual property rights) and ineffective enforcement of contracts; law and order; and corruption in the administration of state functions (including legal functions).

11.2 Multilateral regulation of foreign direct investment

As has been noted in earlier chapters, historically the GATT was almost exclusively focused on international trade in goods, and not international trade in services or international movement of capital. However, a GATT panel decision in 1984,[6] in response to a complaint by the USA relating to various undertakings obtained from foreign investors pursuant to Canada's *Foreign Investment Review Act*, held that certain features of domestic foreign investment regulations may fall within the purview of the GATT where these affect international trade in goods. In this case, the USA challenged undertakings that required foreign investors to commit to certain local sourcing and minimum export requirements as a condition for approval of their investments in Canada. The Panel held that the local sourcing requirements violated the National Treatment Principle in Article III of the GATT by treating local suppliers of these inputs more favourably than foreign suppliers, although it held that minimum export requirements did not violate any provision in the GATT.

At the beginning of the Uruguay Round in 1986, the USA proposed that the multilateral negotiating agenda for this round should include a comprehensive agreement on foreign investment. The Agreement on Trade-Related Investment Measures (TRIMS) that emerged from the Round is, in fact, much more modest than the initial US proposals, and builds on the prior GATT Panel ruling in 1984 by prohibiting domestic regulations that would violate the National Treatment Principle in

6 *Canada: Administration of the Foreign Investment Review Act* (1984) BISD 305/140.

Article III.4 of the GATT, including local sourcing requirements, trade balancing requirements, and export restrictions. This illustrative list is non-exhaustive. The TRIMS Agreement has attracted very little subsequent formal dispute-settlement activity, in large part because it does little more than reaffirm the application of Article III.4 of the GATT to certain forms of regulation or FDI that may influence imports or exports of goods by foreign direct investors.

However, TRIMS was at issue in a recent case. In *Canada – Feed-in Tariffs*,[7] the Appellate Body considered the relationship between TRIMS Article 2.1 (which provides that no member shall apply any TRIMS that is inconsistent with Article III or Article IX of the GATT and is accompanied by an illustrative list of inconsistent measures in Article 2.2) and Article III.8(a) of the GATT (which provides an exception to the National Treatment Principle for government procurement). It upheld the Panel's finding that the illustrative list in TRIMS Article 2.2 does not remove the need to analyze whether a measure falls outside of the scope of the national treatment requirement by virtue of Article III.8(a). In this case, it was held that FIT contracts did not fall within the government procurement exception because the Government of Ontario's procurement under the FIT Programme was undertaken with a view to commercial resale.

Disaffected with the modest outcome from the Uruguay Round, the USA and other developed countries sought to shift the venue for multilateral negotiations on a comprehensive investment treaty from the WTO to the OECD. It was assumed that, due to the predominance of developed countries, the OECD would yield a readier consensus on liberalizing restrictions on FDI than the WTO where the preponderance of developing country members with more skeptical, or at least more cautious, views of the merits of FDI was likely to preclude achievement of a consensus on a more ambitious set of international disciplines. The expectation was that non-OECD members would be able to accede to any resulting treaty and that there would be strong inducements to do so in order to compete effectively for FDI. From 1996 through to 1998 negotiations on a multilateral agreement on investment (MAI) proceeded within the OECD, but negotiations were non-transparent, even clandestine, and the leaking of a draft of the agreement to various NGOs precipitated an international firestorm of criticism of the draft agreement and the process by which it was being negotiated. The

7 *Canada – Measures Relating to the Feed-in Tariff Program* (2013) WT/DS426/AB/R.

principal criticism was that it would confer extensive rights on foreign direct investors but with few, if any, concomitant obligations on their part to host countries or their citizens, for example, with respect to technology transfer, health and safety, the environment, labour standards, international human rights, and so on. In the face of these criticisms, the MAI negotiations were formally abandoned in December 1998. Proposals to include negotiations over FDI in the Doha Round of the WTO were also abandoned at the Cancun Ministerial in September 2003 in the face of opposition from developing countries.

11.3 Bilateral investment treaties

While attempts at negotiating a comprehensive multilateral treaty on FDI appear to have been abandoned, at least for the time being, a notable contrasting phenomenon has been the dramatic proliferation since 1990 in the number of bilateral investment treaties (BITS) or international investment agreements (IIAs) that have been negotiated – up from just over 400 in 1990 to more than 3000 today (paralleling the proliferation of Preferential Trade Agreements).[8] The primary impetus behind this proliferation of BITS appears to be that in the competition for FDI many countries, especially developing countries, feel obliged to provide investors with certain legally enforceable protections of their investment, although BITS are not limited to developed–developing country dyads (only about 40 per cent); about a quarter of all BITS are between pairs of developing countries.[9]

BITS typically include provisions on the scope and definition of FDI; admission of investment; national and Most Favoured Nation treatment; fair and equitable treatment; guarantees and compensation in respect of expropriation and compensation for war and civil disturbances; guarantees of free transfer of funds and repatriation of capital and profits; subrogation on insurance claims; and dispute settlement, both state-to-state and investor-to-state (typically by international arbitration, most often the International Centre for Settlement of Investment Disputes (ICSID) affiliated with the World Bank).

8 See Gus Van Harten, *Investing Treaty Arbitration and Public Law* (Oxford: Oxford University Press, 2008), chapter 2; Stephan Schill, *The Multilateralization of International Investment Law* (Cambridge: Cambridge University Press, 2009).

9 UNCTAD, "Recent Developments in International Investment Agreements", IIA Monitor No. 3 (2009).

The proliferation of BITS has raised a number of controversies. First, the "fair and equitable" standard of investment protection lacks precision and consistent interpretation or clearly articulated exceptions or qualifications for measures by host countries addressing health, safety, and environmental concerns or financial crises, which has led to criticisms of BITS as unduly constraining host countries' political sovereignty. Second, the expropriation provisions in most BITS also lack clear definition and may be interpreted as extending beyond outright transfer of title to foreign investors' assets or physical dispossession of those assets to various forms of regulatory "takings" that can be viewed as significantly impairing the value of these assets. This is criticized for constraining or "chilling" legitimate spheres of regulatory autonomy. Third, given that many countries have signed multiple BITS with various other countries, each of which typically contains a Most Favoured Nation clause, major disputes have arisen as to when foreign investors are able to invoke ("cherry pick") either substantive or procedural provisions in BITS other than the BIT to which their home country is a party (which are more favourable to their claims than their own BITS). Fourth, the National Treatment Principle, which is contained in most BITS, also gives rise to ambiguity as to when foreign investors have been treated less favourably than domestic investors in "like circumstances". Fifth, the international arbitral dispute resolution system has been criticized as lacking transparency, consistency, and scope for effective third-party (amicus) interventions, and in general for being biased towards the interests of foreign investors.[10] Finally, it is argued that BITS largely remove foreign investors as a political constituency for domestic legal reform in host countries by providing them with privileged supra-national legal protections.[11]

A new generation of BITS attempts to strike a finer balance between the interests of investors and the interests of host countries by adding interpretive provisions, general exceptions clauses, and new preambular language as to the purpose of the agreements,[12] but how arbitrators are likely to interpret such provisions and whether they are effectively justiciable in a consistent and credible manner remains to

10 For a review of many of the foregoing critiques, see David Schneiderman, *Constitutionalizing Economic Globalization: Investment Rules and Democracy's Promise* (Cambridge: Cambridge University Press, 2008).

11 Tom Ginsburg, "International Substitutes for Domestic Institutions: Bilateral Investment Treaties and Governance", (2005) 25:1 *International Review of Law and Economics* 107.

12 See Suzanne A. Spears, "The Quest for Policy Space in a New Generation of International Investment Agreements", (2010) 13:4 *Journal of International Economic Law* 1037–75.

be tested by experience. Evidence is mixed regarding whether BITS actually increase FDI flows to host countries that are signatories to them.[13] Perhaps the best reading of this evidence is that BITS have a modestly positive impact on attracting FDI – albeit a declining marginal impact as more BITS are signed – and are a weak substitute for well-functioning domestic legal institutions,[14] in part because arbitral awards still need to be enforced in host countries' domestic courts, and in part because purely private disputes may still need to be resolved in these courts unless the parties have contracted out of the jurisdiction through (increasingly common) choice of law and choice of forum clauses.[15]

Chapter 11 of NAFTA, while involving three parties, exemplifies many of the issues and controversies that have arisen with respect to BITS and has been a prominent lightning rod for critics of NAFTA. When Chapter 11 was initially negotiated, it was thought likely to apply in practice mostly to Mexican laws and regulations pertaining to FDI, given a long and somewhat tangled history in Mexico of cycles of nationalization and liberalization of FDI. However, Chapter 11 has provoked a number of formal complaints (in excess of 30 to date), including a number against measures adopted in Canada and the USA.

Chapter 11 of NAFTA contains a National Treatment provision in Article 1102 (subject to reservations that the three parties have entered in schedules to NAFTA) and a Most Favoured Nation Treatment provision (Article 1103). Article 1105 (Minimum Standard of Treatment) requires that each party shall accord to investments of investors of another party treatment in accordance with international law, including fair and equitable treatment and full protection and security. Article 1106 (Performance Requirements) prohibits a long list of performance requirements, including those contained in the TRIMS Agreement but extending to other performance requirements such as technology transfer requirements. Article 1110 (Expropriation and Compensation) provides that no party may directly or indirectly nationalize or expropriate an investment of an investor of another party in its territory or

13 See Amnon Lehavi and Amir N. Licht, "BITS and Pieces of Property", (2011) 36(1) *Yale Journal of International Law* at 11–13.

14 See Susan Rose-Ackerman and Jennifer Tobin, "When BITS Have Some Bite: The Political-Economic Environment of Bilateral Investment Treaties", (2011) 6(1) *Review of International Organizations* 1–32.

15 See Jans Damman and Henry Hansmann, "Globalizing Commercial Litigation", (2008) 94 *Cornell L. Rev.* 1.

take a measure tantamount to nationalization or expropriation of such an investment except: a) for a public purpose; b) on a nondiscriminatory basis; c) in accordance with due process of law and Article 1105; and d) on payment of compensation.

Chapter 11 then sets out a procedural regime for the resolution of disputes which permit private investors to file complaints with international arbitral panels, primarily the International Centre for Settlement of Investment Disputes (ICSID). Awards issued by such arbitral panels providing for monetary compensation for foreign investors who have been able to satisfy an arbitral panel that the host country's measures in question violate one of the substantive provisions of Chapter 11 are enforceable in the domestic courts of host countries.

The arbitral case law that has emerged under Chapter 11 has raised major uncertainties as to the interpretation and application of key substantive provisions in Chapter 11, especially the International Minimum Standard of Treatment requirement in Article 1105 and the Expropriation provisions in Article 1110, which different arbitral panels have interpreted both expansively and narrowly but without a system of appellate review or precedent to resolve inconsistencies. Critics of Chapter 11 argue that its provisions and the investor-driven complaints dispute-settlement process have undesirably constrained the domestic political autonomy of member countries and imposed a regulatory chill on legitimate environmental and health and safety measures that host countries have sought or might seek to adopt.[16] Moreover, the expropriation provisions of Chapter 11 risk standing the National Treatment Principle on its head by requiring compensation of foreign investors in circumstances where similarly situated domestic investors may lack any such entitlement.[17]

Other commentators take a more benign view of the operation of Chapter 11, and regard the few decisions that have led to liability as properly sanctioning protectionist or abusive behaviour by host country governments.[18] While some of the procedural shortcomings of the dispute-settlement process under Chapter 11 have recently been mitigated by member countries in an Interpretive Statement and by reforms by arbitral panels themselves in authorizing the release of the written pleadings of the parties at the time they are filed with an arbitral panel, authorizing amicus curiae briefs, and making the oral hearings open to the public, concerns remain about the extent of the substantive constraints on host countries' jurisdiction to regulate FDI, particularly given the absence of any provision in Chapter 11 analogous to Article XX of the GATT.

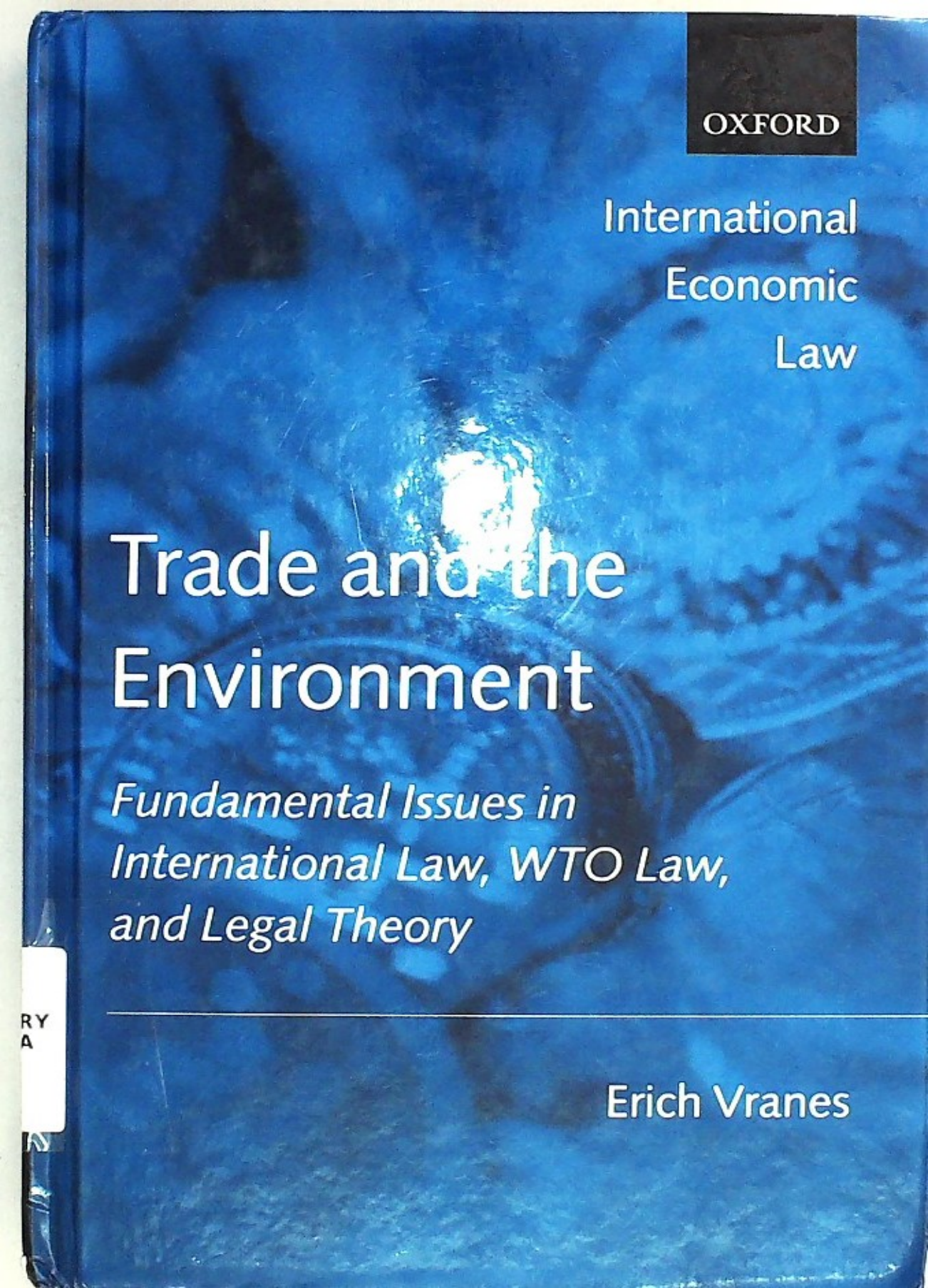
16 See Chris Tollefson, "NAFTA's Chapter 11: The Case for Reform", in John Kirton and Peter Hajnal (eds), *Sustainability, Civil Society, and International Governance* (Aldershot: Ashgate Publishing Limited, 2006), chapter 10.

17 See David Schneiderman, "NAFTA's Takings Rule: American Constitutionalism comes to Canada", (1996) 46 *University of Toronto Law Journal* 499; Michael Trebilcock, "Trade Liberalization, Regulatory Diversity, and Political Sovereignty", in Kirton and Hajnal, *ibid* at 224-225.

18 See Julie Soloway, "NAFTA's Chapter 11: Investor Protection, Integration, and the Public Interest", in Kirton and Hajnal, *ibid*.

11.4 Conclusion

The proliferation of BITS stands in stark contrast to successive failures to negotiate a multilateral agreement on investment. However, BITS entail a risk of collective action problems and a race to the bottom among host countries (especially developing countries). This argues for a further attempt at negotiating a multilateral agreement (where coalition bargaining is possible), probably under the aegis of the WTO, building on the new generation of BITS that attempt to strike a better balance between the interests of foreign investors and host countries.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Trade and the Environment
Fundamental Issues in International Law, WTO Law, and Legal Theory
Erich Vranes

Summary Table of Contents

I. Introduction[1]

In academic writings on international law, it appears to be the prevailing view that a conflict of norms arises only where a party to two treaties 'cannot simultaneously comply with its *obligations* under both treaties'.[2] This definition has found its way into WTO panel decisions and recent academic writings.[3] The problem with this strict definition is that it does not recognize that a permission may conflict with a prescriptive norm, that is an obligation or a prohibition.[4] Consequently, established conflict maxims such as the *lex posterior* and *lex specialis* maxims[5] could not be applied in order to determine whether a permission actually constitutes the *lex posterior* or the *lex specialis* that was meant to prevail by the contracting parties. In other words, permissions have to give way, even when they are later in time and more specific than prescriptive norms.

Moreover, in writings on international law, in the jurisprudence of international tribunals, and in legal theory as well, one finds a wide variety of divergent definitions of conflict. While some writers imply that there is some discretion in the adoption of an appropriate definition of conflict,[6] others fail to give an express definition. The following analysis will examine the definitions adopted in academic writings on international law and will explore whether an adequate definition can be derived from legal theory and, if so, whether such a definition can be transposed to international law.

[1] A slightly abbreviated version of this chapter has been published in the *European Journal of International Law* (E Vranes, 'The Definition of "Norm Conflict" in International Law and Legal Theory' (2006) 17(2) EJIL 395–418.

[2] CW Jenks, 'The Conflict of Law-Making Treaties' (1953) 30 BYIL, 401, 426 (emphasis added).

[3] Cf below, sections III.B and IV.A.

[4] By 'obligation' and 'prohibition' we refer to norms that require a person or a state to adopt or refrain from adopting a given conduct. By 'permission', we refer to a legal provision that allows a person or a state to adopt (or refrain from adopting) a given conduct. These are preliminary definitions which will be refined and explained in more detail in section V.A.1 of the present chapter.

[5] According to the *lex posterior* maxim, between two conflicting norms, the norm that is later in time ought to prevail. Likewise, pursuant to the *lex specialis* maxim, between two conflicting norms, the norm that is more specific should prevail. The legal nature of these maxims and their consequences will be examined in more detail in ch 2, below.

[6] Thus, Gabrielle Marceau has submitted that definitions of norm conflict can be adopted according to one's conception of the international legal order: 'If one believes that international commitments should be understood in the light of *some coherent* international order, one favours *narrow definitions* of conflict…' (cf G Marceau, 'Conflicts of norms and conflicts of jurisdictions: the relationship between the WTO Agreement and MEAs and other treaties' (2001) 35 JWT, 1081, 1082 (emphasis added)). In view of this statement (and the plural 'definitions'), the question arises to what extent one actually enjoys the freedom to adopt a definition of conflict of norms.

II. Adequacy of Jurisprudential Definitions

In view of the variety of definitions of conflict of norms in international law and legal theory that will have to be addressed in the subsequent analysis, the preliminary question arises as to when a definition is to be regarded as 'correct' or 'appropriate'. Although it is arguably unfeasible to establish a uniform theory of definitions, given that definitions are employed for a variety of different purposes in various disciplines and situations,[7] it is possible, in line with clearly convergent views in legal theory and philosophy,[8] to rely on the distinction between analytical ('lexical') and synthetic ('stipulative') definitions, and on established principles for giving adequate definitions, as appropriate tools for assessing existing definitions in our context.

An analytical definition examines and explains the actual way a term is used in a given language or context.[9] Hence, it is an assertion concerned with past or present usage and possesses truth-value.[10] A stipulative definition, by contrast, establishes the meaning of a word; it thus takes the form of a command or proposal on the meaning of a given term.[11] Therefore, it cannot be true or false. Although stipulative definitions rest on an arbitrary choice, the author of a stipulative definition does not normally enjoy unrestricted discretion: the author is bound in particular by teleological considerations[12] and may be restricted by the fact that the system or theory within which the definition is meant to operate may already trace out the definition to be adopted;[13] moreover, definitions should not be misleading,[14] which ensues logically from the main aim of definition, namely to increase precision and clarity. These principles can be subsumed under the postulate that stipulative definitions have to be adequate to the aim pursued; this means, for purposes of legal doctrine, that they must adequately describe, or fit into, the legal system or doctrine within which they are intended to operate.

These considerations intersect with the 'traditional' requirements for definitions, which have their origin in Aristotle's *Topics* and have been upheld, with minor modifications, until today. According to these requirements, a definition must in particular be commensurate with that which is to be

[7] O Weinberger, *Rechtslogik* (2nd edn, 1989) 360ff.

[8] On this and the following cf in particular the classic work of W Dubislav, *Die Definition* (4th edn, 1981), which still constitutes the starting point of definition theory; see also the English treatise by R Robinson, *Definition* (1968); U Klug, *Juristische Logik* (4th edn, 1982), at 89–109; Weinberger (ibid) 360ff.

[9] Klug (ibid) 103; Weinberger (ibid) 360–361; Rademacher, 'Definition' in E Braun and H Rademacher (eds), *Wissenschaftstheoretisches Lexikon* (1978) at 111.

[10] Cf Dubislav (n 8 above) 131.

[11] Robinson (n 8 above) 19, 21, 59–92.

[12] Klug (n 8 above) 93; Weinberger (n 7 above) 360.

[13] Essler, 'Einführung', in Dubislav (n 8 above) at 18.

[14] Robinson (n 8 above) at 72ff.

defined (ie the *definiens* must be equivalent to the *definiendum*).[15] Hence, and this is crucial for the following analysis, a definition is too narrow if the *definiens* is a sub-class of the *definiendum*; it is too broad if the reverse is true.[16] In the course of this work we shall come back, in particular, to the last rule, to the distinction between stipulative and analytical definitions, and the principle of teleological adequacy of stipulative definitions.

By way of answer to our introductory question, we may submit, therefore, that an 'appropriate' analytical definition is one that is correct or logically true, while an 'appropriate' stipulative definition is teleologically adequate.

III. Background of the Problem

A. The Essential Questions Further Delimited

Norms have the fundamental functions of prescribing (obligating), prohibiting, and permitting, according to legal logic (often also referred to as deontic logic[17]).[18] Besides such norms, which are also referred to as norms of conduct, there is the category of norms of competence: it is disputed in legal theory whether norms of competence can be reduced to norms of conduct;[19] moreover, there is hardly any research on the question whether norms of competence can conflict among each other. Therefore, in the

[15] Moreover, a definition must not include contradictions nor introduce multiple meanings; it must not directly or indirectly define the subject by itself; it should not be in negative terms where it can be in positive terms; and it must use clear and known terms: cf Aristoteles, *Die Topik*, 6th book (1882/2000), at 126–63 (translated by JH von Kirchmann (1882)), reprinted in 100 Werke der Philosophie, Digitale Bibliothek Sonderband (2000).

[16] Cf Robinson (n 8 above) at 140–8; Weinberger (n 7 above) at 368ff.

[17] On this cf eg Weinberger (n 7 above) 228ff; H Lenk, 'Konträrbeziehungen und Operatorengleichungen im deontologischen Sechseck' in H Lenk (ed), *Normenlogik. Grundprobleme der deontischen Logik* (1974) 198; R Alexy, *Theorie der Grundrechte* (1994) 182–194; K Adomeit, *Normlogik-Methodenlehre—Rechtspolitologie* (1986) 26–9 and 82–6.

[18] These functions will be dealt with in detail, from the perspective of deontic logic, below, section V.A; cf also eg KF Röhl Allpemeine Rechtslehre. Ein Lebesbuch, Heymann (Köln, 1994) 192–6; according to Kelsen, derogation is also a specific function of norms. Cf the English article by H Kelsen, 'Derogation' in H Klecatsky, R Marcic and H Schambeck (eds), *Die Wiener Rechtstheoretische Schule*, vol II (1968) 1429; the article was originally published in RA Newman (ed), *Essays in Jurisprudence in Honor of Roscoe Pound* (1962) 339–61. We will come back to the problem of derogation when we deal with the individual conflict rules (cf chapter 2).

[19] It has repeatedly been held in legal theory that norms of competence can be reduced to norms of conduct. According to this view, norms of competence make it obligatory for the person subjected to a competence to act according to the norms of conduct (ie prohibitions, obligations, and permissions) which have been created by the holder of the competence. Cf H Kelsen, *Allgemeine Theorie der Normen* (1979) 210; Röhl (ibid) 237. For a critique of such views cf E Wiederin, 'Was ist und welche Konsequenzen hat ein Normkonflikt?' (1990) 21 *Rechtstheorie* 311, 325–7; R Alexy, *Theorie der Grundrechte* (2nd edn, 1994) 216–18; this issue is addressed further below in section V.B.3.

context of the definition of norm conflict, three related problems have to be examined.

First, there is the question as to which constellations of incompatible norms should be comprised by the notion of 'conflict of norms'. The consequences of the answers given are far-reaching: as noted, if one excludes given constellations from the definition of conflict, the established conflict maxims of *lex posterior*, etc do not come into play. This is clearly problematic if one considers such conflict maxims eg as devices for reducing the discretion of the judge who is faced with incompatible norms and has to decide which to apply.[20] More precisely, the question is that of whether, for instance, the definition of norm conflict should cover incompatibilities between obligations and prohibitions only, as is apparently the preponderant view in the field of international law;[21] or whether it should also extend to incompatible obligations, prohibitions, and *permissions*; or whether an incompatibility between two obligations should also be recognized as constituting conflict. An example of the last constellation would be a situation in which one norm requires a person to pay an indemnity of $200, while another norm stipulates the sum of $100. Compliance with the second obligation violates the first (stricter) obligation, but not vice versa. In the following, this constellation will therefore be referred to as a unilateral incompatibility between two obligations. This first issue of which constellations of incompatible norms should be covered by the definition of conflict of norms thus in fact consists of the three interrelated questions just sketched out. This issue is disputed in legal theory and international law scholarship.[22]

Secondly, there is the problem whether one can find a criterion for making a norm conflict *recognizable* as such in an objective and reliable manner. Thus, for example, a *logical contradiction* between two assertions is *formally* recognizable, as the assertions cannot both be *true*. The examples typically given are assertions of the sort that 'God exists' and 'God does not exist'. However, the truth-criterion is not transposable to *conflicts of norms*, the opposite view having been overcome since the 1960s at the latest. Thus, as pointed out by Kelsen (who, as one of the most pronounced writers on the issue, changed his mind in his last works), a norm conflict 'is not a logical contradiction and cannot even be compared to a logical contradiction', as it is perfectly possible for two conflicting norms to be *valid* within one and the same *legal* system.[23] Moreover, unlike a logical

[20] The legal nature of these principles will be examined in detail below in ch 2.

[21] Cf below, section IV.A.

[22] Relevant writings will be analysed below in IV.A and section V; for an overview of judicial decisions in international law cf J Pauwelyn, *Conflict of Norms in Public International Law. How WTO Law Relates to other Rules of International Law* (2003) 200ff, 440ff; L Bartels, 'Treaty Conflicts in WTO Law' in St Griller (ed), *At the Crossroads: The World Trading System and the Doha Round* (Springer, Vienna–New York, 2008), 129.

[23] Kelsen (n 18 above) 1439.

system (which proves inconsistent and unfit for use, if it can be shown that two assertions are both *valid* according to the system[24]), the legal system does not become unfit for use if two of its norms conflict, as was sometimes held by authors wrongly equating the legal order to a logical system.[25]

Hence, if the truth-criterion and the validity-criterion cannot be transposed in the sense of a simple 'litmus test' from logical contradictions to norm conflicts, it is necessary to ascertain whether it is possible to find an appropriate criterion in the legal context.

Third, there is the aforementioned problem of whether a norm granting competences can conflict with another such norm. In academic writings and WTO rulings in particular, this question has not so far been sufficiently distinguished from the foregoing issues.[26]

B. Two Examples Taken from WTO Jurisprudence

A good illustration of the problems ensuing from a strict definition of conflict is furnished by two WTO panel reports. In the first panel report, *Indonesia—Automobiles*, a claim was brought against Indonesia *inter alia* under the national treatment provision of the GATT, Article III. When Indonesia invoked, as a defence, a *permission*—which was specially granted to developing countries under the WTO Agreement on Subsidies and Countervailing Measures (SCM Agreement)—to provisionally maintain certain subsidies, the panel referred to the strict definition of conflict found in international law:[27]

> 'In international law for a conflict to exist between two treaties, ... [their] provisions must conflict, in the sense that the provisions must impose *mutually exclusive obligations*... Technically speaking, there is conflict when two (or more) treaty instruments contain obligations which *cannot be complied with simultaneously*.'[28]

[24] Cf Ch Perelman, 'Les antinomies en droit. Essai de synthèse' in Ch Perelman (ed), *Les Antinomies en droit* (1965) 393, 398.

[25] Cf eg P Foriers, 'Les antinomies en droit' in Ch Perelman (ibid) 20, 22–3, who held that a conflict of norms constitutes an 'abnormal situation in a system in which the principle of non-contradiction is essential and in which logical coherence constitutes a fundamental requirement' ('situation anormale dans un système où le principe de non-contradiction est essentiel et où la cohérence logique est une exigence fondamentale') (at 22); such conflict 'endangers the logical coherence of the system as a whole' ('[met] en péril la cohérence logique du système tout entier') (at 23).

Similarly, but with further qualifications, Ch Huberlant, 'Antinomies et recours aux principes généraux' in Ch Perelman (ibid) 204, 212 speaks of a 'coherence which excludes contradiction' ('cohérence excluant la contradiction').

[26] Cf below, V.B.3.

[27] The panel referred to the writings of Jenks and Karl. These and other relevant writings on international law will be analysed below in section IV.

[28] WTO Panel Report, *Indonesia—Certain Measures Affecting the Automobile Industry*, WT/DS54/R, WT/DS59/R, WT/DS64/R (*Indonesia—Automobiles*), adopted on 23 July 1998, at footnote 649.

Hence, the panel recognized only that a conflict of norms exists in a situation of mutually exclusive obligations, thus excluding the possibility of conflicts between express permissions and obligations. The practical consequence in this case was that the panel did not even examine whether the permission invoked by Indonesia was the *lex specialis* which should have prevailed. In other words, it was the very definition of conflict that influenced the outcome of this dispute in that the panel declined to address Indonesia's developing country permission under the SCM Agreement, which pursuant to an explicit conflict clause in Annex 1A of the WTO Agreement[29] would have prevailed to the extent of conflict.[30]

A second case in point is the 1999 panel report on *Turkey—Textiles*. In this case, India challenged quantitative restrictions imposed by Turkey on Indian textiles and clothing upon the formation of the customs union between Turkey and the EC. In defence, Turkey argued that these quantitative restrictions did not violate relevant provisions of the GATT and the WTO Agreement on Textiles and Clothing,[31] submitting that they were justified by GATT rules on regional trade agreements (Article XXIV of the GATT), which, in its view, constitute a *lex specialis* for the rights and obligations of WTO Members at the time of formation of a customs union.[32] In addressing this defence, the *Turkey—Textiles* panel, too, referred to Jenks' strict definition of conflict, holding that '[t]here is no conflict if the *obligations* of one instrument are *stricter* than, but not incompatible with, those of another, or it is possible to comply with the obligations of one instrument by refraining from exercising a privilege or discretion accorded by another'.[33] While this definition denies the very existence of conflict in such instances, the panel nonetheless went on to examine 'whether Article XXIV *authorizes* measures' which the GATT and the Agreement on Textiles and Clothing 'otherwise *prohibit*'.[34] After a lengthy analysis of Article XXIV of the GATT, it concluded that this provision does not permit a departure from relevant obligations contained in the GATT and the Agreement on Textiles and Clothing.[35] It is evident that the stance taken

[29] Cf the General Interpretative Note to Annex 1A of the WTO Agreement, stipulating that specific Agreements like the SCM Agreement take precedence over the GATT (the WTO agreements are available at <http://www.wto.org>. Marrakesh Agreement Establishing the World Trade Organization, 15 April 1994, reprinted in: (1994) 33 ILM, 1144ff).

[30] This is also pointed out by Pauwelyn (n 22 above) 193–4.

[31] The pertinent provisions were Articles XI and XIII of the GATT and Article 2.4 of the Agreement on Textiles and Clothing (The WTO agreements are available at <http://www.wto.org>. Marrakesh Agreement Establishing the World Trade Organization, 15 April 1994, reprinted in: (1994) 33 ILM, 1144ff). Article XI prohibits quantitative restrictions; Article XIII requires non-discriminatory administration of quotas; Article 2.4 prohibits new restrictions on textiles trade.

[32] WTO Panel Report, *Turkey—Restrictions on Imports of Textile and Clothing Products*, WT/DS34/R (*Turkey—Textiles*) para 9.88 (adopted on 19 November 1999).

[33] Ibid para 9.92.

[34] Ibid para 9.95.

[35] Cf ibid paras 9.97–9.192, in particular at paras 9.188–9.189.

by the panel is paradoxical: had it really complied with the definition of conflict that it set forth, then there would have been no need to inquire into whether there exists an authorization colliding with obligations under the GATT.

Yet the point of this section is not to criticize this apparent inconsistency, but rather to stress the problematic consequences of the definition unambiguously adopted by the *Indonesia—Automobiles* panel and referred to by the *Turkey—Textiles* panel. Thus, whereas the *Indonesia—Automobiles* panel denied the existence of a conflict of norms where a permission and a prescription collide, the *Turkey—Textiles* panel additionally indicated a denial of the possibility of a unilateral conflict between obligations in the similar situation in which complying with a less stringent obligation results in breaching a stricter one, as in the example given above.[36] This definition unavoidably favours the strictest obligation among a given set of 'parallel' obligations.[37]

Regarding WTO jurisprudence, where the problem of conflicts of norms has surfaced repeatedly, it must be mentioned that a wider definition of conflict has been adopted by the panel report in *Bananas III*. With respect to the GATT's *General Interpretative Note* on the interrelationship between the GATT and specific WTO agreements on trade in goods, the panel argued that a narrow definition of conflict

> would render whole Articles or sections of Agreements covered by the WTO meaningless and run counter to the object and purpose of many agreements listed in Annex 1A which were negotiated with the intent to create rights and obligations which in parts differ substantially from those of the GATT 1994.[38]

On the other hand, however, it must also be mentioned that decisions of the Appellate Body appear to have been misread as supporting broader definitions of conflict, whereas they actually concerned the special problem of norms of competence.[39]

IV. (Conflicting) Conflict Definitions in International Law Doctrine

A. The Prevailing Narrow Definition of Conflict

The 'classic' narrow definition of conflict which still appears to prevail in public international law doctrine was arguably first advocated by Jenks

[36] Cf the example of an addressee facing a norm requiring her to pay $100 and another norm requiring her to pay $200 in a given case, above, section III.A.

[37] Cf also Marceau (n 6 above) 1085.

[38] WTO panel report, *European Communities—Regime for the Importation, Sale and Distribution of Bananas*, WT/DS27/R (*Bananas III*), adopted on 25 September 1997, para 7.159 and fn 728.

[39] Cf below, section V.B.3.

in his treatise on conflicts of law-making treaties in 1953. According to Jenks, one has to distinguish conflicts *stricto sensu* from mere divergences: 'A conflict in the strict sense of direct incompatibility arises only where a party to the two treaties cannot *simultaneously comply* with its *obligations* under *both* treaties'.[40]

Jenks does not recognize other divergences as conflicts, even if they 'defeat the object of one or both of the divergent instruments'. Jenks makes it expressly clear that he is aware of the fact that '[s]uch a divergence may, for instance, prevent a party to both of the divergent instruments from taking advantage of certain provisions of one of them'. He also admits that such a divergence may, 'from a practical point of view be *as serious as a conflict*; it may render inapplicable provisions designed to give one of the divergent instruments a measure of flexibility of operation which was thought necessary to its practicability'.[41] Nonetheless, Jenks explicitly upholds his strict definition, according to which there is no conflict 'when one instrument eliminates *exceptions* provided for in another instrument', even if one of the agreements 'loses much or most of its practical importance'.[42]

As noted, this classic narrow definition of conflict in public international law has had a marked influence on recent WTO jurisprudence, where express reference is made to Jenks' definition.[43] A strict definition has apparently also been advocated by Marceau and Trachtman,[44] by Puth,[45] and Karl in the *Encyclopedia of Public International Law*.[46] Karl, however, adopts the wider definition of Engisch in his main treatise on the subject.[47] Several other authors, among them Czaplinski and Danilenko[48] and most recently Wolfrum and Matz,[49] have also opted for narrow definitions of conflict;

[40] Jenks (n 2 above) 401ff, 426 (emphasis added).

[41] Ibid (emphasis added).

[42] Ibid 426–7 (emphasis added).

[43] Cf above, III.B.

[44] G Marceau and J Trachtman, 'TBT, SPS, and GATT: A Map of WTO Law of Domestic Regulation' in F Ortino and EU Petersmann, *The WTO Dispute Settlement System 1995–2003* (2004) 330–1.

[45] S Puth, *WTO und Umwelt. Die Produkt-Prozess-Doktrin* (2003) 160.

[46] W Karl, 'Conflicts between Treaties' in R Bernhardt (ed), *Encyclopedia of Public International Law*, vol VII (1984) 467, 468 ('Technically speaking, there is a conflict between treaties when two or more treaty instruments contain obligations which cannot be complied with simultaneously').

[47] W Karl, *Vertrag und spätere Praxis im Völkerrecht* (1983) 61ff. On Engisch's definition cf below, section V.A.1.

[48] According to W Czaplinski and G Danilenko, 'Conflicts of Norms in International Law' (1990) 21 *Netherlands Yearbook of International Law* 3, 12–13, '[o]ne can speak of the conflict of treaties when one of the treaties *obliges* party A to take action X, while another stipulates that A should take action Y, and X is incompatible with Y'. Pauwelyn (n 22 above) 168–9, however, reads this definition as a wide one.

[49] R Wolfrum and N Matz, *Conflicts in International Environmental Law* (2003) 4 apparently opt for a broader definition of conflict than Jenks; however, this is obviously not done so as to include divergences between permissions and obligations, but to include 'conceptual conflicts between different approaches or programs', 'conflicting objectives', and

yet it is not always clear whether in doing so authors in international law are aware of the particular problem of conflicts between permissions and prescriptive or prohibitive norms. Moreover, the proposed definitions are often open to different interpretations.

Thus Klein, Wilting, and Kelsen have been understood as giving strict definitions, excluding any incompatibility of permissions and prescriptive norms.[50] In relation to Kelsen, in particular, this interpretation appears problematic, as this author not only adopted a wide definition in his *General Theory of Norms*, but also in other works. Thus he expressly stated '... that one cannot deny that a permission and a prescription mutually exclude each other'.[51] The same should hold true for Klein[52] and Wilting, who builds upon Kelsen's definition.[53]

Most recently, Jenks' narrow definition and corresponding WTO practice have been explicitly defended by Marceau, who submits that a conflict may be defined narrowly or broadly[54] 'depending on one's conception of the international legal order'.[55] One central argument for Marceau's supporting of Jenks' definition is the coherence of the international legal order, which her definition is meant to promote.[56] Marceau even admits that this strict definition 'will often favour the most stringent obligations',[57] a fact which was illustrated in the WTO panel reports *Indonesia—Autos* and *Turkey—Textiles* discussed above.

'political conflicts' in the conflict terminology. This impression is reinforced in the sections in which these authors deal with 'conflicting *obligations*' and 'conflicts in the implementation phase' (ibid 10–11).

[50] This is the reading of Pauwelyn (n 22 above) 167.

[51] '*Wenn man "Gebieten" und "Erlauben" als zwei verschiedene normative Funktionen gelten lassen muss, kann man nicht leugnen, daß sich Erlaubt-Sein und Geboten-Sein gegenseitig ausschließen*' ('If one has to recognize that "prescribing" and "permitting" constitute two different normative functions, one cannot deny that a permission and a prescription mutually exclude each other'), cf *Kelsen's General Theory of Norms* (Kelsen, *Allgemeine Theorie der Normen* (1979) 79).

As regards Kelsen's definition of conflict, cf his essay on derogation (Kelsen (1438 n 18 above), where he held that '[a] conflict between two norms occurs if in obeying or applying one norm, the other one is nessecarily or possibly violated'; Kelsen adopted a similar definition in his *General Theory of Norms* (99). On Kelsen's definition of conflict see also the detailed discussion below in section V.B.2.

[52] In explaining his definition, Klein writes: 'in practice, only those instances of parrallel treaties are important, in which the treaty provisions, *in particular* treaty obligations, of two or more treaties contradict each other in a formally unresolvable manner' ('[p]raktisch bedeutsam sind nur diejenigen Vertragskonkurrenzen, in denen sich die Vertragsbestimmungen, *insbesondere* die Vertrags*verpflichtungen*, in zwei oder mehreren völkerrechtlichen Verträgen formal unauflösbar widersprechen'; Klein in K Strupp, *Wörterbuch des Völkerrechts* (2nd edn 1962) vol III, 555, right column).

[53] WH Wilting, *Vertragskonkurrenz im Völkerrecht* (1994) 2–12.

[54] Marceau (n 6 above) 1081, 1083ff; see also the concurring view of Puth (n 45 above) 160.

[55] Ibid 1082–3.

[56] 'If one believes that international commitments should be understood in the light of *some coherent* international order, one favours *narrow definitions* of conflict...' (ibid 1082).

[57] Ibid 1085.

It follows logically from Marceau's standpoint that '[i]n the area of *trade and environment*, where MEAs may authorize (and not oblige) the use of trade restrictions otherwise prohibited by GATT, we would not be faced with a conflict *stricto sensu*'. The problematic consequence of this view is that conflict maxims such as the *lex posterior* principle cannot come into play to resolve such an incompatibility, even if an MEA is clearly later in time. Marceau explains her stance with the somewhat ambiguous reasoning that 'since the main objective of interpretation rules is to identify the intention of the parties, it is suggested that 'conflicts' should be interpreted narrowly, in order to keep as much as possible of the agreement of the parties'. To take into account explicit permissions provided in another treaty, one should, in her view, refer to the *lex specialis* principle.[58] We will discuss her point of view together with that of other writers favouring a narrow definition in the following subsection.

An analogy with the strict definitions submitted by international law writers can be found in the jurisprudence and academic literature on domestic law in some countries, as well as in legal theory.[59]

B. Critical Assessment of the Narrow Conflict Definition

We will briefly present some of the main arguments that can be put forward against the narrow conflict definition in this subsection. Additional reasons will ensue from the discussion of the broader definition offered in section V. Thus, both sections have to be seen in conjunction.

Several objections have been voiced against the strict definition advocated by Jenks, such as the fact that states may intend to detract from their existing obligations by establishing permissions.[60] Moreover, this definition appears not to correspond to the prevailing opinion in legal theory and in domestic legal systems.[61] Furthermore, if one views conflict rules such as the *lex posterior* and *lex specialis* maxims as devices for approximating the probable intentions of the contracting parties on the basis of *objective* factors (time and specialty),[62] it seems problematic to exclude incompatibilities between permissions and obligations, permissions and prohibitions, as well as unilateral incompatibilities between divergent obligations (ie which are

[58] Marceau (n 6 above) 1086.

[59] Cf eg Wiederin (n 19 above) 311ff, 323; Wiederin himself favours a wider definition, however, similarly, St Griller, 'Der Schutz der Grundrechte vor Verletzungen durch Private' (1992) 114 *Juristische Blätter* 205, 209 and fn 21.

[60] Pauwelyn (n 22 above) 174.

[61] Cf also below, section V. To quote but one author, Kelsen expressly held 'that one cannot deny that a permission and a prescription mutually exclude each other' ('Wenn man "Gebieten" und "Erlauben" als zwei verschiedene normative Funktionen gelten lassen muss, kann man nicht leugnen, daß sich Erlaubt-Sein und Geboten-Sein gegenseitig ausschließen'; cf H Kelsen (n 51 above)).

[62] Cf N Bobbio, 'Des critères pour résoudre les antinomies' in Ch Perelman (ed), *Les Antinomies en droit* (1965) 237, 241 and 244; for a discussion of the wide variety of views held in this regard in international law, domestic law and legal theory, cf ch 2 below.

not *mutually* exclusive), from the scope of these conflict rules altogether. This, however, is the effect of excluding such divergences from the notion of conflict in the first place. Consequently, these types of incompatibilities are 'defined away' and a less stringent obligation or a permission, which constitutes the *lex specialis* or the *lex posterior*, cannot prevail.[63] Finally, introducing such a strict definition runs counter to the basic principle that norms have to be interpreted in a way that does not reduce them to inutility.[64]

Beside these reasons presented in the academic literature, it is possible to put forward even more fundamental arguments. The main objection against the narrow definition advocated by Jenks and others is given by Jenks himself when he states, as has already been quoted above, that incompatibilities between permissions and obligations, permissions and prohibitions, and unilateral incompatibilities between obligations which are not mutually exclusive, may 'from that a practical point of view be *as serious as a conflict*; [as they] may render inapplicable provisions designed to give one of the divergent instruments a measure of flexibility of operation which was thought necessary to its practicability'.[65] In terms of the theory of definition discussed by way of introduction, the *definiens* offered therefore appears *inadequately narrow*: it excludes incompatibilities that appear analogous to the mutual incompatibility between obligations and prohibitions[66] which Jenks is willing to recognize as conflicts.

This becomes even clearer when one recalls that we are not here faced with an analytical definition, but with a *stipulative* definition: as was pointed out above, a stipulative definition has to be adequate to the purpose pursued with the adoption of that definition. The purpose of norms is to regulate behaviour. Thus, if a given conduct is at the same time permitted and prohibited, or subject to unilaterally incompatible obligations, it is not unequivocally but *contradictorily* regulated from the viewpoint of the addressee of these norms. In other words: if attaining this *telos* is impaired by a permission incompatible with a prohibition, or by a permission inconsistent with an obligation, one should recognize these norms as being *in conflict*.

[63] Cf Pauwelyn (n 22 above) 171 *et passim*.

[64] This principle is also frequently referred to in WTO Appellate Body jurisprudence, cf Appellate Body Report, *United States—Standards for Reformulated and Conventional Gasoline*, WT/DS2/AB/R, adopted 20 May 1996, DSR 1996:I, 3 (see page 3 of the original report as available at www.wto.org); Appellate Body Report, *Japan—Taxes on Alcoholic Beverages*, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, adopted 1 November 1996, DSR 1996:I, 97 (see page 12 of the original report as available at www.wto.org); Appellate Body Report, *United States—Restrictions on Imports of Cotton and Man-made Fibre Underwear*, WT/DS24/AB/R, adopted 25 February 1997, DSR 1997:I, 11 (see page 16 of the original report as available at www.wto.org); Appellate Body Report, *Argentina—Safeguard Measures on Imports of Footwear*, WT/DS121/AB/R, adopted 12 January 2000, DSR 2000:I, 515, paras 81 and 95; Appellate Body Report, *Korea—Definitive Safeguard Measure on Imports of Certain Dairy Products*, WT/DS98/AB/R, adopted 12 January 2000, DSR 2000:I, 3, para 81.

[65] Ibid (emphasis added).

[66] As will be shown in more detail below, in section V.A.1, an obligation to adopt a given conduct can be understood as a prohibition on refraining from adopting this very conduct.

It shall only briefly be noted that the reasoning of the second writer having recently emphatically argued in favour of a narrow definition, Marceau, appears partly unfounded and partly contradictory as well. First, as regards the underlying reason of Marceau's argumentation[67]—that one should promote the coherence of the international legal order—it is not only dubious why one should, but also how one could, create more coherence by mechanically defining away an evident problem.

Marceau's second argument—'since the main objective of interpretation rules is to identify the intention of the parties, "conflicts" should be interpreted narrowly, in order to keep as much as possible of the agreement of the parties'—is also difficult to sustain: it seems impossible to see a valid reason why arbitrarily subordinating explicit permissions, or less stringent obligations, to other obligations automatically, or at least typically, better conforms to the presumptive intention of the parties.

Marceau's third argument—ie that '[t]o take into account explicit "rights" provided in another treaty, one should refer to the lex specialis principle of interpretation'—appears contradictory. The *lex specialis* principle, at least as employed by Marceau in her reasoning,[68] constitutes a maxim for resolving *conflict*.[69] Hence, she implicitly, though involuntarily, recognizes that there is a conflict, since she wants to give priority to a '*right*...*inconsistent* with a subsequent treaty provision drafted in general terms'.[70] There would be further contradictions if one tried, on the basis of this argumentation, to determine in a concrete case to what extent the *lex generalis* has to be carved out to make room for the *lex specialis*, since this operation depends upon determining the *extent of conflict* between the *lex specialis* and the *lex generalis*.

Finally, Marceau holds that the *Bananas III* panel should have used the approach of effective interpretation instead of 'extending' the notion of conflict. To refute this argument, it suffices to point to writers who have rightly emphasized that effective interpretation is a two-edged device:[71] using this principle, one would first have to give reasons explaining which of two conflicting norms should be interpreted narrowly and which extensively. Hence, the suitability of the principle of effective interpretation as a sufficient device for avoiding conflict is doubtful.

[67] Cf above, section IV.A.

[68] 'The *lex specialis* principle of interpretation favours the application of a more specific provision over a general one. Therefore, it may appear from the intention of the parties and in application of the *lex specialis* principle, that a state may exercise an express and more specific right provided for in an earlier or later treaty, albeit inconsistent with a subsequent treaty provision drafted in general terms' (Marceau (n 6 above) 1086).

[69] On the legal status of this maxim cf also the more detailed discussion below, ch 2.

[70] Ibid.

[71] Pauwelyn (n 22 above) 250–1; on the principle of effective interpretation cf also R Bernhardt, *Die Auslegung völkerrechtlicher Verträge* (1963) 88ff; H Lauterpacht, 'Restrictive Interpretation and the Principle of Effectiveness in the Interpretation of Treaties' (1949) 27 BYIL 48.

C. Authors Advocating a Broader Definition

Unlike writers in legal theory, among whom a broader definition of conflict seems to have prevailed,[72] few authors have explicitly opted for a wider definition of conflict of norms in public international law. Engisch's wide definition in legal theory[73] has been adopted, in international law, by Karl.[74] A broad definition has also been put forward by Klein, according to whom there is a conflict, if 'two treaty provisions, *in particular* treaty *obligations*, in two or more international treaties cannot be resolved'.[75] Recently, Falke expressly approved Klein's definition and that of the *Bananas III* panel, which opted for a broader definition of conflict.[76]

However, just as in the case of several writers apparently favouring a narrow definition of conflict,[77] the definitions given by other authors writing on public international law are often not entirely clear as regards the issue of divergences between permissions and obligations. This is due to the fact that it is not always evident whether the authors providing a broader definition were actually aware of this issue. One may by way of example refer to Aufricht, whose definition is apt to encompass divergences between permissions and obligations,[78] and who has been read as providing a wide definition,[79] but who does not actually deal with this issue in his treatise. The same can be said, for example, of Salmon.[80]

[72] Cf eg the definition given by Engisch in 1935, according to whom there is a conflict '1) if conduct of a given type is at the same time prohibited and *permitted*, or prohibited and prescribed, or prescribed and not prescribed in a given legal order. Or if incompatible ways of conduct are prescribed at the same time...2) if a concrete conduct appears at the same time to be prohibited and *permitted* etc in a given legal order' (K Engisch, *Die Einheit der Rechtsordnung* (1935) 46 (translation by the author); similarly, K Engisch, *Einführung in das juristische Denken* (7th edn, 1977) 162). Cf also the discussion on conflict definitions in legal theory in section V below.

[73] Cf the preceding note.

[74] Karl (n 47 above) 61ff.

[75] Klein referred to 'instances of parrallel treaties, in which the treaty provisions, *in particular* treaty obligations, of two or more treaties contradict each other in a formally unresolvable manner' ('Vertragskonkurrenzen, in denen sich die Vertragsbestimmungen, *insbesondere* die Vertrags*verpflichtungen*, in zwei oder mehreren völkerrechtlichen Verträgen formal unauflösbar widersprechen'; Klein in K Strupp, *Wörterbuch des Völkerrechts* (2nd edn, 1962) vol III, 555, right column).

[76] Cf *Bananas III* (n 38 above), para 7.159 and fn 728; see also D Falke, 'Vertragskonkurrenz und Vertragskonflikt im Recht der WTO: Erste Erfahrungen der Rechtsprechung 1995–1999' (2000) 3 *Zeitschrift für Europarechtliche Studien* 307, 328.

[77] Cf section IV.A above.

[78] 'A conflict between an earlier and a later treaty arises if both deal with the same subject matter and if at least one state is party to both treaties' (H Aufricht, 'Supersession of Treaties in International Law' (2002) 37 *Cornell Law Quarterly* (1952) 655–6).

[79] Cf Pauwelyn (n 22 above) 167–8; Bartels (n 22 above).

[80] Salmon defines conflict (*antinomie*) as 'the existence, in a given legal system, of incompatible rules of law, leading to the consequence that the interpreter cannot apply two rules at the same time, that he must make a choice' ('l'existence, dans un systeme juridique déterminé, de règles de droit incompatibles; de telle sorte que l'interprète ne peut appliquer les deux règles en même temps, qu'il doit choisir'; J Salmon, 'Les Antinomies en Droit International Public' in Ch Perelman (ed), *Les Antinomies en Droit* (1965) 285).

Recently, Pauwelyn, having criticized the 'classic' narrow definition of conflict, opted for a broader definition. He defines conflict of norms 'as a situation where one norm breaches, has led to or may lead to breach, of another norm', making clear in the accompanying argumentation, though not in the definition itself, that this definition is meant to cover incompatibilities between permissions and obligations.[81] As Pauwelyn's definition shows some affinity to Kelsen's definition, we will discuss it in the next section together with Kelsen's approach.

D. Interim Conclusions

By way of interim conclusion, it is submitted that a broad definition of conflict has arguably not yet unequivocally asserted itself in international law. This is reflected in particular in the WTO panel reports referred to above. In view of this finding, further reasons for a broader definition of conflict in public international law, building also on legal theory, will be discussed in the next section.

V. An 'Adequate' Definition of Conflict in Legal Theory and Public International Law

A. Conflict Types According to Legal Theory

1. *The Inter-Relations between Obligation, Prohibition, and Permissions*

As regards conflicts between norms in international law, we are concerned with rights held by one state vis-à-vis another state (or group of states).[82] A crucial problem in this context is that the term 'right' is used with a series of different meanings such as claim, competence, permission, liberty, privilege, etc, which may be employed to refer to very different legal functions.[83] To be in a position to analyse the set of possible legal relations between 'rights', it

[81] Pauwelyn (n 22 above) 175ff (quotation at 199).

[82] As will be shown below, to speak of a right of state A vis-à-vis state B is logically equivalent to speaking of the converse obligation of state B vis-à-vis state A. Thus, we do not prejudge the issue of an adequate definition of conflict when we talk of the rights of a given state instead of its obligations. It may also be helpful to point out that the following considerations apply equally to natural persons, legal persons and states, whenever these entities are the addressees of obligations and prohibitions or the holders of permissions and rights: this follows from the fact that the considerations presented in the following apply irrespectively of who holds such rights, permission, etc, given that the aforementioned modalities (obligation, prohibition, permission, and right) are defined abstractly.

[83] On this cf the classic study by WN Hohfeld, 'Some Fundamental Legal Conceptions as Applied in Judicial Reasoning' (1913) 23 *Yale Law Journal* 16; and (1917) 26 *Yale Law Journal* 710; reprinted in WW Cook (ed), *Wesley Newcomb Hohfeld: Fundamental Legal*

is indispensable, therefore, briefly to recall some fundamentals of the theory of norms and the basic structure of norms. It has already been pointed out by Bentham in his *Of Laws in General* that the multitude of legal provisions and complex legal concepts (such as 'competence', 'property', etc) can be reduced to sets of norms of conduct, which he referred to as complete norms, namely prohibition, obligation, and permission.[84] In this regard, legal logic and Bentham's imperative theory of law are congruent. A norm of conduct consists of two parts, that is to say the so-called deontic operator, which expresses an obligation, prohibition, or permission, and a descriptive proposition[85] which can be any conduct, be it an act or an omission. An example is the norm: it is incumbent (deontic operator) on *a* to adopt conduct C (descriptive proposition). Expressed in more traditional terminology:

(1) *a* is *obligated* to do C.
(2) *a* is *prohibited* from doing C.
(3) *a* is *permitted* to do C.

All of these 'basic units' of legal thinking are *interdefinable* through mere negations. Thus, if the prohibition of a given conduct is negated, this same conduct is permitted, and *vice versa*. In other words, the prohibition of a given conduct constitutes the contradictory opposite of the permission of this conduct ('non-prohibition', positive permission). The same is true for the permission to forbear from adopting a given conduct and the obligation to adopt this conduct: negating this obligation yields a permission of contradictory content ('non-command', negative permission), and *vice versa*. Hence, there are two types of permissions, the first consisting in the absence, or negation, of a prohibition; the second in the absence, or

Conceptions as Applied in Judicial Reasoning (1919, with manuscript changes by the author, 4th printing 1966).

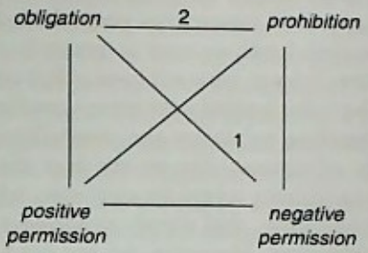
[84] Cf J Bentham, *Of Laws in General* (edited posthumously in 1970 by HLA Hart) 93–109 and 153–83; Bentham pointed out that there is no complete law which is not imperative or deimperative. Incomplete norms, in contra-distinction, are fragments of complete norms: thus, legal definitions, exceptions, norms referring to other norms or setting out legal fictions, are merely parts of the antecedent (the if-clause) of complete norms: a complete norm is equivalent to the complete expression of the legislator's will in respect of a given conduct. It therefore varies, in extent and complexity, from a simple command to a multitude of legal provisions.

A right (in the sense of a claim) on the other hand is constituted by a series of commands (obligations and prohibitions) addressed to a class of persons except the holder of the right. Hence, a legal institution like property is constituted by a compound of norms which can be resolved into prohibitions on interferences directed against everyone except the holder of the right. For a concise overview of Bentham's thinking, the imperative theory and its overlap with modern legal logic cf HLA Hart, 'Bentham's "Of Laws in General"' (1971) 2 *Rechtstheorie*, 55–66. The notion of 'right' will also be dealt with in more detail below in Part II, ch 1, section II.A.1.b.

[85] The descriptive proposition is also referred to as *Satzradikal*; cf Weinberger (n 7 above) 228–9; St Griller, 'Der Schutz der Grundrechte vor Verletzungen durch Private' (1992) 114 *Juristische Blätter*, 209 and fn 21. It is called '*modal indifferentes Substrat*' by Kelsen (n 51 above) 45–6.

negation, of an obligation. Prohibition and obligation are also logically interdefinable through negation, if the conduct which is regulated (the descriptive proposition) is negated.[86, 87]

The possible set of inter-relations can be illustrated by using the so-called deontic square, which in fact relies on the logic square known since Greek antiquity,[88] and which was arguably first used in deontic logic by Bentham:[89]



The relation between the obligation to adopt a given conduct C and the permission not to adopt this conduct (designated as *1* in the graph) is commonly referred to as a *contradictory conflict* in legal theory, since negating the obligation to do C yields a permission not to do C, ie its contradictory opposite, and *vice versa*. The same is true for the relation between a prohibition to do C and a permission to do C: negating either modality yields the contradictory opposite, as was just explained. The relation between obligation and prohibition (designated as 2 in the square) is termed *contrary conflict*, since both norms cannot be applied at the same time.[90]

There is no conflict between a permission to adopt a given conduct and a permission to adopt the opposite conduct: the conjunction of positive and

[86] Let us assume the conduct in question is 'to stay in Vienna'. A given norm may prohibit a person from 'staying in Vienna'. The negation of this conduct is 'not staying in Vienna'. If this person is prohibited from 'not staying in Vienna', the person is actually under an obligation 'to stay in Vienna'. Thus, negating the descriptive part of a prohibitive norm yields the contrary obligation, and *vice versa*.

[87] Cf eg Lenk (n 17 above) at 199; Weinberger (n 7 above) 231 ff; Alexy (n 19 above) 182–4; Griller (n 85 above) at 209.

[88] Cf Lenk (n 17 above) 198.

[89] Cf Bentham (1970) at 93–109; see also Adomeit (1986) 26–9 and 82–6.

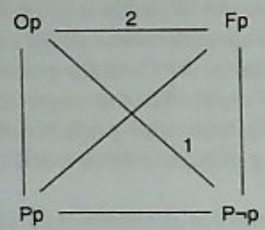
[90] In order to make it clear that the assertions explained in the text are not the result of involuntary *changes* in the *meaning of the notions* employed, it is possible to express the relevant considerations in formalized terminology: the deontic operators are commonly abbreviated by O (obligatory), F (forbidden) and P (permitted). The descriptive proposition is denoted p. An obligation, prohibition or permission to do C then is expressed as Op, Fp or Pp, respectively. As explained in the text, the deontic operators are inter-definable through negations, which—when 'non' is denoted as '¬'—can be expressed as:
Op = *def* ¬P¬p, Fp = *def* ¬Pp, Pp = *def* ¬Fp, Fp = *def* O¬p.

negative permission (permission to do something and to refrain from doing the same thing) can be defined as liberty in the legal sense.[91]

As noted, unlike in public international law, the two situations when a permission conflicts with either an obligation or a prohibition (ie contradictory conflicts) are recognized as conflicts by the prevailing opinion in legal theory.[92] The main assertions expressed in the deontic square coincide with Engisch's definition of conflict, according to which there is a conflict 'if a given behaviour appears in abstracto or in concreto as prescribed and not prescribed, or as prohibited and not prohibited, or even as prescribed and prohibited'.[93, 94] The first two alternatives refer to what we have called contradictory conflicts, the third to what we have designated as contrary conflicts here.

Of course it is appealing to accept the constellations of contradictory conflicts as 'conflicts of norms', due to the fact that simply negating a positive permission transforms it into its opposite, which *ex definitione* is the corresponding prohibition, and merely negating a negative permission yields the opposite obligation. However, we are not faced with an *analytical* definition here, in the sense of a definition that can be deduced from legal texts, and which would therefore be binding. Hence, one may indeed

The deontic square then takes the following form:



As noted, negating the obligation to adopt a given conduct yields a permission not to adopt that conduct. Therefore, the relation between obligation (Op) and permission (Pp) is commonly designated as a 'contradictory' conflict in legal theory:

(1) Op = ¬P¬p (*ex definitione*), from which it logically follows that:

(2) ¬Op = ¬ ¬P¬p = P¬p (read: if it is not obligatory to do p, it is permissible not to do p). Likewise, negating the prohibition of a given conduct yields a permission of this same conduct:

(3) Fp = ¬Pp (*ex definitione*), from which it logically follows that:

(4) ¬ ¬Pp = ¬ ¬Fp = Fp.

[91] It is sometimes also called *permission bilatérale* or *Indifferenz*. Cf eg Lenk (n 17 above) 198; Weinberger (n 7 above) 232 and 236; Alexy (n 19 above) 185.

[92] Cf Wiederin (n 19 above) 322 and fn 38; Griller (n 85 above) 209.

[93] Engisch (n 72 above) 162: 'a conduct appears, in abstracto or in concreto, to be prescribed and not prescribed, or to be prohibited and not prohibited, or even as prescribed and prohibited at the same time' ('Ein Verhalten [erscheint] in abstracto oder in concreto zugleich als geboten und nicht geboten oder als verboten und nicht verboten oder gar als geboten und verboten').

[94] However, Engisch's definition does not make explicit the decisive criterion for determining exactly *when* there is a conflict between two given norms, regardless of whether they are prescriptions or permissions. This issue of the appropriate criterion will be addressed in the following subsection.

argue that there is discretion to adopt a different (stipulative) definition, eg a narrower definition excluding the type of contradictory conflict.

Nevertheless, while it is correct that we are here concerned with a stipulative definition, such a definition has to be justified as being as adequate to the ends pursued as possible.[95] After all, it is a notion *introduced* more or less arbitrarily (ie in academic writings) in order to describe the legal system. Regarding this justification, it has to be recalled that we have pointed out above that the *telos* of norms is to regulate behaviour. It follows that if a given conduct is at the same time permitted and prohibited, it is not unequivocally but *contradictorily* regulated from the viewpoint of the addressee of these norms. The same is true for a permission of a given conduct and a norm prescribing the opposite conduct; and for the prohibition of a given conduct and an obligation to adopt this conduct. In other words: *if attaining this telos is impaired by a permission incompatible with an obligation or prohibition, or by an obligation incompatible with a prohibition*, one should recognize these norms as *conflicting*.

This reason holds true for both legal theory and given legal fields, such as international law. As noted, it has to be seen in conjunction with the additional reasons advanced against the narrow conflict definitions predominating in international law, which were set out in section IV above.

2. *Treaty Norms as Norms Establishing 'Relational' Rights*

Rights established eg by treaties are rights of a state *a* against another state (or group of states) *b* that *b* adopt a conduct defined in the treaty. This 'relational' or 'relativized' aspect[96] might cause problems in understanding the inter-relations, outlined in the preceding section, between rights, obligations, and prohibitions, and thus the definition of norm conflict.

However, it is relatively easy to show that what has been said on these inter-relations and norm conflicts holds true, even if one makes explicit this additional layer of complexity.

It is appropriate, in this context, to refer to the classic analysis of Hohfeld.[97] Hohfeld distinguished eight 'strictly fundamental legal relations' (right, duty, privilege, no-right, power, liability, disability and immunity), and categorized them as jural opposites (right and no-right; privilege and duty; power and disability; immunity and liability) and jural correlatives (right and duty; privilege and no-right; power and liability; immunity and disability). According to this fundamental classification, a right of *a* against

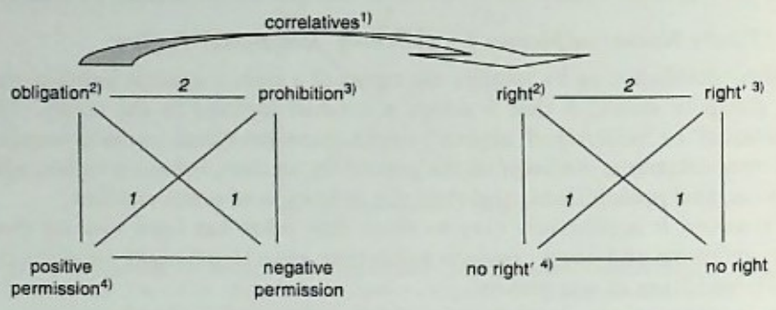
[95] Cf above, section II.

[96] Cf Alexy (n 19 above) 185–6, who speaks of 'relational obligations' ('*relationale Verpflichtungen*').

[97] WN Hohfeld, 'Some Fundamental Legal Conceptions as Applied in Judicial Reasoning' (1913) 23 *Yale Law Journal*, 16 and (1917) 26 *Yale Law Journal*, 710; reprinted in WN Hohfeld, *Some Fundamental Legal Conceptions as Applied in Judicial Reasoning* (WW Cook (ed), 1919, with manuscript changes by the author, 4th printing 1966).

b that *b* adopt a given conduct C is the *correlative* (and logical equivalent) of the duty of *b* toward *a* to adopt conduct C (eg to pay a debt). The same is true for privileges and 'no-rights' in Hohfeld's terminology: if *b* has no right against *a* that *a* adopt conduct C, *a* has the privilege *vis à vis b* not to adopt conduct C. It is important, in this context, to look at the allegedly conflicting norms from the perspective of *one* state. Moreover, it is essential to recognize that 'right' does not mean 'permission' here. A (positive) permission—ie to adopt a certain conduct—was defined as the opposite of a prohibition to adopt that conduct in the preceding section. A (negative) permission—ie not to do something—was defined as the logical opposite of an obligation (duty) to do that same thing. As just explained, a 'right', however, is not the opposite, but the correlative of an obligation: a right in this sense can also be referred to as a claim.

On this basis, Hohfeld's scheme, and his insight concerning the correlative relation between rights and duties, can be used to extend the deontic square, which yields the following double scheme.[98] The relations between the individual positions of both squares are converse (logically equivalent) ones, which Hohfeld called correlative relations:



[1] *All* positions in the respective corners are correlatives (obligation versus right, etc). For instance:

[2] The obligation of state *a* vis à vis state *b* to do C is the correlative of the right held by state *b* that *a* adopt conduct C.

[3] A prohibition imposed by *b* on *a* to do C constitutes the correlative of the right held by *b* that *a* refrains from doing C.

[4] A positive permission to do C, which is held by *a* in its relation to *b*, has its correlative in the legal position of *b* that *b* has no right that a adopt conduct C, etc.

[98] On this cf also Alexy (n 19 above) 185–94 with further references.

This graph shows that the insights gained from the deontic square are also applicable to rights and obligations if analysed as 'relativized' rights between two states (or groups of states): the contradictory conflict (designated as '*1*' in the diagram) between obligation and permission (obligation of *a* vis à vis *b* to do C versus permission of *a* vis à vis *b* not to do C) in the left square has its logical correlative in the inconsistency between *b*'s right and *b*'s 'no-right' in the right square. In other words, if one accepts *a*'s situation as constituting a conflict, one must logically accept the converse situation as giving rise to that same conflict (right versus no-right of *b*).

This also holds true for the contradictory conflict between a positive permission and a prohibition, which translates into the equivalent inconsistency between 'no right' and 'right' in the right square. The same is true of contrary conflicts between a prohibition and an obligation, designated as '2' in the left square, and the correlative inconsistency between a given right and an irreconcilable right, also marked as '2', in the right square.

This may be illustrated by a concrete example taken from the much debated *trade and environment* context:

(1) Let us assume that state *a* is under a WTO-imposed obligation not to restrict imports of state *b*'s goods (left top corner in the left square).
(2) Thus, there is a correlative right of state *b* toward state *a* that *a* is not to restrict imports of *b*'s goods (left top corner in the right square).
(3) Let us assume that a multilateral environmental agreement concluded, inter alia, by *a* and *b* provides that *a* is *not obligated* to allow imports from *b*, if *b* does not comply with the MEA, and let us assume that this condition is fulfilled. Then there is no obligation of *a* toward *b* not to restrict imports of *b*'s goods. This is *ex definitione* equivalent to a corresponding *permission* of *a* to restrict imports of *b*'s goods (bottom right corner in the left square).
(4) It follows that *b* has no converse ('corresponding') right *vis à vis a* (bottom right corner in the right square).

Crucially, this is one of the situations in which eg Jenks, Marceau, and WTO panels *deny* the existence of a conflict of norms. However, as just shown, a conflict between an MEA permission and a WTO obligation corresponds to a contradictory conflict from the viewpoint of state *a* in the terminology of deontic logic, marked as '*1*'. It follows that the reasons given in the preceding sections against a narrow definition of conflict (excluding this type of incompatibility from the notion of conflict) apply, by implication, to this concrete example as well.[99] Moreover, as all positions in the

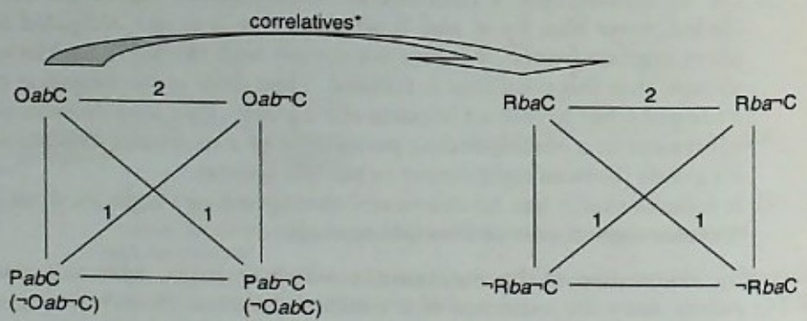
[99] It has been explained in the text above: (i) that the deontic modalities (obligation, prohibition, and permission) are interdefinable by mere negations; (ii) that this holds also

respective corners of both squares are converse (logically equivalent), it ensues that these reasons hold true in case of relational rights between two or more states in general.

B. The Appropriate Definition: Wide Definition Focussing on Breach of Norms

We now have to turn to the second question stated by way of introduction. The preceding sections have weighed arguments for and against narrow and wider definitions of norm conflict. It was concluded that a wide definition (including incompatibilities between rights and obligations, and unilateral incompatibilities between obligations) is to be preferred for a range of reasons. Thus, it has been made clear *what* is to be included in the definition. However, we have not yet determined *how* to formulate the definition appropriately. This is what will done in this section. Therefore, the question now becomes: which criterion, or criteria, constitute an appropriate definition of conflict?

true in the second square; and (iii) that rights and obligations are logical correlatives. Hence, it is possible again to translate the considerations in the text abve into formalized terminology, in order to underline that these considerations are not affected by involuntary *changes* in the *meaning of the notions* employed. Thus, a norm stating that state *a* is under an obligation toward *b* to adopt conduct C can be denoted as O*ab*C (read: 'obligation of *a* towards *b* to do C'). Likewise, the correlative right of *b* toward *a* that *a* adopt conduct C can be abbreviated as R*ba*C, etc. The double square then takes the following form:



In the example given in the text above, the obligation of state *a* vis à vis state *b* not to restrict imports of *b*'s goods (=conduct C) can then be abbreviated as O*ab*C. The correlative (ie logically equivalent) right of state *b* toward state *a* that *a* is not to restrict imports of *b*'s goods (R*ba*C) figures in the right square. The legal consequence of the hypothetical MEA referred to in the text above (that *a* is not obligated to allow imports from *b*, which is not complying with the MEA) amounts to a 'no-right' of *b* vis à vis *a* (¬R*ba*C). This is the logical equivalent of the 'non-obligation' of *a* vis à vis *b* (¬O*ab*C). This 'non-obligation' is *ex definitione* equivalent to the permission of *a* to restrict imports of *b*'s goods: ¬O*ab*C = P*ab*¬C. Hence, there is a conflict between an obligation and a contradictory permission (O*ab*C versus ¬O*ab*C, or, put differently, O*ab*C versus P*ab*¬C).

1. *Potential Criteria*

Several criteria for defining conflict appear possible at first sight. In this section the so-called *test of joint compliance* will be discussed, since it is the test employed by the prevailing opinion in legal theory.

It shall only be briefly remarked beforehand that two other criteria are conceivable, but suffer from evident shortcomings. First, one could try to translate two norms into declarative statements (*Aussagesätze*) to determine whether their conjunctions result in a *logical* contradiction.[100] However, a statement that, in a given legal system, there exist two norms with (presumptively) contradictory legal *consequences* (p and ¬p), is a true statement. Thus, this test does not employ an appropriate criterion[101] in the sense of yielding a contradiction between statements each time there is a conflict between the underlying norms. A modified test would compare statements that correspond to the content of two norms (eg Op and O¬p) in order to determine whether there is a contradiction. However, if the content of two norms (eg Op and Oq) is incompatible not logically, but merely empirically, then this test will not yield unequivocal results.[102]

On the other hand, the test of *joint compliance*, which prevails in legal theory, asks whether it is *possible* for the addressee of two norms to comply with the second norm, *after* having complied with the first one. However, this test appears unsuitable in several constellations as well. It is useful to take the hypothetical example of two divergent provisions on copyright protection:[103] let us assume that a given norm prescribes a minimum term of copyright protection of 50 years, whereas another norm prescribes a minimum duration of 40 years. Here there appears to be a conflict;[104] and we may once more refer to the reasons against the classic narrow definition of conflict set out above, according to which there is no conflict in such cases. After 40 years, according to the criterion of joint

[100] Such a test is arguably proposed by R Walter, *Über den Widerspruch von Rechtsvorschriften* (1955) 61, according to whom 'there would be a conflict, if the interpreter had to conclude that two rules that have been simultaneously enacted by a legal authority contradict each other' ('Eine Antinomie müsste ... dann vorliegen, wenn über zwei (gleichzeitig erlassene) anordnende Sätze der Rechtsautorität zwei rechtswissenschaftliche Urteile gefällt werden müssten, die einander widersprechen'). Such a test is vehemently criticized by Kelsen in his later thinking, cf Kelsen (n 51 above); see also Wiederin (n 19 above) 312–18.

[101] On this see in particular Wiederin (n 19 above) 312ff, who rightly states that, in view of this shortcoming, the standard argument given in legal theory in support of the existence of a conflict (ie that if one did not recognize a conflict in such instances, one could not describe the legal system without contradiction) is logically untenable. Cf the references provided ibid. This argument can also be found in Foriers (n 25 above) 38.

[102] Wiederin refers to the example of one norm prescribing that at a given time the addressee has to be in Salzburg (Op), and one hour later in Vienna (Oq). The conjunction p&q may or may not be true, depending on further circumstances, which shows that this criterion is evidently unsuitable for an unequivocal definition. Cf Wiederin (n 19 above) 315. Cf also Kelsen (n 51 above) 166ff.

[103] This example is taken from Pauwelyn (n 22 above) 180–1.

[104] Cf also Wiederin (n 19 above) 315–16, who uses a similar example.

compliance, it is still *possible* to protect copyrights for 10 more years and thereby to comply with the second norm. Hence, the test of joint compliance would not designate this situation as one involving conflict. Yet one could argue that after 40 years, ie after compliance with the first norm, there is an—at least implicit, if not, depending on the circumstances of a concrete treaty, explicit—*permission not* to protect copyrights. This would correspond to a contradictory conflict in the above scheme and should be recognized as a conflict of norms for the reasons given in the preceding analysis.

Incidentally, this example also shows that there is no reason to extend the deontic square, as has been intimated in Pauwelyn's study,[105] so as to cover this constellation that we have referred to as a unilateral incompatibility between two divergent obligations in the introduction, ie the situation where compliance with one obligation may breach the other. In this example, if there is an implicit or explicit permission not to protect copyrights after 40 years, there actually exists a conflict between a (conditional) permission and a contradictory obligation. In the alternative, two given obligations may turn out to be irreconcilable, because the first obligation requires the opposite of what the other obligation requires: hence, the first norm actually *prohibits* what the other requires. In other words, there exist only two types of conflicts between norms of conduct: contradictory conflicts (between permission and obligation, or between permission and prohibition) and contrary conflicts (between obligation and prohibition).

2. *The Appropriate Criterion: Kelsen's Focus on Breach of Norms*

The fourth method focuses on breach. This method, which avoids the problems of the approaches just discussed, was arguably first introduced by Kelsen,[106] according to whom '[a] conflict between two norms occurs if in obeying or applying one norm, the other one is necessarily or possibly *violated*'.

Kelsen further categorized conflicts as bilateral and unilateral, potential and necessary, and total and partial conflicts. According to Kelsen, a conflict

> 'is bilateral if in obeying or applying each of the two norms, the other one is (possibly or necessarily) violated. The conflict is unilateral if obedience or application of only one of the two norms violates the other one. The conflict is a total one if one norm prescribes a certain behaviour which the other forbids (prescribes the omission of the behaviour). The conflict is a partial one if the content of one norm is only partially different from the other one.'[107]

[105] Pauwelyn (n 22 above) 179.

[106] Cf Kelsen's 1962 English treatise on derogation in Newman (n 18 above), reprinted in Klecatsky et al (n 18 above). See also Kelsen (n 19 above) 99. The same approach is advocated by Wiederin (n 19 above) 318–25; most recently, Pauwelyn (n 22 above) 175–6 has focused on breach of norms as well.

It is appropriate to illustrate the practical application of this definition and its subdivisions using the following examples. In line with the above definition of conflict of norms, the decisive question is whether compliance with, or the application of, one norm necessarily or potentially *violates* the other. This test is to be applied *twice* in each case of a conflict of norms, ie from the side of each norm.

(1) Norm 1: Restrictions of imports from country *a* are prohibited.
Norm 2: Imports from country *a* are prohibited.

Compliance with norm 1 (ie granting free trade) necessarily violates norm 2. Conversely, complying with norm 2 (banning imports) necessarily violates norm 1. Thus, there is a *bilateral* conflict which is *necessary* from the perspective of both norms. The conflict is a *total* one (norm 1 stipulating p norm 2 stipulating ¬p).

(2) Norm 1: Restrictions of imports from country *a* are prohibited.
Norm 2: Imports from country *a* are prohibited if there is no sufficient environmental protection in country *a*.

Compliance with norm 1 violates norm 2 only if norm 2 is applicable, ie if there is no sufficient environmental protection in country *a*. Hence, complying with norm 1 only potentially violates norm 2.

Norm 2 is applicable if there is no sufficient environmental protection in country *a*. Compliance with norm 2 necessarily violates norm 1.

Thus, the conflict is bilateral. But it is a necessary conflict only on the side of norm 2, while it is potential on the side of norm 1.

(3) Norm 1: Restrictions of imports from country *a* are prohibited.
Norm 2: Import bans on goods from country *a* are *permitted* if there is no sufficient environmental protection in country *a*.

In complying with norm 1, the state which is the addressee of these norms does not violate norm 2, since that state cannot breach the permission granted to itself.

Complying with norm 2 violates norm 1 if use is made of the permission set out in norm 2.

Thus the conflict is unilateral and only potential: it can be avoided by refraining from asserting the explicit permission.[108]

[107] Kelsen (n 18 above) 1438; Kelsen (n 19 above) 99–100.

[108] See also Wiederin (n 19 above) 324, who holds that conflicts between prescriptions and permission are always *unilateral* avoidable conflicts.

In this example, as in the others, it is important to distinguish the perspective of the addressee of these norms from that of a tribunal: if a tribunal fails to recognize this situation as constituting conflict, it does *not* infringe the permission set out in norm 2, as the tribunal is not the addressee of this norm. However, by not recognizing this situation as involving conflict, the tribunal would violate a *third* norm of which it is the addressee, namely the obligation to apply valid law.[109] Only by accepting that there is a unilateral conflict between norm 1 and norm 2 is it possible to let maxims of conflict resolution such as the *lex posterior* and *lex specialis* maxims come into play in order to determine whether the prohibition or the permission were meant to prevail.

(4) Norm 1: Import restrictions vis à vis countries *a* through *f* are prohibited, unless this is *necessary* for environmental protection. 'Necessary' is to be understood as requiring that the *least trade-restrictive means* be adopted.
Norm 2: Imports from countries *a* through *f* are prohibited if there is insufficient environmental protection in these countries.

Let us assume that there is insufficient environmental protection in country *a*.

Compliance with norm 1 possibly violates norm 2: this depends on whether an import ban constitutes the *least restrictive means* in a given case and whether it is, therefore, permissible under norm 1.

Compliance with norm 2 possibly violates norm 1. This again depends on whether the import ban required by norm 2 is permissible under norm 1 in a given case.

Thus, there is a possible conflict from the perspective of both norms; the key criterion is the necessity test in norm 1.

An example for a unilateral conflict between obligations that are merely different would be the following:

(5) Norm 1: Copyrights are to be protected for 40 years at least.
Norm 2: Copyrights are to be protected for 50 years at least.

Complying with norm 1 violates norm 2. Yet, the conflict can be avoided by protecting copyrights for 50 years. However, the fact that there is an 'easy' *solution* in theoretical terms does not mean that there is no conflict in the sense of our *definition*; nor does this fact mean that the conflict can be 'easily' avoided, in any given case, in *practice*.

Complying with norm 2 does not violate norm 1. Even if it ensues from norm 1 that, after 40 years, there is a permission not to protect copyrights, it is to be recalled that a permission cannot be breached by the state holding that permission.

[109] On this see again Wiederin (n 19 above) 326.

Thus, there is a only a unilateral conflict which is avoidable. As in example (3), it is to be emphasized that the tribunal that fails to recognize that there is conflict in such a constellation (and which thereby fails to apply the *lex posterior* and *lex specialis* maxims) infringes the obligation to apply valid law.

In what follows, we will build upon this wider definition of conflict, which is based on the criterion of violation. In order to make clear that permissions are included, the definition should read:[110]

There is a conflict between two norms, one of which may be permissive, if in obeying or applying one norm, the other one is necessarily or possibly violated.

3. *Conflicts of Norms between 'Norms of Competence'?*

So far we have dealt with norms of conduct, ie conflicting prohibitions, obligations, and permissions. There remains the—at first sight slightly more intricate—problem of norms granting competences (often also referred to as legal powers) that appear inconsistent among each other. As indicated by way of introduction to this chapter, this issue has given rise to considerable problems in WTO jurisprudence and international law more generally. It seems useful therefore to refer to an actual example taken from WTO case law, namely that of the often-discussed[111] 1998 decision *Guatemala—Cement*, in which the Appellate Body had to address the relationship between Article 6.2 of the WTO Dispute Settlement Understanding (DSU) and the special procedural provisions contained in Article 17 of the WTO Antidumping Agreement. According to Article 6.2 of the DSU, a WTO Member is entitled to request the establishment of a panel subject to the conditions that the request be made in writing, that it identify the specific measures at issue, and provide a brief summary of the legal basis of the complaint. Article 17.5 of the Antidumping Agreement, however, sets forth partially different conditions for the request for the establishment of a panel.[112]

[110] Beside the focus on breach, this definition is co-extensive with the aforementioned definition of Engisch (n 72 above) and Engisch (n 72 above) 162: 'Ein Verhalten [erscheint] in abstracto oder in concreto zugleich als geboten und nicht geboten oder als verboten und nicht verboten oder gar als geboten und verboten.'

[111] Cf eg Marceau (n 6 above) 1085; E Montaguti and M Lugard, 'The GATT 1994 and Other Annex 1A Agreements: Four Different Relationships?' (2000) 3 JIEL, 473, 475–6, 481, 483; Pauwelyn (n 22 above) 194–7; W Weiss and C Herrmann, *Welthandelsrecht* (2003), marginal note 352.

[112] According to Article 17.5 of the Antidumping Agreement, '[t]he DSB shall, at the request of the complaining party, establish a panel to examine the matter based upon: (i) a written statement of the Member making the request indicating how a benefit accruing to it, directly or indirectly, under this Agreement has been nullified or impaired, or that the achieving of the objectives of the Agreement is being impeded, and (ii) the facts made available in conformity with appropriate domestic procedures to the authorities of the importing Member' (the WTO agreements are available at <http://www.wto.org>. 'Marrakesh Agreement Establishing the World Trade Organization', 15 April 1994, reprinted in: (1994) 33 ILM, 1144ff).

In dealing with these two provisions, the Appellate Body held that there is a conflict between two norms, if 'adherence to the one provision will lead to a *violation* of the other provision'.[113] Moreover, it found that a conflict occurs 'only in the specific circumstance where a *provision* of the DSU and a special or additional *provision* of another covered agreement are *mutually inconsistent*'.[114] It placed these statements against the background of Article 1 DSU,[115] which it interpreted as providing that 'it is only where the provisions of the DSU and the specific or additional rules and procedures *cannot* be read as *complementing* each other that the special or additional provisions are to *prevail*'.[116] In the case at issue, the Appellate Body concluded that there is 'no inconsistency' between these two provisions.[117] The Appellate Body's definition in this case has generally been read as a strict definition—ie a definition excluding that a *permission* and an incompatible obligation or prohibition constitute a 'conflict of norms'—not only by commentators,[118] but also by subsequent panel practice,[119] which referred to it to justify narrow definitions of conflict.

It is submitted, however, that these inferences miss an essential point: Article 6.2 of the DSU and Article 17.5 of the Antidumping Agreement do not constitute norms of conduct (permissions, prohibitions, or obligations), but have to be regarded as *norms of competence*. By norm of competence is meant a norm which enables the state or person holding the competence to *transform* the legal situation of persons/states subjected to this power: in the exercise of this competence, new norms of conduct (prohibitions, obligations, and permissions) as well as subordinate norms of competence can be brought into existence. This is the reason why competences have to be distinguished from 'mere' permissions.[120] In our example, Article 6.2 of the DSU and Article 17.5 of the Antidumping Agreement grant the power to request the establishment of a panel, albeit under divergent preconditions. By using this competence, the complaining Member creates a new legal

[113] Appellate Body report, *Guatemala—Anti-Dumping Investigation Regarding Portland Cement from Mexico*, WT/DS60/AB/R (*Guatemala—Cement*), para 65 (emphasis added) adopted on 5 November 1978.

[114] Ibid para 66 (emphasis added).

[115] According to Article 1, para 2 of the DSU, the special or additional rules of the Antidumping Agreement prevail '[t]o the extent that there is a difference'.

[116] Ibid para 66; similar statements can be found eg in para 75.

[117] Ibid para 66; see also para 75.

[118] Cf E Montaguti and M Lugard (n 111 above) 473, 476; Marceau (n 6 above) 1085; Weiss and Herrmann (n 111 above) at marginal note 352; but see the more nuanced view of Bartels (n 22 above), pointing out that this passage of the ruling should not be taken at face value.

[119] Cf the 1999 panel report *Turkey—Textiles* (n 32 above) at para 9.93.

[120] Competences are not only bestowed on the state, but can be held also by private persons. A typical example is the competence to conclude treaties or to institute court proceedings by bringing a claim. Treaties, in turn, can establish new competences, to be exercised by the contracting parties. Cf eg Röhl (n 19 above) 238; see also Alexy (n 19 above) 211ff.

situation from which new rights and obligations (procedural obligations of the defendant, etc) arise.[121]

As the exercise of both competences may entail different consequences, the question arises whether norms of competence can 'conflict'. This question, which relates to the more fundamental issue of whether competences can be reduced to 'mere' obligations, permissions or prohibitions,[122] is disputed in legal theory, as has been indicated already.[123] What is crucial, however, is the fact that exercising competences may create incompatible prohibitions, obligations, and permissions.

This is well illustrated by a further WTO Appellate Body decision, the 1999 *Brazil—Aircraft* ruling,[124] which had to address provisions contained in the DSU and the WTO Agreement on Subsidies and Countervailing Measures (SCM Agreement) that grant powers to WTO panels to determine the time-frame within which the losing party has to implement a WTO dispute settlement decision. As these provisions differ,[125] their exercise by a panel can give rise to an obligation (prompt compliance with a WTO ruling) incumbent on the defendant which is in potential conflict with a permission (the permission of not complying for a longer period of time). Thus, there clearly is a potential conflict on the 'level' of concrete prohibitions, obligations, and permissions, irrespective of whether one holds that there cannot be a conflict on the 'level' of competences[126] or whether one takes the opposite view, since competences may give rise to conflicting norms of conduct.

In view of the fact that one has to distinguish these two levels, however, the aforementioned stances in panel practice and academic writings seem problematic to the extent that they attempt to infer from these two rulings whether or not the Appellate Body has actually opted for a wide or narrow definition of conflict of norms.

[121] For the view that a 'right' to bring a claim before a court constitutes a competence (to be exercised by a private person or a state, as the case may be) see eg Alexy (n 19 above) 210.

[122] Cf Kelsen (n 19 above) 210; Alexy (n 19 above) 216–17 with further references; Wiederin (n 19 above) 325.

[123] Cf above, section III.A.

[124] Appellate Body report, *Brazil—Export Financing Programme for Aircraft*, WT/DS46/AB/R (*Brazil—Aircraft*), adopted on 20 August 1999, para 191.

[125] Article 4.7 of the SCM Agreement provides that 'the panel shall recommend that the subsidizing Member withdraw the subsidy *without delay*. In this regard, the panel shall specify... the time period within which the measure must be withdrawn'. On the other hand, Article 21 of the DSU *juncto* Article 4.12 of the SCM Agreement stipulates that WTO Members shall be granted *up to seven and one half months* for compliance with a WTO ruling.

[126] This is the position taken by Wiederin (n 19 above) 327.

VI. Conclusions on the Definition of Conflict of Norms

The preceding analysis has shown that the narrow definition of conflict arguably prevailing in international law infringes the adequacy rules for stipulative definitions and is problematic in legal terms: in denying that there is a conflict of norms when a permission is incompatible with a prohibition or an obligation, the proponents of this strict definition exclude legal problems from the scope of established conflict maxims such as the *lex posterior* and *lex specialis* maxims that appear analogous to the mutual incompatibility between obligations and prohibitions. Thus, in terms of definition theory, this definition of conflict is *inadequately narrow*. Further, a stipulative definition has to be adequate to the *telos* pursued with the adoption of that definition. The *telos* of norms is to regulate behaviour. Thus, if a given conduct is at the same time permitted and prohibited, or if a given conduct is obligatory while another norm permits a contrary conduct, the conduct in question is not unequivocally but contradictorily regulated from the viewpoint of the addressee of these norms. In other words: if attaining this *telos* is impaired by a permission incompatible with a prohibition, or by a permission incompatible with an obligation, one should recognize these norms as being *in conflict*.

Moreover, the arguments recently advanced in favour of a strict definition of conflict appear unfounded. While it has been submitted in academic writings, for example, that adopting a narrow definition of conflict would promote the coherence of the international legal order, it appears impossible to see how one could create more coherence by artificially defining away an evident problem instead of resolving it by letting conflict maxims such as the *lex posterior* principle come into play.

By contrast, this chapter has argued that an adequate definition of conflict of norms: (i) has to be a *wide* one that includes incompatibilities between permissions and obligations, permissions and prohibitions, and obligations and prohibitions; and (ii) has to rely on the 'test of violation', since the criterion of 'joint compliance', which is regularly employed in legal theory and domestic law, does not produce unequivocal results.

Additionally, this chapter has tried to clarify misunderstandings in panel practice and academic writings relating to Appellate Body rulings which have not in fact addressed the issue of conflicting norms of conduct, but the problem of inconsistent norms granting competences.

In conclusion, the definition of conflict of norms in legal theory, in any given legal fields, and in international law should read: *There is a conflict between norms, one of which may be permissive, if in obeying or applying one norm, the other norm is necessarily or potentially violated.*

Chapter Two

The Principles of Conflict Resolution

I. The Legal Status of the Maxims on Conflict Resolution—General Considerations

A. The Relevant Issues Delimited[127]

Even with a cursory examination, one quickly detects that principal questions regarding the so-called 'rules' on conflict resolution such as the *lex*

[127] A German translation of section I was published, in 2005, in ZaöRV (E Vranes, '*Lex Superior, Lex Specialis, Lex Posterior*—Zur Rechtsnatur der "Konfliktlösungsregeln"' (2005) 65 ZaöRV, 391–405).

posterior maxim are still unresolved and disputed in international law just as in domestic law doctrine. These ambiguities concern the legal nature of these maxims, their number, contents, and legal consequences. Needless to say, this is an unsatisfactory starting point for resolving the ever more frequent problems surrounding overlapping and conflicting international instruments which recently have become a focus of the academic debate on the 'fragmentation of international law'.[128]

In international law, this lack of clarity bears on issues such as the status of the *lex specialis* maxim, whose legal standing is cast into doubt by some authors;[129] it also concerns other maxims such as that of *lex posterior*, since several states have not ratified the Vienna Convention on the Law of Treaties (VCLT). Even if one sets out from the premise that in particular the *lex posterior* maxim, which has been laid down in Art 30 of the VCLT, is part of customary international law, there remains the question of the relationship between the *lex specialis* and *lex posterior* maxims in cases where they yield incompatible results instead of resolving a given norm conflict: whereas most authors hold that the *lex specialis* and *lex posterior* maxims function at the same level,[130] others regard them as forming

[128] On this cf eg International Law Commission, Study Group on Fragmentation, 'Fragmentation of International Law. Topic (a): The function and scope of the *lex specialis* rule and the question of "self contained regimes" '. An outline (drafted by M Koskenniemi), *Official Records of the General Assembly*, Fifty-ninth Session, Supplement No, 10 (A/59/10) chapter X, paras 298–358; D Pulkowski, 'Narratives of Fragmentation. International Law between Unity and Multiplicity' (available at <www.esil-sedi.org/english/pdf/Pulkowski.PDF>, visited 7 March 2005). On the drastic increase in multilateral treaty regimes cf also JHH Weiler, 'The Geology of International Law—Governance, Democracy and Legitimacy' (2004) 64 ZaöRV 547.

[129] Just as Aufricht and other authors before him have, Pauwelyn has recently argued that the *lex specialis* principle is ordinarily subordinated to the *lex posterior* principle, in particular in view of the fact that the *lex specialis* principle has not been laid down in the VCLT (cf J Pauwelyn, *Conflicts of Norms in Public International Law. How WTO Law Relates to other Rules of International Law* (2003) 408–9); H Aufricht, 'Supersession of Treaties in International Law' (1952) 37 *Cornell Law Quarterly* 655, 698 ('if the scope of the later treaty provisions is broader than that of the earlier ones the maxim *lex posterior generalis non derogat priori specialis* applies'); a similar stance is taken by W Malgaud, 'Les antinomies en droit' in Ch Perelman (ed) *Les Antinomies en Droit* (1965) 7, 12–13 ('la loi générale, quand elle est postérieure, n'abolit pas la loi spéciale antérieure'). On the question of the relations between both principles in a theoretical perspective see also R Alexy, *Theorie der juristischen Argumentation* (2nd edn, 1991) 288ff, 303ff with further references; recently, R Howse and PC Mavroidis, 'Europe's Evolving Regulatory Strategy for GMOs—the issue of consistency with WTO Law: of Kine and Brine' (2000) 24 *Fordham International Law Journal* 317, 322–3 have suggested that the *lex specialis* may not form part of customary international law.

[130] Cf H Quaritsch, *Das parlamentslose Parlamentsgesetz. Rang und Geltung der Rechtssätze im demokratischen Staat* (1961) 11ff, in particular 13–14; F Bydlinski, *Juristische Methodenlehre und Rechtsbegriff* (2nd edn, 1991) 572–3; on international law cf notably W Karl, 'Conflicts between Treaties' in R Bernhardt, *Encyclopedia of Public International Law*, vol 7 (1984) 467, 469ff; W Karl, *Vertrag und spätere Praxis im Völkerrecht. Zum Einfluß der Praxis auf Inhalt und Bestand völkerrechtlicher Verträge* (1983) 56ff; J Pauwelyn (ibid) 361ff, 385ff.

a hierarchy in which either the *lex specialis* or the *lex posterior* maxim should prevail.[131]

In order to address these and related issues, it is indispensable to gain more clarity on the *legal nature* of these conflict maxims. It is useful to also take writings in legal theory and legal methodology into perspective to the extent that they shed additional light on the issues discussed here.

B. Wide Array of Views in the Literature and the VCLT Travaux

Conflict maxims are classified by authors in at least 10, sometimes overlapping, categories. Thus, maxims such as that of *lex posterior*, *lex superior* and *lex specialis* are viewed as:

(1) Principles of legal logic.[132]
(2) General principles of law.[133]
(3) Interpretative 'rules'.[134]

[131] Cf eg Pauwelyn (n 129 above), according to whom 'the *lex posterior* rule in Art; 30 [of the VCLT] is and should remain the rule of first resort' (at 408) and who goes on to state 'in the event that Art 30 on 'successive treaties' does apply, the fact that the earlier norm is *lex specialis* should not prevent the later *lex generalis* from prevailing' and that the lex specialis principle 'cannot, in my view, overrule the *lex posterior* principle in Art 30' (at 409). See also the apparantly concurring view of P Eeckhout, 'Review: Conflict of Norms in Public International Law. How WTO Law Relates to other Rules of International Law' (2005) 8 JIEL 583–9; for similar views cf Aufricht (n 129 above) 698, and Malgaud (n 129 above) 12–13. For a discussion of Pauwelyn's arguments cf below, section II.C.2.

[132] Cf D Heckmann, *Geltungskraft und Geltungsverlust von Rechtsnormen* (1997) 157ff, who does not share this view, with further references; A Hensel, 'Die Rangordnung der Rechtsquellen' in G Anschütz and R Thoma, *Handbuch des deutschen Staatsrechts. Zweiter Band* (1932) 314; H Mosler, 'Allgemeine Rechtsgrundsätze' in Görres-Gesellschaft (ed), *Staatslexikon. Recht. Wirtschaft. Gesellschaft. Erster Band* (7th edn, 1985) 100, 102; *contra*: A Merkl, 'Die Rechtseinheit des österreichischen Staates. Eine staatsrechtliche Untersuchung auf Grund der Lehre von der lex posterior' in D Mayer-Maly et al (eds), *Adolf Julius Merkl. Gesammelte Schriften. Band 1* (1993) 169, 185ff; H Kelsen, *Allgemeine Theorie der Normen* (1979) 101ff; W Karl (n 130 above) 469; W Karl (n 130 above) 66–7; E Wiederin, *Bundesrecht und Landesrecht. Zugleich ein Beitrag zu Strukturproblemen der bundesstaatlichen Kompetenzverteilung in Österreich und in Deutschland* (1995) 52; E Wiederin, 'Was ist und welche Konsequenzen hat ein Normenkonflikt?' (1990) 21 *Rechtstheorie*, 311, 328–9; G Winkler, *Zeit und Recht. Kritische Anmerkungen zur Zeitgebundenheit des Rechts und des Rechtsdenkens* (1995) 219 refers to the *lex posterior* principle as 'a principle of positive law and, in this sense, a principle of legal logic *par excellence*' ('posivitvrechtliches und in diesem Sinn ein rechtslogisches Prinzip par excellence').

[133] Regarding international law, cf eg Aufricht (n 129 above) 655 (regarding the *lex posterior* principle); W Czaplinski and G Danilenko, 'Conflicts of Norms in International Law' (1990) 21 *Netherlands Yearbook of International Law* 3, 21; *contra* (regarding international and domestic law) Mosler (n 132 above) 102; Koskenniemi (n 128 above) 'Fragmentation', 5 with further references; according to Heckmann (n 132 above) 158, fn 102, it is essentially a matter of terminology whether one classifies conflict rules as general principles of law.

[134] Cf Merkl (n 132 above) 187ff; Bydlinski (n 130 above) 465 and 572 (*ad lex specialis*); Heckmann (n 132 above) 161 and 158 fn 102; regarding international law cf A McNair, *The Law of Treaties* (1961) 219; concurring I Sinclair, *The Vienna Convention on the Law of Treaties* (1984) 93; I Tammelo, 'Tensions and Tenebrae in Treaty Interpretation' in Ch Perelman (ed), *Les Antinomies en Droit* (1965) 337ff; Karl (n 130 above) 61, fn 277 *in fine*;

(4) Presumptions.[135]
(5) (Conditionally applicable) legal rules.[136]
(6) Customary law.[137]
(7) Mere adages or 'brakes for reflection'.[138]
(8) Some authors contest their legal standing as rules or principles at all.[139]
(9) According to the extensive treatise of Heckmann, conflict rules are 'relatively undifferentiated methodological maxims' which have no derogatory power at all, but are mere expressions of the complex interplay of other rules.[140]
(10) Writing on public international law, Pauwelyn has recently declined to regard conflict rules 'as absolute and self-standing legal norms. They are rather practical methods in the search of "current expression of state consent" '.[141]
(11) On the other hand, any classification is avoided, for example, in Engisch's seminal treatise on coherence and conflicts of norms. However, Engisch's characterization of the issue still holds true today: according to him, conflict rules are 'only conditionally applicable, not clarified as to their contents, [and] complicated in their

Koskenniemi, 'Fragmentation' (n 128 above), 5 with further references; Kelsen originally classified these principles as interpretative rules (cf H Kelsen, 'Derogation' in H Klecatsky, R Marcic and H Schaubeck (eds), *Die Wiener Rechtstheoretische Schule*, vol II (1968) 1429, 1442 and Kelsen, *Allgemeine Theorie der Normen* (Kelsen (1979) 102–3); however, there arguably is a contradiction in his writings to the extent that he submits in the same work that norm conflicts must not be resolved through interpretation (cf Kelsen (1979) 101–3 and 179; this is also pointed out by Heckmann (n 132 above) 161, fn 126). *Contra* the classification as mere interpretative principles: W Czaplinski and G Danilenko (ibid) 21.

[135] See in particular the ILC commentary in RG Wetzel and D Rauschning, *The Vienna Convention on the Law of Treaties* (1978) 234, paras 9 and 10 (the *lex posterior* principle embodied in Articles 30.3 and 30.4 VCLT is 'no more than an application of the general principle that a later expression of intention is to be *presumed* to prevail over an earlier one'); N Bobbio, 'Des critères pour résoudre les antinomies' in Ch Perelman (ed), *Les Antinomies en Droit* (1965) 244, 250 passim (writing with an emphasis on legal theory, he submits that the *lex superior*, *lex posterior* and *lex specialis* principles 'peuvent être approchés de la catégorie des *présomptions*, c'est-à-dire, de cette forme d'argumentation qui...permet le passage du connu à l'inconnu' (244)); but see the doubts expressed by Quaritsch (n 130 above) 21.

[136] Cf Kelsen (n 134 above) 101ff, according to whom conflict rules, in particular the *lex posterior* principle, have to be positively stipulated rules ('positiviert'); similarly H Maurer, *Allgemeines Verwaltungsrecht* (12th edn, 1999) 76; cf also Th Schilling, *Rang und Geltung von Normen in gestuften Rechtsordnungen* (1994) 455; *contra* Heckmann (n 132 above) 158.

[137] Bydlinski (n 130 above) 574 (according to whom the *lex posterior* principle constitutes a 'universal customary rule' ('allgemein anerkannte und mit Selbstverständlichkeit geübte Norm, somit...universale[r] Gewohnheitsrechtssatz').

[138] Quaritsch (n 130 above) 18ff ('Reflexionsbremsen').

[139] G Schwarzenberger, *International Law as Applied by International Courts and Tribunals, vol I* (3rd edn, 1957) 427ff.

[140] Heckmann (n 132 above) 'im Prinzip nur relativ undifferenzierte methodische Sätze' (at 157).

[141] Pauwelyn (n 129 above) 388. In his view, conflict rules could be regarded as principles of legal logic (388, fn 127) which he regards as general principles of law (126); for a view *contra* this classification see Mosler (n 132 above) 102.

application...Moreover, [they] may collide and, most importantly, do only incompletely resolve the problem of conflicts'.[142]

Writers on public international law normally stress that there are no fixed relationships or hierarchies between the various conflict maxims.[143] According to Jenks, who proposes eight maxims,[144] '[n]o particular principle or rule can be regarded as of absolute validity. There are a number of principles and rules which must be weighed and reconciled in the light of the circumstances of the particular case'.[145, 146]

The only apparently 'fixed' point is the fundamental trias of the principles of *state sovereignty*, *pacta sunt servanda*, and *pacta tertiis*, which underlie the conflict rules of *lex posterior*, etc.[147] However, these fundamental principles evidently do not and cannot yield uniform standards due to their dialectic interrelationships.

Thus, an observation issued by Zuleeg in 1977 is still apposite today: according to him the *travaux préparatoires* of the Vienna Convention on the Law of Treaties revealed that there was anything but unanimity on these maxims.[148]

C. The Seminal Analysis of Merkl

Just as norm conflicts is a topic of predilection among legal theorists, the particular problem of the *lex posterior* maxim and inter-temporal law became a focus of the *Wiener rechtstheoretische Schule*. In our context,

[142] K Engisch, *Die Einheit der Rechtsordnung* (1935) 47 ('Es ist aber zu beachten, daß alle diese Regeln nur bedingte Geltung besitzen, ihrem Sinne nach nicht hinreichend aufgeklärt, in der Anwendung kompliziert sind, daß sie außerdem miteinander in Kollision geraten können und schließlich—was das wichtigste ist—doch nur eine lückenhafte Lösung des Problems bieten'). See also the concurring view of Schilling (n 136 above) 399.

[143] For writings in legal theory cf eg E von Savigny, 'Methodologie der Dogmatik: Wissenschaftstheoretische Fragen' in U Neumann, J Rahl and E von Savigny (eds), *Juristische Dogmatik und Wissenschaftstheorie* (1976); E von Savigny, 'Die Rolle der Dogmatik—wissenschaftstheoretisch gesehen' 110–19 (published in the same volume; see also the further works published therein); R Alexy, *Theorie der juristischen Argumentation. Die Theorie des rationalen Diskurses als Theorie der juristischen Begründung* (2nd edn, 1991) 303.

[144] CW Jenks, 'The Conflict of Law-Making Treaties' (1953) 30 BYIL, 401, 436ff ('the hierarchic principle, the lex prior principle, the lex posterior principle, the lex specialis principle, the autonomous operation principle, the "pith and substance" principle, and the legislative intention principle' (436)); in general, however, only the *lex specialis*, *lex posterior* and *lex superior* principles, as well as the international law barriers against derogation (Article 41, VCLT) are regarded as principles for resolving conflicts of norms; cf eg E Roucounas, 'Engagements parallèles et contradictoires' (1987) 206 RdC 9, 56ff and 71ff W Karl (n 130 above) 56ff.

[145] Jenks (ibid) 436; similarly, J Salmon, 'Les Antinomies en Droit International Public' in Ch Perelman (ed), *Les Antinomies en Droit* (1965) speaks of a 'faisceau de directives à appliquer selon les circonstances' (312).

[146] Similarly, Nascimento e Silva proposes six principles (the hierarchical principle, the principles of *lex prior*, *lex posterior*, and *lex specialis*, the principle of autonomous operation, and the principle of legislative intent; cited according to the English work of Sinclair (n 134 above) 96).

[147] Cf Salmon (n 145 above) 204; and Pauwelyn (n 129 above) 327–8.

[148] Cf M Zuleeg, 'Vertragskonkurrenz im Völkerrecht, Teil I: Verträge zwischen souveränen Staaten' (1977) 20 GYIL, 247.

the writings of Kelsen and, in particular, two early studies by Merkl, are of interest as they illuminate our problem.

According to Kelsen, the formula *lex posterior derogat legi priori* is misleading in that it creates the wrong impression that derogation is the function of one of the two conflicting norms. In his view, derogation is the function of a positive third norm, not a logical principle. The fact that 'a norm which regulates derogation, taking place when norms are conflicting with each other, is usually not present as an expressly formulated norm in a positive legal order... can be explained by the fact that the legislator omits formulating expressly much which he silently presupposes and assumes to be self-understood'.[149] Since the maxims of *lex superior* and *lex posterior* are often applied by tribunals as *principles of interpretation*, 'their existence is taken for granted by the legislator... If this is the case, the principles are positive legal norms'. However, Kelsen concludes, 'conflicts between norms *remain unresolved* unless *derogating norms* are expressly stipulated or silently presupposed'.[150]

While clarifying that derogation is not a function of one of the conflicting *norms*, Kelsen's explanations, in particular the last one, create the impression that derogation is a function of the *lex posterior maxim* or the *lex superior maxim*. From this premise, it does indeed logically ensue that conflicts remain unresolved if these maxims are not positively stipulated.

But is derogation really a function of these maxims?

Interestingly, Kelsen builds on Merkl in this context. If one takes a closer look at Merkl's studies, things are less clear. In a much-discussed essay,[151] Merkl started out from the –overstated and thus questionable—premise that the legislator is in principle *not authorized* to enact a later-in-time rule conflicting with an earlier one, as the *lex prior* enacted by him already 'occupies the pertinent place' in the legal system. Hence, there has to be a positive *authorization for derogation* in a legal system.[152] Moreover, the maxim of *lex posterior* has to be positively stipulated, according to Merkl in the same essay.[153]

However, in the same study, Merkl argues that the '*lex posterior* principle merely is the *expression* of a norm, which authorizes derogation... Its *logical* existence is dependent upon such a norm. The possibility of lawful derogation within a legal order is the basis for the *conclusion* that an act has modified another one, and in particular that the later one has modified the earlier one'.[154] And more emphatically still, Merkl submits: 'It is *not*

[149] Kelsen (n 134 above) 1442; similarly Kelsen (n 134 above) 102–3.

[150] Ibid.

[151] Merkl (n 132 above) 169ff; see also A Merkl, 'Die Unveränderlichkeit von Gesetzen—ein normlogisches Prinzip' in D Mayer-Maly et al (eds), *Adolf Julius Merkl. Gesammelte Schriften. Band 1* (1993) 159ff; on this cf eg Engisch (n 142 above) 47–8 with further references; Bydlinski (n 130 above) 573–4.

[152] Ibid 190–1 (emphasis added).

[153] Ibid 191–2 (emphasis added).

[154] Ibid 192 (emphasis added): 'Wir behaupten also im Gegensatze zur ganzen bisherigen Theorie über diesen Punkt, das Prinzip von der lex posterior sei richtig verstanden

correct to say: the principle "lex posterior derogat priori" makes it possible to modify laws; quite on the contrary, it is only the authorization for modifications (laid down in the legal order) which makes it permissible to speak of the *lex posterior* principle'.[155]

Thus, the *lex posterior* maxim is portrayed here by Merkl as a (logical) *consequence* of the legislator's authorization to amend earlier-in-time law. However, in other parts of the very same essay, immediately preceding this conclusion, but also in later writings,[156] Merkl holds that the *lex posterior* maxim has to be positively stipulated.[157]

D. The Conflict Maxims as Interpretative Criteria Inherent in the Legal System

Despite the arguable ambiguities in Merkl's somewhat meandering argumentation, it is submitted that the main point in Merkl's treatise arguably stands out clearly and is to the point: derogation takes place on the basis of the authorization for derogation, *not* on the basis of 'logical rules' such as the *lex posterior* maxim. It is a different question whether the *lex posterior* maxim has been or has to be positively stipulated.

Thus, one has to abstract from Merkl's premise (that a legislator is *not* permitted to modify existing law, unless there is a norm authorizing derogation) which is too restrictive: rather, such an authorization to modify existing law should be seen as being inherent in the capacity of the legislator to enact laws.[158] Moreover, one has to concede that such capacity is not a logical one which exists *per se* regardless of the concrete structure of any conceivable legal order,[159] as is shown by the fact that the possibility for later law to modify 'good old law' was not recognized in times when law was deemed to be pre-existent (emanating eg from nature or God's will).[160]

Yet, at the very moment one recognizes that law is a creation of man, one also has to concede that law can be altered by the legislator who acts on a

nur der Ausdruck eines Rechtssatzes, welcher Rechtsänderungen, insbesondere Verfassungsänderungen vorsieht; sei in seiner rechtslogischen Geltung durch einen solchen Rechtssatz bedingt. Die rechtssatzgemäße Abänderbarkeit der Rechtsordnung ist Erkenntnisgrund für das Urteil, daß ein Gesetz das andere und insbesondere das spätere Gesetz das frühere abgeändert habe'.

[155] Ibid (emphasis added): 'Nicht richtig ist zu sagen: Der Satz "lex posterior derogat priori" ermögliche die Abänderung der Gesetze, vielmehr ist es umgekehrt die (in der Rechtsordnung niedergelegte) Abänderungsmöglichkeit, die erst den Satz von der lex posterior auszusprechen erlaubt'.

[156] A Merkl, *Allgemeines Verwaltungsrecht* (1927, reprinted in 1999) 211: 'the precept "lex posterior derogat priori" is valid only as a positive rule of law and not as a logical axiom as it is commonly understood'.

[157] Ibid 191–2.

[158] Similarly Bydlinski (n 130 above) 574, and Engisch (n 142 above) 48, fn 1 '...schon in der Ermächtigung zum Erlaß gültiger Imperative...[ist] auch die Ermächtigung zur Zurücknahme eben dieser Imperative enthalten'.

[159] Cf Merkl (n 132 above) 181ff; Engisch (n 142 above) 47.

[160] Quaritsch (n 130 above) 18ff; Bydlinski (n 130 above) 574.

permanent authorization to create and to modify law, which is only constrained by constitutional rules.[161] If one adopts this point of view, the *lex superior*, *lex posterior* and *lex specialis* maxims do indeed appear as mere but necessary *conclusions* deriving from the structure of the legal order: if there is superior and inferior law in a given legal system, the *lex inferior* must, in principle, yield to the *lex superior*, since otherwise the system's legal structure would be led *ad absurdum*.[162] Furthermore, to the extent that the legislator is authorized to enact law and thereby also to modify it, the *lex posterior* and *lex specialis* maxims are but a consequence expressing more or less plausible conclusions that a prior or general norm has been changed or at least superseded by the legislator. Thus, the 'principles' of *lex posterior* and *lex specialis* need *not* be positively stipulated, as was held by Kelsen and several other writers concurring with him. Rather, they are subordinate interpretative criteria, as will be shown in the following.

The concrete legal consequences of a conflict between two norms, however—eg abrogation or mere supersession of one of the incompatible norms, appropriate procedures, etc—have to be determined for each given legal order.[163] Thus, it is correct to state that the 'derogation maxims' of *lex posterior*, etc as such do not have derogatory power, but are merely abbreviated expressions of underlying legal rules,[164] namely the authorization to create (and modify existing) law within pertinent constitutional constraints.

In other words, these criteria are not logical ones in the absolute sense of existing in an identical manner in any given legal system; but they are inherent in a concrete legal system as interpretative maxims that follow from the structures of the legal order; put differently, the exact consequences of a conflict of norms have to be ascertained according to the concrete rules and structures of the particular legal system in question.

It is submitted that, if one intends to classify these maxims, one should classify them as subordinate interpretative criteria, or at least regard them as functionally equivalent criteria. It is appropriate to briefly illustrate this point, before we consider whether and how to transpose these considerations to international law.

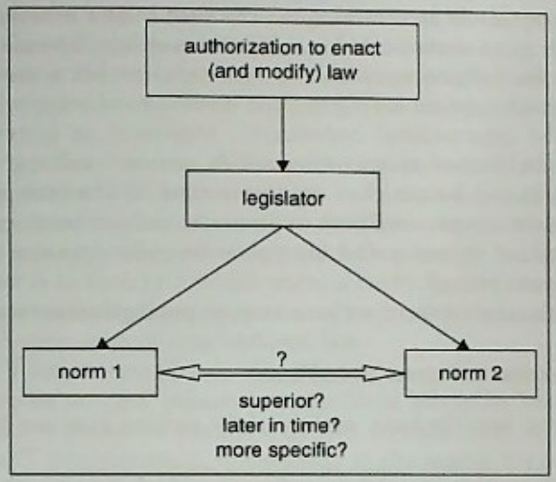
[161] H Quaritsch, *Souveränität. Entstehung und Entwicklung des Begriffs in Frankreich und Deutschland vom 13. Jh. bis 1806* (1986) 46ff; H Quaritsch, 'Bodins Souveränität und das Völkerrecht' (1976/1978) 17 AVR, 257ff; cf also below, section II.C.1.

[162] Similarly Heckmann (n 132 above) 163 and Schilling (n 136 above) 400.

[163] Cf those authors who submit that the term '*derogat*' in the principles of *lex posterior*, etc is not unequivocal, cf eg Wiederin (n 132 above) 51ff; Schilling (n 136 above) 548; Heckmann (n 132 above) 163; Karl (n 130 above) 59, fn 264; Kelsen (n 134 above) 1434ff; Kelsen (n 134 above) 89ff.

[164] Heckmann (n 132 above) 172; similarly Bydlinski (n 130 above) 574, who submits that the *lex posterior* principle is a universally recognized customary principle in modern legal systems, but who adds that: 'Noch näher liegt es allerdings, die Ermächtigung zur Erlassung von Gesetzen zugleich als Ermächtigung zur Aufhebung oder Abänderung bereits erlassener Gesetze zu interpretieren'.

Let us assume that, on the basis of his elementary authorization to create law, the legislator creates two rules:



At this point, interpretation sets in, which has the task of determining the sense of the legislator's enactments. Interpretation of norm 1 and norm 2 may lead to the conclusion that both norms are in conflict. Upon this, the question apparently changes and becomes that of which of the two rules shall 'prevail'. Yet the underlying question remains the same: it is still that of ascertaining the appropriate sense of the legislator's directives, expressed in these two norms—in other words, we are *ex definitione*[165] still concerned with interpretation.[166] Thus, the conflict maxims of *lex posterior*, etc which come in at this stage are no more than subordinate interpretative criteria (or at least functionally equivalent criteria) in the search for the 'correct' sense of the conflicting rules: they come into play when the preceding steps of 'ordinary' interpretation have shown the existence of a conflict between two norms. The fact that the more specific norm does prevail in a given case, for example, is not the consequence of the *lex specialis maxim* but of the underlying authorization of the legislator to modify more general rules,

[165] On the concept of interpretation cf eg HF Köck, *Vertragsinterpretation und Vertragsrechtskonvention* (1976) 60–62 with further references; R Zippelius, *Rechtsphilosophie* (2nd edn, 1989) 247; Bydlinski (n 132 above) 427ff; St Griller and M Potacs, 'Zur Unterscheidung von Pragmatik und Semantik in der juristischen Hermeneutik' in H Vetter and M Potacs (eds), *Beiträge zur juristischen Hermeneutik* (1990) 66, 67, 69; St Griller, 'Gibt es eine intersubjektiv überprüfbare Bedeutung von Normtexten? Anmerkungen zur Sprachphilosophie Ludwig Wittgensteins' in St Griller, K Korinek and M Potacs (eds), *Grundfragen und aktuelle Probleme des öffentlichen Rechts. Festschrift für Heinz Peter Rill* (1995) 543.

[166] Similarly arguably Karl (n 130 above) 61, fn 277 *in fine*.

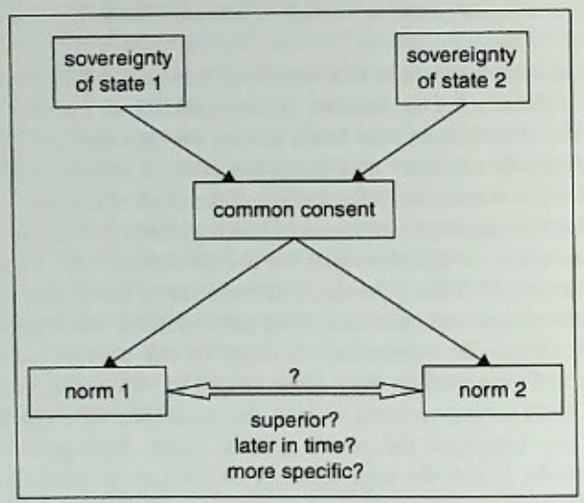
which connects with the interpretative result that one norm is more special. The same is true in cases involving a norm which forms a *lex posterior* or *lex superior*, although the interpretative process here is normally facilitated as it consists of merely ascertaining which norm is later in time or superior.

Things are more complicated in international law, however, where *jus cogens* is not formally recognizable as a *lex superior*, but where such norms have to be determined according to their contents and acceptance as superior law by the international community. Moreover, in international law there is the problem of ascertaining which of two 'evolving' multilateral treaty networks can be qualified as later in time.[167] The interpretative process is also more complicated both in domestic and international law, when the criteria of *lex specialis* and *lex posterior* yield opposite results as to which norm is to prevail.[168]

With these caveats issued, we now turn to public international law.

E. The Situation in International Law

In international law, the basic outline of the picture does not change:



Based on state sovereignty,[169] states are *authorized* to create two norms, norms 1 and 2, in line with international law. If the search for the sense of each of both norms—ie 'primary' interpretation—shows that these norms

[167] Cf below, section II.C.2.

[168] Cf below, section E and section II.C.2.c(ii).

[169] The notion of sovereignty will be analysed in detail below in Part II, ch 1, section II.B. For present purposes, it is seen as comprising the competence to create law internally and externally.

collide, the question of the 'correct' meaning of the norms and of the 'correct', ie most probable, state consent arises in view of these conflicting norms. Once again, this subsequent question—which of the two rules is to prevail—is only *prima facie* different from that of the preceding steps of analysis: the underlying issue still is that of ascertaining the state consent expressed in two conflicting norms. As explained above, this still constitutes interpretation, albeit a subordinate step in the interpretative process.

Thus, the conflict maxims of *lex posterior*, etc which come in at this stage are, in international law as well, no more than subordinate interpretative criteria (or at least functionally equivalent criteria in the search for the 'correct' sense of the conflicting rules): they merely make it clear that the interpreter is to ascertain which norm is superior, later in time, or more special. The concrete legal consequences of such a determination depend on the rules and structures of international law.

Crucially, if one accepts this classification of the conflict maxims, it ensues that there can be no rigid inherent or regulated hierarchy between the *lex specialis* and *lex posterior* maxims, as was recently held in international law doctrine:[170] interpretation, understood as the search for correct meaning, cannot be regulated, since it is impossible to regulate the process of understanding.[171] Hence, a legislator can provide in a concrete case that a given *lex prior specialis* is to prevail over a concrete *lex posterior generalis*; and he may enact a converse regulation in a given other case. However, establishing a general rule to the effect that the *lex specialis maxim* always prevails over the *lex posterior maxim* or vice versa is not feasible as an academic enterprise, and devoid of purpose in legislation.[172]

Hence, in a case where a *lex prior specialis* and a *lex posterior generalis* conflict, the interpreter is called upon to refer to, and weigh, all interpretative means available.[173] We shall briefly come to this point below.[174]

Conflict maxims such as that of *lex posterior* may be expressly stipulated and thereby gain the status of legal rules, as has happened in the Vienna Convention. However, on the basis of what has been said, the question as to whether the *lex specialis* maxim is a (customary) rule of international law, or as to whether it has been implicitly stipulated in Article 30 of the

[170] Cf the theory developed by Pauwelyn (n 129 above) 405ff; see also the apparently partially concurring view of Eeckhout (n 131 above); on this see also below, section II.C.2.

[171] Köck (n 165 above) 70–1 and 91 with further references.

[172] These considerations lead to the same result as Quaritsch's statement that the *lex posterior* and *lex specialis* principles, as opposed to the *lex superior* principle in domestic law, do not function as 'mechanic correcting factors which dispense from ascertaining the meaning of norms'. Quaritsch (n 130 above) 21 ('...haben jedenfalls nicht—wie es nach ihrer zumeist unreflektierten Wiedergabe scheinen mag—den Wert mechanisch wirkender Berichtigungsfaktoren, welche die Ausmittlung des Gesetzessinnes ersparen').

[173] See eg Bydlinski (n 132 above) 572–4; Schilling (n 165 above) 456–7; Zippelius (n 136 above) 37; Quaritsch (n 130 above) 18ff.

[174] Cf below, section II.C.2.

VCLT,[175] is not really to the point: its status and functioning follow from the legal order of public international law.

F. Interim Conclusions

The main conclusions of the preceding analysis shall be briefly summarized:

- The authorization to derogate from existing law needs to be positively stipulated. However, in modern legal orders this authorization is *implicit* in the authorization to create law in the first place; in international law, it is inherent in the fundamental principle of state sovereignty, which makes it possible for one state to create and modify law in interaction with other states.
- In turn, the so-called conflict maxims can, but need not be positively stipulated or enacted, as their status and functioning follow from the basic structures of the legal order. The *lex superior* maxim ensues from the fact and to the extent that there are superior and inferior rules in a given legal system; otherwise, there would be no structure and no legal system to begin with. Likewise, to the extent that the legislator is authorized to enact law and thereby also to modify it, the *lex posterior* and *lex specialis* maxims are 'inherent' in concrete legal orders, in the sense that their status and functioning follow from the structures of the legal order. They simply make it clear that it is incumbent on the adjudicator to ascertain which norm is later in time, or more special.
- The concrete consequences of norm conflicts—mere supersession, nullity, procedural requirements, extent of the presumption against conflict,[176] etc—have to be ascertained for every concrete legal order.
- The so-called conflict maxims should be classified as subordinate interpretative criteria, or should at least be regarded as functionally equivalent criteria, since the timing and specificity of norms are elements to be considered in the search for the meaning of a regulation, once 'normal' interpretation has determined that there is a conflict between norms.
- Derogation is, therefore, *not* a direct consequence of these conflict maxims, but of the underlying authorization to modify law.
- Since the conflict maxims in fact are criteria in the search for the correct meaning of legal enactments, and since they are 'inherent'—in the sense of constituting interpretative maxims as outlined above—in a legal system, questions such as that of whether the *lex specialis* and *lex posterior* maxims form part of customary international law[177] are not really to the point. Assuming, *arguendo*, that they would not be part of *customary* international law at all, they would still be inherent as interpretative criteria in the international legal system. As just indicated, the concrete consequences of a norm conflict have to be ascertained for public international law, however (cf below, section II). Yet these legal consequences are not results of the adages *lex specialis*, etc as such, but of the concrete rules and basic structures of the international legal order.
- Finally, there can be no *abstract* hierarchy between the *lex posterior* and *lex specialis* maxims and thus no *generalized* rule of the form *lex posterior generalis derogat legi priori speciali* or vice versa.

These are preliminary conclusions. We will deal with the maxims of *lex superior*, *lex posterior* and *lex specialis*, as well as barriers to derogation, in turn before setting out our overall conclusions.

[175] On this cf eg Roucounas (n 144 above) 111–12, 83 and fn 241 with further references on this issue; Sinclair (n 134 above) 96.

[176] On this presumption cf eg H Lauterpacht, 'Second Report to the ILC', Document A/CN.4/87 (1954) *Yearbook of the International Law Commission*, vol II, 123, 137ff.

[177] As indicated in section I.A above, R Howse and PC Mavroidis, 'Europe's Evolving Regulatory Strategy for GMOs—the issue of consistency with WTO Law: of Kine and Brine' (2000) 24 *Fordham International Law Journal*, 317, 322–3 have suggested that the *lex specialis* may not form part of customary international law.

[178] Concerning international law cf Jenks (n 144 above) 436ff; Karl (n 130 above) 69; Karl (n 130 above) 468; Salmon (n 145 above) 285ff; Pauwelyn (n 129 above) 278ff; regarding legal theory, European and domestic law cf Schilling (n 136 above) 401ff; regarding domestic law cf Hensel (n 132 above) 313ff.

II. Problems Relating to the Specific Conflict Maxims

In international law, norm conflicts possess some specific characteristics which are directly connected to the structure of the international legal order, in which there is no constitution in the domestic law sense, no clear hierarchy between rules, and no central legislator, but an ever increasing number of treaties not normally emanating from identical parties: thus, for example, there are not only problems of overlaps *ratione temporis et materiae*, but also problems stemming from overlapping treaties with partly divergent *membership*.

These characteristics, in turn, bear on the functioning of the conflict maxims in international law, which have to take into account problems such as the legality of *inter se* agreements.

A. The *Lex Superior* Maxim in International Law

The formula '*lex superior derogat legi inferiori*' is commonly seen as having the purpose of safeguarding hierarchically superior norms,[178] which

can be understood to mean that the *lex superior* maxim functions as a methodological guideline or argumentative safeguard reminding the judge not to apply the 'wrong' (ie hierarchically inferior) norm. Generally speaking, this maxim functions on a merely formal basis, ie without regard to the contents of the norms involved.[179] This observation has to be curtailed by a twofold qualification, however: first, in order to determine the extent of a concrete conflict, regard must be had to the meaning of the conflicting norms. Second, in public international law, *jus cogens* norms have to be identified according to their contents.[180]

The maxim as such can be regarded as a transposition of domestic law principles of 'unconstitutionality' to international law.[181] Its historic origins can be traced back to the general settlements following the great wars in Europe which came to be regarded as a sort of 'public law of Europe', an idea then also reflected in Article 20 of the Covenant of the League of Nations and Article 103 of the UN Charter.[182]

According to the Vienna Convention, a treaty in conflict with *jus cogens* is void *ex tunc*;[183] if it is incompatible with *jus cogens superveniens*, it is only invalid to the extent of conflict, a distinction which has rightly attracted criticism in academic writing.[184] Besides norms conflicting with *jus cogens*, acts of international organizations in conflict with their constituent instruments are invalid in international law.[185]

Norms conflicting with the UN Charter are not void,[186] but inapplicable, as Articles 103 of the UN Charter and 30.1 of the VCLT have to be regarded as setting out priority rules.[187] Thus, derogations from the

[179] Cf Bobbio (n 135 above) 243 *et passim*.

[180] See eg I Brownlie, *Principles of Public International Law* (5th edn, 1998) 514ff; K Zemanek, 'Völkervertragsrecht' in H Neuhold, W Hummer and Chr Schreuer, *Österreichisches Handbuch des Völkerrechts* (3rd edn, 1997) 51, 74–5; P Weil, 'Towards Relative Normativity in International Law?' (1983) 17 *American Journal of International Law*, 413, 423ff; St Kadelbach Zwingendes Volkerrecht (1992) with extensive further references.

[181] Salmon (n 145 above) 286ff; Pauwelyn (n 129 above) 278ff; Jenks (n 144 above) 436.

[182] Cf Karl (n 130 above) 468–9; Jenks (n 144 above) 436–7; H Kelsen, *The Law of the United Nations* (1951) 111–14.

[183] On views *contra* cf St Kadelbach (n 180 above) 324–5 who does not share this view himself. Cf also H Waldock, 'Second Report on the Law of Treaties', Document No A/CN.4/156 (1963) *Yearbook of the International Law Commission*, vol II 26ff; Karl (n 130 above) 69.

[184] See eg the extensive references in St Kadelbach (n 180 above) 69ff; see also Pauwelyn (n 129 above) 281ff with further references. On *jus cogens* see also Sinclair (n 134 above) 203ff.

[185] Jenks (n 144 above) 437ff, 440ff; for a discussion of the situation under WTO law, cf Pauwelyn (n 129 above) 285ff.

[186] This was the view put forward by Kelsen (n 182 above) 113–14 and McNair (n 134 above) 217–18 and 221.

[187] Cf eg W Czaplinski and G Danilenko (n 133 above) 16 (with further references); Waldock (n 183 above) 54ff; G G Fitzmaurice, 'Third Report to the ILC', Document No A/CN.4/115 (1958) *Yearbook of the International Law Commission*, vol II 43; cf also Aufricht (n 129 above) 682–3; Kadelbach (1992) 28 with further references. The effect of UN Charter obligations *vis à vis third party treaty rights* is disputed, however, cf eg McNair (n 134 above) 218; Pauwelyn (n 129 above) 337ff.

[188] Cf Karl (n 130 above) 70, who argues that this is the indirect result of Article 30.1 VCLT, which disapplies the other provisions in Article 30 in favour of the UN Charter; Article 103 UN Charter as such would not suffice to bring about this effect, since it does not differ from other clauses intended to prohibit future derogations, which are futile under international law (cf Karl (n 130 above) 471; Pauwelyn (n 129 above) 335ff).

[189] According to Sinclair (n 134 above) 94, the 'Commission were clearly puzzled as to how to deal with this complex problem'. Cf also the reports by the Study Group of the International Law Commission: International Law Commission, *Fragmentation of International Law: Difficulties Arising from the Fragmentation and Expansion of International Law, Report of the Study Group of the International Law Commission finalized by Martti Koskenniemi*, A/CN.4/L.682, 13 April 2006; International Law Commission, Study Group on Fragmentation, *Fragmentation of International Law. Topic (a): The function and scope of the lex specialis rule and the question of 'self contained regimes'*. An outline (drafted by M Koskenniemi), Official Records of the General Assembly, Fifty-ninth Session, Supplement No 10 (A/59/10), chapter X, paras 298–358. Cf also the reports prepared by the members of the ILC Study Group, in particular R Daoudi, *The Modification of Multilateral Treaties between certain of the Parties only*, ILC Fifty-seventh Session 2005, 20 July 2005; and by T Mescanu, *Application of Successive Treaties relating to the Same Subject-Matter*, ILC(LVI)/SG/FIL/CRD, 13 May 2004.

[190] On this and the following cf H Lauterpacht, 'Report to the ILC', Document A/CN.4/63 (1953) *Yearbook of the International Law Commission*, vol II, 90, 156ff and H Lauterpacht, 'Second Report to the ILC', Document A/CN.4/87 (1954) *Yearbook of the International Law Commission*, vol II, 123, 133ff; Fitzmaurice (n 187 above), 27ff, 39ff; Waldock (n 183 above) 36, 54ff; Pauwelyn (n 129 above) 280, 425; Sinclair n 134 above.

[191] See Lauterpacht (ibid) 158; he had maintained this thesis since his very first publications, cf H Lauterpacht, 'Contracts to Break a Contract', in E Lauterpacht (ed), *International Law. The Collected Papers of Hersch Lauterpacht* (1978) 340, 374–5; cf also H Lauterpacht, 'The Covenant as the "Higher Law"' BYIL (1936) 54, 63–4.

UN Charter are prevented by the joint effect of Articles 103 and 30.1 VCLT.[188]

B. Successive Treaties and Barriers to Derogation

The problem of explicit and implicit prohibitions on derogation, the legal nature of the various obligations involved in successive treaties and the problem of the variety of conceivable overlaps *ratione personae* of treaties in international law, have caused considerable debate among scholars and within the International Law Commission, both when it dealt with the VCLT and when it addressed the issue of fragmentation in international law.[189] Moreover, the problem of successive treaties and barriers to derogation is a topic situated at the borderline between the law of treaties and state responsibility, which also gives rise to intricate issues.[190]

In his function as ILC Special Rapporteur, Lauterpacht had defended the thesis that 'contracts to break a contract' are null and void due to a 'general principle of law' for which he claimed to have found evidence in a comparative analysis of private law[191] and which, in his view, 'followed cogently' from general principles of law, international public policy and the principle

of good faith.[192] The premise underlying Lauterpacht's proposals—though substantially in line with the traditional *lex prior* maxim known in international law since Vattel,[193] but then already questioned in international law[194] and overcome in domestic law for a much longer time[195]—has generally been criticized.[196]

Lauterpacht's approach was largely reversed by the second Special Rapporteur, Fitzmaurice, who elaborated the crucial distinction between treaties of the integral and interdependent type on the one side and of the reciprocating type on the other side.[197] According to this distinction, multilateral treaties, the rights and obligations of which are of the *integral* and *interdependent* type, have the effect that any subsequent treaty that is concluded by two or more of the parties (either alone or in conjunction with third countries), ought to be regarded as *null and void* to the extent of conflict.[198] On the other hand, as regards treaties of the *reciprocating* type, the later conflicting treaty ought to be regarded as invalid only *if* the earlier treaty prohibits *inter se* modifications in the strict sense (of the type ABCD/ABC, ie decreasing membership without any new parties), or if such a later treaty involves, for the parties to it, action in direct breach of their

[192] Lauterpacht (n 190 above) 157. In Lauterpacht's view, this consequence of nullity should only be disapplied in two instances: first, where the subsequent multilateral treaty was 'partaking of a degree of generality which imparts to them the character of legislative enactments properly *affecting all members of the international community* or which must be deemed to have been concluded *in the international interest*' (cf draft Article 16, para 4 in Lauterpacht (n 190 above) 156); and, second, pursuant to a modification by Lauterpacht one year later, the principle of invalidity was not to apply 'to treaties revising multilateral conventions in accordance with their provisions or, in the absence of some provisions, by a substantial majority of the parties to the revised convention' (cf the revised draft Article, para 4 in Lauterpacht (n 190 above) 133).

[193] Cf Karl (n 130 above) 469.

[194] Cf Jenks (n 144 above) 444; as regards the jurisprudence of the PCIJ and other tribunals, cf eg Fitzmaurice (n 187 above) 41ff and Waldock (n 183 above) 56ff.

[195] Cf section II.C.

[196] Cf eg Fitzmaurice (n 187 above) 41, who points out that the principle of nullity does not even apply in Anglo-American private law without cardinal qualifications, where it arguably is derived from by Lauterpacht; cf also the criticism issued by Kelsen (n 182 above) 114 and Zuleeg (n 148 above) 249–50: the prior treaty cannot be regarded as having priority in all legal systems; moreover, priority of the earlier treaty may be inadequate in international law, where treaties fulfil legislative functions. Finally, jurisprudence of international courts can hardly be regarded as supporting the theory of invalidity.

[197] According to Fitzmaurice, a treaty is of the *reciprocating* type if it provides 'for a mutual interchange of benefits between the parties, with rights and obligations for each involving specific treatment at the hands of and towards each of the others individually' (draft Article 18, para 2 in Fitzmaurice (n 187 above) 27); a treaty is of the *interdependent* type if a 'fundamental breach of one of the obligations of the treaty by one party will justify a corresponding non-performance generally by the other parties, not merely a non-performance in their relations with the defaulting party'; it would be of the *integral* type 'where the force of the obligation is self-existent, absolute and inherent for each party, and not dependent on a corresponding performance by the others' (draft Article 19 in Fitzmaurice (n 187 above) 27–8), in other words, an obligation is integral if breaching it *necessarily affects all other parties* to the treaty (44).

[198] Cf draft Article 19 (Fitzmaurice (n 187 above) 27–8.

obligations under the earlier treaty. Otherwise, such constellation *ratione personae* of successive treaties should be approached on the basis of the principles of *priority* of the earlier treaty and *non-invalidation* of the later one, coupled with a liability to pay damages for not carrying out either obligation; the same solution was suggested by Fitzmaurice for conflicts between treaties that have partly common and partly divergent parties (of the type ABCD/ABEF and AB/AC).[199] The later-in-time treaty should prevail in all other cases, ie where the later treaty has contracting parties identical or additional to the earlier one (AB/AB, AB/ABC).

Although the categories of *integral* and *interdependent* treaties have influenced the drafting of several provisions of the VCLT,[200] Fitzmaurice's proposals were partly changed by the third Special Rapporteur, Waldock, who confined the principle of invalidity to conflicts with *jus cogens*, arguing first that this principle was not supported in PCIJ jurisprudence;[201] and second, that a prohibition on later conflicting treaties is a mere contractual obligation which does not normally affect the treaty-making capacity of the parties.[202]

In line with Waldock, the principles of *priority of application* and *unopposability* constitute the cornerstones of the VCLT approach to conflicts between treaty provisions:[203] *inter se* treaty modifications are illegal, but not invalid: (a) if they are prohibited by the earlier multilateral treaty; (b) if they infringe third party rights; or (c) if they are incompatible with the aim and purpose of the earlier treaty pursuant to Article 41.

C. Particular Problems Pertaining to the *lex posterior* Maxim

1. *General Remarks*

The *lex posterior* principle, repeatedly referred to in international jurisprudence,[204] is defined 'as being that later legislation supersedes

[199] Cf draft Article 18 (Fitzmaurice (n 187 above) 27 and 41ff).

[200] Cf Pauwelyn (n 129 above) 59ff.

[201] Cf Waldock (n 183 above) 56ff, referring in particular to the PCIJ ruling in the *Oscar Chinn* case (PCIJ, Series A/B, No 63), the PCIJ advisory opinion in the *European Commission of the Danube* case (PCIJ, Series B, No 14), and the *Mavrommatis Palestine Concessions* case (PCIJ, Series B, No 14).

[202] Waldock (n 183 above) 58–60. But see eg the 1917 *Costa Rica/Nicaragua* dispute over the Bryan-Chamorro treaty, in which the complainant—and arguably also the tribunal—still discussed the case in terms of incapacity to conclude an AC treaty conflicting with an earlier AB treaty, cf Central American Court of Justice, *Costa Rica v Nicaragua*, decision of 13 September 1916 (1917) 11 *American Journal of International Law* 181, 228 and 729.

[203] Cf eg W Czaplinski and G Danilenko (n 13 above) 16 (with further references), who emphasize that the VCLT focusses on modification and suspension rather than elimination of obligations, and on unopposability and unenforceability rather than invalidity; see also Waldock (n 183 above) 54ff, 58 paras 20, 30, and 60; Fitzmaurice (n 187 above) 43; Aufricht (n 129 above) 682–3; Kadelbach (1992) 28 with further references; Pauwelyn (n 129 above) 280.

[204] Cf eg PCIJ, *Mavrommatis Concessions*, Series A, No 2 (1924) 31; PCIJ advisory opinion, *European Commission of the Danube*, Series B, No 14 (1927) 23.

earlier legislation' by public international law writers.[205] It has already been pointed out in the preceding analysis that derogation of the earlier norm is a function of the authorization of the legislator to change existing law and of states to modify treaties, not of the *lex posterior maxim* as such. In fact, this permanent authorization to create and modify law is the distinguishing feature of a modern state and a modern legal order, in which the *puissance souveraine* prevails over long-lived tradition or law founded in religion.[206]

In international law, the maxim is based on the analogy of contracting parties acting like a legislator in adopting treaties.[207] Two inferences follow from this analogy: first, the *lex posterior* maxim presupposes, and only finds application, among identical contracting parties (cf also Article 30.3 and 30.4(a) VCLT).[208] Secondly, unlike in domestic law, the *lex posterior* maxim is not a mere inversion of the *lex prior* principle: whereas the *lex posterior* maxim expresses the idea that identical contracting parties can revoke and modify earlier agreed upon rules, the *lex prior* maxim finds application among *divergent* contracting parties,[209] and is meant to protect parties to earlier treaties from infringements of their rights through later conflicting treaties. It is therefore linked to the principles of *good faith* and *pacta tertiis*.[210]

In line with the international law presumption against conflict,[211] states are not presumed to have entered into incompatible treaties; if, however, a conflict cannot be avoided by interpretation, a presumption in favour of the later treaty applies.[212] In view of the fact that the *lex posterior* maxim only finds application among identical parties, its ambit is restricted in international law for lack of a centralized legislature.

Besides this qualification, two more fundamental problems underlie the *lex posterior* maxim in international law.

[205] Cf Jenks (n 144 above) 445; see also Aufricht (n 129 above) 657ff; Karl (n 130 above) 469.

[206] Quaritsch (n 136 above) 20, who underlines that the *lex posterior* principle was not recognized in Roman law at the time of the Roman praetors and in medieval German law where the principle 'Altes Recht bricht jüngeres Recht' was valid. The principle was then expressly laid down in 1140 in the Normannic laws for Sicily: 'We demand that the statutes enacted in Our name and any subsequent ones be complied with, and order that they be regarded in future as inviolable, any prior conflicting laws and traditions therey being abrogated' (translation from the German version printed in Quaritsch). See also Schilling (n 136 above) 448 and Bydlinski (n 132 above) 572ff.

[207] Pauwelyn (n 129 above) 368.

[208] Cf eg Karl (n 130 above) 469.

[209] Karl (n 130 above) 469.

[210] Cf Jenks (n 144 above) 442ff.

[211] Aufricht (n 129 above) 657; Jenks (n 144 above) 427–9; Karl (n 130 above) 470; Lauterpacht (n 190 above) 137–8; Pauwelyn (n 129 above) 212ff, 488.

[212] Karl (n 130 above) 469.

2. *Problems Central to Article 30*

Two questions affect the application of Article 30 of the VCLT. In establishing which of two conflicting treaty norms is to prevail, Article 30 abstractly focusses on the criterion of a treaty being *later in time*. This criterion is linked to the underlying assumption that the later treaty is likely to more closely reflect the *current consent* of the contracting parties.[213]

Hence, the two key problems have already been indicated. The first one is the extent to which the assumption that the later treaty is more likely to express the current state consent, is well-founded in the various constellations of conflicts that may occur. The second one, intertwined with the first, is the question of whether it is actually possible to determine which of two bi- or multilateral treaties is the earlier one on the basis of Article 30 VCLT; in other words, it is the question whether there is a criterion that yields an unequivocal answer in any given constellation of conflicting treaties.[214]

a) The Assumption of Current State Consent

Underlying Article 30 of the Vienna Convention is the assumption that the inference from a clearly intelligible criterion—the 'timing' of two conflicting treaties—to the presumptive state consent is sufficiently reliable. However, in times of a constantly increasing number of bi- and multilateral treaties, this probability is decreasing. Thus, even if it is possible to determine that one treaty is earlier in time than another (which may not always be possible, as will be shown in the next subsection), the standardized conclusion that the *later* treaty is *likely* to express the 'correct common intent' of the contracting parties may be questionable, as states cannot per se be presumed to have known the contents of the many treaties in force, or the exact contents of treaties having been negotiated in parallel, but having been adopted or having entered into force slightly sooner or later, as the case may be.[215]

b) The Problem of Determining the 'Successive Order' of Treaties

At first sight, characterising the issue of the timing of conflicting treaties as a problem may appear far-fetched, as one would expect that distinguishing a *lex posterior* and a *lex prior* is an unambiguous and elementary task,

[213] Cf Pauwelyn (n 129 above) 368ff *et passim*.

[214] Within Article 30 VCLT, the wording 'same subject matter' is sometimes regarded as giving rise to interpretative problems. If one analyses Article 30 in the light of the approach to conflicts of norms taken in this study, Article 30 appears less ambiguous: Article 30 is concerned with the resolution of conflicts of norms. A conflict of norms has been understood in ch 1 as comprising the situations: (i) where one norm requires a given *conduct* that is prohibited by another norm; (ii) where one norm prohibits a given *conduct* that is permitted by another norm; or (iii) where one norm requires a given conduct, whereas another norm permits the opposite conduct. Given that Article 30 is concerned with conflicts of norms, the wording 'same subject matter' should be understood as referring to a given conduct, ie a conduct which is (i) required by one norm, but prohibited by another, etc.

[215] Cf also Jenks (n 144 above) 444–5, concurring with Pauwelyn (n 129 above) 370, who speaks of a 'shaky analogy' with domestic law.

since it merely consists of determining a given point in time for both treaties. However, a closer look into international customary law, the VCLT, and academic literature reveals that the 'time of conclusion' of a treaty is anything but a clear-cut concept referring to a *single* point in time, such as the adoption of a treaty text or its opening for signature. This problem, which proves to be an intricate one even when one is faced with bilateral treaties, is compounded in the case of conflicting multilateral treaties.

Article 30 of the VCLT refers to '*successive*' treaties in its title and in paragraph 1; it refers to the '*conclusion*' of conflicting treaties in paragraph 2; and it employs the notions '*earlier*' and '*later*' in paragraphs 2, 3 and 4(a). All these terms refer to the timing of the conflicting treaties. However, the VCLT is silent on the meaning of these notions, ie on how to determine the relevant points in time in order to establish the successive order of the conflicting treaties. The definition proposed by ILC Special Rapporteur Fitzmaurice[216] in the VCLT negotiations was dismissed by his successor, who, however, did not provide an explicit definition in turn.

While the problem was recognized in the *travaux préparatoires* to the VCLT, it has primarily been dealt with in depth by Vierdag[217] and Pauwelyn.[218] Whereas Vierdag has defined the problem (see below), Pauwelyn has proposed solutions to it which will be critically assessed in the next subsection.

As rightly pointed out by Vierdag, the *problem* is that the notion of 'conclusion' is employed in customary international law and academic writings to refer to various stages of treaty-making, eg the signature of a treaty by heads of states, the conclusion of the negotiations of a treaty, the adoption of the text through signature or vote, the opening for signature, and the entry into force.[219] It is also used to designate the whole procedure, encompassing all of these acts. Hence, 'conclusion' cannot be regarded as a term of art with a fixed content in international customary law.[220]

[216] Paragraph 26 of Sir Fitzmaurice's draft read:
'1. The conclusion of a treaty—which is not the same thing as bringing it into force, though the same act may do both—is the process of giving active assent to the text of the treaty as the basis of an agreement, but not necessarily a consent then there to be bound by it.
2. Conclusion is usually effected by signature (provided is full signature), but other acts may have a concluding aspect as provided in Article 28 below'—cf (1962) *Yearbook of the International Law Commission*, vol II, 112.

[217] EW Vierdag, 'The Time of the Conclusion of a Multilateral Treaty' (1989) 60 BYIL, 75.

[218] Pauwelyn (n 129 above) 367ff; but cf also T Voon, 'Sizing up the WTO: Trade-Environment Conflict and the Kyoto Protocol' (2000) 10 *Journal of Transnational Law and Policy* 71, 77 with further references; and M Buck and R Verheyen, *International Trade Law and Climate Change—a Positive Way Forward* (FES-Analyse Ökologische Marktwirtschaft, July 2001) 34ff.

[219] S Rosenne, 'Conclusion and Entry into Treaties' in R Bernhardt (ed), *Encyclopedia of Public International Law*, vol VII (1984) 465; EW Vierdag (n 217 above) 76ff with further references; Jenks (n 144 above) 444.

[220] Vierdag (n 217 above) 79–81.

The term 'conclusion' (as well as 'to conclude' and 'concluded') is used several times with different meanings in the various VCLT provisions.[221] Therefore, its meaning has to be determined according to the contents and context of each individual provision.[222] It is obvious that Article 30 presupposes that both conflicting treaties are in force, since it refers to the '*contracting parties*' of successive treaties in paragraphs 1, 3 and 4. According to the definition of this term in Article 2(g),[223] the treaties must have entered into force for the states involved in the conflict. The same should hold true for paragraph 2 of Article 30, which does not speak of 'contracting parties', but which has to be interpreted in the context of the other paragraphs and the title of Article 30.

Apart from this interpretative clarification, however, the key concepts of 'successive', 'conclusion', 'later', and 'earlier' in Article 30 remain unclear. If one holds that the VCLT is applicable to itself,[224] one should conclude that it is permissible to have recourse to the *travaux préparatoires* as a subsidiary means of interpretation, since the interpretative criteria recognized in VCLT Article 31 obviously prove insufficient in this regard.

One then finds an apparently clear answer to our problem. According to the Expert Consultant, 'for purposes of determining which of two treaties was the later one, the relevant date should be that of the *adoption* of the treaty and not that of its entry into force. His own understanding of the intentions of the International Law Commission confirmed that assumption'.[225, 226]

Yet a closer look reveals that focussing on the *adoption* of a treaty as the relevant point in time can only solve the most basic constellations of conflicting treaties. As has already been pointed out by Sinclair during the *travaux*, problems in applying the *adoption* criterion emerge as soon as a bi- or multilateral treaty is open for accession by other states.[227] This can be illustrated by using the following example: In 2000, states A and B sign convention *I*, which enters into force the same year. In 2001, convention *II* is signed by the same parties, and enters into force. Hence, applying the criterion of adoption, the later treaty is convention *II*. If a third state C accedes to treaty *II* in 2002, and to treaty *I* in 2003, from the point of view of C, the later treaty is *convention I*. Are we thus faced with irreconcilable

[221] These are Articles 2(1)(a), 3, 4, 6, 30, 31, 32, 40, 41, 46, 48, 49, 52, 53, 58, and 59.

[222] Vierdag (n 217 above) 81–2.

[223] Article 2(g) of the VCLT stipulates: '"party" means a state which has consented to be bound by the treaty and for which the treaty is in force'.

[224] This reading is advocated by Karl (n 130 above) 358ff with good reasons.

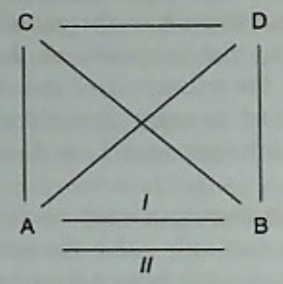
[225] Cf the Official Records of the Vienna Conference, vol II, 253, paras 39–40 (cited in Vierdag (n 217 above) 93).

[226] This concurs with the opinion of the delegation of the UK as expressed by Ian Sinclair ('His delegation's opinion was that the decisive date should be that of the adoption of the treaty'; cf the Official Records of the Vienna Conference, vol II, 222; cited in Vierdag (n 217 above) 93).

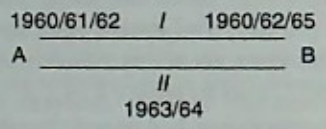
[227] On this see also the text below; see also Pauwelyn (n 129 above).

points in time, eg in the relation between A and C, whereas, according to the intention of the drafters of Article 30, we should have *one* single point in time in order to make Article 30 applicable?

One could venture to argue that conventions *I* and *II* were reconfirmed when states A and B admitted C to these in 2002 and 2003, and that convention *I* should, therefore, be the later one for them as well. Obviously, it is questionable whether such reasoning would conform with the intent of the contracting parties. Moreover, such reasoning is prone to create more problems than it may solve, as will become clear below. Let us take an example which had already been alluded to by Jenks in 1953[228] and which has also been discussed by Vierdag and Pauwelyn:[229] a multilateral convention *I* negotiated by state A and states C, D, etc is opened for signature in 1960. In 1961, it is ratified by A, and it enters into force in 1962. In 1963, states A and B conclude a bilateral treaty *II* on the same subject, which enters into force in 1964, after which state B accedes to the multilateral convention in 1965:



Which treaty is the later one? Concentrating on the *relation between A and B*, the following points in time, in principle, come into question:

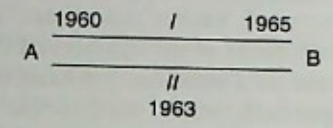


If one applies, in accordance with the *travaux préparatoires*, the *adoption* of the treaties as the relevant point in time in order to establish which treaty is the *lex posterior*, one ends up with the dilemma we encountered in the first example. From the point of view of A, convention *I* is the treaty adopted first; from the point of view of B, it is convention *II*:[230]

[228] Cf Jenks (n 144 above) 444.

[229] Cf Vierdag (n 217 above) 92ff; Pauwelyn (n 129 above) 372ff.

[230] This problem is not to be confused with the question of when the *conflict* between conventions *I* and *II* first occurs. This point of time (which is also the one when the *lex posterior* principle enshrined in VCLT Article 30 becomes *applicable*) and the point of time of the *adoption* of the treaty (which determines which treaty is the *lex posterior*) have to be distinguished. Let us use the above example once more: supposing that the treaty adopted in 1963 entered into force only in 1967, this means that the conflict first occurs in 1967. As of this point of time, there are two successive treaties in force in the sense of Article 30, which therefore is first applicable as a conflicts rule in 1967. Yet, for the resolution of the conflict, the point of time of *adoption* of the treaty (1963) remains relevant. Cf the *prima facie* somewhat cryptic statement by the Expert Consultant, who, having said that 'for purposes of determining which of two treaties was the later one, the relevant date should be that of the adoption of the treaty and not that of its entry into force' added: 'Another question, however, arose: that of the date at which the rules contained in Article 26 [now Article 30] would have effect for each individual party. In that connexion, *the date of entry into force of a treaty for a particular party* was relevant for the purposes of determining the moment at which that party would be bound by the obligations under Article 26…' (Official Records of the Vienna Conference, vol 2, 253, paras 39–40; cited in Vierdag (n 217 above) 93; emphasis added).



Article 30, therefore, is founded on the *assumption* that the point of time of adoption of a treaty is one and the same for all contracting parties, and that, consequently, among two conflicting treaties one and the same treaty would be designated, by Article 30, as the later one for all contracting parties. As *Vierdag* noted, '[this] assumption will often appear not to be correct, as it fails to take account of the complication in time of multilateral treaty-making through complex procedures'.[231] This assumption is also linked to the VCLT's focus on treaties as abstract instruments instead of the concrete rights and obligations of individual contracting parties, which may arise at different points in time, eg in case of successive accessions to treaties.[232]

c) Efforts to Resolve the Problem

(i) The Criterion of Time of Convergence of State Consent In view of this dilemma, the question arises as to whether Article 30 is simply inapplicable in certain cases, or whether its applicability can be saved in some way. Such a way of safeguarding has been alluded to by Vierdag, and more fully dealt with by Pauwelyn, who discusses whether it would be feasible to use the point in time when the consent of two contracting parties to a given treaty 'has first converged'. In the above example this would be 1963 (time of adoption of convention *II*) and 1965 (time of accession to convention *I* by state B) respectively. The later treaty in the sense of Article 30 would then be convention *I*.

[231] Vierdag (n 217 above) 98 (quotation) and 102; cf also the critical appraisal by Pauwelyn (n 129 above) 368ff; see also Sinclair (n 134 above) 94ff ('Although [the VCLT rules on successive treaties] may be appear to be somewhat complicated, their substance is relatively simple. Indeed, it is their very simplicity which may occasion some concern, given the varying types of situation which they are designed to cover', 94–5).

[232] Pauwelyn (n 129 above) 368; Vierdag (n 217 above) 94–5 and 97–8.

There are some problems pertaining to such an approach. First, such interpretation of the criteria of 'earlier' and 'later' arguably does not correspond to the explicit intentions of the drafters of the VCLT, which, as we have seen, become relevant as a subsidiary means of interpretation in this context. Second, this approach would lead to the paradoxical situation, pointed out by Vierdag and others, that certain multilateral treaties which are periodically revised would re-emerge as the *lex posterior* at regular intervals *vis à vis* all other treaties.[233] As this is in particular true of technical treaties, such treaties would always prevail over more 'fundamental' ones. It is doubtful that this is in line with the presumptive state consent that Article 30 is meant to approximate.[234] Pauwelyn also rejects this approach on a third ground, namely that it does not work in all constellations, including more than one multilateral treaty.[235]

(ii) Is there a Need to 'Disapply' Article 30? An alternative solution has been proposed by Pauwelyn. He argues that 'one could submit, indeed, that in situations where for one state a conflicting treaty is the earlier one, whereas for the other state it is the later one, it is impossible to define the treaty as either "earlier" or "later" in time as required in Art 30'.[236] As there are, therefore, no successive treaties in the sense of Article 30, 'Article 30 does not apply and one must have resort to other conflict rules', in particular the *lex specialis* principle.[237]

At this point, Pauwelyn proposes to introduce the concept of '*continuing treaties*'. According to him, such treaty norms form

> part of a framework or system which is continuously confirmed, implemented, adapted and expanded, for example, by means of judicial decisions, interpretations, new norms or the accession of new state parties... [such norms] were not only consented to when they originally emerged, but continue to be confirmed, either directly or indirectly, throughout their existence...[238]

This reasoning would apply, for example, to the WTO treaty.[239] In conflicts involving such 'continuing treaties', Pauwelyn suggests that one should 'disapply' the *lex posterior* maxim laid down in Article 30 VCLT in order to make room for the *lex specialis* principle. This somewhat artificial reduction of the scope of Article 30 is arguably not necessary. It rather appears to be the unavoidable consequence of Pauwelyn's view that the *lex specialis* maxim is almost always *subordinated* to the *lex posterior* principle.[240] Since, according to this view, the *lex prior specialis* would regularly be superseded by the *lex posterior generalis*, there is an evident need for rebalancing in case this somewhat rigid approach leads to problematic results. And this is arguably where Pauwelyn's concept of 'continuing' treaties comes into play: Pauwelyn obviously needs and makes room for the *lex specialis* maxim in such cases by disapplying Article 30, which he does by labelling either, or both, conflicting treaties as 'continuing'. It is submitted, however, that these intricacies are avoidable: if one does not create a hierarchy between the *lex posterior* and *lex specialis* maxims, but regards them as subordinate interpretative (or at least at functionally equivalent) criteria that function on the same level,[241] then there is no need to reduce the scope of the *lex posterior* maxim in cases where the hierarchy created by Pauwelyn proves inadequate.

In other words, the concept of 'continuing treaties' can be of argumentative support in certain constellations where Article 30 proves inapplicable per se, in that it supports a pertinent decision. It can also assume this role in cases where the *lex specialis* maxim is to be given more weight. However, there is no need for the two-step approach suggested by Pauwelyn: ie first to make Article 30 a conflict rule superior *vis à vis* the *lex specialis* principle; and then, secondly, to reduce the scope of Article 30—through making the application of Article 30 dependent on the abstract labelling of certain treaties as 'continuing' ones—in those cases where this artificial hierarchy proves inappropriate.

D. Particular Questions Pertaining to the *lex specialis* Principle

1. *General Remarks*

While publicists generally refer to Grotius, Vattel and Pufendorf as the writers having first dealt with the *lex specialis* maxim in international law,[242] the maxim as such can arguably be traced back even to Greek philosophy

[233] Vierdag refers to the example of the ITU Radio Regulations in conflict with the UN Covenant on Civil and Political Rights 1966 (n 217 above 98ff); cf also M Buck and R Verheyen, *International Trade Law and Climate—A Positive Way Forward* (FES—Analyse Ökohopische Marktvietschaft, 2001) (available at <http://library.fes.de/pdf-files/stabsabreilung/01052.pdf>, 34ff, who refer to the WTO and the international climate change regimes as examples.

[234] Similarly Pauwelyn (n 129 above) 375ff, who refers to the example of the reconclusion of GATT 1947 at the end of the Uruguay Round.

[235] Pauwelyn discusses the example of the 1994 WTO treaty and the 2001 Cartagena Biosafety Protocol: states A and B are original WTO members who adopted the Protocol in 1999. State C acceded to the WTO in 2000 after it had adopted the Protocol in 1999. State D acceded to the WTO in 2001 and subsequently adopted the Protocol. According to criterion of the date at which the consent of two states converged, the outcome is anything but uniform: among states A and B, the Protocol would be the later treaty; as between A and C, or B and C, the WTO treaty would be the lex posterior; as between A and D, B, and D, C and D, however, the Protocol would again qualify as the later treaty. The approach discussed would lead to a 'Balkanisation' of multilateral treaties, as Pauwelyn (n 129 above) 375 rightly observes. This is also pointed out by D Palmeter, 'Environment and Trade: Much Ado About Little?' (1993) 27(3) JWT 55, 60. Cf also Buck and Verheyen (2001) 34ff, who refer to the WTO and the international climate change regimes.

[236] Pauwelyn (n 129 above) 378.

[237] Ibid.

[238] Ibid.

[239] Ibid 379.

[240] Ibid 405ff.

[241] Cf above, section I.E.

[242] Eg Jenks (n 144 above) 446; Karl (n 130 above) 469; Koskenniemi, 'Fragmentation' 4, n 128 above; Pauwelyn (n 129 above) 387, with further references to Pufendorf and Vattel.

and Roman law.[243] In justifying the plausibility of the principle, one can underline that the *lex specialis* typically is more likely than the conflicting *lex generalis* to express the presumptive legislative intent in domestic law[244] and current state consent in international law;[245] that it constitutes a 'maxim' supported by experience,[246] and shows affinity to the fundamental principle of '*suum cuique tribuere*' in the sense that the special norm derogating from the general norm contributes to the legitimacy of the latter.[247] Moreover, subordinating the *lex generalis* can be regarded as logically mandatory, since otherwise the more special norm may not have scope of application.[248]

2. *Problems Specific to the lex specialis Maxim*

We have already pointed out that the maxim can be seen as an interpretative maxim that follows from the structures of the legal order, that is as a maxim which directs the interpreter to take into account the specificity and generality of conflicting norms.[249] For the *lex specialis* maxim to apply, it must be ascertained that the legal consequences of both norms conflict, and not merely accumulate.[250]

Turning to the *definition of speciality*, a norm can be regarded as being more special *vis à vis* another if its applicability depends upon at least one criterion more than that of the more general norm:[251]

(1) norm 1: conditions $c_1 + \ldots + c_n$ => consequence A
(2) norm 2: conditions $c_1 + \ldots + c_n + c_{n+1}$ => incompatible consequence B

On the other hand, there is *no relation of speciality* between two norms when the conditions for application of both norms overlap without one set of criteria being completely included in the other one:

(1) norm 1: conditions $c_0 + c_1 + \ldots + c_n$ => consequence A

[243] '*In toto iure generi per speciem derogatur*' (D. 50,17,80), cf Schilling (n 136 above) 447; cf also Bobbio (n 135 above) 249.
[244] Bobbio (n 135 above) 249.
[245] Pauwelyn (n 129 above) 387–8.
[246] Bydlinski (n 130 above) 465 ('*Erfahrungssatz*').
[247] Bobbio (n 135 above) 249 ('*justice au cas concret*'); H Buch, 'Conception dialectique des antinomies juridiques' in Ch Perelman (ed), *Les Antinomies en droit* (1965) 372, 381 ('*l'exception justifie la règle*').
[248] K Larenz, *Methodenlehre der Rechtswissenschaft* (Springer, Berlin, 1979) 251–2; Schilling (n 136 above) 448.
[249] See above, section I.E.
[250] Cf J Rödig, *Theorie des gerichtlichen Erkenntnisverfahrens* (1973) 212; Larenz n 248 above.
[251] Rödig ibid; Larenz (n 248 above) ibid; Zippelius (n 165 above) 35; Bydlinski n 130 above; Schilling (n 136 above).

(2) norm 2: conditions $c_1 + \ldots + c_n + c_{n+1}$ => incompatible consequence B

The latter constellation cannot be resolved through recourse to the *lex specialis* principle; in trying to find a solution, one has to rely to a greater extent on systematic and teleological considerations in the interpretative process.

Additional problems arise in case two or more sets, or clusters, of norms are potentially applicable to a given case. Owing to the state of development of international law, such problems, which have been intensively examined particularly in private law,[252] have attracted comparatively less attention in international law doctrine and jurisprudence until recently. These issues, which have come to be discussed more intensively under the catchwords 'self-contained regimes' and 'fragmentation of international law',[253] have become more pressing in view of overlapping regulatory treaty systems.[254]

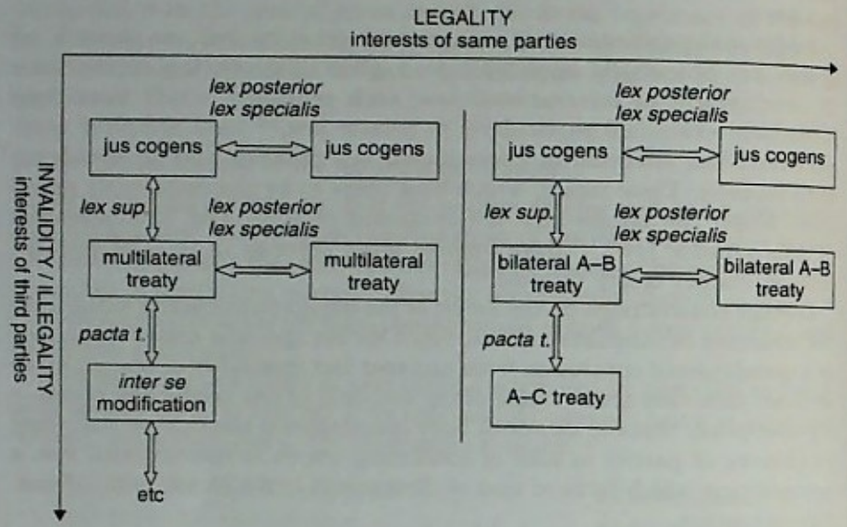
Further constrictions on the ambit of the *lex specialis* maxim ensue from the structure of international law. Since the *lex specialis* maxim functions as a standardized conclusion from an outer fact (speciality of one norm) to an inner fact—the actual intent of the author(s) of two conflicting norms—it *presupposes* that the author of both enactments is identical: ie that there be identity of parties in case of conflicting norms in international law, a precondition which lacks in case of divergences in the membership of conflicting treaties.

E. Conclusions: Hierarchy of Conflict Principles

In addition to the interim conclusions set out above,[255] it is possible to outline a hierarchy of conflict maxims in international law which is interwoven

[252] Cf eg the problem of liability *ex contractu* and *ex delicto* discussed by Larenz ibid with further references.
[253] Cf eg International Law Commission, Study Group on Fragmentation, *Fragmentation of International Law. Topic (a): The function and scope of the lex specialis rule and the question of 'self contained regimes'*. An outline (drafted by M Koskenniemi). Cf also the reports prepared by the members of the ILC Study Group, in particular T Mescanu, *Application of Successive Treaties relating to the Same Subject-Matter*, ILC(LVI)/SG/FIL/CRD, 13 May 2004.
[254] Cf the various overlap issues in WTO law discussed below, Part III, ch 2, sections II.B.4 and II.B.5, and Part III, ch 4, section III.B; on the manifold overlaps and inconsistencies between multilateral environmental treaties cf R Wolfrum and N Matz, *Conflicts in International Environmental Law* (2003); on conflicting approaches in MEAs and the WTO cf also J Neumann, Die Koordination des WTO-Rechts mit anderen völkerrechtlichen Ordnungen (2002); United Nations University Institute of Advanced Studies/Global Environment Information Centre (eds), *Global Climate Governance. Scenarios and Options on the Inter-Linkages between the Kyoto Protocol and other Multilateral Regimes. Report—Part 2* (year of publication not available) 18.
[255] Cf section I.F of the present chapter.

with the derogatory power of public international law norms. By 'derogatory power' we do not merely refer to the power of one norm to render invalid another norm; we rather use the notion in a broader sense, including the fact that one norm cannot be *lawfully* derogated from, as is the case when one speaks of barriers to derogation with regard to Article 41 VCLT.



It has become clear already that one—evidently—has to take exception to the notion that there can be no hierarchical relations among conflict rules at all.[256] Taking into account the possibility of lawful derogation from international treaties, the functioning of, and the inter-relations between, the conflict maxims in international law can be explained in the following manner:[257]

- First, in case interpretation shows that there is conflict between two norms, it has to be ascertained whether both form part of *jus cogens*,

[256] Thus, it is too categorical to state 'that one faces a plurality of criteria...a bundle of directives to be applied according to the circumstances' ('*on se trouve en présence d'une pluralité de critères...un faisceau de directives à appliquer selon les circonstances*' (cf Salmon (n 145 above) 312 regarding the *lex prior* and *lex posterior* principles, but possibly also the *lex superior* principle)); cf also Jenks (n 144 above) 436 and 436ff; moreover, the hierarchy ensues not merely or predominantly from the *reliability* of the standardized conclusion from outer facts to the inner fact of the intent of the law-maker, as is insinuated to some extent in Bobbio (n 135 above) 237ff, 243ff, 252ff, but from the positive legal norms and structures of a given legal order.

[257] On the following cf in particular Pauwelyn (n 129 above) 436ff; Karl (n 130 above) 66ff, 69ff; Karl (n 130 above) 468ff.

which includes the determination whether both norms have been accepted and recognized by the international community of states as a whole as *jus cogens* norms. If this is the case, both norms pertain to the same level, and the conflict maxims of *lex posterior* and *lex specialis* come into play.

- Secondly, if interpretation shows that only one norm is part of *jus cogens*, the inferior norm has to be regarded as invalid in line with Articles 53 and 64 of the VCLT. Although this interplay can, by way of simplification, be understood as an application of the *lex superior* maxim, it has to be borne in mind that the concrete legal consequences (invalidity etc) are not legal or logical consequences of this maxim, but of the structures of the international legal order.
- Thirdly, regarding multilateral treaties, if membership in the later treaty decreases, the later-in-time treaty *inter se* modifying an earlier multilateral one is *illegal*, but not invalid pursuant to Article 41 VCLT, if: (a) it is prohibited by the earlier treaty; (b) it infringes third party rights; or (c) it is incompatible with the aim and purpose of the earlier treaty. In all three alternatives, the interests of third parties are typically involved.
- Fourthly, the rights of a third party under an earlier bilateral treaty must not be infringed by a later agreement (AB/AC conflict) pursuant to the *pacta tertiis* principle.
- Fifthly, explicit conflict clauses set out in treaties apply (Article 30.2 VCLT), which have to be in accordance with the preceding requirements.
- Sixthly, the *lex posterior* and the *lex specialis* maxims come into play: if the parties to the later treaty comprise all parties to the earlier treaty (identical or augmenting membership), the earlier treaty is to be regarded as superseded by the later one to the extent of conflict pursuant to the *lex posterior* maxim (Article 30.3 VCLT), unless the conflict is of such an extent that the earlier treaty must be deemed terminated or suspended pursuant to VCLT Article 59, *and unless* the provisions of the earlier treaty constitute *leges speciales* clearly intended to continue to apply.

The above hierarchy of conflict rules can be explained to a large extent on the basis of the over-riding interests of third parties: as regards *jus cogens*, derogations are invalid because of the fundamental interests of the 'community of states as a whole'. Since modifications are lawful, however, if agreed upon by the same states, ie the 'community of states as a whole', it ensues that it is in particular the fundamental interests of *third* states which render attempts of '*inter se* deviations' from *jus cogens* invalid. Hence, the higher derogatory power of *jus cogens* norms can also be explained to a certain extent in the terms of the *pacta tertiis* principle.

The *pacta tertiis* and *lex superior* maxims also show functional affinity, if one turns to *inter se* modifications of multilateral treaties. If an *inter se* modification infringes third party rights, it is illegal pursuant to the *pacta tertiis* principle laid down in Article 41 VCLT. However, this barrier to derogation can also be regarded as the earlier multilateral treaty having higher derogatory power than the *inter se* modification. In other words, seen from the perspective of derogatory power (the possibility of *lawful* derogation) such treaty norms, in particular integral and interdependent treaty norms, can be regarded as functional 'higher law', because of the third party rights involved. In the same vein, an earlier bilateral AB treaty cannot normally be lawfully derogated from by states A and C, to the extent that third party rights are infringed.

Hence, the inter-relationships between the conflict maxims of *lex superior*, *lex posterior*, and *lex specialis* in international law are governed to a considerable extent by the *pacta tertiis* principle: the ambit of the *lex specialis* and *lex posterior* maxims is curtailed where third party rights come into play.

Chapter Three

The Role of International Law Conflicting with WTO Law in WTO Proceedings

I. The Central Questions[258]

At this point of the study it is necessary to address a related issue of systemic importance, namely the question whether international law in conflict with WTO law must, under certain circumstances, be recognized as *superseding* WTO law even *within* WTO proceedings. While this appears

[258] The present chapter is a revised and slightly extended version of an article that was published, in 2005, in the *GYIL* (E Vranes, 'Jurisdiction and Applicable Law in WTO Proceedings' (2005) 48 GYIL, 265–89).

to be a technical question at first sight, it relates to the core of the debate surrounding world trade and non-economic concerns, if one looks at this problem from a juridical perspective.[259]

These issues are complicated by the fact that GATT 1947 and WTO dispute settlement decisions have so far not been consistent in their treatment of conflicting non-WTO international law rules.[260] They may even have nourished distinctly restrictive stances on the role international law can play in WTO proceedings.[261] Thus, it has been held, for instance, that WTO adjudicating bodies are permitted to apply only WTO law.[262] This would imply that conflicting rules of non-WTO international law cannot be invoked as a defence in WTO proceedings, even if these rules are more specific and later in time.[263] It has also been submitted that panels cannot take account of *inter se* modifications of WTO law for lack of a competence to do so,[264] and that *inter se* modifications of WTO law are even

[259] For recent works on this debate cf eg J Neumann, *Die Koordination des WTO-Rechts mit anderen völkerrechtlichen Ordnungen* (2002); G van Calster, *International and EU Trade Law. The Environmental Challenge* (2000); see also the contributions in St Griller (ed), *International Economic Law and Non-Economic Concerns. New Challenges for the International Legal Order* (2003); on dispute settlement in the WTO more generally cf EU Petersmann, *The GATT–WTO dispute settlement system. International law, international organizations and dispute settlement* (1997); JHH Weiler, 'The Rule of Lawyers and the Ethos of Diplomats: Reflections on the Internal and External Legitimacy of WTO Dispute Settlement' Jean Monnet Working Paper 9/00 (2001).

[260] Cf fn 261 below and section IV; similarly L Bartels, 'Applicable Law in WTO Dispute Settlement Proceedings' (2001) 35 JWT 499, 509. For a recent overview of stances taken in WTO dispute settlement and WTO doctrine see also A Lindroos and M Mehling, 'Dispelling the Chimera of "Self-Contained Regimes" in International and the WTO' (2005) 16 EJIL 857.

[261] Cf eg the 1984 WTO panel report, *United States—Imports of Sugar from Nicaragua*, adopted 13 March 1984, BISD 31S/67, L/5607, in which the panel confined itself to an examination of the claims 'solely in the light of the relevant GATT provisions', despite the fact that the US had invoked non-GATT international law in its defence (para 4.1); see also the 1988 panel report, *Canada—Herring and Salmon*, BISD 35/S/98, L/6268, adopted on 22 March 1988, where the panel tersely noted 'Canada referred in its submission to international agreements on fisheries and the Convention on the Law of the Sea. The Panel considered that its mandate was limited to the examination of Canada's measures in the light of the relevant provisions of the General Agreement. This report therefore has no bearing on questions of fisheries jurisdiction'; cf also the 1984 panel report, *Canada—Administration of the Foreign Investment Act*, adopted on 7 February 1984, L/5504, BISD 30S/140, where the Council decided 'that it be presumed that the Panel would be limited in its activities and findings to within the *four corners of GATT*' (cf the panel report at para 1.4); these cases are discussed by J Pauwelyn, *Conflicts of Norms in Public International Law. How WTO Law Relates to other Rules of International Law* (2003) 456–9; see also D Palmeter and P Mavroidis, 'The WTO Legal System: Sources of Law' (1998) 92 *American Journal of International Law* 411, who refer to a 'tendency of GATT panels to disregard public international law'.

[262] JP Trachtman, 'The Domain of WTO Dispute Resolution' (1999) 40 *Harvard Journal of International Law* 333, 343 *et passim*.

[263] For a detailed discussion of this view cf below, section V.

[264] G Marceau, 'Conflicts of Norms and Conflicts of Jurisdictions. The Relationship between the WTO Agreement and MEAs and other Treaties' (2001) 35 JWT 1081, 1104 ('...WTO adjudicating bodies, although they have to perform all the necessary reasoning to establish the state of international law and the applicable law between the two WTO

impermissible for the reason that WTO obligations are always to be 'the same for all WTO Members'.[265]

Regarding the jurisdictional dimension of these issues, it has been held that a complainant Member 'cannot even agree...to take its WTO dispute to another forum' and that 'no WTO adjudicating body would terminate its process solely on the ground that...aspects of the same dispute are being examined...in another forum', unless WTO Members formally amend the DSU.[266]

These views call for further exploration of these systemic issues.

II. Legal Starting Points

It is clear that, pursuant to Article 3.2 of the DSU, WTO adjudicating bodies are not only allowed, but even required to rely on established international law principles governing the interpretation of treaties.[267] Moreover, WTO panels and the Appellate Body have resorted to non-WTO international law in order to fill gaps in WTO provisions.[268] However, there is no

Members, do not seem to have the constitutional capacity to reach any standard recommendations in situations where another treaty provision has (and thus added to or diminished) a WTO provision'); this view will be discussed in more detail below; a similar stance has been taken by Bartels (n 260 above) 499ff. For a detailed discussion of this view cf also below, section V.

[265] Marceau (ibid) 1104–5 (expressing doubts regarding changes of substantive WTO law: 'If the WTO obligations are always the same for all Members—and it can be argued they are—such bilateral modification of WTO rights and obligations may simply not be possible without affecting the rights of other third WTO Members') and passim; K Kwak and G Marceau, 'Overlaps and Conflicts of Jurisdiction between the WTO and RTAs', paper presented at the Conference on Regional Trade Agreements, World Trade Organization, 26 April 2002 (available at <www.wto.org>) regarding modifications to the exclusivity of WTO dispute settlement laid down in Article 23 of the DSU. For a detailed discussion of this view cf below, section V.

[266] Kwak and Marceau (ibid) 8, in the aforementioned paper published on the WTO website. This position is restated in part in G Marceau and A Tomazos, 'Comments on Joost Pauwelyn's paper: "How to win a WTO dispute based on non-WTO law?"' in St Griller (ed), *At the Crossroads: The World Trading System and the Doha Road* (Springer, Vienna–New York, 2008), 129.

[267] Cf eg the Appellate Body report, *United States—Import Prohibition of Certain Shrimp and Shrimp Products*, WT/DS58/AB/R, adopted on 6 November 1998, para 158; the WTO jurisprudence is summarized and discussed in Bartels (n 260 above) 510; Pauwelyn (n 261 above) 253ff; and J Pauwelyn, 'How to Win a World Trade Organization Dispute Based on Non-World Trade Organization Law?' (2003) 37(6) *Journal of World Trade* 997. On the principle that international treaties have to be interpreted having regard to the system of international law more generally cf eg R Bernhardt, *Die Auslegung völkerrechtlicher Verträge insbesondere in der neueren Rechtsprechung internationaler Gerichte* (1963) 134ff; Ph Sands, 'Treaty, Custom and the Cross-Fertilization of International Law' (1998) *1 Yale Human Rights and Development Law Journal*.

[268] Cf eg the panel report, *United States—Collection of Countervailing Duties on Non-Rubber Footwear from Brazil*, adopted on 13 June 1995, BISD 42S/208, para 4.10 (applying Article 28 of the Vienna Convention on the Law of Treaties); Appellate Body report, *United States—Measure Affecting Imports of Woven Wool Shirts and Blouses*, WT/DS33/AB/R,

provision in WTO law explicitly regulating the applicability of non-WTO international law in WTO proceedings.[269]

Nevertheless, there are three relevant legal starting points in this context. First, it must be noted that the *jurisdiction* of WTO adjudicating bodies is *limited*—in principle[270]—by the *claims* that can be brought before them: complaints are restricted to claims under the so-called 'covered agreements' listed in Appendix 1 to the DSU.[271] Hence, the jurisdiction of WTO panels can be characterized as being claim-specific.[272]

The issue of the *claims* that can give rise to WTO proceedings constitutes only part of the relevant picture, however. The reverse of the medal is the question which *defences* can be invoked in WTO dispute settlement. More precisely, the fact that the bases on which claims can be raised are restricted to WTO law in principle, does not necessarily imply that relevant defences in WTO proceedings are likewise limited to provisions laid down in the WTO agreements: the actual question is that of whether the WTO treaty framework has to be interpreted as explicitly or implicitly permitting that a defendant invokes conflicting norms of non-WTO international law, which allegedly supersede WTO law. This question relates to the concept of 'applicable law' (the law which has to be applied by a given dispute settlement forum), which is intertwined with that of a tribunal's jurisdiction, but must be distinguished from it nonetheless:[273] in particular, even a

adopted on 23 May 1997, p 14 (applying general principles of international law on the burden of proof in judicial proceedings in view of the relevant lacuna in the DSU); see also the extensive discussion in Pauwelyn (n 261 above) 207–12; cf also Bartels (n 260 above) 510ff; Pauwelyn (n 267 above) 997–8.

[269] See also Pauwelyn (n 261 above) 465; Lindroos and Mehling (n 260 above) 857ff.

[270] On the exceptions see subsection IV.A.

[271] On this cf Bartels (n 260 above) 503, fn 15: exceptions are laid down in Article XXIII GATS (exclusion of situation complaints; cf also W Zdouc, 'WTO Dispute Settlement Practice Relating to the GATS' (1999) 2 *Journal of International Economic Law* 295, 297ff); Article 17 of the Antidumping Agreement, as well as Article 19 of the Agreement, on the Implementation of GATT Article VII.

[272] Pauwelyn (n 261 above) 443ff, 454. It follows from Articles 6 and 7 of the DSU that the matter in dispute is defined by the parties: the request for the establishment of a panel must: (i) identify the specific measure at issue; and (ii) provide a brief summary of the legal basis of the complaint (cf Article 6.2 of the DSU). Pursuant to DSU Article 7.1, panels and the Appellate Body can only address claims under covered agreements and must not *ex officio* address violations not asserted by the complainant.

[273] Bartels (n 260 above) 502ff in particular has rightly emphasized that the distinction between jurisdiction and applicable law is well recognized in a number of international treaties providing for dispute settlement, such as the ICJ Statute, UNCLOS, NAFTA, and ICSID; on this cf also Pauwelyn (n 267 above) 1000 and the concurring view of Lindroos and Mehling (n 266 above) 857ff; G Verhoosel, 'The Use of Investor-State Arbitration under Bilateral Investment Treaties to Seek Relief for Breaches of WTO Law' (2003) 6 *Journal of International Economic Law* 493ff on the applicable law in bilateral investment disputes and NAFTA proceedings; the distinction is also made by public international lawyers, cf P Hilpold, 'Aktuelle Rechtsfragen zum WTO-Streitbeilegungsverfahren' (2002) 2 *Favorita Papers*, 49–50 and 52–3.

Recently, an Arbitral Tribunal constituted pursuant to UNCLOS underlined that 'there is a cardinal distinction between the scope of its jurisdiction . . . and the law to be applied by the Tribunal' (cf Arbitral Tribunal Constituted Pursuant to Article 287, and Article 1 of Annex VII, of UNCLOS for the Dispute Concerning the MOX Plant, International Movements of Radioactive Materials, and the Protection of the Marine Environment of the Irish Sea, *The MOX Plant Case, Ireland v United Kingdom*, Order No. 3, Suspension of Proceedings on Jurisdiction and Merits, and Request for further Provisional Measures, 24 June 2003) para 19; the same distinction is apparent in the ICJ ruling in the *Lockerbie* case (*Questions of Interpretation and Application of the 1971 Montreal Convention Arising from the Aerial Incident at Lockerbie, Libyan Arab Jamahiriya v US and UK*, Provisional Measures, *ICJ Reports* 1992, para 42); cf also Pauwelyn (n 261 above) 461–2 with further references.

tribunal with restricted jurisdiction *may* be required to apply also norms not forming part of the treaty by which it is set up, eg to fill lacunae or as a valid defence.

For instance, the litigants in a given WTO dispute may have concluded an *inter se* agreement which sets out rules that are more special and/or later in time than their WTO obligations. Pursuant to the principles of public international law, a *lex posterior* which has been concluded *inter partes* is lawful, if such modification of the earlier multilateral treaty is not prohibited by the latter, and (i) does not affect the enjoyment by the other parties of their rights under the earlier treaty or the performance of their obligations; moreover (ii) it must not relate to a provision, derogation from which is incompatible with the effective execution of the object and purpose of the treaty as a whole (Article 41 para 1 VCLT).[274] Given that Article 41 VCLT is an expression of the fundamental *pacta tertiis* principle, one can arguably submit that analogous conditions apply to a special norm which is earlier in time than the conflicting multilateral treaty: in particular, such a norm can be regarded as relevant only if it does not violate the rights of third parties under the later in time multilateral treaty.

In academic writings, the debate on the permissibility of derogations from WTO law has focussed not only on Article 41 VCLT.[275] On a related, though more general level, it has also been discussed whether substantive WTO obligations are reciprocal or integral in character (reciprocal obligations are sometimes also referred to as 'bilateral', while integral obligations are also designated as 'multilateral' or '*erga omnes partes*' obligations in the literature[276]). It must be recalled, in this context, that the distinction between reciprocal and integral obligations relates to the fields of the law of treaties and of state responsibility as well, and therefore has a bearing on the permissibility of suspensions, terminations, and *inter se* modifications

[274] Cf above, ch 2, section II.B.

[275] Cf Marceau (n 264 above) 1104–5.

[276] Cf eg ILC, Commentaries to the draft articles on Responsibility of States for internationally wrongful acts adopted by the International Law Commission at its fifty-third session (2001) extract from the Report of the International Law Commission on the work of its Fifty-third session, *Official Records of the General Assembly, Fifty-sixth session, Supplement No 10* (A/56/10), ch IV.E.2, Commentary on Article 42, para 5, available at <http://www.un.org/law/ilc>.

of obligations, on the permissibility of countermeasures, and the issue of standing.[277] In an attempt at generalization, Pauwelyn has submitted that

> in case WTO obligations were of the multilateral or *erga omnes partes* type, *inter se* modifications to the WTO treaty and the suspension of WTO obligations as against a wrongdoing state would *not* be acceptable, whereas standing to bring a WTO complaint would, in principle, be granted to all WTO members, irrespective of the breach. In contrast, if WTO obligations were seen as bilateral or reciprocal obligations, *inter se* modifications and suspension in response to breach would, in theory, be *permissible*, whereas standing would normally be limited to those WTO members at the other end of the (compilation of) bilateral relationship(s) allegedly breached.[278]

Building on these affinities of the characteristics of reciprocal obligations on the one side and integral obligations on the other side, it seems possible to infer some preliminary interpretative guidance for our context: if, under WTO law, a breach of a WTO obligation renders suspensions as a form of retaliation possible, and if standing were to be seen as being limited to affected WTO Members, this would constitute an *interpretative indication* for the reciprocal nature of WTO obligations and, by implication, also for the permissibility of *inter se* modifications of WTO law.[279] While these indications have to be balanced with any other relevant interpretative criteria, this line of thinking makes it possible to also take into account recent studies which have addressed the issue of the legal nature of substantive WTO norms from the viewpoints of state responsibility and standing to bring claims. With regard to the issue of responsibility, Hahn and Pauwelyn have argued that especially the fact that *inter se* suspensions of substantive WTO obligations as a form of countermeasure are permissible under WTO law, shows that most substantive WTO obligations do not have to be regarded as integral.[280] Regarding the question of standing to bring complaints, although it has been submitted that the WTO treaty has introduced an *actio popularis*,[281] an analysis of relevant provisions and case law shows that complainants must have a legal interest in the claim brought, even though this interest is examined with a very low degree of scrutiny in WTO dispute settlement.[282] Hence, even these general preliminary considerations on the *legal nature* of substantive WTO norms cast doubt on the claim that

[277] Cf the two extensive studies of MJ Hahn, *Die einseitige Aussetzung von GATT-Verpflichtungen als Repressalie* (1996); and Pauwelyn (n 261 above) 52ff.

[278] Pauwelyn (n 261 above) 54 (italics original).

[279] Cf Pauwelyn (n 261 above) 54ff.

[280] Hahn (n 277 above) 90–1 and 93ff; Pauwelyn (n 261 above) 76–7.

[281] Chr Tietje, *Normative Grundstrukturen der Behandlung nichttarifärer Handelshemmnisse in der WTO/GATT-Rechtsordnung* (1998) 163–73.

[282] Cf E Vranes, 'Fundamental Issues in WTO Law' in F Breuss, St Griller and E Vranes, *The Banana Dispute. An Economic and Legal Analysis* (2003) 39, 41–4 discussing relevant GATT and DSU provisions and the seminal *Bananas III* ruling (Appellate Body report, *EC—Regime for the Importation, Sale and Distribution of Bananas*, WT/DS27/AB/R, adopted on 25 September 1997); cf also Pauwelyn (XXX) 81–5, who examines the *Bananas* III case and further WTO case law.

WTO obligations are to be 'always the same for all Members',[283] a position which would exclude the possibility of *inter se* modifications.

As noted, reflections on this rather abstract level can only yield limited interpretative guidance regarding the issue of whether WTO obligations can be modified *inter se*, as this question must be answered for every substantive WTO obligation *individually*. Importantly, in this regard, the studies of Hahn and Pauwelyn have shown that most substantive WTO obligations could in principle be modified *inter parties*, *inter alia* for the reason that such modification does not necessarily negatively affect and thus violate the rights of third WTO Members (an obvious exception are some provisions of the TRIPS Agreement, which may give rise to integral obligations[284]).[285] Notably, such modification is not *per se* precluded by the MFN principle, since *inter se* modifications of substantive WTO obligations do not necessarily negatively affect other WTO Members, who may even economically benefit from such restrictions in concrete cases.[286] To be sure, substantive obligations have to be distinguished from institutional and jurisdictional provisions in this respect. Concerning provisions governing the institutional structure of the WTO, *inter se* derogations appear illegal per se, since such *inter se* modifications will affect the rights of third parties.[287] As respects jurisdictional issues, further distinctions appear appropriate: thus, an *inter se* agreement not to sue or not to appeal a panel decision in a given case will not normally negatively affect the substantive or procedural rights of

[283] Marceau (n 264 above) 1105.

[284] Pauwelyn (n 261 above) 69ff.

[285] Cf Hahn (n 277 above) 113ff, who infers further arguments in particular from the GATT principles of negotiation and renegotiation of concessions under Article II of the GATT, from the exceptions in Articles II:2(b) and II:5, from Articles XI, I, and III, provisions on GATT exceptions, rules on the institutional structure of the WTO, and on WTO dispute settlement; cf also Pauwelyn (n 261 above) 69ff.

[286] Cf Pauwelyn (n 261 above) 78ff. To give an example for illustration, suppose that several WTO Members agree in an MEA to restrict trade in goods *vis à vis* those contracting parties that fail to comply with the MEA requirements. Such restrictions on trade may benefit third WTO Members that are not parties to the MEA: when export restrictions are imposed *vis à vis* the non-complying party, export opportunities of third WTO Members may actually be enhanced. If import restrictions are imposed *vis à vis* the non-complying party, third WTO Members may again profit from lower prices of products originating in the non-complying country. A further dimension comes into play due to the fact that some WTO agreements, notably the GATS, function as investment protection treaties (on these issues cf Vranes, *Trade and the Environment* (habilitation manuscript, Wirtschaftsuniversität Wien, 2006) Part IV, ch 2, section II.C.4.c(i)). Nonetheless, the pertinent rights of third WTO Members are not necessarily violated when an MEA party in our example restricts trade: to be sure, such trading restrictions may affect the investments undertaken by companies from third WTO Members that have invested in the WTO Member resorting to trading restrictions. Yet, so long as these restrictions are imposed on a basis which does not discriminate between these companies and domestic ones, nor between these companies and those of other WTO Members, the pertinent non-discrimination disciplines of the GATS will not be violated.

[287] Pauwelyn (n 261 above) 70.

third WTO Members.[288] On the other hand, an *inter se* agreement to settle a 'WTO dispute' in another judicial forum would arguably only be lawful if, in particular the extensive third party rights granted to third WTO Members under the DSU[289] were preserved in an equivalent manner.[290]

If one therefore takes the view that *inter se* modifications of substantive WTO law may be possible under limited circumstances, the concept of jurisdiction of WTO adjudicating comes into play once more: in view of the aforementioned fact that this jurisdiction is restricted to complaints based on the claims that are set out in the WTO covered agreements, an *inter se* modification of WTO obligations may supersede the basis for the claim and, thereby, affect the *claim-specific jurisdiction* of panels. This leads us to the *third relevant starting point*: it is established in the jurisprudence of international tribunals and in WTO dispute settlement practice that adjudicating bodies have the implied jurisdiction to decide the issues inextricably linked to the exercise of the judicial function, including the competence to decide on their own competence (*Kompetenzkompetenz*).[291] This arguably includes the issue of whether a panel's jurisdiction has been taken away through lawful *inter se* modifications of the treaty by which the panel is established.[292]

Restated succinctly, therefore, the central thesis underlying this chapter is that substantive WTO obligations essentially being reciprocal in nature, WTO Members should be regarded as being in a position, in principle, to

[288] Procedural third party rights under the DSU (cf Article 10) should arguably be regarded as 'derivative rights' that can be exercised only to the extent a complaint is brought and pursued by a complaining party (this also follows from the DSU principle that an amicable solution of a dispute is to be preferred; cf Article 3.7 of the DSU). Self-standing substantive rights can be pursued through dispute settlement proceedings by any WTO Member that is potentially negatively affected by another Member's regulations (cf Article 10(4) of the DSU).

[289] Cf Article 10 of the DSU.

[290] This leads to the question whether even quite hypothetical interests of any third WTO Member in a dispute would render such an *inter se* agreement unlawful; in this regard, it has to be taken into account that the DSU particularly protects '*substantial* interests' of third WTO Members (cf Article 10.2 of the DSU).

[291] Cf the Appellate Body report, *EC—Regime for the Importation, Sale and Distribution of Bananas*, WT/DS27/AB/R, para 142 (confirming the reasoning of the panel in the *Bananas* case at paras 7.26ff); and, most clearly, Appellate Body report, *United States—Antidumping Act of 1916*, WT/DS136/AB/R and WT/DS162/AB/R, adopted on 26 September 2000, fn 30 ('We note that it is a widely accepted rule that an international tribunal is entitled to consider the issue of its own jurisdiction on its own initiative, and to satisfy itself that it has jurisdiction in any case that comes before it'); cf also Pauwelyn (n 261 above) 447–9 with further references regarding WTO and ICJ practice; Pauwelyn (n 267 above) 1006, and Vranes (n 282 above) 39, 48ff. For a recent treatise in international law cf CF Amerasinghe, *Jurisdiction of International Tribunals* (2003) 121–3.

[292] See Pauwelyn (n 261 above) 447–449 and Pauwelyn (n 267 above) 1006; but see also L Bartels, 'The Separation of Powers in the WTO: How to Avoid Judicial Activism' (2004) 53 ICLQ 861; extensive further references on jurisprudence and literature on the issue of *Kompetenzkompetenz* in international law is given by the Appellate Body in its report *United States—Antidumping Act of 1916*, WT/DS136/AB/R and WT/DS162/AB/R, adopted on 26 September 2000, in fn 30.

modify such rights and duties *inter partes*. Given that the jurisdiction of WTO adjudicating bodies is claim-specific, their competence may lapse also due to *inter se* modifications of substantive WTO law (ie the legal grounds on which claims can be brought). This requires panels, in the framework of their *Kompetenzkompetenz*, to take account of such non-WTO norms that are invoked as a defence, if the latter have to be regarded as lawful modifications of WTO law and as being meant to prevail over WTO law by the WTO Members bound by them.

Most of the authors taking divergent attitudes on the question of whether conflicting non-WTO international law can be taken into account even within WTO proceedings would arguably object to some of the aspects of this thesis.[293] This chapter will therefore proceed in the following manner: it will first examine the relevant WTO provisions, as well as WTO dispute settlement decisions relied on by the prevailing majority of authors who take the more restrictive stances that were sketched out by way of introduction. This chapter will then move on to analyse the arguments advanced in the legal literature, and will also examine the arguments proffered by authors who defend less restrictive stances and who would implicitly or explicitly let non-WTO international law prevail over WTO law within WTO proceedings.[294] So far, however, the view that non-WTO *leges speciales* and *leges posteriores* conflicting with WTO law can be relied on as a defence in WTO proceedings, if they do not infringe Article 41 of VCLT, has been explicitly advocated in an elaborate way by Pauwelyn only.[295]

[293] One possible objection should arguably be addressed at this point: it could be argued that the fact that the WTO Agreement contains provisions on the amendment of WTO law (cf Article X WTO Agreement) shows that modifications, which do not comply with the requirements set out therein, are impermissible. In this context, however, it is mandatory to distinguish between amendments in the strict sense, ie amendments in line with Article X, and *inter se* modifications: the fact that the WTO Agreement contains provisions on amendments does not necessarily imply that *inter se* modifications are excluded. Rather, this is an interpretative question. Since Article X does not explicitly rule out the possibility of *inter se* modifications, one has to look for additional interpretative guidance on this issue. This will be done in the remainder of this chapter.

[294] Schoenbaum has submitted that Art 11 of the DSU is to be understood as an implied powers clause enabling WTO adjudicating bodies to 'decide all matters of a dispute' (cf Th Schoenbaum, 'WTO Dispute Settlement: Praise and Suggestions for Reform' (1998) 47 ICLQ 647, 653); however, it does not become clear from this rather terse statement whether Schoenbaum actually had the disputed question of whether non-WTO international law has to be recognized as *prevailing* over WTO law in WTO proceedings in mind. The same is true of the view of Palmeter and Mavroidis, who have maintained that Article 7 of the DSU should be regarded 'as the WTO substitute' for Article 38 of the ICJ Statute. These authors list 'other international agreements' as one of the sources of WTO law (Palmeter and Mavroidis (n 261 above) 399); yet they merely allude to the question of whether panels are competent (and required) to recognize non-WTO law as *prevailing* over WTO law without discussing this issue (407).

[295] Pauwelyn (n 261 above) 440ff; Pauwelyn (n 267 above) 1003–5 and passim.

III. Interrelated Issues

In dealing with these issues, this chapter will also address the following set of interrelated questions:

(1) Can the jurisdiction of WTO adjudicating bodies exceptionally be *restricted* (or widened) *inter se*, ie by some WTO Members only?
(2) Which are the principles delimiting the law to be applied in WTO proceedings?
(3) Can non-WTO international law be used not only for the purpose of interpreting WTO law and to fill in gaps, but also as a *defence*?
(4) Are there limits to such a defence which is based on non-WTO international law, ie are there barriers to the restriction of:
    (a) the jurisdiction of WTO adjudicating bodies?
    (b) applicable WTO law in WTO proceedings?
(5) Are such barriers to be derived from:
    (a) WTO law only?
    (b) international law only?
    (c) the interaction of WTO law and international law?

IV. Review of Relevant Dispute Settlement Practice

A. Decisions Concerning Jurisdiction of WTO Adjudicating Bodies

While WTO adjudicating bodies have clarified that a panel's jurisdiction can *exceptionally* be *widened* through a bilateral agreement negotiated by the disputing parties,[296] the inverse question whether a non-covered agreement

[296] The WTO Dispute Settlement Body is authorized according to Article 7.3 of the DSU to establish panels with *non-standard* terms of reference. Furthermore, arbitration under Article 25 of the DSU can take place under non-standard terms of reference. These exceptions have been subjected to further qualifications in GATT 1947 and WTO dispute settlement practice: accordingly (i) there has to be a *close connection* between the non-WTO agreement under which the claim is brought and WTO law; (ii) the agreement has to be *consistent with the objectives* with WTO law; and (iii) both disputing parties must have joined in requesting such *widening of jurisdiction* (cf the 1990 GATT arbitration award *Canada/EC Wheat*, DS12/R BISD 37S/80, section II.A, last paragraph; as well as the 1998 panel report in *EC—Poultry*, WT/DS69/R, paras 199ff; see also Palmeter and Mavroidis (n 261 above) 410; Bartels (n 260 above) 503, fn 16; Pauwelyn (n 261 above) 444; although the *Canada/EC—Wheat* case concerned an arbitration proceeding, the *Poultry* panel explicitly referred to the three preconditions mentioned in the text above, which were formulated by the arbitrator in the *Wheat* case (para 200)).
While such extension of the jurisdiction constitutes the exception, the rule according to which such widening is normally impermissible has been confirmed in the Appellate Body report, *EC—Measures Affecting Importation of Certain Poultry Products*, WT/DS69/AB/R, adopted on 23 July 1998, para 81 (the case concerned the so-called Oilseeds Agreement negotiated by the European Communities and Brazil under Article XXVIII of the GATT 1947,

can take away a panel's jurisdiction has so far been addressed only cursorily in two panel reports. In 2002, the panel on *India—Automotive Sector* indicated in an *obiter dictum* that it might recognize a bilateral agreement, in which the complainant had agreed not to sue, as a defence. The panel held that it 'sees merit in [the defendant's] argument that the issue in this respect is not solely whether the mutually agreed solution is a covered agreement, but rather what effects it may have on the exercise of procedural rights under the DSU in subsequent proceedings'.[297]

In the same vein, the 2003 panel in the *Argentina—Poultry* case suggested that it might take into account *non-WTO rules conflicting* with WTO provisions to ascertain whether they have taken away the panel's jurisdiction. In this case, after having lost an anti-dumping case against Argentina in MERCOSUR arbitration, Brazil brought a complaint on the same Argentinean measures before the WTO. The panel noted that relevant MERCOSUR rules did not impose restrictions on Brazil's right to initiate subsequent WTO proceedings. It then referred to the 2002 MERCOSUR-related Protocol of Olivos, which then was *not* in force yet and which provides that a MERCOSUR party is not allowed 'to bring a subsequent case regarding the same subject-matter' in the WTO, once it has initiated proceedings under MERCOSUR (and vice versa). The panel did so to justify its conclusion that '(*in the absence of such Protocol*) a MERCOSUR dispute settlement proceeding could be followed by a WTO dispute settlement proceeding in respect of the same measure'.[298]

Hence, the arguments of both reports suggest that the panels may be prepared to take account of conflicting international law rules. However, both panels failed to specify the legal preconditions they regarded as relevant in this context.

B. Decisions Concerning Applicable Law in WTO Proceedings

Decisions rendered in proceedings where non-WTO international law has been invoked as a defence against violations of WTO disciplines, have not yet

as part of the settlement of the dispute decided in the panel report, *European Economic Community—Payments and Subsidies Paid to Processors and Producers of Oilseeds and Related Animal-feed Proteins*, adopted on 25 January 1990, BISD 37S/86 and DS28/R); and in the Arbitration report, *EC—Measures Affecting Livestock and Meat (Hormones)*, WT/DS26/ARB and WT/DS48/ARB, circulated on 12 July 1999, para 50 (emphasizing that the rights on which the relevant US claim was based 'are not rights under any of the WTO agreements covered by the DSU'); cf also Pauwelyn (n 261 above) 478–9.

[297] Panel report, *India—Measures Affecting the Automotive Sector*, WT/DS146/R, adopted on 5 April 2002, para 7.116. The panel was able to circumvent this systemic issue, and to confine itself to these insinuations, since it found that the bilateral agreement invoked by the defendant did not cover the matter in dispute. See also Pauwelyn (n 267 above) 1007–8.

[298] Panel report, *Argentina—Definitive Anti-dumping Duties on Poultry From Brazil*, WT/DS241/R, para 7.38 (emphasis added). This case is also discussed by Pauwelyn (n 267 above) 1012–13.

yielded a clear picture. In the first pertinent case, the 1998 *EC—Hormones* ruling, the Appellate Body held that the precautionary principle, invoked in defence by the EC, does not 'by itself, and *without a clear textual directive* to that effect, relieve a panel from the duty of applying the normal...principles of treaty interpretation'. In its view, therefore, the 'precautionary principle *does not override* the provisions of Articles 5.1 and 5.2 of the SPS Agreement'.[299] This step in the argumentation, although not the overall result in this case, appears problematic to the extent it insinuates that for it to be relevant, non-WTO law has to be *incorporated* by reference to WTO law. As rightly observed by Pauwelyn, it would have been incumbent on the Appellate Body to ascertain the status of the precautionary principle in international law, and whether it would have prevailed pursuant to established conflict principles, irrespective of whether the SPS agreement explicitly refers to the principle or not.[300]

A different, but little noticed position concerning this fundamental issue was adopted by the Appellate Body in the *Argentina—Footwear* case. As this ruling has received diametrically opposite readings in doctrinal writings,[301] it is appropriate to take a closer look at this decision. Argentina essentially argued that its violation of Article VIII of the GATT (through the enactment of an *ad valorem* tax of 3 per cent on imports) resulted from a conflicting obligation that it owed to the IMF.[302] In contrast to the decision in *EC—Hormones*, the Appellate Body actually dealt with the non-covered international law norms invoked by the defendant. It first held that it was not possible, from the panel record, to determine the precise legal nature of the agreement concluded by Argentina and the IMF, and that it was not, therefore, in a position to decide on 'the extent to which commitments undertaken by Argentina in this Memorandum constitute legally binding obligations'. Moreover, in the view of the Appellate Body, Argentina had not shown an 'irreconcilable conflict' between the non-WTO instrument and GATT. The Appellate Body then examined three further instruments, which do *not* form part of WTO covered agreements in the sense of the DSU,[303] in order to ascertain whether it ensued from these that Argentina's alleged obligations towards the IMF should prevail over WTO law. It concluded 'that there is nothing' in these instruments—ie the Agreement between the IMF and the WTO, the Declaration on the Relationship of the

[299] Appellate Body report, *EC—Measures Affecting Livestock and Meat (Hormones)*, WT/DS26/AB/R and WT/DS48/AB/R, adopted on 13 February 1998, para 124.

[300] Pauwelyn (n 261 above) 482.

[301] Thus Trachtman has read this case as suggesting that a non-WTO agreement cannot modify WTO obligations (Trachtman (n 262 above) 342); it has been understood in the opposite sense by Pauwelyn (n 261 above) 479–81 and Bartels (n 260 above) 508–9.

[302] Appellate Body report, *Argentina—Certain Measures Affecting Imports of Footwear, Textiles, Apparel and Other Items*, WT/DS56, adopted on 22 April 1998, para 65.

[303] The so-called 'covered agreements' are those agreements under which complaints can be brought under the DSU, cf Article 1 and Appendix 1 of the DSU.

WTO with the IMF and the Declaration on Coherence[304]—'which justifies a conclusion that a Member's commitments to the IMF shall prevail over its obligations under Article VIII of the GATT 1994'.[305] In particular, the Appellate Body found that the first-mentioned agreement 'does not modify, add to or diminish the rights and obligations of Members under the WTO Agreement...It does not provide any substantive rules concerning the resolution of possible conflicts.'[306]

Put differently, the Appellate Body examined international instruments not covered by the DSU in order establish whether allegedly conflicting non-WTO obligations had modified WTO obligations. It even did so employing the disputed terms of Articles 3.2 and 19.2 DSU (according to which WTO adjudicating bodies must not '*add to or diminish* the rights and obligations' provided in the covered agreements[307]), which also can be regarded as an indication that these provisions do not hinder the application of non-WTO international law as a defence in WTO proceedings. The fact that the Appellate Body took this first step of examining non-covered agreements that were invoked as a defence should arguably be read as implying that the Appellate Body would also have been prepared to take the next logical step, ie to accept that non-WTO international law may prevail over WTO obligations in certain circumstances. Otherwise, the Appellate Body could simply have held that non-covered agreements 'do not override' WTO disciplines 'without a clear textual directive to that effect', as it had done in the *Hormones* case.[308] Strikingly, however, this case has even been read as implying the opposite, namely that international law cannot supersede WTO law in WTO dispute settlement.[309]

Finally, the panel in *Korea—Government Procurement* addressed the relationship between non-WTO international law and WTO law in an explicit manner. It held that customary international law applies between WTO Members 'to the extent that the WTO treaty agreements do not "contract out" from it', that is 'to the extent there is no conflict or inconsistency, or an expression in a covered WTO agreement that implies differently',[310] Hence, the panel rejected the *a contrario* conclusion from Article 3.2, which has actually been drawn by publicists,[311] that international law can solely

[304] On these instruments cf ibid, paras 65ff.

[305] Ibid para 70.

[306] Ibid para 72.

[307] For a discussion of these provisions cf below, section V.A.

[308] Pauwelyn (n 267 above) 480.

[309] Trachtman (n 262 above) 343.

[310] Panel report, *Korea—Measures Affecting Government Procurement*, WT/DS163/R, adopted on 19 June 2000, para 7.96.

[311] Cf eg Trachtman (n 262 above) 342 submitting that the 'language [of Article 3.2 DSU] would be absurd if rights and obligations arising from other international law could be applied by the DSB'. Moreover, on the basis of this provision and Articles 7 and 11, he submits that 'it would be odd if the member intended non-WTO law to be applicable'.

be used for the interpretation of WTO obligations in WTO proceedings.[312] However, while the panel held that customary international law applies between WTO Members 'to the extent there is no conflict', it did not indicate whether in its view *conflicting* non-WTO international law could *prevail* over WTO law.

By way of *interim conclusion*, it is to be underlined that there are some sporadic signs, although these are not unequivocal, that WTO adjudicating bodies may be prepared to recognize that WTO law has been superseded by conflicting non-WTO international law and WTO instruments not covered by the DSU. However, these signals cannot be regarded as sufficient legal arguments for the fact that they are mostly not supported by explicit legal reasoning so far. This chapter will therefore explore in the following whether and to what extent international law can be taken into account as superseding WTO obligations even within WTO dispute settlement proceedings.

V. Examination of the Arguments Prevailing in Academic Writings

A. Articles 3.2 and 19.2 of the DSU as the Main Anchors for Divergent Theories

1. *Do these Provisions Exclude the Applicability of International Law?*

On the basis of Article 3.2 of the DSU—which like Article 19.2 recalls that panels, the Appellate Body and the DSB 'cannot add to or diminish the rights and obligations provided in the covered agreements' in their findings and recommendations—Trachtman has submitted that WTO adjudicating bodies 'are *only permitted to apply WTO law*'. In his view, '[t]his language would be absurd if rights and obligations arising from other international law could be applied by the DSB'.[313]

However, Trachtman's argument fails to make it clear why Article 3.2 should be regarded as relevant for the problem of the applicability of

On the view of Trachtman and similar theories entertained in academic writings see below, section V.

[312] Thus, in a footnote the panel added: 'We should also note that we can see no basis here for an *a contrario* implication that rules of international law other than rules of interpretation do not apply. The language of 3.2 in this regard applies to a specific problem that had arisen under the GATT to the effect that, among other things, reliance on negotiating history was being utilized in a manner arguably inconsistent with the requirements of the rules of treaty interpretation of customary international law' (ibid, fn 753 to para 7.96); on this case see also Pauwelyn (n 267 above) 482–4.

[313] Trachtman (n 262 above) 342–3 (emphasis added); cf also the (less pronounced) view of W Weiss, 'Security and Predictability under WTO law' (2003) 2 *World Trade Review* 183–219, 192–201.

non-WTO international law. On the contrary, in the view of most writers,[314] and indeed even Trachtman himself,[315] Article 3.2 deals with the interpretative function of WTO adjudicating bodies. It obviously merely confirms the fundamental principle that interpretation of a legal text by a tribunal must not amount to its 'judicial' amendment.[316] It is quite a different question, however, (i) whether WTO Members may *themselves* modify WTO law *inter se*, and (ii) whether WTO adjudicating bodies are to take account of such modifications. Article 3.2—and the equivalent wording in Article 19.2—are obviously not concerned with this question. Moreover, as just pointed out, it has been explicitly highlighted in WTO dispute settlement proceedings that one should not draw the *a contrario* conclusion from these provisions that international law—other than the VCLT principles on interpretation—cannot apply in WTO proceedings.[317] Further, in contrast to Trachtman's argument, several panel and Appellate Body rulings have applied non-WTO international law to fill gaps.[318]

Trachtman also advances a second argument on the basis of Articles 3.2 and 7 of the DSU, which he develops in an attempt to refute a stance taken by Palmeter and Mavroidis, according to whom Article 3.2 (in conjunction with Article 7) *incorporates* international law into WTO law.[319] In contrast, Trachtman argues (i) that Articles 3.2 and 7 'refer only to interpretation'; hence, (ii) these provisions 'cannot be taken as making the WTO dispute resolution system a *court of general international law jurisdiction*'.[320]

As just explained, the first part of Trachtman's argument appears correct to the extent that Article 3.2 is obviously concerned with the interpretative function of panels. Nonetheless, this part of the argument is not to the point to the extent that it submits that Article 7 refers only to interpretation, as this provision in fact deals with the law to be *applied* by panels.[321] Still, Article 7 does not explicitly refer to the applicability of non-WTO law. We would therefore concur with Trachtman, on the basis of this adjusted reasoning, that neither provisions have to be seen as incorporating non-WTO international law, as maintained by Palmeter and Mavroidis, and as *thereby* making such norms applicable in WTO proceedings.[322]

More importantly, however, the second part of Trachtman's argument appears unfounded to the extent it implies that recognizing that non-WTO international law is applicable in WTO proceedings would amount to

[314] See also eg Bartels (n 260 above) 507.

[315] Trachtman (n 262 above) 342, in fn 41.

[316] On this see also Pauwelyn (n 261 above) 353 who characterizes this provision as one adopted *ex abundante cautela*.

[317] Cf para 7.96 of the *Korea—Government Procurement* panel report.

[318] Cf above, section II.

[319] Palmeter and Mavroidis (n 261 above) 399.

[320] Trachtman (n 262 above) 342, fn 41.

[321] We will address Article 7 in subsection V.B.

[322] See also Bartels (n 260 above) 504–5.

transforming the WTO dispute settlement system into a court of general international law jurisdiction.[323] In this respect, it is essential to distinguish the concepts of jurisdiction and applicable law and to recall that the jurisdiction of WTO adjudicating bodies is limited in terms of the *claims* that can be brought and cannot normally be extended.[324] It is a different question, however, whether non-WTO international law—through which WTO law has been modified in accordance with fundamental international law principles—can be applied *as a defence* in WTO proceedings. This is overlooked by Trachtman also when he invokes the Appellate Body's *EC—Poultry* decision as confirming that a bilateral non-covered agreement 'does not constitute WTO law applicable by a panel'. In fact, the Appellate Body merely confirmed in this case that the jurisdiction of panels cannot be widened by *complaints* brought under non-covered agreements.[325] To the extent that non-WTO law is applied as a *defence*, however, the jurisdiction of WTO adjudicating bodies, limited as it is in terms of the claims that can be brought, is not extended.[326]

2. *Do Articles 3.2 and 19.2 Restrict the 'Constitutional Capacity' of Panels?*

A different reading of Article 3.2—and the equivalent wording in Article 19.2—has been suggested by Marceau and Bartels.[327] According to

[323] Cf above; a similar argument has been advanced by Marceau and Tomazos in St Griller (n 266 above).

[324] On the exceptions cf above, section IV.A.

[325] Cf Appellate Body, *EC—Measures Affecting Importation of Certain Poultry Products*, WT/DS69/AB/R, adopted on 23 July 1998, para 81.

[326] Finally, in trying to give some scope of application to Trachtman's categorical statement, one could attempt to read it in a different manner, ie as implying that non-WTO international law has to be explicitly *incorporated* in order to become applicable as a defence; this reading seems supported by related considerations of the author according to which panels and the Appellate Body, being 'only permitted to apply WTO law', can refer to non-WTO international law in two types of cases only: ie for the purpose of interpretation, and to the extent that international law is 'incorporated by reference in WTO law, either by treaty language... or by a waiver'. Besides these two exceptions, substantive non-WTO law would only 'indirectly be incorporated by reference in provisions such as Article XX(b) of GATT' (Trachtman (n 262 above) 343).

This view would entail the—hardly persuasive—consequence that WTO Members would have to go through the whole of WTO proceedings in all cases not covered by the exceptions recognized by Trachtman, before they could claim *ex post* (ie after the termination of WTO proceedings) that the WTO complaint and the ensuing WTO ruling actually infringe other international law. It is submitted that such a reading is not convincing. There arguably are no indications to be found in these provisions, or the rest of WTO law, that the WTO treaty was meant to derogate from the standard international law rules set out above: ie to make it impossible for panels to take account: (i) of *inter se* modifications of the WTO treaty which are lawful under international law; or (ii) of treaties that were meant to prevail as a *lex specialis* by the contracting parties and that do not infringe third WTO Members' rights.

[327] Marceau (n 264 above) 1102ff, 1104; her arguments are reproduced, in part, in A González-Calatayud and G Marceau, 'The Relationship between the Dispute-Settlement Mechanisms of MEAs and those of the WTO' (2002) 11 *Review of European Community and International Environmental Law* 275ff; Bartels (n 260 above) 506ff.

Marceau, panels and the Appellate Body 'do not seem to have the constitutional capacity to reach any standard recommendations in situations where another treaty provision has superseded...a WTO provision'.[328] While Marceau nevertheless concludes that a panel may decline jurisdiction in such cases, or should '[a]t best... declare that in international law the WTO provision has been superseded by another treaty's provision but that the WTO dispute settlement mechanism is prohibiting from acting further on that specific claim',[329] a more categorical stance has been taken by Bartels. In his view, Articles 3.2 and 19.2 are to be understood as expressing a *conflict rule* operating in an 'indirect manner', in that these provisions 'limit the powers of the DSB, Panels and the Appellate Body'. Unlike Marceau, he would never let non-WTO international law prevail over conflicting WTO law in WTO proceedings.[330] Writing in 2004, Bartels, however, has further developed his view.[331]

For reasons of clarity, it appears nonetheless appropriate to address the issue of the 'constitutional capacity' of WTO adjudicating bodies. In this regard, it is appropriate to recall the actual wording of Article 3.2 of the DSU:

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

Article 19.2 adds:

> In accordance with paragraph 2 of Article 3, in their findings and recommendations, the panel and Appellate *cannot add to or diminish the rights and obligations* provided in the covered agreements.

Articles 3.2 and 19.2 can arguably be understood in two ways. These provisions can, as mentioned, be read, and are in fact usually read, as setting out limits on too broad an interpretation.[332] Looked at from this angle, it would be difficult to infer from the clause 'add to or diminish' that panels must not take account of modifications of WTO law that are brought about lawfully, in terms of international law, by WTO Members themselves. On the contrary, given that such modifications of WTO law may affect their *claim-specific* jurisdiction, panels should be regarded as being called upon

[328] Ibid 1104.

[329] Ibid 1107–8.

[330] Bartels (n 260 above) 507 and *passim*.

[331] L Bartels, 'The Separation of Powers in the WTO: How to Avoid Judicial Activism' (2004) 53 *International and Comparative Law Quarterly*, 861ff.

[332] Cf above, section V.A.1; similarly Bartels (n 260 above) 507.

to address such norms in the exercise of their *Kompetenzkompetenz*, as has been explained by way of introduction. In other words, in this first reading of Articles 3.2 and 19.2 of the DSU, it would be difficult to sustain that this implied competence of WTO adjudicating bodies has been restricted.

However, and this brings us to the second possible reading, it could be argued that the third sentence of Article 3.2 can not only be read in the context of the second part of the second sentence of Article 3.2, which refers to the interpretative task of adjudicating bodies, but also against the background of the first part of the second sentence of Article 3.2, according to which WTO Members 'recognize that [the WTO dispute settlement system] serves to preserve the rights and obligations of Members under covered agreements'. In other words, in the first reading, the question was whether the *Kompetenzkompetenz* of WTO *adjudicating bodies* has been limited. In the second reading the questions are: does it follow from this context of the clause 'must not add to or diminish': (i) that *WTO Members* have restricted their own capacity to modify WTO law; and (ii) that, consequently, WTO adjudicating bodies must not take account of attempted *inter se* modifications in conflict with WTO law?

This second reading, which also finds explicit support in academic writings,[333] does not appear convincing: it would imply that WTO law would be exempt from normal international law rules on treaty modification; the primary links to other international law would then be clauses of the type of Article XX of the GATT. This would entail the consequence that WTO Members would regularly only be allowed to pursue certain non-economic concerns according to the strictures imposed by Article XX. In contrast, it has to be emphasized, as was already pointed out by Pauwelyn, that there are no indications in these technical DSU provisions that WTO Members intended to introduce protection against *inter se* modifications which is higher than that provided by established international law principles, such as the *pacta tertiis* principle and related conflict principles.[334] In addition, both alternative readings, if true, fail to explain the fact that at least two panel reports may appear to be prepared to recognize that non-WTO law has superseded WTO provisions.[335]

[333] Thus, Marceau has submitted that *inter se* modifications of WTO law in line with Article 41 VCLT are not permissible, since 'WTO obligations are always the same for all WTO Members' (n 260 above, 1105). In her approach, therefore, Article XX of the GATT becomes central, as she expressly admits (1107).

[334] See Pauwelyn (n 261 above) 352ff, 354, who also submits that WTO adjudicating bodies would actually 'add to or diminish WTO rights and obligations', if they did not take account of the fact that such rights and obligations have been modified by WTO Members *themselves* in line with international law principles (474).

[335] Cf the 2003 panel report, *Argentina—Definitive Anti-dumping Duties on Poultry From Brazil*, WT/DS241/R, para 7.38, as well as the panel report, *India—Automotive Sector*, para 7.116; on these cases cf above, section IV.A.

B. Arguments Based on Articles 7 and 11 of the DSU

Pursuant to Article 7.1 of the DSU, panels are to examine the matter in dispute 'in the light of the relevant provisions [of the covered agreements] cited by the parties'. Thus, Article 7 stresses, like Article 6, that the matter in dispute is defined by the disputing parties. This provision has given rise to irreconcilable conclusions.[336] While several authors have inferred from Article 7 that non-WTO law cannot be applied in WTO dispute settlement proceedings,[337] others have submitted that one cannot deduce from Article 7 that international law must not be applied by WTO panels.[338] According to Schoenbaum and Pauwelyn, Article 7.1—which instructs panels to make 'such findings as will assist the DSB in making the recommendations or in giving the rulings provided for [in the relevant WTO covered agreements]'—has to be regarded as an implicit confirmation that WTO panels are to apply non-WTO rules of international law;[339] an inference rightly criticized as arguably unsupported by the unspecific wording of this provision.[340] We would submit, with Bartels, that Article 7, the only DSU provision explicitly addressing the issue of applicable law, is 'fairly inconclusive on the matter' of the applicability of *non-WTO* international law,[341] which is why it appears necessary to look for further interpretative indications.

Turning to Article 11 of the DSU, this provision stipulates, first, that panels 'should make an objective assessment of the matter before it, including...the *applicability* of and conformity with the relevant *covered agreements*' and, second, that panels are to 'make such other findings as will assist the DSB in making the recommendations or in giving the rulings provided for in the covered agreements'. The fact that this provision refers to the 'relevant covered agreements' has led Trachtman to conclude that 'it would be odd if the members *intended* non-WTO law to be applicable'.[342] It is submitted, however, that this stance, which focuses exclusively on WTO law, loses sight of the fact that an intention, referred to also in Trachtman's argument, to overrule WTO law and make non-WTO law applicable, may

[336] This is also pointed out by Bartels (n 260 above) 504.

[337] E Canal-Forgues, 'Sur l'interpretation dans le droit de l'OMC' (2001) 105 *Revue Générale de Droit International Public*, 1, 11–12; JI Charney, 'Is International Law Threatened by Multiple International Tribunals?' (1998) 271 *Recueil des Cours* 101, 219; G Marceau, 'A Call for Coherence in International Law—Praises for the Prohibition against "Clinical Isolation" in WTO Dispute Settlement' (1999) 33 *Journal of World Trade* 87, 110; Trachtman (n 262 above) 342.

[338] Cf Palmeter and Mavroidis (n 261 above) 399; Pauwelyn (n 261 above) 466.

[339] Pauwelyn (n 261 above) 468–469; Schoenbaum (n 294 above) 653.

[340] Trachtman (n 262 above) 342 and fn 41.

[341] Bartels (n 260 above) 504–5.

[342] Trachtman (n 262 above) 342. This argument has also been advanced by Trachtman on the basis of Articles 3.2 and 7 of the DSU, which use similar language. To the extent that this argument hinges upon these provisions, it has already been addressed above, section V.A.1.

ensue precisely from such non-WTO norms; the real question is whether such an effect is permissible. Moreover, it has been rightly pointed out by Pauwelyn and Bartels that Article 11 might also be read as implying that a panel may be required to apply other rules of international law in order to make—in the words of this very provision—'an objective assessment... of the applicability of... the relevant covered agreements'.[343]

Second, in dealing with the argument that the second part of Article 11 ('make such other findings...') should be understood as an *implied powers clause* enabling WTO adjudicating bodies 'to decide all aspects of a dispute' including international law issues,[344] Trachtman argues that this provision appears too general for such systemic conclusions.[345] In addressing Trachtman's thesis, we do *not* intend to defend the characterization of Article 11 as an implied powers clause. According to the perspective adopted in the present work, there is no need for such an explicit clause to make international law norms, which have lawfully modified WTO law, applicable as a defence in WTO proceedings; the same is true for prior agreements which were meant to apply as a *lex specialis* and which do not infringe the rights of third WTO Members.[346] Moreover, it is to be recalled that we do not submit that the jurisdiction of WTO panels should be widened in the sense that *claims* could be brought based on non-WTO international law.

We do submit, however, that this provision is not only 'too general' to support the views criticized by Trachtman, but that it *also is too unspecific* to sufficiently support Trachtman's restrictive stance: it is to be conceded that his theory, if true, would not amount to a direct exclusion of fundamental international law principles on treaty modification; however, according to this stance, panels would nonetheless never be able to take into account modifications of WTO law—which in fact should be regarded as affecting the claim-specific competence of WTO adjudicating bodies—brought about by WTO Members in accordance with international law. This would also entail the consequence that WTO Members could only claim that a WTO law has been modified by specific or later-in-time international law norms *after* WTO proceedings are concluded. It is submitted with regard to *Trachtman*'s stance that such consequences do not appear persuasive without weighty interpretative arguments.

C. Article 23 of the DSU—Exclusive or Insuperable Jurisdiction?

It remains to address a last facet of the jurisdictional dimension of our problem. According to Article 23.1 of the DSU, WTO Members 'shall

[343] Pauwelyn (n 261 above) 469; Bartels (n 260 above) 505–6.
[344] Schoenbaum (n 294 above) 653.
[345] Trachtman (n 292 above) 342–3 and fn 41.
[346] Cf above, section II.

have recourse to' the DSU in disputes concerning WTO issues. Pursuant to Article 23.2, WTO Members must not unilaterally determine that their WTO rights have been infringed. Article 23 is often referred to as an 'exclusive jurisdiction' clause,[347] although this denomination does *not* form part of the actual treaty text. The question under this provision, too, is whether Article 23 is to be understood as even excluding any pertinent *inter se* modifications by WTO Members themselves.

Taking a distinctly restrictive stance in an essay devoted to this question, Kwak and Marceau have submitted that according to Article 23, a WTO complainant 'arguably cannot even agree to take its WTO dispute to another forum, even if that other forum appears to be more relevant'.[348] What is more, according to these authors Article 23 'reflects the clear intention of WTO Members to ensure that WTO adjudicating bodies can always exercise exclusive jurisdiction... In order to change this, Members would have to negotiate amendments to Article 23'.[349]

The arguments submitted by Kwak and Marceau are largely confined to WTO law. Their argument that, pursuant to Article 23, the 'exclusivity' of the WTO dispute settlement system can only be changed by *explicit amendments* amounts to claiming that WTO Members have also reduced their capacity to modify WTO law *inter partes*. In contrast, the wording of Article 23, in particular of paragraph 2, as well as the negotiating history, underline that the parties to the negotiations were more concerned with the prevention of *unilateralism*[350] than with possible (lawful) *inter se* modifications of Article 23, eg through the bi- or plurilateral establishment of overlapping international procedures. This criticism of the thesis advanced by Kwak and Marceau is also supported by the modest integrative ambitions of the WTO, in which, in the words of Shany, 'the value of jurisprudential coherence in international trade is important, but not as crucial as in regional economic integration'; therefore, the establishment of a 'watertight closed legal subsystem' does not appear necessary in the case of the WTO.[351] Hence, the arguments of Kwak and Marceau arguably do not suffice to call into question the proposition that WTO Members themselves are capable under international law of establishing competing

[347] Cf eg Y Shany, *The competing jurisdictions of international courts and tribunals* (2003) 183 with further references; see also the panel report, *US—Sections 301–310 of the Trade Act of 1974*, WT/DS152/R, adopted on 27 January 2000, para 7.43 (speaking of an 'exclusive dispute resolution clause'); Gonzalez-Calatayud and Marceau (n 327 above) 281; Kwak and Marceau (n 265 above) 8 and *passim*; D Kalderimis, 'Problems of WTO Harmonization and the Virtues of Shields over Swords' (2004) 13 Minn J Global Trade 305, text at fn 278–9; see also Marceau and Tomazos in St Griller (n 266 above).
[348] Kwak and Marceau (n 265 above) 12 (emphasis added); see also Marceau and Tomazos in St Griller (ed), *The WTO after Cancun* (working title, 2006 forthcoming); similarly Kalderimis (ibid) text at fn 278–9.
[349] Kwak and Marceau (n 265 above) 8.
[350] Shany (n 347 above) 185.
[351] Cf Shany (n 347 above) 185–6.

fora with non-exclusive or exclusive jurisdiction, as well as of excluding the jurisdiction of WTO adjudicating bodies *inter se*, as long as this is done in accordance with international law. However, since—as has been explained already—complying with international law in this respect notably requires that the rights of third WTO Members—in particular their procedural third party rights—must not be violated, this type of *inter se* modification will as a rule be difficult to achieve.[352]

VI. Conclusions

The preceding examination yields a surprising picture.

On the one hand, several DSU provisions have been invoked in the literature as support for arguments that non-WTO international law is part of the law to be applied by WTO adjudicating bodies. However, examination of these provisions has cast into doubt whether these provisions actually support such arguments with sufficient clarity. Thus, Articles 3.2 und 7 of the DSU do not necessarily have to be regarded as clauses incorporating non-WTO international law into WTO law, as they clearly are rather concerned with the interpretation and application of WTO law. For the same reason, it is not convincing that the clause 'to make such other findings' contained in Article 7 should necessarily be read as mandating WTO adjudicating bodies to apply non-WTO international law. Nor does it follow from Article 11 that this provision should be regarded as an implied powers clause.

On the other hand, for the reasons discussed in the preceding section, it is also doubtful that the DSU provisions invoked by authors advancing arguments *against* the applicability of non-WTO international law in WTO proceedings can be regarded as sufficiently buttressing such arguments.

Hence, in the light of this interpretative exercise, there arguably remains only one reliable main argument, which appears like a truism, and which militates in favour of *restricted applicability* of non-WTO international law in WTO proceedings, namely that, in the words of *Schoenbaum*,[353] 'WTO law is part of the larger corpus of public international law'. The point is not that this argument allegedly ensues from Article 11 of the DSU,[354] which is equivocal.

As the preceding discussion has demonstrated, the point is that there is no provision or clear indication to be found in the WTO agreements which would imply that WTO Members have actually contracted out of the fundamental principles regulating treaty modification and norm conflicts

[352] Cf above, section II.
[353] Schoenbaum (n 294 above) 653.
[354] As intimated by Schoenbaum (n 294 above) 653.

under international law. This is not to say that the results presented by authors taking more restrictive stances could not be reached at all, as this question remains one of interpretation. However, these stances appear problematic for the reason that arguably no sufficient arguments in their support appear to have been inferred from the very anchor of these rather WTO-centric views, that is from WTO law *itself*.

By contrast, the conclusions drawn from the above are, first, that it is not per se excluded that WTO obligations can be modified *inter se* to the extent that international law rules on treaty modification are not violated. Consequently, if Article 41 VCLT is complied with and the rights of third WTO Members are not infringed, WTO Members may in principle alter WTO law *inter partes*. As has been explained, these preconditions trace out a typology of the WTO provisions that come into question for lawful *inter se* modifications: these requirements normally render attempts to modify the institutional structure of the WTO *inter se* illegal, as such modifications will in particular affect the rights of third WTO Members. Regarding attempts to directly modify the jurisdiction of WTO adjudicating bodies, further distinctions will have to be drawn.[355] As respects substantive WTO obligations—(most of) which should be regarded as reciprocal obligations—*inter se* modifications are not per se precluded, to the extent that third WTO Members' rights are not negatively affected.[356] To the extent such lawful modification of substantive obligations of WTO law through non-WTO norms affects the claim-specific jurisdiction of WTO adjudicating bodies, they are required to take account of such rules. However, this is so only to the extent that such conflicting norms also have to be interpreted as being meant to prevail over WTO law pursuant to the established conflict principles of international law.[357] Moreover, rules contained in treaties that are *earlier* in time than the WTO treaty and more special than conflicting WTO rules have to be recognized as a valid defence, if such priority is supported by other relevant interpretative criteria[358] and if third WTO Members' rights are not infringed. In other words, the barriers to treaty modification and invokability of non-WTO law are derived both from international law, which provides the legal framework, *as well as* from WTO law, which sets out the concrete rights of third parties which must not be violated.

[355] Cf above, section II.
[356] Cf above, section II; cf also Pauwelyn (n 261 above) 71 who argues that some of the harmonization obligations arising under the TRIPs Agreement may have to be classified as integral obligations and as being immune to *inter se* modifications, therefore.
[357] Cf also Pauwelyn (n 267 above) 1003–5.
[358] On the view that there can be no general priority of the *lex posterior generalis vis à vis* the *lex prior specialis* cf above, ch 2, section I.E, where it has been submitted that the *lex specialis* and *lex posterior* principles are subordinate interpretative criteria that have to be balanced against other relevant indications of state intent.

It follows finally, but crucially, that WTO exception clauses such as Article XX of the GATT, WTO provisions incorporating non-WTO norms by reference, and waivers, are *not*, as would however necessarily ensue from most of the restrictive views, the unique or primary clauses opening up substantive WTO law *vis à vis* international law and legitimate non-trade concerns. In particular therefore, WTO Members are not required, under clauses like Article XX(b) of the GATT or Article XIV(b) of the GATS, to adopt the *least-trade restrictive means* to pursue non-trade objectives, *if* the general international law conditions for lawful modifications of substantive WTO law are met, *and if* the relevant norms in conflict with WTO law are designated as prevailing according to international law conflict principles.

PART II

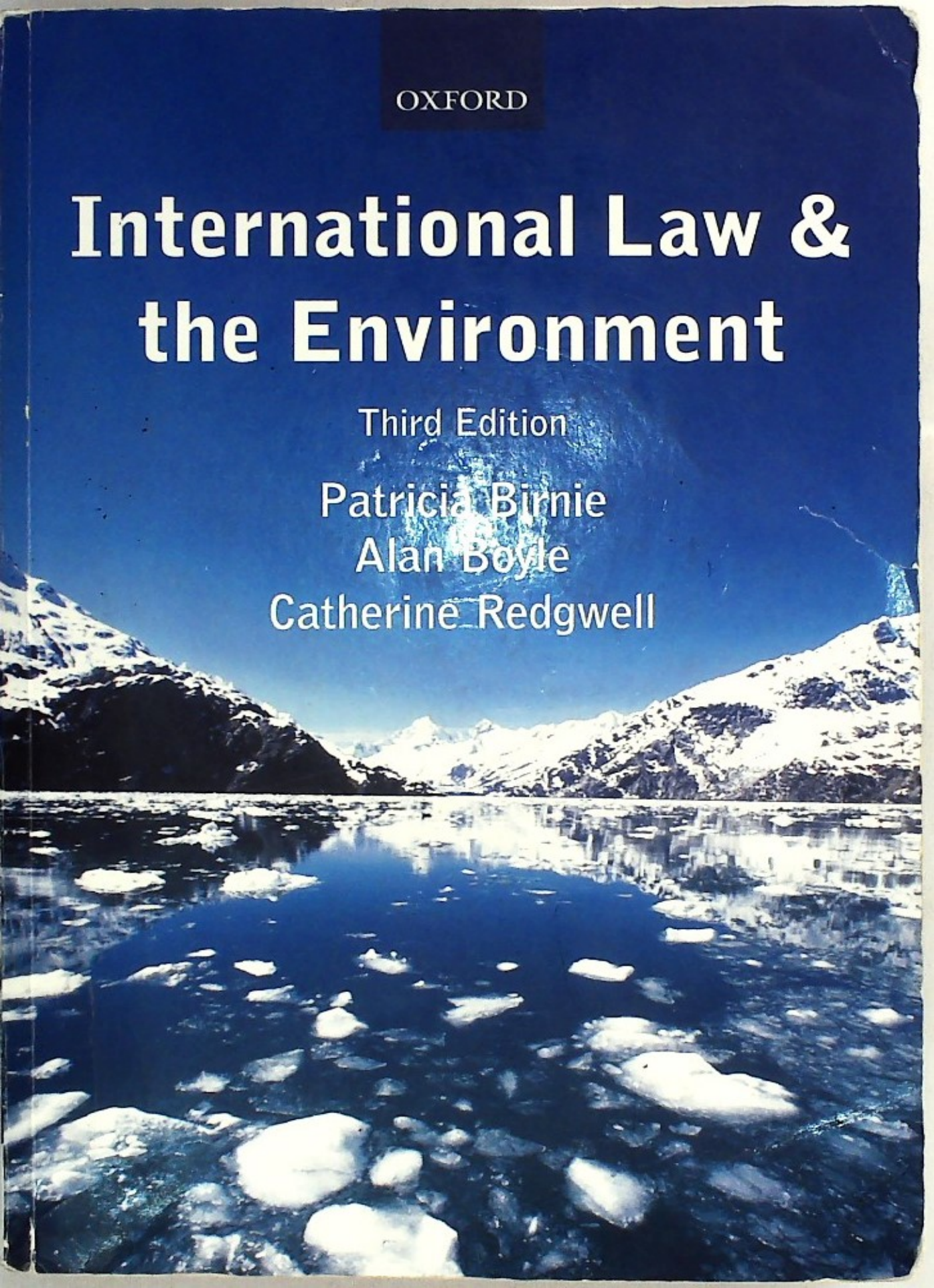
Further Issues in General International Law and Legal Theory: Extraterritorial Jurisdiction, Unilateralism, and Proportionality

This study now turns to examine three further problems that are central to the present topic, namely the concepts of extraterritorial jurisdiction, unilateralism, and proportionality. Efforts to protect the environment—particularly the global commons and the non-domestic environment more generally—are often discussed with reference to the conceptions of extraterritorial jurisdiction and unilateralism. This is true for the doctrinal debate on so-called process-based trade measures, through which a state restricts the import of given products on the basis of the manner in which they have been produced, but also for measures by which a state more directly seeks to regulate the behaviour of persons abroad.

The notions of extraterritorial jurisdiction and unilateralism overlap to some extent, but need to be distinguished nonetheless to increase clarity in legal reasoning. In view of the fact that their application is ordinarily seen as requiring the employment of similar concepts, such as that of sovereignty, non-intervention, and the disputed notion of balancing of interests, this part of the study will examine the conceptions of extraterritorial jurisdiction and unilateralism jointly. It will first concentrate on the issue of extraterritorial jurisdiction, and will then analyse the concept of unilateral state action against this clarified background.

The present part will also examine the legal status and contents of the principle of proportionality. This approach is adopted in view of the fact that this principle is regarded here as a method for rationally resolving conflicts of interests. Dealing with this concept in the context of extraterritorial jurisdiction and unilateralism not only helps in addressing

these two issues; but they in turn provide suitable illustrations for the functioning of this principle. At the same time, the following chapters will argue that the principle of proportionality has a considerably broader status and scope of application. The following considerations on the proportionality principle will therefore also serve as a basis for later chapters in Parts III and IV.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INTERNATIONAL TRADE AND ENVIRONMENTAL PROTECTION

1 INTRODUCTION

Promotion and liberalization of free trade in goods and services has been the objective of international trade law since the General Agreement on Tariffs and Trade (GATT) was first adopted in 1947.[1] Many states have subsequently become parties to what is now a complex system of international trade agreements based on GATT. Since the Marrakesh Agreement of 1994 entered into force these agreements have been administered by the World Trade Organization (WTO). The WTO now provides the principal forum for negotiations on multilateral trading relations among

[1] For texts of the 1947 GATT as amended in 1994, the 1994 Marrakesh Agreement Establishing the World Trade Organization, and related agreements, understandings, and decisions, see WTO, *The Legal Texts: The Results of the Uruguay Round of Multilateral Trade Negotiations* (Cambridge, 1999). On WTO law and policy see: Trebilcock and Howse, *The Regulation of International Trade*, (2nd edn, London, 1999); Jackson, *The World Trading System*, (2nd edn, Cambridge, Mass, 1997); Kreuger (ed), *The WTO as an International Organization* (Chicago, 1998); Jackson, *The World Trade Organization: Constitution and Jurisprudence* (London, 1998); Jackson, Davey, and Sykes, *Legal Problems of International Economic Relations* (5th edn, St Paul, Minn, 2008); Matsushita, Schoenbaum and Mavroidis, *The World Trade Organization: Law, Practice and Policy* (2nd edn, Oxford, 2006); Van den Bossche, *The Law and Policy of the World Trade Organization: Text, Cases and Materials* (2nd edn, Cambridge, 2008)

member states, and for the binding settlement of disputes arising under WTO agreements. These institutional and dispute settlement features of the WTO, contrasted with the decentralized and consensual dispute settlement features of international environmental agreements, have further fuelled the 'trade and environment debate' with the propsect that trade and environment disputes would inevitably fall for resolution before a trade body perceived to be inimical to environmental concerns.[2] In practice, however, this 'centrifugal pull' of the WTO has not resulted in a multitude of cases before the WTO dispute- settlement body arising from trade and environment conflicts. Nonetheless, as we discuss further below, though few in number the impact of the WTO's trade and environment cases has been significant, and reveals a more nuanced approach to environmental issues than that displayed by the pre-WTO GATT panel in *Tuna-Dolphin*.[3]

A policy of free trade will inevitably involve some conflict with international environmental agreements or environmental-protection requirements in national law that have the effect of restricting trade in certain goods. Although some commentators condemn free trade as generally bad for the environment,[4] most focus their critique on specific issues, arguing (i) that the rules of the multilateral trading system may pose difficulties for the implementation of multilateral environmental agreements that use trade restrictions to protect the environment, such as the 1973 Convention on Trade in Endangered Species, the 1987 Protocol for the Protection of the Ozone Layer, the 1989 Basel Convention on the Control of Transboundary Movement of Hazardous Wastes and the 2001 Rotterdam Convention on the Prior Informed Consent Procedure for Certain Hazardous Chemicals and Pesticides in International Trade (PIC Convention); (ii) that the rules of the multilateral trading system frustrate attempts to protect resources and the environment in areas beyond national jurisdiction (e.g. the oceans), as in the US–Mexico dispute concerning dolphin-friendly tuna-fishing regulations, or the similar attempt to protect sea turtles from shrimp fisheries; (iii) that the rules of the multilateral trading system prevent nations from adopting measures to protect their domestic environment, such as setting high environmental standards for products and services, labelling, packaging, recycling, and conservation of natural resources; and (iv) that the rules of the multilateral trading system obstruct efforts to compel other countries to adopt high environmental standards, although these may be necessary to prevent or correct transboundary pollution, to remove competitive advantages in attracting investment and in selling products and services, or to conserve natural resources. This chapter focuses on these issues.[5]

[2] For the flavour of this debate following the GATT Panel decisions in *Tuna-Dolphin*, see the contributions by Weiss and by Schoenbaum, 86 *AJIL* (1992) 700.

[3] *US—Restrictions on Imports of Tuna*, Report of the Panel, 30 *ILM* (1991), 1598, para 5.28 (not adopted by the GATT Council) (hereafter, '*Tuna-Dolphin I*'); see *infra*, section 4.

[4] Daly, 15 *Loyola ICLJ* (1992) 36. Compare OECD, *The Environmental Effects of Trade* (Paris, 1994), and GATT, *Trade and Environment* (Geneva, 1991).

[5] On trade and environment generally see: Esty, *Greening the GATT: Trade, Environment, and the Future* (Washington DC, 1994); Cameron, Demaret, Gerardin (eds), *Trade and Environment: The Search for Balance* (London, 1994); Petersmann, *International and European Trade and Environmental Law after the Uruguay Round* (The Hague, 1995); Wolfrum (ed), *Enforcing Environmental Standards: Economic Mechanisms as Viable Means* (Berlin, 1996); Van Calster, *International and EU Trade Law: The Environmental Challenge* (London, 2000); Steinberg, *The Greening of Trade Law* (New York, 2002); Sampson, *The WTO and Sustainable Development* (Tokyo, 2005); Goyal, *The WTO and International Environmental Law* (Oxford, 2006); Bernasconi-Osterwalder, *Environment and Trade: A Guide to WTO Jurisprudence* (London, 2006); Ward, 45 *ICLQ* (1996) 592; Schoenbaum, 91 *AJIL* (1997) 268; McRae, 9 *Otago LR* (1998) 221; Esty and Gerardin, 32 *JWT* (1998) 5; Trebilcock and Howse, *The Regulation of International Trade* (2nd edn, London, 1999) Ch 15; Scott, in Weiler (ed), *The EU, the WTO, and the NAFTA: Towards a Common Law of International Trade* (Oxford, 2000), Ch 5.

International policy does not seek to give free trade priority over environmental protection, but neither does it endorse any general exception for environmental purposes. Recognizing the potential for conflict, what is sought is balance between the two objectives. Thus the preamble to the 1994 Marrakesh Agreement Establishing the World Trade Organization acknowledges that expansion of production and trade must allow for:

> the optimal use of the world's resources in accordance with the objective of sustainable development, seeking both to protect and preserve the environment and to enhance the means for doing so in a manner consistent with their respective needs and concerns at different levels of economic development.

As we will see below, this preambular reference to 'the objective of sustainable development' has influenced the interpretation of the WTO-covered agreements, including the GATT in the *Shrimp-Turtle Case*.[6]

At the same time, Principle 12 of the Rio Declaration calls for states to cooperate to promote an 'open international economic system that would lead to growth and sustainable development in all countries'. It provides that 'Trade policy measures for environmental purposes should not constitute a means of arbitrary or unjustifiable discrimination or a disguised restriction on international trade'. Unilateral measures aimed at extraterritorial environmental problems are to be avoided, and 'environmental measures addressing transboundary or global environmental problems should, as far as possible, be based on an international consensus'. Since 1994 a number of important decisions of the WTO Appellate Body have helped clarify how this balance between free-trade agreements and environmental protection is to be achieved, but the WTO itself has been less successful in its search for better ways to integrate both concerns. Multilateral environmental agreements concluded since 1994 addressing transboundary or global environmental problems have likewise sought accommodation between trade and environmental concerns, though often merely repeating in preambular terms the exhortation to balance trade and environmental concerns. The Cartagena Protocol on Biosafety and the PIC Convention are recent examples.[7] This may be explained by the fact that, in environmental treaty negotiations, there is a risk attached to the consideration of the compatibility of trade-related environmental

[6] WTO Appellate Body Report, *US—Import Prohibition of Certain Shrimp and Shrimp Products*, WT/DS58/AB/R, adopted 6 November 1998, paras 152–3.

[7] For further discussion of the 'savings clauses' adopted in the PIC Convention and substantially duplicated in the Cartagena Protocol, see Safrin, 96 *AJIL* (2002) 606.

mechanisms (TREMS) with WTO rules at the design stage of MEAs since 'the potential for conflict with WTO rules is near deal-breaking in new MEA negotiations, as demonstrated by the difficulty in drafting the Biosafety Protocol, the Kyoto Protocol and the Rotterdam (PIC) Convention'.[8]

2 THE MULITLATERAL TRADING SYSTEM

2(1) THE WORLD TRADE ORGANIZATION

The World Trade Organization (WTO) came into existence on 1 January 1995[9] as the successor to the General Agreement on Tariffs and Trade (GATT), which had operated 'provisionally' since 1947. The WTO has legal personality and enjoys privileges and immunities 'similar to' those of a specialized agency of the United Nations.[10] With over 150 members, including China, the European Community, Japan, and the USA, together with many developing states, it provides a common institutional framework for the conduct of trade relations among its members.[11] The WTO oversees the implementation, administration, and operation of the 'Multilateral Trade Agreements' which are legally binding upon its members. In addition to the General Agreement on Trade in Goods (GATT), these Agreements include the General Agreement on Trade in Services (GATS), the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), the Agreement on Trade-Related Investment Measures (TRIMS), the Agreement on Technical Barriers to Trade (TBT Agreement), the Agreement on the Application of Sanitary and Phytosanitary Measures (SPS Agreement), the Agreement on Agriculture, and the Agreement on Subsidies and Countervailing Measures (SCM Agreement). As is discussed further below, trade-related environmental measures can fall for consideration under one or more of these agreements; in addition, most of them contain specific environmental exceptions, largely a product of the Uruguay round of negotiations from which the WTO emerged.[12]

[8] *Environment and Trade: A Handbook* (2000, New York, UNEP/IISD) 62. During negotiation of the 1992 Climate Change Convention, early drafts included a conflict clause which called for the decisions of the COP and other measures taken to combat climate change to be consistent with the GATT/WTO, but this did not find a place in the final text. For more recent analysis, including of the Kyoto mechanisms, see Green, 8 *JIEL* (2005) 143.

[9] 1994 Marrakesh Agreement Establishing the World Trade Organization (hereafter 'WTO Agreement'). For text see *supra*, n 1.

[10] Article VIII. [11] Article II.

[12] For example, like GATT, GATS contains an exception for measures 'necessary to protect human, animal or plant life, or health' (Article XIV (b)); similar wording is found in TRIPS Art 27.2 where a patent may be refused where preventing the domestic commercial exploitation of an invention is necessary to protect human, animal, or plant life or health or to avoid serious prejudice to the environment. Risk-assessment criteria under Article 5.2 of the SPS Agreement include 'ecological and environmental conditions' while Article 6.2 refers to 'ecosystems' as one factor members should consider in determining pest or disease free areas. Protection of the environment is also a recognized legitimite objective under the TBT Agreement (Article 2.2). The Agreement on Agriculture provides certain exceptions from its subsidy reduction obligations for environmental measures (Article 6.1 and Annex II, paras 2(a), 8(a),12); but the SCM Agreement's five-year exception for governmental assistance to industry to adapt to new environmental requirements has not been renewed, with the possibility that such subsidies are now actionable (Article 8.2(c))

The main organs of the WTO are a Ministerial Conference, a General Council, which also functions as the WTO's Dispute Settlement Body and Trade Policy Review Body, and Councils for Trade in Goods and Services, and Trade-Related Aspects of Intellectual Property Rights.[13] Each member has one vote,[14] and decisions are usually taken by consensus, but when that is not possible, a simple majority of votes cast is normally sufficient.[15] Certain decisions, such as interpretation of the multilateral trade agreements, waivers, and amendments and accessions, can be taken only by a specified majority vote.[16] The GATT, newly promulgated as 'GATT 1994', is the fundamental trade agreement administered by the WTO, and it is to this agreement and its impact on TREMs that we now turn.

2(2) PRINCIPAL WTO/GATT NORMS RELEVANT TO THE ENVIRONMENT

(a) The most-favoured-nation principle and the national treatment principle

At the core of the WTO/GATT system are two non-discrimination principles: the most-favoured-nation principle (MFN) and the national treatment principle. These non-discrimination mandates are essential for the full implementation of the Schedules of Concessions—lowered tariffs—which are binding obligations under GATT Article II.

The most-favoured-nation principle of Article I is designed to ensure equality of treatment of 'like product[s] originating or destined for the territories of all other contracting parties'. This equal treatment must be accorded 'unconditionally' and extends to (i) 'customs charges and duties', (ii) 'all rules and formalities connected with importation or exportation', and (iii) internal taxes, charges, and domestic regulation of a product's distribution, sale, and use. The MFN principle was considered in the *Belgian Family Allowances Case*,[17] which involved a law that levied a charge on foreign goods purchased by public authorities when the countries in which the goods originated did not administer a system of family allowances similar to that required under Belgian law. A GATT dispute-settlement panel concluded that the charge was illegal under GATT Article I and that even internal charges cannot discriminate between like products on the basis of distinctions between the production conditions in different countries.

The national treatment provision (GATT Article III) applies broadly to all 'internal' requirements applied to imported products, including taxes, charges, and all manner of regulations. The equality of treatment between domestic and imported

[13] Article IV. [14] Article IX(1). [15] Article IX(1). [16] Articles XI, X, XII.

[17] *Belgian Family Allowances (Allocations Familiales)*, GATT BISD (1st Supp), 59 (1953).

products required by this provision is delicately worded. For regulations, two standards must be met, one positive and one negative: they must be applied to imported products to accord 'treatment no less favourable than that accorded to like products of national origin',[18] and they must not be applied 'to afford protection to domestic production'.[19] For internal taxes and charges, two negative criteria apply: they must not be 'in excess of those applied, directly or indirectly, to like domestic charges',[20] or 'applied to imported or domestic products so as to afford protection to domestic production'.[21] In the two leading cases concerning these provisions, *Japan Shochu* and *Asbestos*, the WTO Appellate Body noted that 'there can be no one precise and absolute definition of what is like', but that the general principle of Article III 'seeks to prevent members from affecting the competitive relationship, in the marketplace, *between the domestic and imported products involved*, so as to afford protection to domestic production'.[22]

Important questions arise in connection with this scheme. One is whether the phrase 'laws, regulations, and requirements' in Article III is limited to the conditions of purchase or sale of products in the domestic market. The *Italian Agricultural Machinery Case* rejected this view, holding that 'the Article was intended to cover... not only the laws and regulations which directly governed the conditions of sale or purchase, but also any laws or regulations which might adversely modify the *conditions of competition* between the domestic and imported products on the internal market'.[23] Subsequent GATT panels have extended this interpretation to hold that the test of the words 'treatment no less favourable' in Article III(4) is whether imported products are given an equal chance to compete with domestic products: 'treatment no less favourable... call[s] for effective equality of opportunities in respect of the application of laws, regulations, and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution, or use of products'.[24]

Just as Articles I and III are paired *in pari materia* in this respect, so, too, is the GATT's quota provision, Article XI, in relation to both articles. Article XI states:

> 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.

[18] 1994 General Agreement on Tariffs and Trade (hereafter 'GATT 1994'), Article III(4).
[19] Article III(1). [20] Article III(2). [21] Article III(1).
[22] *Japan—Taxes on Alcoholic Beverages*, Appellate Body Report, WTO Doc AB-1996-2 (1996) 17–25 ['*Japan Shochu Case*']; *EC—Measures Affecting Asbestos and Asbestos-Containing Products*, WT/DS135/AB/R (2001) paras 87–100 ['*Asbestos Case*'].
[23] *Italian Discrimination against Imported Machinery*, GATT BISD (7th Supp) 60, para 12 (1959).
[24] *US—Section 337 of the Tariff Act of 1930*, 7 Nov 1989, GATT BISD (36th Supp), 345, para 5.1.1 (1990). This ruling means that the actual economic impact of a discriminatory measure or tax is irrelevant: see *US—Taxes on Petroleum and Certain Imported Substances*, GATT BISD (34th Supp), 136, para 5.19 (1988) (hereafter '*US Superfund*').

Article XI concerns more than just quotas. It also extends to 'other measures... instituted or maintained on the importation... or exportation... of any product'. The word 'measures' in this formulation was interpreted in the *Japan Semi-Conductor Case* to refer not only to laws and regulations, but also, more broadly, even to non-mandatory government involvement.[25] Thus, Article XI is comprehensive in scope; it deals with everything other than fiscal matters.

As for the relationship between Articles III and XI, in the *Canada Foreign Investment Review Act Case*,[26] the GATT dispute-resolution panel interpreted Article XI as regulating only measures affecting the importation (or exportation) of a product, not internal requirements affecting imported products, which are left to Article III. This mutual exclusivity of Articles III and XI often presents difficulty and can be understood only in the context of the correct methodology for applying the tests of the two articles. The measure in question should *first* be analysed as to whether it is protected by Article III. If it fails the tests of Article III, then Article XI is automatically applicable and, unless it falls under one of the narrow exemptions in that article, the measure will violate the GATT. One such exception is import restrictions on agricultural or fisheries products that are necessary for the enforcement of certain governmental measures.[27]

(b) GATT environmental exceptions

The 'General Exceptions' provision of the GATT, Article XX,[28] constitutes conditional exceptions to GATT obligations, including those in Articles I, III, and XI. Although the word 'environment' is not used,[29] Article XX may be applied to justify certain environmentally inspired rules that affect free trade. The pertinent wording of Article XX is 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

[25] *Japan—Trade in Semi-Conductors*, GATT BISD (35th Supp) 115, paras 106–9 (1989). The panel set out a two-part test for determining whether non-mandatory government requests could be regarded as 'measures' within Article XI: (i) whether there were sufficient incentives for the requests to take effect; and (ii) whether the operation of the measures was dependent on government action. Non-binding 'administrative guidance' by the Japanese government was ruled in the *Semi-Conductor Case* to be within Article XI.
[26] *Canada—Administration of the Foreign Investment Review Act*, GATT BISD (30th Supp) 140, para 5.14 (1984).
[27] Article XI(2) excepts three types of measures from the prohibition of Article XI(1), the other two being export restrictions to relieve critical shortages of foodstuffs and other products 'essential' to the exporting contracting party, and import or export restrictions necessary to the application of standards for grading or classifying commodities.
[28] As indicated above, a virtually identical 'General Exception' appears in Article XIV GATS.
[29] The word 'environment', meaning nature and the natural world, came into current use only in the 1960s. The GATT, drafted in 1947, uses the older term, 'natural resources': GATT 1994, Article XX(g). For detailed discussion of the drafting history of the environmental exceptions in Article XX, see Charnovitz, 25 *JWT* (1991) 37.

Agreement shall be construed to prevent the adoption or enforcement by any contracting party of measures:

...

(b) necessary to protect human, animal or plant life or health;...

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

The burden of showing that an Article XX exception applies is placed upon the party asserting it as a defence.[30] This burden has not often been discharged, largely because of the strictness with which its provisions are interpreted. An understanding of Article XX requires careful interpretation.

(i) The chapeau The entire catalogue of exceptions under Article XX is qualified by an introductory clause commonly termed the *chapeau*. Even if a measure otherwise falls within one of the exceptions in Article XX, it would be illegal under the *chapeau* if it constitutes (i) arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or (ii) a disguised restriction on international trade. In 1996, the significance of the *chapeau* was emphasized by the WTO Appellate Body in the *US Gasoline Standards* decision.[31] This case involved the reformulated and conventional gasoline programmes established under the Clean Air Act Amendments of 1990. Both programmes required changes in the composition of gasoline sold to consumers, using 1990 as a baseline year. The baseline establishment rules of the Environmental Protection Agency (EPA), however, distinguished between foreign and domestic producers and refiners: domestic refiners were permitted to establish individual 1990 baselines, but foreign refiners generally were not allowed to do so and were required instead to use a statutory baseline established by the EPA. The WTO Appellate Body found that the measure could be justified under Article XX(g) but that it nonetheless constituted 'unjustifiable discrimination' and a 'disguised restriction on international trade' contrary to the *chapeau*. It noted that the USA could have avoided the discrimination involved in the baseline rules in two ways: either by imposing statutory baselines on both domestic producers and importers, or by making individual baselines available to all. The Appellate Body rejected the reasons the USA set forth for not following one of these options: administrative difficulties and problems of verification and enforcement. Thus, the Appellate Body interpreted the *chapeau* as invalidating a measure that otherwise meets the requirements of Article XX if it involves unjustified or arbitrary discrimination; and such discrimination tends to show that a measure is a 'disguised' trade restriction as well.

(ii) Article XX(b) Interpreting Article XX(b) commonly requires a three-step analysis. First, does the measure in question protect human, animal, or plant life or health?

[30] *Canada—Administration of the Foreign Investment Review Act*, *supra*, n 26, para 5.20.

[31] *US—Standards for Reformulated and Conventional Gasoline*, Report of the Appellate Body, WT/DS2/AB/R (1996); 35 *ILM* (1996) 274 ['*US Gasoline Standards Case*'].

Second, is the measure for which the exception is being invoked *necessary* for this purpose? Third, is the measure applied consistently with the *chapeau*, avoiding arbitrary or unjustifiable discrimination and/or a disguised restriction on international trade?[32] The Appellate Body has held that a measure is 'necessary' under Article XX(b) if no GATT-consistent alternative is reasonably available and provided it entails the least degree of inconsistency with other GATT provisions.[33]

(iii) Article XX(g) Article XX(g) is an important GATT exception designed to allow WTO members to take action to conserve exhaustible natural resources. It contains four separate requirements: (i) that the measures for which the provision is invoked concern 'exhaustible natural resources' ; (ii) that these measures are related to the 'conservation' of those resources; (iii) that the measures are made effective in conjunction with restrictions on domestic production or consumption; and (iv) that the measures are applied in conformity with the requirements of the *chapeau* of Article XX.[34]

What is obvious from this brief preliminary discussion is that the GATT Agreement does not provide a simple or straightforward framework for resolving conflicts between free trade and environmental protection. Both the interpretation of Article XX and its application to multilateral environmental agreements have proved difficult in practice. These problems and the central dilemma of how to reconcile competing social and economic values have been addressed through two WTO institutions: the Committee on Trade and Environment, and the Dispute Settlement Body. It is also intended to be addressed in the current Doha round of trade negotiations, still ongoing as of mid-2008, with paragraph 31(i) of the Doha Ministerial Declaration, adopted in 2001, committing WTO members to negotiate on the relationship between WTO rules and 'specific trade obligations' set forth in MEAs.[35]

2(3) THE COMMITTEE ON TRADE AND ENVIRONMENT

At the meeting held to sign the Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations in Marrakesh on 14 April 1994, the GATT contracting parties adopted a Ministerial Decision that formally established a new

[32] See the *Asbestos Case*, *supra*, n 22, paras 155–75, and *infra*, section 4(3).

[33] Ibid, paras 164–75.

[34] E.g., *US Gasoline Standards Case*, *supra*, n 31, where the Appellate Body held that clean air is an exhaustible natural resource. See section 4, *infra*.

[35] Para 31(i) instructs WTO Members to negotiate on 'the relationship between existing WTO rules and specific trade obligations set out in multilateral environmental agreements (MEAs). The negotiations shall be limited in scope to the applicability of such existing WTO rules as among parties to the MEA in question. The negotiation shall not prejudice the WTO rights of any Member that is not a party to the MEA in questions.' Paragraph 31(ii) is addressed to 'procedures for regular information exchange between MEA Secretariats and the relevant WTO committees, and the criteria for the granting of observer status' while the final paragraph addresses 'the reduction or, as appropriate, elimination of tariff and non-tariff barriers to environmental goods and services'. These negotiations take place in special sessions of the CTE, with proposals submitted by WTO members available at <http://www.wto.org>.

Committee on Trade and Environment (CTE)[36] under the auspices of the World Trade Organization. The CTE was charged with making appropriate recommendations on 'the need for rules to enhance the positive interaction between trade and environment measures for the promotion of sustainable development'. It was asked to address the following matters:

(1) the relationship between the provisions of the multilateral trading system and trade measures for environmental purposes, including those pursuant to multilateral environmental agreements

(2) the relationship between environmental policies relevant to trade and environmental measures with significant trade effects and the provisions of the multilateral trading system

(3) the relationship between the provisions of the multilateral trading system and:
   (a) charges and taxes for environmental purposes
   (b) requirements for environmental purposes relating to products, including standards and technical regulations, packaging, labelling and recycling

(4) the provisions of the multilateral trading system with respect to the transparency of trade measures used for environmental purposes and environmental measures and requirements which have significant trade effects

(5) the relationship between the dispute settlement mechanisms in the multilateral trading system and those found in multilateral environmental agreements

(6) the effect of environmental measures on market access, especially in relation to developing countries, in particular to the least developed among them, and environmental benefits of removing trade restrictions and distortions

(7) the issue of exports of domestically prohibited goods

(8) the relevant provisions of the Agreement on Trade-Related Aspects of Intellectual Property Rights

(9) the work programme envisaged in Decision on Trade in Services and the Environment

(10) input to the relevant bodies in respect of appropriate arrangements for relations with intergovernmental and non-governmental organizations.[37]

There has been little progress in the CTE on these issues. Directed by the Marrakesh decision to report to the first WTO Ministerial Conference in Singapore in 1996, this first report of the Committee[38] is primarily a compilation of the debates within the CTE and the views of its members. There is very little analysis and evaluation and

[36] *Trade and Environment*, GATT Ministerial Decision of 14 April 1994, 33 *ILM* (1994) 1267. See Charnovitz, 8 *YbIEL* (1997) 98, 106ff and Shaffer, in Steinberg (ed), *The Greening of Trade Law* (Rowman and Littlefield Publishers, 2002) 81–114.

[37] GATT Ministerial Decision, 1994, 1267–9.

[38] WTO Doc WT/CTE/1 (1996) (hereafter 'CTE Report').

virtually no recommendations for specific actions.[39] Seen in its best light, the report provided a foundation for future progress, confirming the need for transparency, cooperation and the determination to accommodate environmental values. This is reflected in the final declaration of the Singapore Ministerial Conference giving the CTE a mandate to continue its work.[40]

Since 1996, the CTE has not taken any concrete decisions on how to reconcile trade and environmental concerns. Its output has been meager, with annual reports notable principally for their brevity.[41] Its significance lies rather in the 'institutionalization of environmental issues into WTO processes' which it symbolizes, and the opportunity its meetings afford for 'socialization' between trade officials and representatives of selected MEAs.[42] Substantive progress in the CTE remains blocked, however, principally because there remain deep divisions between the most economically developed members, such as the EC and the USA, which support introducing environmental values more explicitly into trade agreements, and the majority of developing member states, who see this as a cover for discrimination against their products.[43] There are also growing differences between the EC and the USA over such matters as the precautionary principle, most recently reflected in the *EC—Biotech* dispute over GMOs. The cumbersome WTO decision-making process, relying on consensus, virtually assures continuing deadlock in meetings of the parties. Thus it is principally in the WTO Appellate Body that some progress has been made in meeting environmental concerns, most notably in the *Shrimp-Turtle* and *Asbestos* decisions considered below.[44]

2(4) WTO DISPUTE SETTLEMENT[45]

One of the great strengths of the WTO is the system of compulsory binding dispute settlement created by the Understanding on Rules and Procedures Governing the

[39] The report summarizes the result of two years of deliberations as follows: 'Work in the WTO on contributing to build a constructive policy relationship between trade, environment and sustainable development needs to continue': Ibid, 47.

[40] Singapore Ministerial Declaration, para 16, WTO Doc WT/MIN(96)/DEC/W (1996), 36 *ILM* (1997) 218, 224.

[41] See Charnovitz, 10 *JIEL* (2007) 685, 687 On the other hand, the WTO Secretariat's Trade and Environment Division has published background papers (e.g. WTO Special Studies, *Trade and Environment* (Geneva, 1999)) and a widely cited 1999 Report on Trade and Environment, *Report of the Committee on Trade and Environment*, WT/CTE/4 (1999).

[42] Ibid.

[43] See *Report of the Committee on Trade and Environment*, WT/CTE/4 (1999) and WTO Special Studies, *Trade and Environment* (Geneva, 1999).

[44] *US—Import Prohibition of Certain Shrimp and Shrimp Products*, WT/DS58/AB/R (1998); *European Communities—Measures Affecting Asbestos and Asbestos-Containing Products*, WT/DS135/AB/R (2001). See *infra*, sections 3, 4.

[45] See Petersmann, *The GATT/WTO Dispute Settlement System* (The Hague, 1997); Palmeter and Mavroidis, *Dispute Settlement in the World Trade Organization: Practice and Procedure* (The Hague, 1999); Trebilcock and Howse, *The Regulation of International Trade* (2nd edn, London, 1999) Ch 4; Matsushita, Schoenbaum and Mavroidis, *The World Trade Organization: Law, Practice and Policy* (2nd edn Oxford, 2006) Ch 2.

Settlement of Disputes adopted in 1994.[46] The WTO dispute-settlement system is administered by the Dispute Settlement Body (DSB). Disputes between members arising under the Multilateral Trade Agreements ('covered agreements') are first remitted to consultations,[47] but if these are not successful, may be adjudicated by panels and appealed to an Appellate Body.[48] Decisions must be implemented by the parties within a reasonable period of time, normally not more than fifteen months from the date of adoption of a panel or Appellate Body Report.[49] In the event of non-compliance, a member can be subjected to sanctions in the form of compensation and suspension of concessions.[50]

This system of dispute settlement is neither self-contained nor static, although the jurisdiction of the DSB extends only to matters arising under the 'covered agreements'.[51] In interpreting WTO agreements the Appellate Body has followed the general rule codified in Article 31(3) of the 1969 Vienna Convention on the Law of Treaties that account may be taken of 'any relevant rules of international law applicable in the relations between the parties'.[52] Since these rules necessarily develop over time, the interpretation given to provisions of WTO agreements is not static but evolutionary. Thus, in the *Shrimp-Turtle* decision, the Appellate Body referred, inter alia, to the 1992 Rio Declaration on Environment and Development, the 1982 UNCLOS, the 1973 CITES Convention, the 1979 Convention on Conservation of Migratory Species, and the 1992 Convention on Biological Diversity. Rather than interpreting GATT Article XX(g) ('exhaustible natural resources') in accordance with whatever might have been the intention of the drafters in 1947, the Appellate Body took account of these much later and directly relevant agreements. In this respect it was following the approach adopted by the International Court of Justice in the *Gabčíkovo-Nagymaros Case* when that Court read the 1977 treaty between Hungary and Czechoslovakia in conjunction with subsequent developments in international environmental law. However, in the more recent *EC—Biotech* decision, the Panel interpreted 'rules of

[46] Hereafter the 'DSU'. See also 1947 GATT, Articles XXII–XXIII and 1994 Agreement Establishing the World Trade Organization, Annex 2, in WTO, *Legal Texts*, *supra*, n 1.

[47] DSU, Article 4. Alternative dispute settlement procedures such as conciliation, good offices, mediation, and arbitration also may be employed: see Articles 5, 25.

[48] DSU, Articles 6, 17.

[49] DSU, Article 21. Reports of the panels and Appellate Body must be adopted unless there is a consensus against.

[50] DSU, Article 22. For an assessment of the effectiveness of WTO remedies, see Mavroidis, 11 *EJIL* (2000), 763.

[51] DSU, Articles 2–3. See, generally, Pauwelyn, *Conflict of Norms in Public International Law, How WTO Law Relates to other Rules of International Law* (Cambridge, 2003).

[52] See Sands, in Boyle and Freestone (eds), *International Law and Sustainable Development* (Oxford, 1999) Ch 3; Howse, in Weiler (ed), *The EU, the WTO and the NAFTA* (Oxford, 2000) 55–9; Boyle, in Bodansky, Brunnee and Hey (eds), *The Oxford Handbook of International Environmental Law* (Oxford, 2007) 136–8. On Article 31(3)(c) see McLachlan, 54 *ICLQ* (2005) 279;on the use of environmental agreements thereunder see French, 55 *ICLQ* (2006) 281; and see *supra*, Ch 3.

international law applicable' to mean those treaties applicable between all parties, and thus declined to use the Biodiversity Convention and Cartagena Protocol.[53]

Most importantly, Article 3(2) of the WTO Dispute Settlement Understanding expressly provides that the existing provisions of the 'covered agreements' are to be clarified 'in accordance with customary rules of interpretation of public international law'.[54] In a major break with pre-1994 GATT jurisprudence, the Appellate Body has made it clear that this means interpreting WTO agreements in accordance with international law on interpretation of treaties, as codified in Articles 31–3 of the Vienna Convention, and not in accordance with specific GATT canons of interpretation. The importance of this change in helping resolve trade-environment conflicts cannot be understated. As one author observes:

> the very decision to follow these general public international law interpretative norms enhances the legitimacy of the dispute settlement organs in adjudicating competing values—because these norms are common to international law generally, including regimes that give priority to very different values, and are not specific to a regime that has traditionally privileged a single value, that of free trade.[55]

The Appellate Body's more consistent and internationally principled approach to interpretation, and the reference to sustainable development in the preamble to the 1994 GATT, have helped it move away from the more rigidly free trade focus of earlier GATT panel awards, such as the *Tuna-Dolphin Cases*. It has thus been able to begin the task of developing a new and more environmentally nuanced jurisprudence, in a manner which appears to justify the decision taken at Marrakesh in 1994 to create a more formally judicial dispute-settlement machinery. It should be noted that it has done so without the requirement for specific environmental expertise within the Appellate Body.[56] There is no provision in the Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU) for panels adjudicating environmental cases to have specific environmental expertise, in contrast with, for example, the requirement that panels adjudicating 'prudential issues and other financial matters' under GATS have the necessary financial services expertise.

[53] Panel Report, *European Communities—Measures Affecting the Approval and Marketing of Biotech Products*, WT/DS291/R, WT/DS292/R, WT/DS293/R, adopted 21 November 2006, paras 7.70–7.95, hereafter *EC—Biotech*. For analysis on this point see Young, 56 *ICLQ* (2007) 907.

[54] These are codified in Articles 31–3 of the Vienna Convention. On treaty interpretation under the Vienna Convention see Sinclair, *The Vienna Convention on the Law of Treaties* (Manchester, 1984) 114–58 and Aust, *Modern Treaty Law and Practice* (Cambridge, 2000) Ch 13.

[55] Howse, in Weiler (ed), *The EU, the WTO and the NAFTA* (Oxford, 2000) 54. See also Palmeter and Mavroidis, *Dispute Settlement in the World Trade Organization: Practice and Procedure* (The Hague, 1999) 84–5; Nichols, 36 *VJIL* (1996) 379, 434–5.

[56] However, it has been noted that the presiding Judge in the Appellate Body which reversed WTO panel holdings which 'threatened to render the environmental exceptions unusable' in *US Gasoline Standards*, *Shrimp-Turtle* and *EC-Asbestos Cases* was Florentino Feliciano: see Charnovitz, 10 *JIEL* (2007) n 53; see also Jackson, in Charnovitz, Steger and van den Bossche (eds), *Law in the Service of Human Dignity. Essays in Honour of Florentino Feliciano* (Cambridge, 2005).

An issue considered by the CTE, but not yet by the Appellate Body, is what is the most appropriate forum for the settlement of a dispute over trade that arises in connection with a multilateral environmental agreement? The CTE's view is that, in the first instance, such disputes should be resolved through the mechanisms established by the multilateral environmental agreement, rather than through WTO procedures. In practice, however, this solution is largely illusory because, as we saw in Chapter 4, dispute settlement under multilateral environmental instruments is rarely compulsory or binding, and generally requires the agreement of the parties. Disputes involving trade and environment agreements have thus arisen, so far, only in compulsory proceedings before the WTO Dispute Settlement Body[57] and, as we discuss below, exclusively in the context of unilateral action by states.

3 MULTILATERAL ENVIRONMENTAL AGREEMENTS AND TRADE RESTRICTIONS

Nonetheless there remains a question of paramount importance: how will the WTO/GATT system accommodate multilateral environmental agreements (MEAs) that employ trade restrictions?[58] Leading examples of such MEAs include the Montreal Protocol on Substances that Deplete the Ozone Layer,[59] which adopts trade controls that are more restrictive as to non-parties than parties; the Convention on International Trade in Endangered Species (CITES),[60] which regulates imports and exports in certain species of animals and plants and allows punitive trade restrictions to be imposed on non-complying parties; and the Basel Convention on the Control of Transboundary Movements of Hazardous Wastes,[61] which prohibits exports and imports of hazardous and other wastes by parties to the Convention to and from non-party states.

[57] To date only three environmental disputes have been fully completed under the WTO's dispute settlement process: *US Gasoline Standards* (1996), *Shrimp-Turtle* (1998) and *EC-Asbestos* (2001). But see the parallel ITLOS/WTO proceedings in Chile–EC: *Case Concerning the Conservation and Sustainable Exploitation of Swordfish Stocks in the South-Eastern Pacific Ocean*, ITLOS No 7, Order No 2000/3 (2000), and EC–Chile: *Measures Affecting the Transit and Importation of Swordfish* (WTO, 2000) (WT/DS193). The 1982 LOSC remains the only agreement with environmental provisions whose interrelationship with WTO law has been explored by an international tribunal.

[58] See Cameron and Robinson, 2 *YbIEL* (1991) 3; Tarasofsky, 7 *YbIEL* (1996) 52; Brack, 9 *YbIEL* (1998) 13; and references in n 3 above. The WTO Secretariat has identified a least 14 MEAs which contain trade-related measures: Note by the Secretariat, *Matrix on Trade Measures Pursuant to Multilateral Trade Agreements*, WT/CTE/W/160/Rev 3 TN/TE/S/5/Rev 1, 16 February 2005.

[59] See *supra*, Ch 10. The question has also been raised whether the Multilateral Fund established under the Protocol amounts to an actionable subsidy contrary to the SCM Agreement: Benitah, *Subsidies, Services and Sustainable Development* (Geneva, 2004) 23 (in the context of GATS); Goyal, *The WTO and International Environmental Law; Towards Conciliation* (New Delhi, 2006) Ch 5.

[60] See *supra*, Ch 12.

[61] See *supra*, Ch 8.

No WTO/GATT dispute-resolution panel yet has directly addressed the conformity of any MEA trade restrictions with GATT rules. However, the validity of some MEA trade restrictions is at least doubtful, in particular those involving process and production methods, discrimination between parties and non-parties, and extra-territorial application.[62] The question of conformity between MEAs and the GATT was heightened by the promulgation of GATT 1994 and the creation of the WTO. These events reset the GATT from 1947 to 1994, theoretically allowing the GATT to trump any inconsistent provisions of an earlier MEA, even between parties that are parties to both treaty regimes.[63] Different solutions may be suggested according to whether the incompatibility arises between, say, a measure under the 1997 Kyoto Protocol and the GATT 1994, than for the 1973 CITES and GATT 1994. Further complexities arise due to the flexible nature of many environmental treaties, with subsequent amendment and use of additional trade-restrictive mechanisms (e.g. non-compliance procedures) rendering a 'one stop shop' approach to treaty interpretation insufficient to address the trade and environmental conflicts which may arise. As the Montreal Protocol[64] experience reveals, even where the trade/environment interface is addressed at the treaty design stage, the dynamic and evolutive character of contemporary MEAs requires some degree of ongoing monitoring of the potential for conflict. The provisions of the 1987 Montreal Protocol were submitted to the GATT Secretariat for an opinion (not binding either on the Parties to the GATT nor to the Montreal Protocol). Not addressed at that time was the design of the non-compliance procedure under the Protocol, which only came into operation in 1992 following further adjustments to the Protocol. Included within the list of indicative measures in response to non-compliance with the Protocol is the suspension of trading privileges under Article 4. In practice the decisions on non-compliance have generally relied on facilitative measures to assist in a return to compliance, but with the suspension of trading privileges held out as a possible further measure. This was threatened against Russia, which evidently gave consideration to remitting the non-compliance measures taken against it to the GATT/WTO for an assessment of their compatibility.[65]

Were such a challenge to be mounted, as a general matter it should be reinforced that both the WTO Committee on Trade and Environment and the Appellate Body are not 'anti-MEA'. The CTE has endorsed 'multilateral solutions based on international cooperation and consensus as the best and most effective way for governments to tackle environmental problems of a transboundary or global nature'.[66] The GATT panel in the *Tuna-Dolphin I Case* stated that dolphins could be protected through 'international cooperative arrangements'.[67] The WTO dispute-settlement panel and the Appellate Body in the *Shrimp-Turtle Case* expressed strong favour for MEAs as well, with the latter encouraging the USA to seek international agreement on turtle conservation

[62] See Wold, 16 *Envtl L* (1996) 841.

[63] For further discussion see *supra*, Ch 1.

[64] See *supra*, Ch 10.

[65] Werksman, 56 *ZAÖRV* (1996) 750.

[66] CTE Report, *supra*, n 38, para 171.

[67] *US—Restrictions on Imports of Tuna*, Report of the Panel, 30 *ILM* (1991) 1598, para 5.28 (not adopted by the GATT Council) (hereafter, '*Tuna-Dolphin I*').

and tolerant of the time-scale required to achieve such agreement.[68] Nonetheless, it is difficult to predict how a WTO panel would rule on particular MEAs. Thus, there is the need to clarify their legal status.

There are four basic ways in which the WTO could address the relationship between GATT and multilateral environmental agreements. First, each MEA could be examined on a case-by-case basis using Article IX(3) of the Agreement Establishing the World Trade Organization. This provision allows waiver of any obligation under 'exceptional circumstances' by vote of a three-fourths majority of the member states. For several reasons this solution seems unsatisfactory. The WTO would abdicate from setting criteria to influence MEAs and thus states would have no prior guidance when framing them. Moreover, the test of 'exceptional circumstances' is unduly vague. Approval under the waiver provision would be a political decision rather than one on the substance of the case. Furthermore, the status of MEAs would be doubtful until they had received the *ex post* blessing of a waiver.

A second possible solution is to follow the approach of the North American Free Trade Agreement (NAFTA), which provides that certain MEAs (such as the Montreal Protocol, CITES, and the Basel Convention) take precedence over NAFTA obligations.[69] This clarifies the status of certain existing MEAs, but does not provide a process for the addition of future MEAs so remains dependent on the agreement of all three NAFTA parties (Canada, USA, and Mexico) Furthermore, an ad hoc approach such as this may be workable for an organization of three states, but may not be for the WTO.

Two additional alternatives are either to amend Article XX by adding a provision on MEAs, or to adopt a collective interpretation[70] of Article XX, that would validate existing MEAs and provide for notification of future MEAs as well as setting out criteria, a 'safe harbour', they would have to fulfil to receive approval.[71] A model for MEAs might be GATT Article XX(h), which creates an exception for trade measures imposed pursuant to obligations in international commodity agreements that are otherwise illegal under the GATT. Article XX(h) sets out two methods of approval: first, commodity agreements that conform to specified criteria are valid automatically; second, other commodity agreements can be validated on an ad hoc basis if they are submitted to the GATT contracting parties and not disapproved. Hudec advocates a similar GATT

[68] *US—Import Prohibition of Certain Shrimp and Shrimp Products*, Report of the Panel, WT/DS58/R (1998), para 50; Report of the Appellate Body, WT/DS58/AB/R (1998) 68–9 ['*Shrimp-Turtle Case*']. On the failure to achieve a negotiated solution, see *US—Shrimp, Recourse to Art 21.5 of the DSU by Malaysia*, Report of the Appellate Body, WT/DS58/AB/RW (2001).

[69] 1992 North American Free Trade Agreement, Article 104(1), 32 *ILM* (1993) 296, 605. See Abbott, in Weiler (ed), *The EU, the WTO and the NAFTA: Towards a Common Law of International Trade* (Oxford, 2000) Ch 6.

[70] An interpretation can be adopted by a three-quarters majority vote of the WTO Ministerial Conference: WTO Agreement, Article IX (2) *supra*, n 1.

[71] These ideas are discussed in Rege, 28 *JWT* (1994) 95, 124–9; and in Hudec and Bhagwati (eds), *Fair Trade and Harmonization* (Cambridge, Mass, 1996) ii, 120–42. See also Charnovitz, 26 *EPL* (1996) 163.

amendment for MEAs.[72] Such an amendment[73] might provide (i) that negotiation of the MEA shall be under the auspices of the United Nations Environment Programme (UNEP) or a similar organization, and accession shall be open to all states that have a legitimate interest in the environmental problem addressed; (ii) that the problem dealt with must relate to serious environmental harm; (iii) that there be a reasonable relationship between the trade restrictions adopted and the object and purposes of the MEA; and (iv) that the MEA must be formally notified to the WTO. This would effectively immunize current and future MEAs from attack under WTO/GATT rules.

The likelihood of any of these changes being adopted is minimal, however, because of the deadlock in the CTE. Thus, it seems most probable that the task of reconciling MEAs with the GATT will primarily be a matter for the WTO dispute-settlement panels and the Appellate Body to resolve. In the *Shrimp-Turtle* decision the Appellate Body clearly upheld the right of WTO members to legislate for the protection of natural resources beyond national boundaries, provided they do so pursuant to an MEA. In coming to this conclusion, it adopted an interpretation of GATT Article XX which would permit MEAs in appropriate circumstances to derogate from GATT obligations.[74] This important decision, and its more controversial predecessors, are considered in the following section.

4 TRADE RESTRICTIONS TO PROTECT RESOURCES BEYOND NATIONAL JURISDICTION

4(1) UNILATERAL TRADE SANCTIONS UNDER 1947 GATT

Whether there is scope under GATT for unilateral state action to protect resources or the environment in areas beyond national jurisdiction was first addressed by the celebrated *Tuna-Dolphin I Case*[75] decided by a GATT panel in 1991. Acting under the Marine Mammal Protection Act (MMPA), the USA had banned imports of yellow fin tuna caught using methods that also kill dolphins, a protected species under the MMPA. Upon Mexico's complaint to the GATT, a dispute-settlement panel found that the US tuna embargo violated GATT Article XI(1), which forbids measures prohibiting or restricting imports or exports. The USA sought to justify the embargo under GATT Article III(1) and (4) since US fishermen were subject to the same MMPA rules. The GATT panel rejected the US argument on the grounds that Article III(1) and (4) permit only regulations relating to products as such. Since the MMPA regulations concerned

[72] Ibid, 125–45.

[73] A similar proposal has been put forward by the European Union. *See* CTE Report, *supra*, n 38, 5–6.

[74] *Shrimp-Turtle Case*, Appellate Body Report, paras 171–2, and see *infra*.

[75] *Tuna-Dolphin I*, *supra*, n 67. For an excellent commentary, see Kingsbury, 5 *YbIEL* (1994) 1.

harvesting techniques which could not possibly affect tuna as a *product*, the ban on tuna could not be justified. This reasoning was reiterated by a second GATT panel in the *Tuna-Dolphin II* decision,[76] which involved the legality of a secondary embargo of tuna products from countries that processed tuna caught by the offending countries. This GATT panel condemned the unilateral boycott in even stronger terms.[77]

Both *Tuna-Dolphin* panels also concluded that neither GATT Articles XX(b) nor XX(g) could justify the US tuna import ban. As to Article XX(b), both panels held that the ban failed the 'necessary' test. They rejected the US argument that 'necessary' means 'needed', stating that 'necessary' means that no other reasonable alternative exists and that 'a contracting party is bound to use, among the measures available to it, that which entails the least degree of inconsistency' with the GATT.[78] A trade measure taken to force other countries to change their environmental policies, and that would be effective only if such changes occurred, could not be considered 'necessary' within the meaning of Article XX(b).[79] Both panels similarly concluded that Article XX(g) was not applicable; they found that the terms 'relating to' and 'in conjunction with' in Article XX(g) meant 'primarily aimed at', and held that unilateral measures to force other countries to change conservation policies cannot satisfy the 'primarily aimed at' standard.[80]

The *Tuna-Dolphin* decisions must now be read in the light of later jurisprudence formulated by the WTO Appellate Body, considered below.

4(2) THE EXTRATERRITORIAL SCOPE OF ARTICLE XX (B) AND (G) UNDER 1947 GATT

The GATT panels in the two *Tuna-Dolphin Cases* came to different conclusions regarding the territorial application of Article XX(b) and (g). The *Tuna-Dolphin I* panel concluded that the natural resources and living things protected under these provisions were only those within the territorial jurisdiction of the country concerned.[81] This view, which was based on the belief that the drafters of Article XX had focused on each contracting party's domestic concerns, has been widely criticized.[82] The *Tuna-Dolphin II* panel, in contrast, 'could see no valid reason supporting the conclusion that the provisions of Article XX(g) apply only to… the conservation of exhaustible natural resources located within the territory of the contracting party invoking

[76] *US—Restrictions on Imports of Tuna*, 33 *ILM* (1994) 839, para 5.29 (hereafter '*Tuna-Dolphin II*'). This decision was not adopted by the GATT Council.
[77] Ibid, paras 5.38–5.39.
[78] *Tuna-Dolphin I*, *supra*, n 67, para 5.27; *Tuna-Dolphin II*, *supra*, n 76, para 5.35.
[79] *Tuna-Dolphin I*, *supra*, n 67, para 5.27; *Tuna-Dolphin II*, *supra*, n 76, paras 5.36–5.38.
[80] *Tuna-Dolphin I*, *supra*, n 67, para 5.33; *Tuna-Dolphin II*, *supra*, n 76, para 5.26.
[81] *Tuna-Dolphin I*, *supra*, n 67, paras 5.26, 5.31.
[82] See, e.g. Snape and Lefkovitz, 27 *Cornell ILJ* (1994) 777, 782–90; Ferrante, 5 *J Transnatl L & Pol* (1996) 279, 297.

the provision'.[83] Nevertheless, the panel ruled that governments can enforce an Article XX(g) restriction extraterritorially only against their own nationals and vessels.[84]

To justify its ruling, the *Tuna-Dolphin II* panel distinguished between extraterritorial and extra-jurisdictional application of Article XX. This is a salutary distinction that makes eminent sense. The extraterritorial application of Article XX(b) and (g) is supported by analysis based on the norms of treaty interpretation under the Vienna Convention on Treaties, Article 31(1) of which requires that treaties be interpreted 'in good faith in accordance with the ordinary meaning [of] the terms of the Treaty in their context'. Together with the 'context', the parties should take into account 'any relevant rules of international law applicable in the relations between the parties'. It is well established as a matter of international law that states have an obligation to prevent damage to both the environment of other states and areas beyond the limits of national jurisdiction.[85] Thus, it should be beyond doubt that paragraphs (b) and (g) of Article XX permit national measures designed to protect extraterritorial resources.

The *Tuna-Dolphin II* panel's position on extraterritorial jurisdiction is based on the concept of nationality, under which a state may control the activities of its own citizens. Other theories of extraterritorial jurisdiction include passive personality jurisdiction over crimes against nationals; objective territorial jurisdiction, where the effect of an extraterritorial act is felt within a state; protective jurisdiction to deal with national security risks; and universal jurisdiction in cases of piracy and certain other crimes.[86] These other international law jurisdictional doctrines seemingly have little relevance to Article XX. Thus, the *Tuna-Dolphin II* panel's conclusion is essentially correct: Article XX may have *extraterritorial*, but not *extra-jurisdictional* effect.

4(3) THE NEW WTO APPROACH UNDER 1994 GATT

The two *Tuna-Dolphin* GATT panel decisions represented the first tentative steps of the multilateral trading system to come to terms with protection of the environment. Neither decision was binding under the GATT because they were not adopted by the contracting parties. Even if they had been, they would have little force as precedents because their reasoning was partially inconsistent and the decisions of prior GATT or WTO panels are not binding on future panels.[87] Moreover, these decisions pre-dated the entry into force of the WTO Agreement and the establishment of the new dispute settlement body. The WTO Appellate Body has been fashioning its own approach to interpretation of Article XX that makes significantly greater allowance for legitimate measures of environmental protection.

[83] *Tuna-Dolphin II*, para 5.20. [84] Ibid.
[85] See, e.g. Rio Declaration on Environment and Development, Principle 2; 1982 UNCLOS, Articles 192–5, and *supra*, Ch 3.
[86] See Higgins, *Problems and Process: International Law and How We Use It* (Oxford, 1994) 56–77.
[87] *Japan Shochu Case*, *supra*, n 22, at 14.

(a) GATT Article XX(g)

A consistent theory of interpretation of Article XX(g) has been advanced by the Appellate Body in two important cases, the *US Gasoline Standards Case*[88] and the *Shrimp-Turtle Case*[89]. The latter is particularly relevant because it involved a trade measure similar to that employed in the *Tuna-Dolphin Cases*, a ban on imported shrimp from countries that do not require their fishermen to harvest shrimp with methods that do not pose a threat to sea turtles. As such it marks the contrast in approach by the WTO Appellate Body to environmental disputes compared with earlier GATT panels. The first issue that must be addressed under Article XX(g) is whether the particular trade measure[90] concerns the conservation of exhaustible natural resources.[91] The Appellate Body has taken a generous view of this matter, adopting an evolutive approach to the interpretation of the term 'natural resources' which does not have static content and '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'.[92] A 'resource' may be living or non-living, and it need not be rare or endangered to be potentially 'exhaustible'. Thus, dolphins, clean air, gasoline, and sea turtles all qualify. Under this expansive interpretation, virtually any living or non-living resource, particularly those addressed by multilateral environmental agreements, would qualify.

The second 'relating to' element of Article XX(g) has proved more difficult to apply. Although a trade measure does not have to be 'necessary' (as in Article XX(b)) to natural resource conservation, the WTO/GATT panels have interpreted 'relating to' to mean that it must be 'primarily aimed at' conservation.[93] Thus phrased, this requirement has proved a difficult obstacle. The question arises whether the 'primarily aimed at' interpretation of 'relating to' is correct. Certainly, these phrases are *not* synonymous. The 'primarily aimed at' requirement seems to be an unwarranted amendment of Article XX. As the Appellate Body in *US Gasoline Standards* pointed out, 'the phrase "primarily aimed at" is not, itself, treaty language and was not designed as a simple litmus test' for Article XX.[94] In *Shrimp-Turtle* the Appellate Body took a more nuanced approach to the 'relating to' element, examining the relationship between the structure of the measure in question and the conservation objectives sought to be achieved and concluded that the US import ban on shrimp was 'reasonably related' to the turtle conservation measures sought to be achieved.[95]

A third requirement of Article XX(g) is that the measure in question must be 'made effective in conjunction with restrictions on domestic production or consumption'.

[88] *US—Standards for Reformulated and Conventional Gasoline*, *supra*, n 31.
[89] *Shrimp-Turtle* Appellate Body Report, *supra*, n 68. For discussion of the case see Mann, 9 *YbIEL* (1998) 28; Schoenbaum, ibid, 36; Wirth, ibid, 40.
[90] By 'measure' is meant the law or rule challenged as inconsistent with WTO/GATT norms: *US Gasoline Standards* App, *supra*, n 31, at 13–14.
[91] *Shrimp-Turtle* Appellate Body Report, *supra*, n 68, para 127. [92] Ibid, paras 129–30.
[93] See *US Gasoline Standards* App, *supra*, n 31, at 16.
[94] *US Gasoline Standards* App, *supra*, n 31, at 19.
[95] *Shrimp-Turtle* Appellate Body Report, *supra*, n 68, para 141.

The definitive interpretation of this phrase was given by the Appellate Body in the *US Gasoline Standards Case*:

> [T]he basic international law rule of treaty interpretation…that the terms of a treaty are to be given their ordinary meaning, in context, so as to effectuate its object and purpose, is applicable here…[T]he ordinary or natural meaning of 'made effective' when used in connection with a measure—a governmental act or regulation—may be seen to refer to such measure being 'operative', as 'in force', or as having 'come into effect'. Similarly, the phrase 'in conjunction with' may be read quite plainly as 'together with' or 'jointly with'. Taken together, the second clause of Article XX(g) appears to us to refer to governmental measures like the baseline establishment rules being promulgated or brought into effect together with restrictions on domestic production or consumption of natural resources…[W]e believe that the clause 'if such measures are made effective in conjunction with restrictions on domestic product[ion] or consumption' is appropriately read as a requirement that the measures concerned impose restrictions, not just in respect of imported gasoline but also with respect to domestic gasoline.[96]

As the Appellate Body further pointed out, however, the 'in conjunction with' element requires a certain amount of even-handedness, but not identity of treatment, and restrictions on either domestic production or consumption will be satisfactory.[97]

A similar approach was used in the *Shrimp-Turtle Case*.[98] As indicated above, the Appellate Body found that the import ban on shrimp was reasonably related to the purpose of protecting sea turtles (just as the Appellate Body in the *US Gasoline Standards Case* found that there was a reasonable relationship between the baseline establishment rules and clean air). In addition, the 'in conjunction with' requirement was satisfied because the USA required all shrimp trawlers to use turtle excluder devices in areas and at times when there is a likelihood of intercepting sea turtles. Thus, there are comparable restrictions on the domestic harvesting of shrimp.[99]

The approach to Article XX(g) now mandated by the Appellate Body is substantially different from the restrictive and somewhat illogical interpretations of GATT panels, particularly the *Tuna-Dolphin* decisions. In fact, the US restrictions on the harvesting of tuna would now pass Article XX(g) with flying colours. Dolphins clearly are an exhaustible natural resource; the import ban on tuna harvested by methods that kill dolphins clearly is related to the purpose of cutting dolphin mortality; and the requirements protecting dolphins also apply to US vessels and fishermen. Also important, the Appellate Body in the *Shrimp-Turtle Case* gave clear *extraterritorial* scope to Article XX(g): it applies without distinction to exhaustible resources beyond areas of national jurisdiction as well as to domestic resources.[100]

(b) Article XX(b)

As we saw earlier, in the *Asbestos Case*,[101] the Appellate Body has followed the interpretation given to the phrase 'necessary to protect human, animal or plant life or

[96] Ibid, 20. [97] Ibid, 21.
[98] *Shrimp-Turtle* Appellate Body Report, *supra*, n 68, paras 138–42. [99] Ibid, paras 143–5.
[100] Ibid, paras 132–3. [101] *Supra*, n 22.

health' by panel decisions in *Tuna-Dolphin* and other cases. It has been said that this interpretation constitutes too great an infringement on the sovereign powers of states to take decisions by democratic means to solve problems and to satisfy their constituents, and that it underestimates the political difficulties and constraints, both domestic and foreign, with which a nation must deal.[102] Thus, in deciding what is 'necessary', WTO panels should employ a deferential standard of review that allows some freedom of action to member states. In the *Asbestos Case*, the Appellate Body appears to have been sensitive to these criticisms.

Upholding a French ban on imports of asbestos under Article XX(b), the Appellate Body held that where there is a scientifically proven risk to health, 'WTO members have the right to determine the level of protection of health that they consider appropriate ', based *either* on the quality of the risk (i.e. is it regarded as socially acceptable) or on the quantity of the risk (i.e. how likely is it). The more vital the common interests or values pursued, the easier it would be to accept as 'necessary' measures designed to achieve those ends. In this case it found that there was no alternative means of eliminating the risk. The Appellate Body's approach to the application of Article XX(b) thus brings it closer to the proportionality[103] or balancing analysis applied by the European Community and the USA[104] when testing the necessity of restrictions on trade for environmental purposes. In the *US-Gambling Case*[105] the Appellate Body stressed that the test whether a contested measure is 'necessary' is an objective one, with the burden of proof falling on the defending government to present the evidence to be weighed in the balance. Factors to be weighted could include: '(i) the relative importance of the common interests or value pursued by the measure, (ii) the contribution made by the measure to the realization of the ends pursued by it, and (iii) the restrictive impact of the measure on international commerce'.[106] In discharging the burden of proof in the face of scientific uncertainty, the Appellate Body in the *Asbestos Case* acknowledged that, in justifying the trade-restrictive measure, the defending government may 'rely in good faith, on scientific sources which, at that time, may represent a divergent, but qualified and respected, opinion'.[107]

(c) The chapeau of Article XX

As already noted, all the Article XX exceptions are qualified by the *chapeau*, which sets out the tests for the *manner* in which a trade measure is applied. Three standards are stated in the *chapeau*: (i) arbitrary discrimination, (ii) unjustifiable discrimination,

[102] See Croley and Jackson, 90 *AJIL* (1996) 193, 211–12.

[103] Others have argued that the language in *EC-Asbestos* amounts to a rejection of the proportionality test, leaving States free to set their own level of protection: see, for example, House and Türk, in Bermann and Mavroidis (eds), *Trade and Human Health and Safety* (Cambridge, 2006) 77, 113.

[104] *Infra*, nn 133–4.

[105] WTO Appellate Body Report, *US—Measures Affecting the Cross-Border Supply of Gambling and Betting Services*, WT/DS285/AB/R, adopted 20 April 2005, paras 304, 309–10. This case arose under GATS but (i) it mirrors the GATT Article XX exceptions and (ii) the Appellate Body expressly indicated that its analysis was based on the GATT Article XX jurisprudence.

[106] Charnovitz, 10 *JIEL*(2007) 685, 691; *US—Gambling*, ibid, para 306.

[107] *EC-Asbestos*, para 178.

and (iii) a disguised restriction on international trade. In the *Shrimp-Turtle Case*, the Appellate Body stated that the *chapeau* is (i) a balancing principle to mediate between the right of a member to invoke an Article XX derogation and its obligation to respect the rights of other members; (ii) a qualification making the Article XX exemptions 'limited and conditional';[108] (iii) an expression of the principle of good faith in international law; and (iv) a safeguard against *abus de droit*, the doctrine that requires the assertion of a right under a treaty to be 'exercised bona fide, that is to say reasonably'.[109] According to the Appellate Body, the *chapeau* protects 'both substantive and procedural requirements'.[110]

In the *Shrimp-Turtle Case*, the unilateral measures applied by the USA to protect sea turtles were found to violate the *chapeau*'s criteria against arbitrary and unjustifiable discrimination. The Appellate Body's reasoning focused on the manner of application of the US regulations. First, it found that there was 'arbitrary discrimination' because US law required a 'rigid and unbending… comprehensive regulatory programme that is essentially the same as the US programme, without inquiring into the appropriateness of that program for the conditions prevailing in the exporting countries'.[111] Arbitrary discrimination was found to exist separately because the US authorities, in their certification process for shrimp imports, did not comply with basic standards of fairness and due process with regard to notice, the gathering of evidence, and the opportunity to be heard. The Appellate Body found that the GATT requires 'rigorous compliance with the fundamental requirements of due process' with respect to exceptions to treaty obligations.[112]

Second, the US regulations were 'unjustifiable'[113] because they required (i) a duplication of the US programme without considering conditions in other countries and (ii) applied differing phase-in periods for countries similarly situated and impacted by the import ban. Most importantly, the Appellate Body held that it was unjustifiable discrimination for the USA not to have negotiated seriously with some of the affected countries: the subject matter—protection of sea turtles—demanded international cooperation, the US statute recognized the importance of seeking international agreements, and the USA had, subsequent to imposing its own restrictions, entered into the 1996 Inter-American Convention for the Protection and Conservation of Sea Turtles. The Appellate Body concluded: 'The Inter-American Convention thus provides convincing demonstration that an alternative course of action was reasonably open to the USA'.[114]

The *Shrimp-Turtle Case* is a well-reasoned decision of great importance for the trade/environment controversy. The Appellate Body, unlike earlier GATT panels, went out of its way to emphasize concern for protection of the environment and respect for both general international environmental law and international environmental agreements. Two striking conclusions emerge from its opinion.

[108] *Shrimp-Turtle* Appellate Body Report, *supra*, n 68, para 157.

[109] Ibid, para 158.

[110] Ibid, para 160.

[111] Ibid, para 177.

[112] Ibid, para 182.

[113] Ibid, para 182.

[114] Ibid, para 171.

First, the Appellate Body did not totally condemn unilateral action or declare it illegal per se as the GATT panels had done. The Appellate Body stated only that '[T]he unilateral character...heightens the disruptive and discriminatory influence of the import prohibition and underscores its unjustifiability'.[115] This leaves some room, albeit small, for unilateral measures to protect the environment beyond national jurisdiction. If, for example, the US measures in the *Shrimp-Turtle Case* had been tailored carefully to meet due process concerns and were suited to conditions in other countries, and especially if the countries concerned had spurned offers of negotiation or refused to negotiate in good faith, it is conceivable that unilateral measures to protect turtles would not be arbitrary or unjustifiable and would have been upheld. Of particular interest is the Appellate Body's emphasis on good faith as a principle of international law. If, in a given case, a state were to spurn environmental controls and refuse to enter into negotiations over the depletion of resources beyond national jurisdiction, it would be deemed to be in breach of the principle of good faith, and unilateral measures might be justified.

Second, the *Shrimp-Turtle* opinion provides a principled basis for upholding multilateral and bilateral environmental agreements under Article XX(b) and (g). By interpreting the requirements of (g) (and impliedly (b)) in a pro-environmental manner, it is virtually certain that MEAs, as well as bilateral environmental agreements, would be upheld. They would meet the requirements of the *chapeau* unless they contained substantial flaws or were disguised protectionist measures. Thus, the *Shrimp-Turtle Case* provides an important new basis for upholding trade-restrictive international environmental agreements.[116] Here the Appellate Body used international environmental agreements not binding on the parties as an aid to the interpretation of existing WTO provisions, not as the applicable law between the parties. This point was emphasized in the *EC—Biotech Case* where the panel considered whether, and how, agreements external to the WTO covered agreements could be taken into account.[117]

4(4) 'CREATIVE' UNILATERALISM

WTO and GATT jurisprudence have tended to frown on unilateral action.[118] However, there are at least two theoretical justifications for 'creative' unilateral action. First, a unilateral act can be *de lege ferenda*, new state practice that may mature into 'opposable' custom under accepted norms of international law.[119] The doctrine of

[115] Ibid, para 172. [116] See Scott, 15 *EJIL* (2004) 311.

[117] Panel Report, *European Communities—Measures Affecting the Approval and Marketing of Biotech Products*, WT/DS291/R, WT/DS292/R, WT/DS293/R, adopted 21 November 2006, paras 7.70–7.95; see Young, 56 *ICLQ* (2007) 907.

[118] See in particular *Tuna-Dolphin I and II* and *Shrimp-Turtle*.

[119] An example of this is President Truman's unilateral proclamation of US 'jurisdiction and control' over the resources of the continental shelves of the USA in 1945. This act matured into the doctrine formulated in the 1958 Geneva Convention on the Continental Shelf. Thus, unilateral measures that are 'illegal' at first may come to be 'opposable' against some states and develop into international law. See also *Norwegian Fisheries Case*, ICJ Reports (1951) 116 (baselines claimed by Norway).

opposability—first employed by the International Court of Justice in the *Norwegian Fisheries Case*[120]—has two aspects: it allows a state to assert an important interest in ways that are not, strictly speaking, consistent with international law; and it serves to promote the adoption of new international-law norms where necessary to clarify 'grey areas' of international practice.[121] Opposability is thus a creative agent of change and an important part of the international 'legislative' process.

The second justification is that a unilateral act may be a countermeasure under international law. Countermeasures can be taken only under certain conditions.[122] A countermeasure must be in response to a prior act contrary to international law; there must be a prior request for redress; and the measure taken by the aggrieved state must not be out of proportion to the gravity of the original wrongful act.[123] Force, as well as extreme political and economic measures that represent a threat to a state's territorial integrity or political independence, must be avoided. Human rights and peremptory norms of international law must be observed, and legal obligations toward third states must be respected. Three examples make the point. First, the *Tuna-Dolphin* dispute might be viewed as an attempt by the USA to put forward a new principle of customary international law, the need to protect marine mammal species regardless of whether they are in danger of extinction. The US action might also be viewed as a countermeasure in retaliation for Mexico's disregard of the duty of all states, recognized under customary international law, as well as the 1982 UNCLOS, to protect marine living resources. However, this theory would not justify the US embargo of tuna imports from 'intermediary' nations (those that buy tuna from the country subject to the direct import ban) because countermeasures against third parties are generally prohibited.

A hypothetical instance of transboundary pollution serves as a second example. Although the duty of every state under customary law to prevent serious harm to its neighbours or to the global environment from activities in its territories is unquestioned, there is usually no forum with compulsory jurisdiction to adjudicate such questions.[124] Under those circumstances, unilateral action imposing an environmental trade restriction as a countermeasure may be permissible.[125]

[120] See also the *Icelandic Fisheries Cases*, ICJ Reports (1974) 3, 175.

[121] The ICJ cases suggest that to be opposable, a unilateral measure must: (i) be within the effective power of the asserting state; (ii) conform to a sense of equity and the general interest of the international community (not merely the special interest of a particular state); (iii) be asserted in good faith; and (iv) not be opposed by consistent objection.

[122] See ILC, 2001 Articles on State Responsibility, Articles 50–5, and generally, Schachter, *International Law in Theory and Practice* (The Hague, 1992) 184–200; Matsui, 37 *Japanese Ann IL* (1994) 1; Elagab, *The Legality of Non-forcible Countermeasures in International Law* (Oxford, 1988); Koskenniemi, 72 *BYIL* (2001) 337.

[123] See ILC 2001 Articles 50, 52, 53; *The Naulilaa (Germany v Portugal)*, 2 RIAA (1928), 1011; *Case Concerning the Air Services Agreement of March 27, 1946* (US–France), 18 RIAA (1978) 417.

[124] *Supra*, Chs 3, 4.

[125] Fox, 84 *Geo LJ* (1996) 249; Okowa, *State Responsibility for Transboundary Air Pollution in International Law* (Oxford, 2000) 248–54, who notes that the scope for other types of countermeasure in response to breaches of environmental obligations is limited because of the likelihood that third state rights will thereby be affected.

A third example is the controversy between Spain and Canada during 1995, when Spanish fishing vessels intensively fished the Grand Banks in the North Atlantic just beyond the Canadian 200-mile exclusive economic zone, thereby disrupting Canadian efforts to rebuild fish stocks.[126] The Spanish vessels' actions violated several provisions of the Northwest Atlantic Fisheries Organization Agreement.[127] If Canada had adopted environmental trade restrictions against Spain,[128] this would have been a permissible countermeasure.

Is unilateral action successful? The outcome of unilateral measures will vary according to the circumstances of the case. Consider the tuna-dolphin controversy. After the US ban on tuna caught in purse-seine nets was ruled inconsistent with the GATT, Mexico, the chief prevailing party, did not press for adoption of the GATT panel report by the GATT Council. In response to the panel decision, the USA passed the International Dolphin Conservation Act[129] and sought to negotiate an understanding with Mexico and Venezuela to create an international moratorium on the practice of fishing for tuna with purse-seine nets. Shortly thereafter, in 1992, the International Agreement for the Reduction of Dolphin Mortality was signed by twelve states, including the USA and Mexico, under the auspices of the Inter-American Tropical Tuna Commission. Within two years, this Agreement reduced incidental mortality of dolphins in the eastern tropical Pacific to below 4,000 animals, prompting the US Marine Mammal Commission to conclude that the incidental take of dolphins 'was no longer significant from a biological perspective'.[130] As a result, the USA revoked the tuna embargo.

Thus, the tuna-dolphin problem was resolved by preserving both free trade and dolphins. Would it have occurred without US unilateral action? Many commentators have pointed out that the USA tried unsuccessfully for twenty years to obtain an agreement reducing dolphin mortality.[131] Only after the tuna ban and the subsequent uproar over the *Tuna-Dolphin* decisions was it possible to negotiate an agreement.

5 TRADE RESTRICTIONS TO PROTECT THE DOMESTIC ENVIRONMENT

The protection of a nation's domestic environment may demand three different kinds of trade restrictions: (i) import restraints against products or services that do not

126 See McLarty, 15 *Va Envtl LJ* (1996) 469 and Davies, 44 *ICLQ* (1995) 927.

127 1978 Convention on Future Multilateral Cooperation in Northwest Atlantic Fisheries. See *supra*, Ch 13 for a fuller discussion.

128 For example, Canada could have adopted a ban on imports of fish products from Spain but did not do so because it chose to retaliate by pursuing and arresting the offending vessels.

129 Pub L 102–583, 106 Stat 3425 (1992), codified at 16 USC §§1411–18 (1994).

130 See Marine Mammal Commission, *Annual Report to Congress* (1994) 121.

131 See, e.g. Dunoff, 49 *Wash & Lee LR* (1992) 1407, 1415–33.

comply with domestic environmental norms; (ii) requirements that imported as well as domestic products comply with regulations involving such matters as labelling, packaging, and recycling; and (iii) export restrictions to conserve natural resources.

5(1) IMPORT RESTRAINTS

Import restrictions on products must, of course, comply with Articles I, II, III, and XI of GATT 1994, or must find an applicable exemption under Article XX. In addition, product import restrictions are subject to the disciplines of two Uruguay Round codes: the Agreement on Technical Barriers to Trade (TBT)[132] and the Agreement on the Application of Sanitary and Phytosanitary Measures (SPS).[133] The TBT and SPS Agreements are mutually exclusive: the SPS Agreement deals with additives, contaminants, toxins, and disease-carrying organisms in food, beverages, and feedstuffs, while the TBT applies to all other product standards. Both Agreements seek to balance state autonomy with the concern that complete freedom to set standards would undermine the WTO/GATT aims. The Agreements successfully combat non-tariff barriers but allow states reasonable freedom to set environmental standards.

Article XX(b) of the GATT and the identically worded Article XIV(b) of the GATS are applicable to justify import restraints on environmentally harmful products or services. This provision can be invoked broadly to protect the domestic environment (although the wording 'human, animal, or plant life' would restrict protection to *living* things). The trade restriction must be 'necessary', and the wording of the *chapeau* of Article XX would appear to mean that like products or services produced domestically must be similarly restricted and discrimination among countries similarly situated would be prohibited. The country asserting this exception would bear the burden of proof and persuasion on these matters.

GATT Article XX(b) or GATS Article XIV(b) would apply to ordinary products and services. However, most trade restrictions would also implicate the TBT or SPS Agreements. The SPS is the more restrictive of the two agreements. WTO member states have the right to take sanitary and phytosanitary measures that are 'necessary' for the protection of human and animal health.[134] Six specific requirements must be fulfilled.

First, SPS measures must 'not be more trade-restrictive than required to achieve their appropriate level of...protection'.[135] This provision presumes the right of each state to choose *its own level* of protection unilaterally.[136] A footnote specifies that a measure is not more trade restrictive than required unless there is another

132 *Legal Texts*, *supra*, n 1, at 163 (1994) (hereafter 'TBT Agreement').

133 Ibid, 69 (hereafter 'SPS Agreement'). See Pauwelyn, 2 *JIEL* (1999) 641 and Scott, *The WTO Agreement on Sanitary and Phytosanitary Measures: A Commentary* (Oxford, 2007).

134 SPS Agreement, Article 2(1)–(2). This repeats the language in GATT Article XX(b).

135 Article 5(6).

136 'Appropriate' is the level of protection deemed appropriate by the member state. See Annex A, para 5.

measure *reasonably* available (meaning feasible) that would do the job.[137] This elaboration effectively gives the word 'necessary' a flexible interpretation.

Second, any SPS measure shall be applied 'only to the extent necessary' to protect human, animal, or plant life and health.[138] This seems to duplicate partially the first requirement; arguably, it places the emphasis on the obligation not to *apply* a measure so as to cause more trade restriction than necessary for the appropriate level of protection desired. Under this interpretation, the first two requirements are complementary: a state can neither *adopt* nor *apply* a measure that goes beyond its chosen level of protection.

Third, a measure must be based upon 'scientific principles' and 'sufficient scientific evidence'.[139] Even without sufficient scientific evidence, the SPS Agreement includes 'precautionary language' that permits standards to be adopted provisionally 'on the basis of available pertinent information'.[140] This does not relieve the state concerned from the continuing obligation 'to obtain the additional information necessary for a more objective assessment of risk' and to review the measure within a reasonable period of time.[141] Nor does it permit a measure to be justified on the basis of the precautionary principle—whatever the international legal status of that principle—if otherwise contrary to the explicit requirements of the SPS Agreement.[142] As we noted in Chapter 11 above, this is a point of potential conflict between the SPS Agreement and the Cartagena Protocol. Even with the Protocol subject to the international discipline of the SPS Agreement and capable of harmonization with it, there is inconsistency in the application of the precautionary principle. The Protocol explicitly adopts the precautionary principle for the regulation of food, feed, and processed LMOs, allowing import regulation even in the face of 'lack of scientific certainty due to insufficient scientific information'.[143] This may result in future conflict with the SPS Agreement, which allows the precautionary principle to be applied only to measures taken on a provisional basis where there is insufficient scientific evidence.[144] Direct conflict has thus far been avoided in so far as the Panel in the *EC—Biotech Case* did not apply the Biodiversity Convention and Protocol to its analysis of precaution under the SPS Agreement, thus at the same time raising high the hurdle for interpretation of WTO agreements in the light of other instruments.[145]

[137] SPS Agreement, Article 5(6), n 3. [138] Article 2(2).

[139] Ibid. For a cogent critique of the use of scientific evidence by WTO panels see Christoforou, 8 *NYUEnvLJ* (2000) 622 and Green and Epps, 10 *JIEL* (2007) 285.

[140] Safrin, 96 *AJIL* (2002) 606, 610.

[141] SPS Agreement, Art 5.7. This was one of the points on which EC member State safeguard measures failed in the *EC—Biotech Case*, *supra*, n.0.

[142] *Beef Hormones* (AB), paras 124–5; see Peel, 5 *Melb JIL* (2004) 483, 493. Although relied upon by the EC in the *EC—Biotech Case*, as we noted above, the Panel did not consider the precautionary principle as reflected in e.g. the Cartagena Protocol.

[143] Article 11(8). [144] See *supra*, text at n 139.

[145] See n.53 above; and criticism by Young, 56 *ICLQ*(2007) 907.

Fourth, measures must be based upon a risk-assessment process 'taking into account' available scientific evidence and economic factors, including the objective of minimizing negative trade effects.[146]

Fifth, Article 2(3) of the SPS Agreement repeats the requirements of the *chapeau* of Article XX, that the measure must not 'arbitrarily or unjustifiably discriminate between members' and must not be a 'disguised restriction on international trade'. Moreover, 'with the objective of achieving consistency', Article 5(5) also prohibits 'arbitrary or unjustifiable distinctions' in the levels of sanitary or phytosanitary protection considered appropriate. In practice and in the case law this provision is the real bite of the agreement.[147]

Sixth, there is an obligation at least to consider adopting international SPS standards in the interests of achieving harmonization.[148] Yet, the Agreement explicitly permits maintenance of higher standards if they are justified scientifically or required by the member state's own unilaterally determined higher level of protection.[149]

Under the TBT Agreement, member states pledge that technical regulations will not be allowed to create 'unnecessary obstacles to international trade. For this purpose, technical regulations shall not be more restrictive than necessary to fulfil a legitimate objective'.[150] Here again, the *level* of protection is up to the individual member state, and a high level of environmental protection can be chosen. Furthermore, member states are free to accept or reject international standards. International standards need not be applied when they would be 'ineffective or inappropriate' for the fulfilment of a legitimate objective. Thus, if a state chooses a strict level of environmental protection, it can employ stricter standards than international technical requirements.

Controversy has arisen, particularly under the SPS Agreement, over the issues of standard-setting and the application of a precautionary approach by some states. In the *Beef Hormones Case*,[151] which involved an EC import ban of meat and meat products derived from cattle to which natural or synthetic hormones had been administered for growth purposes, the Appellate Body clarified the criteria and the process

[146] Article 5. [147] See *infra*, and see also Pauwelyn, 2 *JIEL* (1999) 641.

[148] Such standards are deemed under the SPS Agreement to include those emanating from three international standards-setting organizations—Codex Alimentarius for food safety, the International Office of Epizootics for animal health, and the Secretariat of the Plant Protection Convention for plant health. In addition, Annex A of the SPS Agreement includes 'appropriate standards' from other international organizations open to membership by all WTO members as identified by the SPS Committee. Interpretation of Annex A was a significant feature of the *EC—Biotech Case*; see discussion by Young, 56 *ICLQ* (2007) 907.

[149] Article 3.

[150] TBT Agreement, Article 2(2). 'Legitimate objective' is broadly defined as including 'national security requirements, prevention of deceptive practices, protection of human health or safety, animal, plant life, or health, or the environment'.

[151] *EC—Measures Concerning Meat and Meat Products* ['Beef *Hormones Case*'], Rept of the Appellate Body, WT/DS26/AB/R (1997). Two further cases have similarly struck down national food safety measures because of a lack of scientific evidence and the failure to carry out a risk assessment. See *Australia—Measures Affecting the Import of Salmon*, Rept of Appellate Body, WT/DS18/AB/R (1998), and *Japan—Measures Affecting Agricultural Products*, Rept of the Panel, WT/DS76/R (1998).

by which a WTO member can adapt and apply high-level sanitary and phytosanitary standards.

First, a member may either choose an international SPS standard, or may base its standard on the international standard without conforming to all its requirements, or may set a level of protection wholly its own.[152] When an international standard is used, there is a rebuttable presumption that it is consistent with the SPS Agreement and GATT 1994. If the national measure is based merely upon the international standard, but not in conformity with it, there is no presumption in its favour, but a complaining member must make a prima facie case in favour of inconsistency. If a member adopts its own level of protection under Article 3(3) of the SPS Agreement, it must be based on a 'risk assessment' (Article 5(1)) and 'sufficient scientific evidence' (Article 2(2)).[153]

Second, what is a sufficient risk assessment is not defined in the SPS Agreement either substantively or procedurally. A member, therefore, is free to consider both 'available scientific evidence' (Article 5(2)) and 'relevant economic factors' (Article 5(3)). But there must be a 'rational relationship between the trade measure and the risk assessment',[154] and the scientific reports relied upon must rationally support the import restriction. Since the risk assessment in the *Beef Hormones Case* failed these tests, the EC's import restriction was held to violate Article 5(1).

Third, Article 5(5) of the SPS Agreement requires the avoidance of arbitrary or unjustifiable discrimination and disguised restrictions on international trade. The Appellate Body, interpreting these elements in the context of SPS Article 2(3) (which is similarly worded), read this to require a showing of three elements: (i) that a member has adopted its own appropriate levels of SPS protection in several situations; (ii) that those levels of protection exhibit arbitrary or unjustifiable differences; and (iii) that these differences are discriminatory or a disguised restriction on international trade.[155] These three elements are cumulative: arbitrary or unjustifiable differences alone will not violate Article 5(5) unless they also result in discrimination or a disguised restriction on international trade.[156]

Several conclusions may be drawn from this brief analysis of the SPS and TBT Agreements. First, a WTO member may choose the level of protection it wants to adopt

[152] Paras 165–73. This interpretation is based upon Article 3(1)–(3) of the SPS Agreement. See also WT/DS231/AB/R *EC—Trade Descriptions of Sardines*, Report of the Appellate Body, para 245 (for domestic regulation based on international standards there must be a 'very strong and close relationship').

[153] Paras 176–80. Article 2(2) is to be read as informing the risk assessment obligation of Article 5(1). This interpretation of the SPS Agreement is curious since the relevant provision, Article 3(3), appears to state two ways of justifying a 'higher level' of protection: '[I]f there is a scientific justification or as a consequence of the level of... protection a Member determines to be appropriate in accordance with... Article 5.' Because of a footnote to this sentence requiring 'scientific information in conformity with the relevant provisions of this Agreement', the Appellate Body interpreted 'or' to mean 'and'. The reasoning of the Appellate Body in the *Beef Hormone Case* was followed by a WTO panel in *Australia—Measures Affecting Importation of Salmon*, Report of the Panel, WT/DS18/R (1998).

[154] *Beef Hormone Case*, para 193. [155] Ibid, para 214.

[156] Ibid, para 2.44–2.46. The Appellate Body held that the EC's measures in the *Beef Hormone Case* were arbitrary in part but did not result in discrimination or a disguised restriction on international trade. See also *Australia—Measures Affecting Importation of Salmon*, Report of the Appellate Body, WT/DS18/AB/R (1998).

regarding its *own* natural resources, environmental quality, and health and safety. However, it must be prepared to justify such trade-restricting measures once a prima facie case of violation is made out by a complaining member. Second, the precautionary principle, whatever its status as a general rule or principle of international law,[157] cannot override the specific provisions of the SPS Agreement.[158] Third, harmonization and the adoption of international standards is encouraged, but not required. Fourth, only the *means* chosen to implement these domestic policies will be subject to WTO review when they impact international trade, and the tests employed attempt to balance the accommodation of national interests, on the one hand, and the need to police disguised trade restrictions on the other.[159]

It is informative to compare the WTO/GATT regime of regulation of disguised trade barriers to those adopted by the European Union and NAFTA.[160] The EU operates a tighter system of controls to ensure the free movement of goods under the European Community Treaty and other EU legislation. Articles 30 and 34 of the EC Treaty are interpreted to require, in principle, freedom of movement of goods among member states. Derogations are allowed under Article 36 for certain reasons, including environmental reasons; but national restrictions are subjected to a balancing test by the European Court of Justice. To survive, they must be 'necessary' and meet the test of 'proportionality'.[161] The NAFTA system to regulate SPS standards and technical barriers to trade is somewhat looser than the WTO/GATT system. Under NAFTA Article 904(4), no party may maintain a standard that is an 'unnecessary obstacle to trade', but such an obstacle shall not be deemed to be created if the purpose of a standard is to achieve a 'legitimate objective'. Article 905(3) of NAFTA also specifically validates national standards that result in a higher level of protection than would the relevant international standard. A similar savings clause applies to SPS standards under Article 713(3).

5(2) RECYCLING AND PACKAGING

Several countries have taken bold steps to introduce mandatory recycling of products and packaging to reduce the generation of waste and the resulting pollution and need for landfills. Germany has led the way, passing the *Verpackungsverordnung* (*Packaging*

[157] See *supra*, Ch 3, section 4(3) [158] *Beef Hormone Case*, paras 123–5.

[159] This is the conclusion of most experts. See, e.g. Nichols, in Stewart (ed), *The World Trade Organization* (Washington DC, 1996) 191.

[160] For a comparative study, see Weiler (ed), *The EU, the WTO and the NAFTA: Towards a Common Law of International Trade* (Oxford, 2000). A fourth system for assuring free movement of goods and eliminating 'unnecessary' obstacles to trade is the US Commerce Clause: see *City of Philadelphia v New Jersey*, 437 US 617 (1978) (discrimination in interstate commerce is prohibited); *Hunt v Washington State Apple Advertising*, 432 US 333 (1977) (facially neutral legislation with a discriminatory effect must be justified); and *Pike v Bruce Church, Inc*, 397 US 137 (1970) (applying a balancing test for incidental burdens on commerce).

[161] *Rewe-Zentral AG v Bundesmonopolverwaltung für Branntwein* ['*Cassis de Dijon*' *Case*], Case 120/78, [1979] ECR 649; *Commission v Denmark* [1988] ECR 4607 ['*Danish Bottles Case*']. In addition, the EU institutions have wide powers to compel the harmonization and mutual recognition of standards.

Ordinance)[162] in 1991, which regulates the packaging of products and sets mandatory recycling requirements for packaging waste. The *Packaging Ordinance* requires the manufacturers of products to take back packaging wastes and to arrange for their recycling. They fulfil this duty by participating in a private waste collection system, which, for a fee, will handle this obligation by collecting waste from consumers. Participating manufacturers may mark their products with a green dot. The *Packaging Ordinance* applies to all products distributed within Germany.[163]

Largely because of this German initiative and in order to harmonize member-state legal regimes, the European Union adopted a Packaging Directive in December 1994.[164] The European Union directive sets target ranges for packaging waste recovery and recycling, standardizes methods of analysing product lifecycles and measuring toxicity of packaging components and waste, and sets maximum concentration levels for heavy metals in packaging. The directive applies to the packaging of all products sold in the European Union, including imports.[165]

These laws are part of an increasing trend in many industrialized countries to consider the environmental impact of products throughout their lifecycles to the point of their ultimate disposal. The purpose of these laws is to weaken this impact by (i) minimizing packaging waste, (ii) prohibiting the use of toxic and hazardous materials in packaging, and (iii) creating incentives or requirements for recycling, reuse, or proper disposal of both the packaging and the products themselves. Such laws have the potential to disrupt international trade. Manufacturing groups are alarmed that the spread of such lifecycle or 'producer responsibility laws' will have a protectionist effect, isolating national markets. Developing countries are especially concerned that their exporters will be unable to comply with these laws.

Nevertheless, life-cycle laws serve important purposes and the international trading system should be adjusted to accommodate them. Two separate sets of issues arise. The most serious problems come from the proliferation of such laws rather than their substantive requirements. If every country adopts its own national (or sub-national) system, trade will be disrupted simply by the burden of satisfying many different national bureaucracies. Moreover, though well intentioned, some packaging or product regulations may be environmentally harmful. The problems stemming from proliferation could be alleviated through international harmonization of product life-cycle regulation. This should be encouraged by the WTO's Committee on Trade and Environment, but is probably best left to private groups like the International Standards Organization that can work with national governments and industry and environmental interest groups. Harmonization efforts should emphasize environmental protection,

[162] 20 August 1991 BGBl I S 1234 *translated in* 21 *ILM* (1992), 1135. For commentary, see Goldfine, 7 *Georgetown IELR* (1994), 309.

[163] Bundesministerium für Umwelt, Naturschutz, and Reaktorsicherheit, *The Packaging Ordinance and International Trade* §1(1), 23 June 1993.

[164] Council Directive 94/62 EC, 1994 OJ (L 365) 10. See generally, Haner, 18 *Fordham ILJ* (1995), 2187; Comer, 7 *Fordham ELJ* (1995)163.

[165] Council Directive 94/62, para 2(1).

but should screen carefully the current array of laws for effectiveness and eliminate those that are not working. The second problem with such laws is that they may be more restrictive than necessary or may discriminate intentionally or unintentionally against foreign producers. To ensure that this does not happen, they should be held to scrutiny under international trade-law norms that recognize the necessity of environmental protection for national governments to have some flexibility in the remedies they adopt.

In principle, product lifecycle and producer responsibility laws are permitted under GATT Article III as long as they apply equally to domestic and foreign producers.[166] These laws should be subject to the discipline of the TBT Agreement,[167] which imposes the additional requirements that they must not create 'unnecessary obstacles to international trade' and not be 'more restrictive than necessary to fulfil a legitimate objective', including, of course, protection of the environment. These tests assure that a proper balancing process will be applied so that restrictive measures are not out of proportion to their benefits.[168]

5(3) ECO-LABELS

Another method of raising environmental standards is through eco-labelling. The theory behind eco-labels is that if consumers are informed, the market and consumer choice can be relied upon to stimulate the production and consumption of environmentally friendly products.[169] A great variety of eco-labelling schemes exist, sponsored by governments, private groups, or a combination of the two. They take several forms: mandatory 'negative content' labelling, mandatory 'content neutral' labelling, and voluntary 'multi-criteria' labelling.[170] Eco-labels can show product characteristics and/or process and production methods (PPMs). They can operate as a 'seal of approval' or objectively impart information. Well-known examples of eco-labelling plans include Germany's 'Blue Angel' programme and the 'White Swan' mark launched by the Scandinavian countries.[171] In the USA a private organization operates a 'Green Seal' programme. Increasingly, governments are adopting such programmes.[172] In 1992 the European Union established an eco-label scheme to 'promote the design, production, marketing, and use of products which have a reduced environmental impact during

[166] See *supra*, section 2(2).

[167] *See* text *supra*, n 150.

[168] A useful balancing test that might be employed is the concept of proportionality; see *Danish Bottles Case*, *supra*, n 161. The ECJ upheld a ban on non-returnable beverage containers, but held that a limitation on the sale of non-approved containers was discriminatory against foreign producers and out of proportion to the benefits served.

[169] See Ward, 6 *RECIEL* (1997) 139; Subedi, 2 *Brooklyn JIL* (1999) 373. For a sceptical view, see Menell, 4 *RECIEL* (1995) 304.

[170] US Environmental Protection Agency, *Status Report on the Use of Environmental Labels Worldwide* (1993).

[171] *See* Staffin, 21 *Col JEL* (1996) 205, 225.

[172] Ibid, 230–2.

their entire lifecycle, and provide consumers with better information on the environmental impact of products'.[173]

Eco-labelling must comply with WTO/GATT requirements. Even mandatory eco-label requirements on products would be permissible if they are applied on a non-discriminatory basis, adhering to the GATT 1994 MFN and national treatment requirements. For example, under the US Energy Policy and Conservation Act,[174] corporate average fuel economy standards for automobiles must be calculated for domestic manufacturers and importers, and new automobiles sold in the USA must bear a label stating the estimated miles-per-gallon rate for city and highway use.[175] This programme was the subject of a GATT panel report in the *US Taxes on Automobiles Case*,[176] which upheld the standards except for the separate foreign fleet accounting aspects, which discriminated unfairly against foreign manufacturers.

Even eco-label schemes that pertain to PPMs may be upheld if they adhere to MFN and national treatment norms. In the *Tuna-Dolphin I Case*, the panel accepted the voluntary 'dolphin safe' labelling scheme for tuna products sold in the USA:

> [T]he labelling provisions of the [US law] do not restrict the sale of tuna products; tuna products can be freely sold both with and without the 'Dolphin Safe' label. Nor do these provisions establish requirements that have to be met in order to obtain an advantage from the government. Any advantage which might possibly result from access to this label depends on the free choice by consumers to give preference to tuna carrying the 'Dolphin Safe' label. The labelling provisions therefore did not make the right to sell tuna or tuna products, nor the access to a government-conferred advantage affecting the sale of tuna or tuna products, conditional upon the use of tuna harvesting methods.[177]

In contrast, a discriminatory PPM labelling scheme would not be upheld. One that singled out wood products made from tropical forests would fail if like products from temperate forests were not included.[178]

Eco-labelling schemes must also comply with the TBT Agreement, which applies to any technical regulation that deals with a product characteristic, including 'terminology, symbols, packaging, marking or labelling requirements as they apply to a product, process or production method'.[179] The Agreement requires that eco-labels 'fulfil a legitimate objective', not be 'more trade-restrictive than necessary', and comply with notice and transparency requirements, including the TBT Code of Good Practice.[180]

Additional steps should be taken as well by the WTO Committee on Trade and Environment to ensure that eco-labelling does not become a barrier to trade. First, eco-label schemes might be required to be registered with the WTO so that transparency

[173] Commission Regulation 880/92, Article I, 1992 OJ (L 99) 1. [174] 17 USC §4001 (1994).
[175] 40 CFR Pt 600 (1996).
[176] *US—Taxes on Automobiles*, DS31/R, 11 Oct 1994 (Report not adopted by GATT Council) ['*Taxes on Automobiles Case*'].
[177] *Tuna-Dolphin I*, *supra*, n 67, para 5.42. For a dissenting view that PPM labels would pass GATT muster, *see* Bartenhagen, 17 *Va Env LJ* (1997) 1.
[178] *See* Chase, 17 *Hastings ICLR* 349 (1994). [179] TBT Agreement, *supra*, n 113, Annex I, para 1.
[180] Ibid, Annex III.

is guaranteed. National eco-label systems also should be open to all producers on a non-discriminatory basis, not contain requirements that favour domestic producers or be too costly or difficult to meet.

5(4) NATURAL RESOURCES

The issue arises whether a country may ban or restrict exports of natural resource products on the grounds that it is necessary for conservation purposes. Natural resources export bans would have to qualify either under GATT Article XI(2)(a), which permits an export prohibition or restriction to relieve temporary domestic 'critical shortages', or under Article XX(g), as a measure related to conservation of exhaustible natural resources. The limits of these sections can best be illustrated by examining a specific case: the US export ban on unprocessed logs from federal and state lands.[181] Section 488 of the US Forest Resources Conservation and Shortage Relief Act of 1990 states that timber is essential to the USA; that forests, forest resources, and the forest environment are exhaustible natural resources that require efficient and effective conservation efforts; that there is evidence of a shortfall in the supply of unprocessed timber in the USA; that any existing shortfall may worsen unless action is taken; and that conservation action is necessary with respect to exports of unprocessed timber. Among the stated purposes of the Act are to take action necessary under the GATT Article XI(2)(a) to ensure sufficient supplies of certain forest resources or products that are essential to the USA and to effect measures aimed at meeting these objectives in conformity with US obligations under the GATT.[182]

It is doubtful, however, whether this Act would survive the scrutiny of a WTO dispute resolution panel. Neither possible justification under the GATT seems to apply. Article XI(2)(a) would not be applicable since there is no evidence that timber or timber products are in 'critical' short supply in the USA. Article XI(g) would not apply because the export restrictions must be 'in conjunction with restrictions on domestic production or consumption'. There are no such domestic restrictions on timber in the USA. In fact, there is ample evidence that timber production is subsidized by low government prices for standing timber on federal and state lands. The real purpose of the ban, then, is more likely to create jobs in the domestic wood products industry by giving domestic mills the right to perform value-added processing.

In contrast, a ban on timber exports for true conservation purposes would be consistent with Article XX(g). For example, if a US ban on unprocessed logs over a certain diameter were accompanied by the elimination of domestic subsidies for timber cutting and restrictions on the cutting of 'old growth' forests,[183] it almost certainly would be upheld by the WTO.

[181] For discussion of these provisions in the context of exhaustible petroleum resources, see 10 *JERL* (1996) *passim*.
[182] 16 USC § 620 (1994).
[183] 'Old growth' or 'ancient' forests are terms given to forest habitat where trees vary considerably in age and size and there is a multilevel canopy that supports a rich ecosystem.

6 POLLUTION HAVENS: TRADE RESTRICTIONS TO IMPROVE THE ENVIRONMENT OF OTHER COUNTRIES

The trade/environment controversy may arise in the context of concern over low or non-existent environmental norms in other countries. This can be rooted in a sincere concern for pollution, environmental degradation, and exploitation of resources in other countries; concern over competitive disadvantages because lax environmental standards allow other countries to attract investment and sell their products more cheaply; or concern over transboundary pollution. It is obvious that the principle of the sovereign equality of states and limitations on the exercise of jurisdiction under international legal norms limit what a country can do directly to deal with environmental laxity in other countries. The question arises whether the problem can be addressed indirectly through trade sanctions or restrictions to punish countries that refuse to improve environmental standards. However, such measures engage the WTO/GATT rules.

6(1) PROCESS AND PRODUCTION METHODS

In addition to placing environmental trade measures on products, states also may concern themselves with how a product is produced, manufactured, or obtained—commonly referred to as process and production methods (PPMs). Some PPMs are directly related to the characteristics of the products concerned. For example, pesticides used on food crops produce residues on food products; cattle raised on growth hormones produce meat with hormone residues; and unsanitary conditions in slaughterhouses result in meat that may be contaminated with disease-causing organisms. PPMs such as these are covered by the SPS and TBT Agreements.[184] Thus, states may regulate such PPMs as long as they adhere to the disciplines in those Agreements. However, other PPMs that generally do not affect the product produced fall outside the existing trade agreements. A good example of a PPM of this type is the practice of catching tuna by setting fishing nets on schools of dolphins without requiring precautions to spare the dolphins. When the USA banned import of tuna caught by such methods, two GATT dispute-settlement panels declared this action inconsistent with GATT norms on the ground that it discriminated between 'like' products.[185] Thus, a state cannot adopt different treatment for two products with the same physical characteristics based upon how the products have been produced or harvested.[186]

[184] See TBT Agreement, Article 2(2) and Annex I, para 1; SPS Agreement, Annex A, para 1.

[185] *Supra*, nn 67 and 76. For extensive discussion see Choi, *'Like Products' in International Trade Law: Towards a Consistent GATT/WTO Jurisprudence* (Oxford, 2003).

[186] Another example of a PPM controversy is the EU proposal to prohibit the import of pelts and manufactured goods of certain animal species caught or killed by methods using leg-hold traps. See Council Regulation 3254/91, 1991 OJ (L 308) 1. Concerns regarding invalidity under WTO rules led to postponement of the import ban and, in the event, agreement with Canada and the Russian Federation in the form of the 1997 Agreement on Humane Trapping Standards: see OJEC L 042, 14 February 1998, approved by EC Council Decision 98/142/EC. Nonetheless the Netherlands applied the import ban unilaterally: see Bowman, Davies and Redgwell, *Lyster's International Wildlife Law* (Cambridge, 2009), Ch 20, and Nollkaemper, 8 *JEL* (1996) 237.

These controversial rulings have been opposed by two different groups. Environmentalists regard them as a setback to the goal of protecting ecosystems all over the world as well as the global commons. Others fear unfair competition from pollution havens, countries that maintain different conditions of production, particularly with respect to environmental, health, and safety laws and workers' rights and pay. This group wants the ability to 'level the playing field' by prohibiting imports from any country that refuses to adopt laws and regulations mirroring those of the importing country.

Scholars sympathetic to one or both of these views have called upon the WTO to overturn the *Tuna-Dolphin* rulings by (i) redefining 'like product' in GATT Article III so that products could be considered 'unlike' on the basis of how they are made, produced, or harvested;[187] (ii) adopting countervailing or 'eco-dumping' duties on products from countries that some believe constitute 'pollution havens' where products are made without adequate environmental controls;[188] or (iii) employing a new method of balancing trade and environmental interests by analysing the intent or effect of the measure, the legitimacy of the environmental policy, and the justification for the disruption to trade.[189] The first and second of these proposals could only be implemented by amendments to the GATT.[190] There are powerful arguments—both political and legal—against these ideas. Although the term 'like product' is defined flexibly on a case-by-case basis,[191] it would be a radical shift to differentiate products based on how they are produced, manufactured, or harvested.

The enforcement of PPMs in other countries could also be encouraged by replacing the current legal tests with a more lenient test that would allow WTO dispute-settlement panels to balance the legitimacy of the protected environmental value with the disruption to trading interests.[192] However, this proposal, which is derived from the way the US Supreme Court decides Commerce Clause cases,[193] may be unsuited to international tribunals like WTO panels whose ad hoc judges would, thereby, be delegated extraordinary discretion. Under this scheme, many PPM regulations undoubtedly would be upheld, but in the international context this would encourage nations

[187] See especially, Snape and Lefkowitz, 27 *Cornell ILJ* (1994) 788–92.

[188] See the discussion in Esty, *Greening the GATT: Trade, Environment, and the Future* (Washington DC, 1994) 163–8.

[189] Ibid, 114–16. On the effect of the *Shrimp-Turtle Case*, see *supra*.

[190] Eco-dumping and countervailing duties are not authorized under the GATT Subsidies and Countervailing Duty Codes or current US law. For analysis, see Hudec, 5 *Minn J Global Trade* (1995) 1, 14–21.

[191] See *Japan Shochu Case*.

[192] See Esty, *Greening the GATT: Trade, Environment, and the Future* (Washington DC, 1994) 114–18.

[193] See, e.g., *Huron Cement Co v Detroit*, 362 US 440 (1960); see also Farber and Hudec, 1 *Fair Trade and Harmonization* (1996) 59, 64–8.

to violate fundamental principles of public international law, which, for the sake of harmony among nations, restrict the exercise of jurisdiction to accepted normative concepts.[194]

Instead of allowing unilateral regulation of PPMs to deal with environmental protection/pollution haven problems, other approaches might be considered, such as international environmental agreements, environmental management systems, and investment standards.

6(2) INTERNATIONAL ENVIRONMENTAL AGREEMENTS

The PPM/pollution-haven problem can be dealt with directly by encouraging countries to negotiate environmental agreements. If PPMs are causing transboundary pollution, the states concerned, relying on well-established principles of state responsibility under international law, may enter into an agreement to abate the pollution and compensate for its damage.[195] Where the problem is serious, as in the border region between the USA and Mexico, new institutions may be required both to deal with the pollution and to upgrade the environmental enforcement of the lax country concerned. Thus, the USA and Mexico have created a US–Mexican International Boundary Water Commission,[196] a Border Plan, and a Border Environmental Cooperation Agreement.[197] Mexico, Canada, and the USA have created a trilateral Commission for Environmental Cooperation to promote enforcement of environmental laws in the three countries.

Second, a specific problem may be addressed either through a bilateral or multilateral agreement designed to deal with it. An example is the tuna-dolphin dispute itself, which was addressed by the 1992 Agreement for the Reduction of Dolphin Mortality in the Eastern Pacific Ocean.[198] The Agreement has been implemented so successfully that scientists say that the eastern Pacific is now the 'world's safest tuna fishery for dolphins'.[199]

Third, regional pollution control agreements could be adopted following the model of the UNEP Regional Seas Programme[200] where 'framework' conventions have been concluded to preserve marine ecosystems in a number of regional-seas areas. These agreements are comprehensive in their regulation of all sources of marine pollution; they are models for facilitating cooperation and technical assistance, and new protocols can be added as needed to focus on particular pollution problems. A similar

[194] See generally, Brownlie, *Principles of Public International Law* (5th edn, Oxford, 1998) Ch 15.

[195] See, e.g. *Trail Smelter Arbitration*, 33 *AJIL* (1939) 182; 35 *AJIL* (1941), 684; 1991 Canada–US Agreement on Air Quality, 30 *ILM* (1991) 676; *supra*, Ch 6.

[196] 22 USC §§277–78b (1994). *See* Mumme, 33 *NRJ* (1993) 93.

[197] See Housman, *Reconciling Free Trade and the Environment: Lessons From the North American Free Trade Agreement* (UNEP, 1994).

[198] 33 *ILM* (1994) 936.

[199] *Int'l Herald Trib*, 26 June 1996, 6 (hereafter '*Dolphin Slaughter Ended*').

[200] See Hulm, *A Strategy for the Seas: The Regional Seas Programme, Past and Future* (UNEP, 1983), and *supra*, Ch 7.

system of regional treaties could foster higher environmental PPMs, as well as control pollution on an appropriate regional basis.[201]

Fourth, appropriate international organizations can encourage the transfer of environmentally friendly technology[202] through development assistance or foreign direct investment. Thus, countries would upgrade PPMs in return for assistance in acquiring environmentally enhancing technology. In this way, as countries develop particular industrial sectors, they would acquire the means to control the environmental consequences. The transfer of technology also would promote voluntary standardization of PPMs. To some extent, this already is happening under international treaty regimes for the control of ozone-depleting substances and climate change.[203]

6(3) ENVIRONMENTAL MANAGEMENT SYSTEMS

Many environmentalists saw the *Tuna-Dolphin* decisions as an obstacle to the maintenance of high environmental standards because they invalidated efforts to require environmentally protective PPMs in other countries. How should the WTO respond to these concerns? Should international minimum PPM standards be required?

The term 'environmental standards' has various meanings. It can refer to the characteristics of products, PPMs, the cleanliness of the ambient environment, or procedural requirements. There are three general approaches to the international treatment of product standards: (i) national treatment, where each country determines its own standards and applies them to imported products; (ii) mutual recognition, where countries agree to recognize each other's standards; and (iii) harmonization, where, through negotiation, countries agree to adopt identical or similar standards, which become, therefore, international.

The WTO/GATT system, through the TBT and SPS Agreements, relies primarily on approaches (i) and (iii), encouraging harmonization and the adoption of international standards, but permitting national treatment. Empirical studies evaluating WTO/GATT harmonization of product standards find that, other than 'interface' harmonization (e.g., weights and measures), it has had very limited success, because the costs and benefits of harmonization are incommensurable, so that most countries perceive it as a 'lose-lose' exchange.[204] If harmonization of product standards on a worldwide basis has proved difficult, harmonizing PPMs would be impossible. There also are valid economic and environmental reasons why process standards should not be identical on a worldwide basis.[205] In addition, the putative international 'race to

[201] Compare, e.g. the 1979 Convention on Long-Range Transboundary Air Pollution, *supra*, Ch 6.

[202] This idea, advanced by Rege, 28 *JWT* (1994) 95, 113–16, is already occurring to some extent through environmental agreements and the Global Environmental Facility. See Doherty, 4 *RECIEL* (1995) 33.

[203] See *supra*, Ch 6.

[204] See Leebron, in Bhagwati and Hudec (eds), *Fair Trade and Harmonization* (Cambridge, Mass, 1996) I, 41.

[205] See Stewart, 102 *Yale LJ* (1993) 2039, 2051–7.

the bottom' has been much exaggerated. Actually, there is much evidence that trade between nations improves environmental standards of all kinds.[206]

If requiring worldwide PPM harmonization is not the answer, what can be done to ameliorate the PPM/pollution haven problem? PPMs can be upgraded through private efforts to protect the environment by means of corporate responsibility programmes and widespread adoption of environmental management systems such as the ISO 14000 Series.[207] ISO 14001 was developed by the International Standards Organization to identify the core elements of a voluntary environmental management system that would call on organizations to conduct their environmental affairs within a structured system integrated with ordinary management activity. The elements of such a corporate system are (i) adoption of a senior-management-level environmental policy; (ii) identification of the key environmental aspects of a company's operations; (iii) identification and implementation of legal requirements; (iv) identification of quantifiable environmental targets and objectives; (v) establishment of an environmental management system that allocates responsibility for environmental improvement; (vi) training of employees; (vii) establishment of monitoring, auditing, and corrective action; and (viii) establishment of management review and responsibility. The ISO 14001 EMS is not limited to compliance, but focuses on pollution prevention as well.

ISO 14001 is becoming established as the internationally accepted voluntary standard system of environmental management. Many companies are moving to adopt this system, and there is every indication that adherence to it will become a prerequisite for access to international markets. ISO 14001 does not establish specific PPMs or standards for pollution control. Rather, it requires companies to commit themselves to continual improvement of their environmental management systems' compliance with applicable laws and pollution prevention, but it leaves each company free to implement individual solutions to pollution and negative externality problems. Although adoption of ISO 14001 is voluntary, governments can provide incentives for its use through relief from 'command and control' regulation, enforcement policies that impose reduced penalties, and environmental privilege guarantees for companies that implement it.

6(4) INVESTMENT

An important aspect of the pollution-haven problem is the charge that countries with lax pollution standards attract industry and jobs away from countries with high standards. Empirical studies, however, fail to show much evidence of this loss of jobs.[208] The USA and other OECD countries enforce similar environmental standards and

[206] See Casella, in Bhagwati and Hudec (eds), *Fair Trade and Harmonization* (Cambridge, Mass., 1996) I, 119; Wilson, ibid, I, 393.

[207] See Roht-Arriaza, 22 *ELQ* (1995) 479; ibid, 6 *YbIEL* (1995) 107; Rodgers, 5 *NYU Env LJ* (1996) 181; and Morrison and Roht-Arriaza, in Bodansky, Brunnee, and Hey (eds) *The Oxford Handbook of International Environmental Law* (Oxford, 2007) Ch 21.

[208] See Carbaugh and Wassink, 16 *World Competition* (1992) 81.

spend about the same to control pollution, about 2 per cent of gross domestic product.[209] Even though certain developing countries have lower pollution standards and there is anecdotal evidence of job losses, empirical evidence again suggests cost differences in environmental standards play little role in company location decisions.[210] Environmental compliance costs in most industries are only a small percentage of production costs. Thus, cost differences in raw materials and wages probably are more significant.[211]

Nevertheless, it may be wise for the WTO to counter this concern by adopting an amendment to the Agreement on Trade Related Investment Measures[212] or a broader Multilateral Agreement on Investment, if one is negotiated.[213] A model might be the NAFTA provision on Environmental Measures:

> The Parties recognize that it is inappropriate to encourage investment by relaxing domestic health, safety or environmental measures. Accordingly, a Party should not waive or otherwise derogate from, or offer to waive or otherwise derogate from, such measures as an encouragement for the establishment, acquisition, expansion or retention in its territory of an investment of an investor. If a Party considers that another Party has offered such an encouragement, it may request consultations with the other Party and the two Parties shall consult with a view to avoiding any such encouragement.[214]

Such a provision would not require any specific level of pollution control in the country where the investment is located, but it would set up a channel of complaint if environmental laxity is used to attract investment.

7 THE EXPORT OF HAZARDOUS SUBSTANCES AND WASTES

7(1) DOMESTICALLY PROHIBITED GOODS

Domestically prohibited goods are products whose sale and use are restricted in a nation's domestic market on the grounds that they present a danger to human, animal, or plant life, health, or the environment. They include unregistered pesticides, expired pharmaceuticals, alcohol, tobacco, dangerous chemicals, and adulterated food

[209] Ibid, 87–8.

[210] Leonard, *Pollution and the Struggle for World Product* (Washington DC, 1988); Pearson, *Down to Business: Multinational Corporations, the Environment, and Development* (New York, 1985).

[211] Carbaugh and Wassink, 16 *World Competition* (1992) 81, 88–90.

[212] The Agreement on Trade Related Investment Measures (TRIMs), *Legal Texts*, *supra*, n 1, was one of the key agreements of the GATT Uruguay Round.

[213] A proposed OECD Multilateral Agreement on Investment was abandoned in 1998: see McDonald, 22 *Melbourne ULR* (1998) 617–56; and Kodoma, 32 *JWT* (1998) 21–40. However, trade and investment is on the tentative agenda for a future WTO negotiating round.

[214] NAFTA, Article 1114(2).

products. For example, in the USA, the export of unregistered pesticides is permitted only under a system of notice that requires prior informal consent.[215]

Clearly a state may bar *imports* of a product that is banned for domestic sale or consumption. Can exports of such products also be restricted? This issue was addressed by a GATT working group in 1991,[216] but there was no consensus on its report; the issue was transferred to the agenda of the Committee on Trade and Environment (CTE). This was followed in 1998 by the negotiation of the Rotterdam Convention on the Prior Informed Consent Procedure for Certain Hazardous Chemicals and Pesticides in International Trade[217] establishing a prior informed consent (PIC) regime for banned or restricted chemical products and hazardous pesticide formulations that may cause health or environmental problems. The international shipment of these products would be barred without the prior notice and explicit consent of a designated national authority in the destination country. Do these export control and PIC regimes for dangerous products conform with WTO rules? The relationship of the PIC Convention with the WTO agreements was a controversial issue during negotiations, with a lack of consensus on the wording of a provision establishing an order of priority between them. As Kummer observes, '[c]ontroversy on this point appears to be inherent in multilateral environmental negotiations addressing transboundary transfer of potentially hazardous substances, since they deal with the interface of environment and trade considerations'.[218] In the event the preamble recognizes 'that trade and environmental policies should be mutually supportive with a view to achieving sustainable development'. Both the 2000 Cartagena Protocol and the 2001 Stockholm POP Convention employ this preambular language. The PIC Convention further emphasizes 'that nothing in this Convention shall be interpreted as implying in any way a change in the rights and obligations of a Party under any existing international agreement applying to chemicals in international trade or to environmental protection' whilst at the same time immediately recording the parties' '[u]nderstanding that the above recital is not intended to create a hierarchy between this Convention and other international agreements'. The Cartagena Protocol (but not the 2001 Stockholm POP Convention) repeats these preambular provisions virtually verbatim, though replaces 'hierarchy' with 'subordinate'. Neither approach is particularly helpful, not least because no specific guidance is given on how 'trade and environment' conflicts

[215] 7 USC §1360 (West Supp 1994).

[216] See *Report by the Chairman of the GATT Working Group in Export of Domestically Prohibited Goods and Other Hazardous Substances*, GATT Doc L/6872 (1991). This group recommended a code that would allow individual member states to decide whether their domestic restrictions should be carried over to exports.

[217] The Convention rests on three cornerstones: prior informed consent, exchange of information, and national decision-making processes, also found in the Basel Convention and the Cartagena Protocol: see Chs 8, 11. In contrast, the 2001 Stockholm Convention on Persistent Organic Pollutants provides for an outright ban on the export/import of the regulated substances. See further Redgwell, in Kiss, Shelton, and Ishibashi (eds), *Economic Globalization and Compliance with International Environmental Agreements* (The Hague, 2003) Ch 6. For analysis of the trade implications of a range of prior informed consent regimes, see Micklitz, 23 *Journal of Consumer Policy* (2000) 3, 12.

[218] 8 *RECIEL* (1999) 322, 325.

are to be resolved should they arise. The dispute settlement provisions of the PIC Convention adopt the familiar, non-compulsory, dispute settlement formula found in so many international environmental treaties.

Would it be permissible for a state to go beyond PIC and adopt a total ban on the export of certain categories of domestically prohibited goods? A PIC restriction or a total ban[219] may be carried out within current established legal limits. GATT Article XX(b) allows trade measures (affecting either imports or exports) that are 'necessary to protect human, animal, plant life or health'. Moreover, according to the *Tuna-Dolphin II* and *Shrimp-Turtle Cases*, nothing in Article XX prevents a state from imposing a trade measure to protect the health or safety of persons or the environment located *outside* the territory of that state. Under this interpretation, then, a PIC export regime or a total export ban would be justified.

However, further clarification by the CTE would remove any remaining uncertainty by reaffirming the requirements of current law and stating explicitly that they apply to domestically prohibited goods. The CTE could also adopt transparency requirements which would compel trade-restricting states to notify the WTO and publish in full all laws, regulations, and decisions relating to the products concerned. The WTO would thus provide a clearinghouse for the notification and publication of domestically prohibited goods restrictions, and they would be fully subject to the WTO dispute resolution regime.

7(2) WASTE

Export of hazardous wastes has received great attention from the international community. The Basel Convention on the Control of Transboundary Movements of Hazardous Wastes and Their Disposal[220] requires prior notification and informed consent of the receiving country as a precondition for authorizing international waste shipments. Furthermore, the Convention provides that parties must prohibit the export of the waste whenever there is reason to believe that it will not be managed in an environmentally sound manner.

Two aspects of the Basel Convention raise problems with respect to WTO rules. First, as we saw in Chapter 8, the Conference of the Parties adopted an amendment to ban the export of hazardous wastes from industrialized countries (the OECD, the European Union, and Liechtenstein) to developing countries. The ban applies both to hazardous waste intended for disposal and, since the end of 1997, to hazardous waste intended for reuse or recycling.[221] Second, Article 4(5) of the Convention prohibits exports and imports of hazardous and other wastes between parties and non-party states. These trade restrictions on wastes are based upon past experiences and future fears concerning the exploitation of developing countries. They also reflect certain principles adopted at the 1992 UN Conference on Environment and Development, notably Principle 14 of the Rio Declaration, which provides that states should cooperate

[219] For example, under the POPS Convention. [220] See Ch 8. [221] Ibid.

to prevent the movement of materials harmful to the environment and humans, and Principle 19, which requires prior notice to potentially affected states with regard to potentially harmful activities.

The international regime for the transboundary movement of hazardous waste is in marked contrast to that in effect domestically in the USA, where the Supreme Court has struck down state-imposed limitations on the import of hazardous waste as violating constitutional norms under the Commerce Clause.[222] On the other hand, the European Court of Justice in the *Belgian Waste Case*[223] stated that waste can be a threat to the environment because of the limited capacity of each region or locality to receive it. Accordingly, the Court ruled that it is permissible under the Articles 30 and 36 of the EC Treaty for a locality to adopt an import ban unless this is inconsistent with EC legislation.[224] The Court based its decision on the 'proximity principle'—that wastes should be treated at their source—and the importance of self-sufficiency regarding waste. The Court's ruling would seem to allow export as well as import restrictions on waste.

An export ban on *hazardous* wastes may be justified under GATT Article XX(b) on the same basis as export restrictions on domestically prohibited goods. Hazardous wastes have the potential to endanger human health and the environment; thus Article XX(b) may be interpreted to allow export bans to protect areas outside the territory of the trade restricting country. Even a discriminatory export ban may be upheld under Article XX(b) if the discrimination is not 'arbitrary or unjustifiable…between countries where the same conditions prevail'. A ban that distinguishes between OECD and developing countries, arguably at least, could pass this test because of the very different conditions in developing countries. Thus, emerging international hazardous waste regimes seem reconcilable under the WTO/GATT system.

8 ENVIRONMENTAL TAXES

Many commentators have called on governments and public authorities to use market-based economic incentives[225] rather than command-and-control regulation to improve environmental quality. As a result, taxes may be used more frequently in the future, both to raise revenue and to achieve environmental goals. Environmental taxes are based on the principle that many resources are under-priced and, therefore, overused. Environmental taxes, in effect, raise the price of the use of these

[222] E.g. *City of Philadelphia v New Jersey*, 437 US 617 (1978).

[223] Case C-2/90, *Commission v Belgium* (1993) 1 *CMLR* 365 ['*Belgian Waste Case*'].

[224] The Court upheld the ban as regards the importation of non-hazardous waste not covered by a Council directive. However, the Court ruled that to the extent that the ban related also to hazardous waste, Belgium had failed to fulfil its obligation to comply with Council Directive 84/631. Ibid, paras 38–9.

[225] There are four basic types of economic incentives: (i) taxes on charges, (ii) transferable pollution permits, (iii) deposit-and-return systems, and (iv) information strategies. See Stewart, 102 *Yale LJ* (1993) 2039, 2093–4; Galizzi, 6 *Eur Env LR* (1997) 155.

resources. They have three purposes: (i) to discourage the consumption of goods and services that create environmental costs; (ii) to encourage producers to develop alternative production methods and products that are less harmful to the environment; and (iii) to implement the polluter-pays principle (PPP), which holds that the polluter should bear the expenses imposed upon society of ensuring that the environment is in an acceptable state.[226] In the *US Superfund Case*, a GATT panel stated: 'The General Agreement's rules on tax adjustment…give the contracting party the possibility to follow the polluter-pays principle, but they do not oblige it to do so'.[227]

Despite their attractiveness, environmental taxes are not yet widespread for several reasons. First, many people are opposed in principle to raising taxes. Second, analysis shows that some environmental taxes would be regressive, falling most heavily on the poor. Third, there is concern that countries employing them would no longer be competitive in the global marketplace, as their industries would suffer in comparison to industries in countries without such taxes. There are, in general, two solutions to this problem. Countries can cooperate and enter into an international agreement that requires all to levy environmental taxes on their producers; or countries that tax their own producers can levy a similar charge on 'like' imported products. Moreover, even if environmental taxes are imposed by international agreement, import taxes may be needed to even out unequal taxation. Charges on imports raise the issue of their consistency with the WTO system and GATT 1994.

There are three different categories of environmental taxes that governments may use. First, taxes can be imposed directly on the sale of a product that has potentially adverse environmental consequences. This category includes deposit-and-return systems, where 'tax' is rebated, and un-rebated taxes on environmentally unfriendly products such as cigarettes, certain types of energy, and certain chemicals. Second, the tax can be levied on the use of an environmental resource itself. Examples include charges for the emission of pollutants into the air, discharges into rivers or sewer systems, the 'congestion' of highways, and the use of landfills or hazardous waste disposal facilities. Third, environmental taxes may be imposed on *inputs* into products. Here, two kinds of measures may be distinguished: taxes on inputs that are physically incorporated into the final product (such as chemical feedstock incorporated into a plastic or petroleum product), and taxes on inputs that are completely consumed during production (such as fuel or energy used in making a manufactured product).

GATT distinguishes two principal categories of taxes and charges and submits them to different controls.[228] Article II(1), which applies to customs duties and import charges, prohibits WTO members from imposing higher charges than those specified

[226] On the polluter-pays principle see *supra*, Ch 3, and OECD, Recommendations C(72)128 on Guiding Principles Concerning International Economic Aspects of Environmental Policies, 11 *ILM* (1972) 1172; C(74)223 on the Implementation of the 'Polluter Pays' Principle, 14 *ILM* (1974) 234.

[227] *US—Taxes on Petroleum and Certain Imported Substances*, GATT BISD (34th Supp) (1988), 136, para 5.2.5.

[228] See generally Fauchald, *Environmental Taxes and Trade Discrimination* (The Hague, 1998); O'Riordan (ed), *Environmental Taxation* (London, 1995).

in their agreed schedules of concessions. Article III, which applies to internal taxes and charges, requires national treatment. To distinguish between the two, Article II(2)(a) provides:

> Nothing in this Article shall prevent any contracting party from imposing *at any time* on the importation of any product:
>
> (a) a charge equivalent to an internal tax imposed consistently with the provisions of paragraph 2 of Article III in respect of an article *from which* the imported product has been manufactured or produced *in whole or in part*. [Emphasis added]

To further clarify the distinction, an interpretive Note Ad Article III states that '[a]ny internal tax... which applies to an imported product and to the like domestic product and is collected or enforced in the case of the imported product at the time of importation, is nevertheless to be regarded as an internal tax'.

This pattern of GATT regulation makes clear that the distinction between customs charges (Article II) and internal taxes (Article III) is not based on when or where the taxes are levied. Internal taxes can be adjusted at the border or anywhere else in the distribution process. The difference is that internal taxes on imports are 'equalizing' taxes for the purpose of subjecting imports to the equivalent tax regime for domestic like products. Environmental taxes are internal taxes subject to the discipline of Article III, not Article II. Thus, environmental taxes theoretically can be imposed on imports and be adjusted at the border.[229] Which kinds of environmental taxes can be applied to imports depends on the GATT's border tax adjustment rules.

Border tax adjustment (BTA) is the mechanism invented to harmonize the international taxation of products in accordance with the destination principle, which holds that goods should be taxed where they are used or consumed. BTA, which can be traced to the eighteenth century,[230] allows each nation to implement its own regime of domestic taxation while assuring that goods that move in international trade are neither exempt from taxation nor subject to double taxation. BTA allows (i) an internal tax to be imposed on imported products and (ii) the remission of internal taxes on domestic products destined for export.

What kinds of domestic taxes are eligible for BTA? From its origin in 1947, the GATT has maintained a fundamental distinction between taxes imposed on *products* (termed 'indirect' taxes) and taxes on various forms of income and the ownership of property (termed 'direct' taxes).[231] Only taxes imposed on *products*, indirect taxes, are eligible for BTA. For example, as to taxes remitted on export, Article VI(4) provides:

> No product of the territory of any contracting party imported into the territory of any other contracting party shall be subject to an anti-dumping or countervailing duty by reason of the exemption of such product from duties or taxes borne by the like product when destined for consumption in the country of origin or exportation, or by reason of the refund of such duties or taxes.

[229] Of course, the requirements of Article III(2) must be met, which means that imports cannot be charged more than domestic products. However, in the *Japan Shochu Case*, the WTO Appellate Body held that Article III(2) embodies two standards.

[230] See Demaret and Stewardson, 28 *JWT* (1994) 5, 6–7.

[231] For the history of this distinction, see ibid, 9–12.

The Note Ad Article XVI also makes this point: 'The exemption of an exported product from duties or taxes borne by the like product when destined for domestic consumption, or the remission of such duties or taxes in amounts not in excess of those which have accrued, shall not be deemed to be a subsidy'. In 1970, the GATT Working Party on Border Tax Adjustments made the distinction explicit, agreeing that 'taxes directly levied on products were eligible for tax adjustment', and that 'certain taxes that were not directly levied on products were not eligible for adjustment, [such as] social security charges... and payroll taxes'.[232]

The economic distinction between direct and indirect taxes originally was based on the idea that indirect taxes generally were passed on to the ultimate consumer, while direct taxes were not. It is now recognized that this distinction is too simplistic; many indirect taxes are absorbed by producers and direct taxes also can be passed on in the price of a product.[233] Thus, today the distinction rests on tradition and practicality. It is fundamentally a political compromise that allows equalization of some, but not all, of the differences in internal tax regimes; it is based on administrative practicality in that BTA would be much more difficult to apply to direct taxes; and also is based on the fact that taxes on products can be abused more easily for protectionist purposes.

(i) Taxes on products Environmental taxes levied on products are eligible for BTA as long as they are consistent with the national treatment standards of GATT Article III. In the *US Superfund Case*, the panel made the point that the GATT 'does not distinguish between taxes with different policy purposes'.[234] The GATT requires only that 'like' imported and domestic products be taxed the same. Moreover, there is some flexibility in this national treatment standard. As stated above, when products are 'like' only in the sense of being 'substitutable or competitive' with each other, a higher tax on imports is allowable.[235] In addition, in the *US Automobile Taxes Case*,[236] the GATT panel upheld the validity of US taxes that fell more heavily on imported cars. This ruling seems to justify de facto (but not *de jure*) discrimination against imports as long as a tax has a valid environmental purpose. This decision is thrown into doubt, however, by the WTO Appellate Body's ruling in the *Japan Shochu Case* that the *purpose* of a tax is not a legitimate inquiry under GATT Article III.[237]

A deposit-and-return system of taxes on products is also permissible under GATT rules. In the *Canada Beer Cases*,[238] panels upheld the Canadian deposit/return system on beer containers as applied to imports; to meet the national treatment standard, however, the system had to be applied equally without different systems of delivery

[232] *Border Tax Adjustments*, 2 Dec 1970, GATT BISD (18th Supp) 97, 100–01, para 14 (1972).

[233] Hufbauer and Erb, *Subsidies in International Trade* (Washington DC, 1984) 23.

[234] *US Superfund Case*, *supra*, n 19, para 5.2.8.

[235] *Japan Shochu Case*, *supra*, n 22.

[236] *Taxes on Automobiles Case*, *supra*, n 150.

[237] *Japan Shochu Case*, *supra*, n 22.

[238] *Canada—Import, Distribution, and Sale of Alcoholic Drinks by Canadian Provincial Marketing Agencies*, 22 March 1988, GATT BISD (35th Supp) 37 (1989) (hereafter '*Canada Beer I*'); *Canada—Import, Distribution, and Sale of Alcoholic Drinks by Canadian Provincial Marketing Agencies*, 18 February 1992, GATT BISD (39th Supp) 27 (1993) (hereafter '*Canada Beer II*').

to points of sale for imported and domestic beer.[239] Thus, GATT norms freely permit BTA with respect to environmental taxes on products.

(ii) Taxes on resource use Environmental taxes and charges on resource use, such as effluent and emission charges, are not subject to BTA under GATT rules. Such taxes are not on products as such, even though they are incurred in connection with the manufacture of products. The GATT would classify these charges as direct taxes paid out of gross revenues not eligible for BTA.

(iii) Taxes on inputs The leading case on environmental taxation of physically incorporated inputs is *US Superfund*, which ruled that taxes on articles used for the manufacture of domestic products may be taken into account in BTA of imported like products. In coming to this conclusion, the panel relied on an example provided by the 1947 drafting committee to explain the word 'equivalent' in Article II(2)(a): 'If a charge is imposed on perfume because it contains alcohol, the charge to be imposed must take into consideration the value of the alcohol and not the value of the perfume, that is to say the value of the content and not the value of the "whole"'.[240] The panel concluded that the tax met the requirements of Article III(2) because the chemical feed stocks taxed were 'used as materials in the manufacture or production' of the final product. '[T]he tax is imposed on the imported substances because they are produced from chemicals subject to an excise tax in the USA and the tax rate is determined in principle in relation to the amount of these chemicals used and not in relation to the imported substance'.[241] The *US Superfund* panel also upheld the method US authorities used in assessing the tax, which was to charge 5 per cent of the appraised value of the final product unless the importer furnished the information necessary to determine the exact amount to impose. This method was permissible[242] because the importer, by furnishing proper information, could avoid the penalty tax.

Thus, environmental taxes on inputs that are physically present in some form in the final imported product are properly subject to BTA. This means that BTA can be made, for example, for a tax on chlorofluorocarbons (CFCs) and other ozone-depleting substances with respect to the export/import of refrigerators in which they are incorporated.

The status of inputs consumed in the production process is more problematic, as is shown by the example of the UN Framework Convention on Climate Change.[243] Although the Convention merely requires parties to work toward the modest goal of reducing greenhouse gas emissions to 1990 levels by the year 2000,[244] the 1997 Kyoto Protocol[245] obliges most developed state parties to make binding reductions of the main greenhouse gases by the year 2012. The parties' implementation of greenhouse gas reductions could include taxes on carbon emissions or energy.[246] Although proposals to

[239] *Canada Beer II*, ibid, para 5.33.
[240] GATT Doc EPCT/TAC/PV/26, at 21 (1947), quoted in *US Superfund Case*, *supra*, n 19, para 5.2.7.
[241] *US Superfund Case*, *supra*, n 227, para 5.2.8. [242] Ibid, para 5.3.9. [243] *Supra*, Ch 6.
[244] Article 4. [245] *Supra*, Ch 6.
[246] See generally, OECD/IEA, *Taxing Energy: Why and How* (Paris, 1993).

tax energy in both the USA[247] and the European Community[248] have proved politically unacceptable—and likely to remain so for the near future given the current high cost of energy—their allure to policymakers is undeniable: such taxes produce more governmental revenues while improving environmental quality. If energy taxes are to become politically palatable, many concerns must be addressed, such as their impact on poorer members of society, how the revenue produced will be used (for reduction of other forms of taxation, deficit reduction, or new programmes), and their impact on international competitiveness. To deal with the latter problem, BTA is essential.[249]

But the GATT is ambiguous about BTA for taxes on inputs consumed during the production process. Article III does not deal with this issue, but Article II(2)(a) appears to preclude BTA, since it allows a tax with respect to Article III only on inputs 'from which', *not* 'with the help of which', the imported and the like domestic product were produced. Hence, energy taxes apparently cannot be imposed on imported products because energy is consumed and is not physically incorporated into the product during its production. The 1970 GATT Working Party on Border Tax Adjustments noted a divergence of views on *taxes occultes*, that is, taxes on energy, advertising, machinery, and transport.[250] Thus, this point needs clarification.[251]

9 THE TRIPS AGREEMENT AND THE BIODIVERSITY CONVENTION

The WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs)[252] guarantees recognition and enforcement of intellectual property rights

[247] In 1993, President Clinton proposed a broad-based energy tax that would have applied to all fuels at a basic rate in proportion to their energy content as measured in British Thermal Units (BTUs). The Senate substituted a 4.3-cent per gallon increase in the tax on motor fuels, which became law. See HR Rep No 103–111, 103d Cong, 1st Sess (1993).
[248] In 1992, the European Commission proposed a hybrid carbon/energy tax to limit carbon dioxide emissions and to improve energy efficiency. See *Commission Proposal for a Council Directive Introducing a Tax on Carbon Dioxide Emissions and Energy*, 1992 OJ (L 196) 1; Christian, 10 *UCLA J Envtl L & Pol* (1992) 332, 342. This and modified versions of an energy tax have not been enacted, although a few member states have adopted their own energy taxes, including the UK and Denmark. However, energy products and electricity are taxed when used as motor or heating fuel, with lower minimum levels of taxation applicable to more environmentally friendly unleaded petrol: see Council Directive 2003/96/EC of 27 October 2003 restructuring the Community framework for the taxation of energy products and electricity For discussion of national, regional and international approaches, see Deketelaere, Milne, Kreiser, and Ashiabor (eds), *Critical Issues in Environmental Taxation* (Oxford, 2006).
[249] Another environmental tax of this kind is §4681 of the US Internal Revenue Code, which provides for a tax on 'any product (other than an ozone-depleting chemical) entered into the USA for consumption, use, or warehousing if any ozone-depleting chemical was used as material in the manufacture or production of such product'. This would cover such products even if the ozone-depleting chemicals were completely consumed in the production process.
[250] On border tax adjustments, see *supra*, section 8.
[251] This is one of the topics of discussion within the CTE: see *supra*, section 2(3).
[252] The text of TRIPS is reprinted in WTO, *The Legal Texts*, *supra*, n 1.

backed by the authority of the WTO's dispute settlement mechanism. As indicated above, the relationship between TRIPS and the environment is one of three areas of focus for the CTE identified in the 2001 Doha Declaration, with two features subsequently dominating CTE discussions: (i) transfer of environmentally friendly technology; and (ii) the general relationship between TRIPS and the Convention on Biological Diversity.[253] As we noted above in Chapter 11, the Biodiversity Convention provides that the genetic resources of plants and animals are under the sovereignty of the state in which they are located,[254] and developing countries have a right to benefit from the development of these resources as well as from the transfer of technology relevant to the development and use of genetic resources. The Biodiversity Convention also requires the recognition 'as far as possible and as appropriate' of the rights of 'indigenous and local communities' in 'innovations and practices' relevant to the conservation and use of biological diversity.[255] These two agreements contain the seeds of potential conflicts with vast implications not only for the environment, but also for the biotechnology, pharmaceutical, and agricultural industries.

The TRIPS Agreement and the Biodiversity Convention were developed, albeit at the same time, by different delegations, in different forums, with different objectives, and with almost no consultation or even communication between the two negotiations. The same is not true for the Cartagena Protocol, however, as we have noted, and subsequent developments under the Biodiversity Convention have seen increased cooperation between, for example, the Biodiversity secretariat and the WTO and WIPO secretariats.[256] Since the Biodiversity Convention is in force and accepted by nearly 190 States and the WTO/GATT by over 150, conflicts are most likely to arise between nations that have accepted both treaty regimes. In such a case, Article 22 of the Biological Diversity Convention adopts the following rule of priority:

1. The provisions of this Convention shall not affect the rights and obligations of any Contracting Party deriving from any existing international agreement, except where the exercise of those rights and obligations would cause a serious damage or threat to biological diversity.
2. Contracting Parties shall implement this Convention with respect to the marine environment consistently with the rights and obligations of States under the law of the sea.

As we noted above in Chapter 11, this 'serious damage or threat' standard is obviously vague and difficult to apply because it can be interpreted in different ways, and highlights the importance of dispute settlement when concrete issues arise. However, the Biodiversity Convention provides a flexible dispute settlement

253 TRIPS Article 64, with a delayed implementation periods for developing countries which have now expired.

254 For the particular problem of genetic resources on the deep seabed, see *supra*, Ch 13 and Scovazzi, in Francioni and Scovazzi (eds), *Biotechnology and International Law* (Oxford, 2006) Ch 4.

255 Articles 3, 8, 10, 15, 16, 19.

256 See Ch 11 above. While the TRIPS is a covered agreement under the WTO and is concerned with the trade-related aspects of intellectual property rights, the other international conventions referred to in it—on trademarks, copyright, and industrial property for example—are administered by WIPO.

mechanism in Article 27: parties are required to negotiate and they may refer the dispute by agreement to mediation, but arbitration or resort to the ICJ are compulsory only if both parties have made a declaration accepting jurisdiction. Since few states have accepted this option, most disputes under the Convention will be resolved by compulsory conciliation, which requires only that the states involved submit their dispute to a conciliation commission and consider the solution proposed by the commission 'in good faith'. This provision also applies to disputes under the Cartagena Protocol. It may be contrasted with the dispute resolution mechanism of TRIPS, where disputes are subject to resolution under GATT Articles XXII and XXIII and the WTO's Dispute Settlement Understanding detailed earlier in this chapter and featuring compulsory jurisdiction, a strict timetable, judicialized procedures, and mandatory compliance or punishment in the form of compensation or suspension of concessions.

Given these two separate regimes, disputes arising under both the Biodiversity Convention/Cartagena Protocol and TRIPS probably will be addressed by the WTO dispute settlement regime. This is because the WTO process is mandatory if either party brings a complaint; the other party will not be able to resist. Thus, conciliation under the Biodiversity Convention will take place only if both parties involved agree to forego resort to the WTO. In some cases disputes may arise between states that have accepted binding arbitration or adjudication by the International Court of Justice as well as the WTO regime. In such a case a true conflict may arise as to which dispute settlement body has primary jurisdiction.[257]

9(1) ACCESS TO GENETIC RESOURCES

Major industries, such as those relating to biotechnology, pharmaceuticals, and agriculture, are dependent on worldwide access to genetic resources. These and other industries use wild plants and animals in three basic ways. First, a species can be used directly as a source of natural chemicals or compounds for the production of drugs or other products. An example is the use of the Pacific yew tree to produce an anti-cancer drug. Second, a species' natural chemicals can provide information and ideas that can lead to the production of useful synthetic chemicals, drugs, and products. An example is aspirin, a drug developed as a synthetic modification of salicylic acid, which is found in plants. Third, a natural species can be a source of a gene or genetic sequence that can be used to develop new varieties through breeding or a genetically modified organism through implantation. The former process is essential to modern agriculture. Because crops and animals are susceptible to disease and adverse climatic conditions, it is critical to have access to natural gene pools (germ plasm) to develop more productive and

257 A precedent for reconciliation of the jurisdiction of different international tribunals is Article 2005 of the North American Free Trade Agreement (NAFTA), which contains a complex regime for deciding when the parties to a trade dispute should go to the World Trade Organization and when the NAFTA dispute settlement provisions should be employed. See Abbott, in Weiler (ed), *The EU, the WTO and the NAFTA: Towards and Common Law of International Trade* (Oxford, 2000) 182–4.

disease resistant plants and animals. The latter process is critical to the biotech industry which develops new products through genetic modification and incorporation of genetic materials.

Article 15 of the Biodiversity Convention authorizes states to limit or place conditions on access to genetic resources.[258] The vague language of Article 15 provides a potential basis for a range of actions, from an export ban to market pricing. However, members of the WTO are required to observe GATT 1994 norms in its implementation. Most notably, export bans or conditions would have to comply with GATT Article XX(g), which requires that export restrictions must relate to the conservation of the resource and must be applied in conjunction with restrictions on domestic production or consumption. In addition, an Article 15 export measure must not employ 'arbitrary or unjustifiable discrimination between countries' or be a 'disguised restriction on international trade'. Thus, the vagaries of Article 15 are subject to the discipline of the GATT.

A striking exercise of Article 15 rights is the control regime adopted by Costa Rica, which, in 1992, passed amendments to its Wildlife Conservation Law declaring wildlife to be in the 'public interest' and requiring advance governmental approval for the export of genetic materials and for bio-genetic research.[259] This law is designed to give the Costa Rican government broad discretion in negotiating contracts with foreign firms that wish to employ genetic resources for research. A precursor of this contractual regime was the 1989 contract[260] signed by Merck & Company, the largest US pharmaceutical company, and the Instituto de Biodiversidad Nacional (INBIO), a non-profit institution created by the Costa Rican government. Under this arrangement Merck advanced $1 million to INBIO for the right to develop drugs from Costa Rican plants, insects, or microbes supplied by INBIO, and INBIO and the Costa Rican government will share an amount, reportedly between 1 and 3 per cent, of the revenues from any products developed from INBIO-supplied genetic resources.

GATT 1994 would not bar this arrangement or any other that requires compensation in the form of payment or royalties in return for resource use.[261] The GATT does not regulate pricing so that any payment arrangement would be permissible; however, if a state trading enterprise is involved, GATT Article XVII requires that purchases and sales must be in accordance with commercial consideration and must be made on a non-discriminatory basis.[262] Thus, the GATT and Article 15 of the Biological Diversity Convention are prima facie compatible.

[258] The provisions on access and benefit sharing in the CBD have been elaborated by the SBSTTA: see *supra*, Ch 11 section 5.

[259] See Aseby and Kempenaar, 28 *Vand JTL* (1998), 703.

[260] See Reid et al (eds), *Biodiversity Prospecting: Using Genetic Resources for Sustainable Development* (Washington DC, 1993); Powers, 12 *Wis ILJ* (1993) 103, 117–20.

[261] For a comprehensive review and analysis of contractual arrangements, see Aseby and Kempenaar, 28 *Vand JTL* (1995) 703.

[262] GATT Article XVII(1)–(2).

Perhaps the most important and troublesome question likely to arise in legislation and contracts implementing Article 15 is whether countries can discriminate against foreign companies, charging them for resource use while exempting domestic firms. The answer to this question depends on whether the charge is levied as a customs charge or an internal tax or charge. A true customs charge must comply only with the most-favoured-nation requirement of GATT Article I, while an internal charge must comply not only with Article I but also with GATT Article III, which requires national treatment. In the latter case it would be GATT-illegal to exempt domestic firms. Thus, foreign firms that establish and carry on research activities in the country of origin of the biological materials cannot be subjected to a discriminatory pricing arrangement.

While Article 15 is, in principle, compatible with the GATT, it may be difficult for substantial revenues to be derived from Article 15 by developing countries unless they illegally control exports and discriminate against foreign firms. First, only rarely will the biological materials concerned be limited to one country, and availability from multiple sources will reduce the price. For example, Eli Lilly Company produced two anti-cancer drugs, vinblastine and vincristine, from periwinkle leaves first obtained in Madagascar. However, the plant grows wild in many areas of the world including Texas, where it is grown commercially. Although Eli Lilly has been criticized[263] for not providing compensation to Madagascar, it is not difficult to see why it did not do so. Second, few new drugs or products are made from unmodified biological resources; more often they will be derivatives or produced purely synthetically.[264] Thus, Article 15 seems to be deficient as a mechanism for achieving the goal of sustainable development.

9(2) PATENTABILITY

Patentability is important for the development of both beneficial biotechnologies and marketable environmental technologies that generate less waste and pollution. The TRIPS Agreement, by strengthening global intellectual property protection, will have a positive effect on both categories by providing incentives for research and development. Under TRIPS Article 27(1) patents must be available for products and processes in all fields of technology. TRIPS Article 8(1) permits 'measures necessary to protect public health and nutrition and to promote the public interest in sectors of vital importance to... socio-economic and technological development', but this is qualified by the requirement that such measures must be 'consistent with... this Agreement'. It would thus appear that Article 8(1) does not qualify the patentability requirement of Article 27. However, Article 27(2) allows members to exclude from patentability inventions that endanger human, animal or plant life or health, or the environment,

[263] See Stone, 256 *Science* (1992) 1624.

[264] Office of Technology Assessment, US Cong, *Biotechnology in a Global Economy*, 75–6 (Washington DC, 1991).

but the exclusion must be 'necessary', not 'merely because the exploitation is prohibited by their law'. Article 27(3) also allows plants, animals, and biological processes to be excluded from patentability, but micro-organisms, non-biological and microbiological processes must be patentable.

This formulation ensures that most biotechnological, pharmaceutical, and agricultural biotechnical inventions must be protected by patent law. Naturally occurring plants and animals are not patentable, but genetically modified micro-organisms, animal genes, human DNA sequences, human proteins, and human genes have all been patented in the USA and Europe.[265] Although TRIPS does not require parties to allow the patenting of genetically engineered animals, such as the 'Harvard mouse', an experimental animal developed for the study of breast cancer, the transgenic process by which such animals are developed would be patentable under TRIPS, either as a microbiological or a non-biological process.[266]

TRIPS also for the first time requires plant breeders rights (PBR) to be given world-wide protection. Although naturally occurring plants cannot be patented, TRIPS Article 27(3)(b) provides that 'Members shall provide for the protection of plant varieties either by patents or by an effective *sui generis* system or by any combination thereof'. The *sui generis* system refers to the International Union for the Protection of New Varieties of Plants (UPOV), established by the UPOV Convention in Paris in 1961 and periodically revised.[267] States adhering to UPOV undertake to create a system of granting PBRs under their domestic laws. TRIPS supplements UPOV by requiring all WTO member states to grant protection to PBRs, either through UPOV or by admitting their patentability.[268]

The Biodiversity Convention, in general, is consistent with the patentability provisions of TRIPS and places no limits on protection of genetic resources. However, the Convention calls for respect and preservation of the knowledge, innovations, and

[265] See generally Walden, in Bowman and Redgwell (eds), *International Law and the Conservation of Biological Diversity*, 171; Hedge, 38 *Ind JIL* (1998) 28. In *Diamond v Chakrabarty*, 447 US 303 (1980) the US Supreme Court held that a genetically altered micro organism was patentable under US law either as a 'manufacture' or a 'composition of matter'.

[266] Genetically altered animals are patentable under US law: see *Ex parte Allen*, 2 USPQ 1425 (1987). The US Patent and Trademark Office issued a patent in 1988 to the inventors of the 'Harvard mouse' (also known as the 'ONCO mouse'). In contrast, a similar patent granted by the European Patent Office in 1991 has been subject to opposition proceedings under Article 53 of the 1973 European Patent Convention, which provides that a patent should not be granted (a) for an invention the exploitation of which would be contrary to *ordre public* or public morality, and (b) for plant or animal varieties, or essentially biological processes for the production of plants or animals. Article 6 of the 1998 EC Directive 98/44/EC on Protection of Biotechnological Inventions retains similar but not identical morality provisions, although its general thrust is to provide for the patentability of biological material in EC member states.

[267] In 1972, 1978, and 1991. 'UPOV' stands for 'Union Internationale pour la Protection des Obtentions Végétales' and its members include the EC and the USA. On international regimes for plant genetic resources see Rose, in Bowman and Redgwell (eds), *International Law and the Conservation of Biological Diversity*, 145; Duffield, *Intellectual Property Rights, Trade and Biodiversity* (London, 1999); and *supra*, Ch 11, section 5.

[268] See Tilford, 30 *Case WRJIL* (1998) 373.

practices of indigenous and local communities.[269] It is not clear what impact, if any, these provisions were intended to have on intellectual property rights. Presumably, domestic legislation could provide for PBR for traditional societies and certain kinds of knowledge could be protected as trade secrets.[270] Thus, these provisions of the Biodiversity Convention may be accommodated under existing categories of intellectual property rights.

Another problem may be posed by the exception clause of TRIPS Article 27(2). On first reading, this exception seems very broad, freely allowing national exceptions to patentability. However, the two qualifying phrases, 'necessary' and 'not made merely because the exploitation is prohibited by their law' could, if interpreted strictly, mean that only when there is a substantial international consensus in favour of non-patentability and only where no other means is available to protect the environment, will this exception be triggered. As yet the meaning and scope of this Article 27(2) exception has not been clarified.[271]

9(3) ACCESS TO AND TRANSFER OF TECHNOLOGY

The Convention on Biodiversity and the TRIPS Agreement may come into conflict depending on how Article 16 of the Convention is interpreted concerning access to and transfer of technology. TRIPS mandates a private, free-market system for the acquisition and transfer of rights to intellectual property. Article 28 confers on the patent owner the right to prevent the selling or importing of patented products; patent owners also have the exclusive right to assign, transfer or license their patents. The Biodiversity Convention, in contrast, requires that the contracting parties provide for (i) priority or concessional access for developing countries; (ii) preferential terms for such countries; and (iii) joint research and development efforts by the firms that develop the IPRs and the country supplying the genetic resources.[272]

All of these requirements potentially conflict with the TRIPS regime, which would leave matters to the private sector to decide without governmental interference. For this reason, as we noted above in Chapter 11, the USA initially refused to sign the Biodiversity Convention,[273] and the Clinton administration essentially repudiated all three requirements in its statement supporting the Convention's ratification. President Clinton's Message to the Congress stated that sharing of results of research and benefits 'must take fully into account exclusive rights that a party may possess and that transfers of proprietary technology will take place only at the discretion of

[269] Articles 8(j), 10(c). See Shelton, 5 *YbIEL* (1994) 77, and *supra*, Ch 11, section 5. See also the UNESCO Convention on intangible property rights.

[270] See generally Starr and Hardy, 12 *Stan ELJ* (1993) 85.

[271] See Harper, 2 *Wm & Mary Envtl L & Pol Rev* (1997) 381.

[272] See Articles 15(7), 16(2)–(3), 19(1)–(2). See *supra*, Ch 11.

[273] See also Chandler, 4 *Col JILP* (1993) 141, 173–5.

the owner of the technology'.[274] Article 16 should be interpreted, the president stated, so 'that in the case of technology subject to patents and other intellectual property rights, such access and transfer shall be provided on terms that are consistent with the adequate and effective protection of intellectual property rights'.[275] The message further holds that:

> technology transfer by the US private sector to other countries requires an economic infrastructure in the recipient country that encourages the voluntary transfer of technology and provides sufficient safeguards for investment... To be considered adequate and effective, a country's intellectual property system must make protection available for all fields of technology and provide effective procedures for enforcing rights.[276]

These comments appear to disregard the primary requirements of Articles 15, 16, and 19 of the Biodiversity Convention and would amount to a reservation, should the USA move to ratification on this basis. However, no reservations are permitted.[277]

There is, perhaps, one way to reconcile the provisions of the Biodiversity Convention with the TRIPS Agreement and the protection of intellectual property rights. Articles 20 and 21 of the Convention provide for a 'financial mechanism' and the provision of financial resources to facilitate transfer of technology to developing countries on favourable terms. Nothing in the TRIPS Agreement would prohibit the use of an international financial mechanism to assure access and the transfer of technology. Articles 15, 16, and 19 can be interpreted to mean that transfer of technology should be left to negotiations between private parties, but should be supplemented where needed by the financial mechanism established by the Convention's contracting parties under Articles 20 and 21.[278]

9(4) COMPULSORY LICENSING

An important question that may arise under the Biodiversity Convention and the TRIPS Agreement is whether a developing country that believes its rights under the Convention are being denied can resort to compulsory licensing. The Biodiversity Convention contains no specific authorization of compulsory licensing, but it does authorize 'legislative, administrative or policy measures, as appropriate' to gain the rights granted by the access to and transfer of technology and biotechnology provisions.[279] Compulsory licensing by WTO members would be controlled by TRIPS Agreement, which has specific provisions dealing with this issue. Article 30 of TRIPS permits 'limited exceptions to the exclusive rights conferred by a patent, provided [the

[274] Convention on Biodiversity: Message from the President of the US, 103 Cong Treaty Doc 103–20, Nov 1993, XI.

[275] Ibid, xi. [276] Ibid. [277] Article 37.

[278] Another possibility might be an Agreement on Implementation analogous to that adopted in 1994 with respect to the 1982 Law of the Sea Convention, which subjects the technology transfer provisions of Part XI on the deep sea bed to GATT disciplines: see Evans, in Evans (ed), *International Law* (2nd edn, Oxford, 2006) Ch 21.

[279] Articles 15(4), 16(3), 19(1).

exceptions] do not unreasonably conflict with the normal exploitation of the patent and do not unreasonably prejudice the legitimate interest of the patent owner...'. These conditions make Article 30 of TRIPS a poor vehicle to claim the transfer of technology benefits accorded by the Biological Diversity Convention. Article 30 envisages only ad hoc exceptions primarily for experimental purposes.

Article 31 of TRIPS authorizes compulsory licensing subject to highly restrictive conditions that would seem to make the use of compulsory licensing impractical to achieve the purposes of the Biodiversity Convention, except in extreme cases. Under TRIPS, the compulsory licensee must be remunerated based upon 'economic value', and it must be preceded by efforts to obtain authorization on 'reasonable commercial terms'. Thus, a developing country could not obtain the 'concessional and preferential terms' provided for by the Biodiversity Convention through compulsory licensing.[280] However, in 2005 an amendment to Article 31 was adopted to give effect to a waiver granted to make it easier for countries in need to import cheaper generic medicines made under compulsory licensing if unable to manufacture it for themselves.[281] This is the first amendment adopted to one of the 'core' WTO agreements and indicates a potential way forward where the political will to act—in this case to facilitate access to generic drugs for the treatment of HIV/AIDS.

10 CONCLUSIONS

The WTO's Committee on Trade and Environment has only taken the first steps in clarifying and reconciling the conflicts between protection of the environment and the rules of the multilateral trading system by ventilating the issues, marshalling different views, and calling for transparency and increased cooperation among WTO members, the public, and non-governmental organizations. Though the stage is now set for concrete decisions to deal with the issues enumerated in the committee's terms of reference, progress has been slow.

There is a need for the WTO to give specific recognition to environmental values. Article XX(b) of the GATT 1994 might be amended to provide a general exception for trade measures that are reasonably necessary for the protection of the domestic environment. This amendment would remove the overly strict 'least trade restrictive' criterion for such measures. In addition, Article XX might be amended to provide a 'safe harbour' for multilateral environmental agreements that employ trade measures

[280] Article 16(2).

[281] A waiver was granted on 30 August 2003 by decision of the General Council (WT/L/540), accompanied by an interpretative statement by the Chair, to give effect to paragraph 6 of the Doha Declaration on TRIPS and public health. At the Hong Kong Ministerial Meeting in December 2005 an amendment inserted a new Article 31 *bis* and Annex to TRIPs, rendering in binding legal form the 2003 Decision and accompanying Chair's statement upon receipt of instruments of ratification by 2/3 of WTO members: see WT/L/641, 6 December 2005.

which are reasonably necessary and reasonably related to the subject matter of the agreement, following the NAFTA example. There is also a need for the WTO to adopt a clear policy on the international use of environmental taxes, especially energy taxes, and food safety.

As for the controversy that became the cause célèbre, the *Tuna-Dolphin* dispute, there is a consensus that the decisions were correct insofar as they interpret the GATT to prohibit trade measures imposed by powerful states to enforce unilateral environmental policies. The goal of raising international environmental standards should be pursued, but there are more effective ways than licensing unlimited unilateral action. Nevertheless, it is no contradiction to say that the US ban on tuna imports was correct and ultimately successful in creating new rules of international law to stop the slaughter of dolphins. This highlights an important point: there is a place, even in the WTO system, for 'creative unilateralism' that operates within the accepted norms of public international law.

We should realize, however, that there will be no grand synthesis of the trade and environment conflict. Rather, the process of accommodation will be ongoing, demanding continual attention and work. Environmental considerations should become a continual concern at the WTO as work proceeds on the Doha Declaration negotiation priorities in the current round of trade negotiations. New trade and environment conflicts are on the horizon, especially in the areas of food safety, intellectual property, trade in services, and subsidies. Other important tasks facing the WTO are the careful monitoring of the impact of new environmental initiatives and protection of developing countries' access to global markets. Finally, the WTO should adopt thoroughgoing procedural reforms to improve the transparency of its decision-making process to both the public and non-governmental organizations. The relatively more transparent and participatory international environmental-treaty framework has had some impact on WTO processes which has recently seen the admission of amicus briefs, observer status for the hybrid state/NGO organization IUCN, and in increased cooperation between the WTO and MEA secretariats.[282]

[282] See Charnovitz, 10 *JIEL* (2007) 685.

ENVIRONMENTAL SOVEREIGNTY AND THE WTO

Trade Sanctions and International Law

Bradly J. Condon

CHAPTER 7

MEA MEASURES AGAINST PARTIES AND THIRD PARTIES

A. INTRODUCTION

This chapter will argue that existing WTO jurisprudence is adequate to resolve the GATT-consistency of trade measures taken to address international environmental problems in multilateral environmental agreements (MEAs), whether against parties to the MEA or third parties. This chapter also argues that the WTO should have jurisdiction to scrutinize the manner in which MEA trade measures are applied, in order to safeguard against abuse. Finally, this chapter concludes that it is preferable to resolve WTO-MEA conflicts under existing WTO provisions, rather than introduce a conflicts clause.

B. DEFINING THE WTO-MEA RELATIONSHIP

An important issue is whether any distinction should be made between trade measures taken pursuant to multilateral environmental and conservation agreements and those that are not. There is nothing in Article XX(g) that explicitly distinguishes between measures applied as part of an international agreement and other measures.

In the Doha Ministerial Declaration, the boundaries of the negotiations in this area are narrowly restricted. The relevant portion of the Declaration provides:

> 31. With a view to enhancing the mutual supportiveness of trade and environment, we agree to negotiations, without prejudging their outcome, on:
>
> (i) the relationship between existing WTO rules and specific trade obligations set out in multilateral environmental agreements

(MEAs). The negotiations shall be limited in scope to the applicability of such existing WTO rules as among parties to the MEA in question. The negotiations shall not prejudice the WTO rights of any Member that is not a party to the MEA in question[.][1]

The narrow scope of the negotiations on this issue reflects a lack of consensus regarding the proper interpretation to give to WTO obligations with respect to global or transnational environmental issues and what actions may be required, if any. In these negotiations, the initial discussions in the Committee on Trade and Environment (CTE) have focused on defining the mandate, particularly the meaning of the terms "specific trade obligations" (STOs)[2] and "multilateral environmental agreements" (MEAs).[3]

In the CTE negotiations on paragraph 31(i), the definition of MEA has been considered within the parameters of the negotiating mandate. The CTE's mandate expressly excludes the issue of the application of MEA trade measures to third parties. Moreover, because the aim of the negotiations is to define the relationship between MEAs and the WTO rather than establish a general definition of MEA, many of the proposed definitions are more limiting

[1] Ministerial Declaration, Fourth Ministerial Conference, Doha, Qatar, Adopted Nov. 14, 2001, WTO Doc. WT/MIN(01)/DEC/1, Nov. 20, 2001, para. 31, at http://www.wto.org/english/thewto_e/minist_e/min01_e/mindecl_e.htm, June 30, 2002.

[2] Submissions on the definition of what constitutes a specific trade obligation (STO) have considered factors such as whether trade measures were compulsory or discretionary, whether the definition should be limited to measures found in the main treaty and its annexes and amendments or whether it would also include measures developed in resolutions and decisions of a Conference of Parties (COP). Canada submitted that an STO could be contained in a combination of articles, read together. See Compilation of Submissions under Paragraph 31(i) of the Doha Declaration, Note by the Secretariat, Revision, WTO Doc. TN/TE/S/3/Rev.1, Apr. 24, 2003, at 18–35. Also see Summary Report on the Ninth Meeting of the Committee on Trade and Environment in Special Session, Note by the Secretariat, WTO Doc. TN/TE/R/9, July 16, 2004, para. 53.

[3] Report of the Chairperson of the CTE Special Session to the Trade Negotiations Committee, WTO Doc. TN/TE/7 and Suppl.1, July 15, 2003.

than they need to be in an academic analysis of this issue.[4] Nevertheless, this negotiating history will inform the interpretation of any outcomes that may result.[5] Moreover, the CTE negotiations provide an overview of the criteria that could be used to determine the relationship between a particular MEA and WTO law.

Defining the term "multilateral environmental agreement" is less important than establishing criteria for assessing the effect that a particular MEA—and a particular MEA provision—should have in the interpretation of WTO rules. Likewise, the nature of the WTO provision in question will be relevant to the effect of MEA rules on its interpretation—the relative clarity or ambiguity of the WTO rule will affect the extent to which an MEA can influence its interpretation under Vienna Convention Article 32. Similarly, whether a particular treaty is classified as an MEA is less relevant than whether its subject matter relates to the subject matter of a WTO provision. For example, a treaty that addresses the protection of human life or health would be as relevant to GATT Article XX(b) as one that addresses the protection of animal or plant life or health.

[4] As noted by the European Communities, "the WTO would exceed its competence if it were to aim to define an MEA in general. Therefore, the only purpose of seeking within the WTO an agreed definition of an MEA is subsequently to clarify the circumstances under which specific trade obligations set out in an MEA should be given explicit recognition under WTO rules." See Multilateral Environmental Agreements (MEAS): Implementation of the Doha Development Agenda, Submission by the European Communities, WTO Doc. TN/TE/W/1, para. 7.

[5] See Vienna Convention on the Law of Treaties, Article 32, which allows recourse to supplementary means of interpretation, such as the *travaux preparatoires*, i.e., the history of the negotiations, in order to confirm the meaning resulting from the application of Article 31, or to determine the meaning when the interpretation according to Article 31 leaves the meaning ambiguous or obscure or leads to a result that is manifestly absurd or unreasonable. The *travaux preparatoires* include written material such as conference records. The summary record of a conference prepared by an independent and skilled secretariat, such as that of the World Trade Organization, will carry more weight than an unagreed record produced by a host state or a participating state. See Anthony Aust, Modern Treaty Law and Practice, at 198 (2000).

The key criteria that have emerged for defining the term "MEA" in the CTE negotiations are: (1) legal status (whether in force or binding); (2) number of parties; (3) nature of parties; (4) nature of negotiations; (5) degree of universality; (6) openness of negotiations and accession; and (7) subject matter. Tables 7.1 to 7.7 summarize the submissions made on criteria for defining "MEA" in the CTE negotiations.

WTO Member Proposals on Definition of MEA in Paragraph 31(i)[6]

Table 7.1 Legal Status	
Criteria	*WTO Members in Favor*
entered into force	Argentina, India, Colombia, China, Malaysia
deposited with U.N.	China
legally binding	EC
status of implementation	Hong Kong
in force or signed and adopted but not yet in force	Japan
whether its contains STOs more important than whether in force	USA
all annexes and amendments to MEA treated as integral parts	Colombia

[6] Sources: Compilation of Submissions under paragraph 31(i) of the Doha Declaration, Note by the Secretariat, Revision, Apr. 24, 2003, WTO Doc. TN/TE/S/3/Rev.1; Summary Report on the Ninth Meeting of the Committee on Trade and Environment in Special Session, Note by the Secretariat, June 22, 2004, WTO Doc. TN/TE/R/9, July 16, 2004; Identification of Multilateral Environmental Agreements (MEAs) and Specific Trade Obligations (STOs), Submission by China, WTO Doc. TN/TE/W/35, June 27, 2003; paragraph 31(i) of the Doha Ministerial Declaration, Submission by Malaysia, WTO Doc. TN/TE/W/29, Apr. 30, 2003; Contribution on paragraph 31(i) of the Doha Ministerial Declaration, Submission by the Separate Customs Territory of Taiwan, Penghu, Kinmen and Matsu, WTO Doc. TN/TE/W/1, Oct. 13, 2002. Matrix on Trade Measures Pursuant to Selected Multilateral Environmental Agreements, WT/CTE/W/160/Rev.2, TN/TE/S/5, Apr. 25, 2003.

Table 7.2 Number of Parties	
Criteria	*WTO Members in Favor*
significant number of signatories, indicating broad participation in negotiations	Canada
participation of substantial number of countries	Japan
substantial number of countries have joined agreement	Colombia
negotiated by more than 2 parties	Argentina
binding at least 3 parties	EC

Table 7.3 Nature of Parties	
Criteria	*WTO Members in Favor*
countries from different geographical regions and at different stages of economic and social development	India
reflects interests of major [WTO] parties concerned (parties with major trade interests, actual and potential major producers and consumers of materials concerned)	Japan
Japan's distinction between "major parties" and "others" not relevant in context	India

Table 7.4 Nature of Negotiations	
Criteria	*WTO Members in Favor*
negotiated under aegis of U.N. or U.N. agencies (eg UNEP)	Argentina, EC, India, Japan, Colombia, China, Malaysia
or under procedures open to all WTO members	EC
effective participation in negotiations by countries from different geographical regions and at different stages of economic and social development	India, Malaysia

Table 7.5 Degree of Universality	
Criteria	*WTO Members in Favor*
has attained degree of universality	Argentina
substantial number of contracting parties which account for a majority of WTO members	China
membership reflects diversity of UNWTO membership	Malaysia

Table 7.6 Openness of Negotiations and Accession	
Criteria	*WTO Members in Favor*
open to all concerned countries from start of negotiations	EC
open to all countries, including those that did not participate in negotiation	Colombia
open to any country sharing the environmental objective	Japan
participation in negotiations open to all countries	India
accession open to countries not participating in negotiations	Argentina, Taiwan
accession open to any WTO members on terms equitable in relation to original members	EC
open for accession by any WTO member, which is eligible on the terms applied to the original members of the agreement	China
all MEAs open for formal participation of any non-party to the MEAs	Taiwan
accession open to countries on terms equitable in relation to original members	India
regional agreements open to countries in region and affected countries outside region	EC

Table 7.7 Subject Matter	
Criteria	*WTO Members in Favor*
main aim to protect environment	EC
relevant to aims in GATT XX(b), (g)	EC
objective is environmental protection	Malaysia

These criteria are relevant to two key issues regarding the WTO-MEA relationship. The first issue is how to avoid or resolve conflicts between WTO and MEA obligations.[7] The second issue is the relevance of MEA provisions in the interpretation of WTO obligations. These two issues are related, since taking MEA provisions into account in the interpretation of WTO rules provides one method for avoiding conflicts. However, the role of MEAs in the interpretation of WTO law is a topic that has provoked controversy in the CTE negotiations.[8] New Zealand made the following proposal to reconcile conflicting views on this issue:

> Applying the customary principles of treaty interpretation, and in particular Article 31 of the Vienna Convention, required that context be taken into account when interpreting treaty provisions, and this was what the Appellate Body had done in the *Shrimp-Turtle* case, when it was interpreting words such as "exhaustible natural resources." Equally, it was worth recalling what the Appellate Body had said in the *Hormones* case, which was that while the precautionary principle was certainly relevant, it could not be used to override the clear terms of a treaty. So, perhaps, this was one way to reconcile the two cases that had been mentioned—other bodies of law could provide context, but could not override the terms of a treaty. Another rule of cus-

[7] Conflicts can also be avoided *ex ante*. The CTE negotiations have identified international coordination as a means to avoid the creation of conflicting obligations in the negotiation of MEAs and national coordination in order to avoid conflicts at the implementation stage. See Report by the Chairperson of the Special Session of the Committee on Trade and Environment to the Trade Negotiations Committee, WTO Doc. TN/TE/10, Dec. 6, 2004.

[8] See WTO Doc. TN/TE/R/9, *supra* note 6.

tomary international law was the presumption against conflict between international treaties, and a preference for the harmonious interpretation of international treaties.[9]

New Zealand's proposal appears to overstate the concept of context as it is defined in Vienna Convention Article 31. Agreements or instruments from other bodies of law can only provide context where they are made "in connection with the conclusion of the treaty" being interpreted.[10] MEAs are unlikely to meet this criterion. However, MEA provisions might be relevant to WTO interpretation under Vienna Convention Article 31 as "relevant rules of international law applicable in the relations between the parties."[11] However, the term "parties" refers to the parties to the treaty, rather than the parties to the dispute, implying that the MEA rule in question would have to be applicable to all WTO members in order to be taken into account under Vienna Convention Article 31(3)(c). Thus, in most cases, MEAs would be relevant to WTO interpretation only as supplementary means of interpretation under Vienna Convention Article 32, which is limited to confirming the interpretation under Vienna Convention Article 31 or determining the meaning where the interpretation under Article 31 leaves the meaning ambiguous or obscure or is manifestly absurd or unreasonable. Where the treaty text is clear, there may be no need to resort to supplementary means of interpretation. Thus, the role of MEAs in the interpretation of the WTO will depend in part on the clarity of the treaty text in question.

In addition to the level of ambiguity in a given WTO provision, the legal status of the MEA obligation in question is relevant to determining the effect of a particular MEA provision on the interpretation of WTO law. As the *Hormones* case illustrated with respect to the precautionary principle, the issue of whether a particular non-WTO rule has attained the status of customary international law may be relevant in determining its effect on the interpretation of WTO

[9] *Id.*, para. 48.

[10] Vienna Convention, art. 31(2).

[11] Vienna Convention, art. 31(3)(c).

rules. This is because customary international law could be applied to the interpretation of WTO law under Vienna Convention Article 31(3)(c) as "relevant rules of international law applicable in the relations between the parties." However, even customary rules of international law cannot override the clear terms of a treaty, making the clarity of a given WTO agreement relevant in this situation as well. This is because the parties to WTO agreements are free to contract out of customary international law, creating *lex specialis*, as they have done with respect to countermeasures, for example.[12]

The *Shrimp* case appears to suggest that the number of parties to the MEA, and whether the WTO members that are parties to a dispute are among the MEA parties, are also factors that should be considered in determining the role an MEA provision plays in the interpretation of WTO rules in a given case. Where only the parties to the dispute are members of the MEA, the MEA could be relevant to the application of Article XX or other provisions of WTO agreements between those parties, as an "*inter se* agreement" that modifies the application of the treaty between themselves.[13] Support for the view that the MEA could be taken into account in interpreting Article XX is found in *European Communities—Measures Affecting the Importation of Certain Poultry Products*, in which the Appellate Body found that a bilateral agreement between two WTO members could serve as "supplementary means" of interpretation for a provision of a covered agreement.[14]

[12] See Understanding on Rules and Procedures Governing the Settlement of Disputes, Apr. 15, 1994, Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations, Legal Instruments—Results of the Uruguay Round, Annex 2, 33 I.L.M. 1197 (1994), art. 22; draft *Articles on Responsibility of States for Internationally Wrongful Acts*, art. 55 and accompanying commentary, International Law Commission, *Annual Report 2001*, Chapter IV, State Responsibility, at http://www.un.org/law/ilc/reports/2001/english/chp4.pdf, Oct. 21, 2003; and Joost Pauwelyn, *The Role of Public International Law in the WTO: How Far Can We Go?*, 95 Am. J. Int'l L. 535 (2001).

[13] See Vienna Convention, art. 41 and Ian Brownlie, Principles of Public International Law, at 601 (6th ed. 2003).

[14] *European Communities—Measures Affecting the Importation of Certain Poultry Products*, WTO Doc. WT/DS69/AB/R, AB-1998-3 (1998) (Report of the Appellate Body), para. 83.

The degree of global acceptance of the MEA and its status in customary international law would be relevant to determining whether the application of MEA provisions to the interpretation of a particular WTO rule in a specific ruling of the Dispute Settlement Body should be followed in subsequent cases.[15] Where all or most WTO members are also members of the MEA, the MEA may be relevant to WTO interpretation as subsequent practice or agreement as those terms are used in Vienna Convention Article 31(2).[16] Not each and every party to the treaty must have engaged in a particular practice for it to qualify.[17] The issue of whether the MEA creates binding legal obligations would be relevant in determining whether a particular MEA provision can be taken into account under Vienna Convention Article 31(3)(c).

The voting procedures followed under a particular MEA could be relevant to determining the degree of global acceptance of measures or provisions adopted in a Conference of Parties. For example, unlike WTO practice, CITES decisions are not taken by consensus, but by a two-thirds majority vote.[18] It would be difficult to argue that a CITES decision has been accepted by all WTO members where some WTO members have voted against the decision.

The geographic distribution of MEA parties, together with the subject matter of the MEA, might serve as evidence that the environmental problem is global in nature. For example, the conservation of elephants might be characterized as a global conservation issue because the conservation of elephants is addressed in an MEA,

[15] Rulings of the DSB are only binding on the parties to the dispute. However, interpretations of WTO rules in disputes create expectations regarding the correct interpretation of WTO law and influence subsequent interpretations. See discussion in Chapter 2 of legal effect of DSB rulings.

[16] See discussion in Chapter 2 of the meaning of subsequent practice in the Vienna Convention.

[17] *European Communities—Customs Classification of Frozen Boneless Chicken Cuts*, WTO Doc. WT/DS269/AB/R, WT/DS286/AB/R (2005) (Report of the Appellate Body), para. 259.

[18] WTO Doc. TN/TE/R/9, *supra* note 6, para. 22.

thereby providing members of the MEA with a legal nexus to the problem that would provide the necessary jurisdictional nexus under GATT Article XX.[19]

The foregoing discussion shows how the criteria for defining MEAs in the Doha Round negotiations are generally relevant to determining how a given provision in a MEA might affect the interpretation of WTO provisions under the Vienna Convention.

1. GATT and WTO Jurisprudence Relating to MEAs

To date, there have been no GATT or WTO disputes involving conflicts between MEAs and WTO law. Nevertheless, the contrast between the analysis in the *Tuna* and *Shrimp* reports provides a useful means of highlighting the different schools of thought regarding the relationship between MEAs and the WTO.[20] The *Tuna I* Panel failed to directly address the issue of what would happen should there arise a conflict between the GATT trade obligations and inconsistent trade obligations imposed under multilateral environmental agreements such as CITES. Such a case has not arisen to date, and is unlikely to be brought by a signatory to a MEA. If such an issue does come before a WTO panel, it would likely be in relation to non-parties to an MEA.

The *Tuna I* Panel concluded that:

> a contracting party may not restrict imports of a product merely because it originates in a country with environmental policies different from its own . . . if the Contracting Parties were to permit import restrictions in response to differences in environ-

[19] See discussion in Chapter 5. Also see Robert Howse, *Back to Court after Shrimp/Turtle? Almost but not Quite Yet: India's Short Lived Challenge to Labor and Environmental Exceptions in the European Union's Generalized System of Preferences*, 18 Am. U. Int'l L. Rev. 1333, at 1376–77 (2003), making a similar argument regarding tropical forests.

[20] While the Tuna/Dolphin reports were never adopted by the GATT parties, it is important to recall that adoption of GATT reports required consensus, whereas adoption of WTO reports, including the Shrimp/Turtle reports, is effectively automatic. See DSU, arts. 16(4) and 17(14).

mental policies under the General Agreement, they would need to impose limits on the range of policy differences justifying such responses and to develop criteria so as to prevent abuse.[21]

The *Tuna I* Panel's ruling was criticized for requiring nations to negotiate international agreements and GATT waivers or amendments if they want to use trade restrictions to implement international environmental policies. But this was a reasonable position to take given the controversy surrounding the proper interpretation of Article XX.[22] The ruling indicated that, if the rights and obligations of the GATT contracting parties were to be modified, they should be modified by the contracting parties themselves, not dispute panels.[23] The Panel in *Tuna II* adopted the same view.

The relevance of the distinction between measures taken under MEAs versus measures taken unilaterally was also raised in the *Shrimp* case. The Appellate Body stated a clear preference for measures taken under international agreements over measures taken unilaterally, but upheld a unilateral measure because serious efforts to conclude an international agreement had failed. Thus, in contrast to the earlier *Tuna* rulings, in *Shrimp* the Appellate Body did not consider such an interpretation of Article XX to be a modification of the treaty text and recognized that multilateral agreement among WTO members regarding environmental measures was not essential in this regard.

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[21] *United States—Restrictions on Imports of Tuna*, GATT BISD, 39th Supp. 155, GATT Doc. DS21/R (1991), 30 I.L.M. 1594 (1991) (Report by the Panel not Adopted), at 50–51.

[22] The controversy over the proper scope of Article XX remained evident in the CTE Report to the Singapore Ministerial Conference. See Trade and Environment in the GATT/WTO, Background Note by the Secretariat, Annex I, Hakan Nordstrom and Scott Vaughan, TRADE AND ENVIRONMENT, WTO Special Studies 74–75 (1999).

[23] The 1982 *Ministerial Declaration on Dispute Settlement*, BISD 29S/13, provided that panel decisions "cannot add to or diminish the rights and obligations provided for under the General Agreement." This was adopted by the WTO in DSU, art. 3(2).

With respect to their parties, MEAs fulfill the key requirements that were imposed on the United States with respect to its unilateral measure in the *Shrimp* case. Most MEA trade measures can be characterized as addressing the protection of transboundary or global resources. Most MEAs can be categorized as relating to environmental problems that affect two categories of natural resources: (1) non-living resources: clean air, water and soil or climate; and (2) living resources: plants and animals. The characterization of clean air as an exhaustible natural resource in *United States—Standards for Reformulated and Conventional Gasoline* supports the first category and the same characterization of turtles in *Shrimp* supports the second category. Measures that are strictly limited to protecting humans should generally be aimed at protecting the citizens of the enacting countries and people inside their territories, and thus would fall within their jurisdictional competence.

Where a country does not have a territorial nexus with the environmental problem, the MEA provides a legal nexus and may provide evidence that the subject matter is global, if not transnational. MEAs thus provide the jurisdictional nexus and cover subject matter that qualifies MEA trade measures for provisional justification under Article XX(g). The conclusion of the MEA fulfills the duty to negotiate. However, the fulfillment of the requirement for flexible and transparent application of the measure cannot be assumed with respect to the implementation of MEA obligations in national law. MEA trade measures must therefore remain subject to WTO scrutiny under the *chapeau* analysis.

The general conclusion that can be drawn from WTO jurisprudence is that trade measures taken pursuant to MEAs would be consistent with GATT if implemented in a non-discriminatory and transparent manner between parties to the MEA. However, WTO jurisprudence regarding unilateral measures does not apply to resources that are located entirely outside the jurisdiction of the importing country and some MEAs, notably CITES, require such "extraterritorial" measures. However, the existence of a MEA may be sufficient to categorize an environmental issue as global, rather than extraterritorial, thus providing a sufficient jurisdictional nexus in

customary international law. With respect to international environmental law, both the Rio Declaration and Agenda 21 indicate that multilateral agreement can justify the use of trade measures with respect to otherwise extraterritorial environmental problems. Thus, the MEA categorizes a problem as global and provides the necessary jurisdictional nexus. On this view, the jurisdictional nexus would be legal rather than territorial. The result is that conflicts between the WTO agreements and MEAs as between parties to both can be resolved without amending WTO agreements, such as through the introduction of a conflicts clause or an exception.

The North American Free Trade Agreement (NAFTA) uses a conflicts clause to resolve the issue more clearly than the WTO.[24] While a conflicts clause may be appropriate for a regional trade agreement among countries that share a regional environment and have environmental cooperation systems in place, such a clause may be impractical in a global trade agreement that contains far greater diversity of members with respect to environmental conditions, technological capacity, financial means, economic priorities and legal systems. The use of a NAFTA-style conflicts clause in the WTO is not as simple a solution as it appears to be, since it involves amending the agreement and choosing which MEAs to list now and which to add in the future. Moreover, such a proposal has already been rejected by both developed and developing country members of the WTO.[25] Resolving ambiguities regarding the relationship between trade and environmental agreements is a complex task that is likely to require a more complex solution than that found in NAFTA Article 104. It seems neither necessary nor feasible to introduce a MEA conflicts clause in the WTO at the moment.

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[24] North American Free Trade Agreement between the Government of Canada, the Government of the United Mexican States and the Government of the United States of America, art. 104.

[25] See Committee on Trade and Environment Special Session, Note by the Secretariat, "Multilateral Environmental Agreements (MEAs) and WTO rules: Proposals made in the Committee on Trade and Environment (CTE) from 1995–2002," WTO Doc. TN/TE/S/1, May 23, 2002, at 2. Also see Jan McDonald, *It's Not Easy Being Green: Trade and Environment Linkages beyond Doha, in* Ross P. Buckley ed., The WTO and the Doha Round: The Changing Face of World Trade, at 145 (2003).

An alternative to using this type of conflicts clause in GATT, which avoids the need to change existing WTO provisions, is to use conflicts clauses in MEAs that contain specific obligations to use trade restrictions or give their signatories discretion to employ trade measures. Most signatories to MEAs are likely to be members of the WTO, and it is not unreasonable to ask them to turn their minds to the issue of a conflicts clause for trade measures when negotiating MEAs. However, incorporating a conflicts clause in future MEAs fails to resolve the question of conflicts with existing MEAs.

The application of MEA trade measures between parties is not controversial. Indeed, there have been no disputes in this area. Both GATT and WTO jurisprudence make favorable statements regarding such measures. They are consistent with general principles of international law and international environmental law. The application of MEA trade measures to third parties and the use of unilateral trade measures in the international environmental context are more controversial and are not currently on the negotiating agenda.

2. Measures Applied to Third Parties

Two issues arise with respect to third parties: the application of trade sanctions to intermediary nations that act as transshipment points and the application of MEA trade provisions to nations that are not parties to the MEA in question. The former issue was addressed in *Tuna I*. The latter issue, while not directly addressed in the *Shrimp* rulings, is analogous to the situation in *Shrimp 21.5*.

In *Tuna I*, the American law provided for an embargo against "intermediary nations" that continued to buy products which the United States had unilaterally decided should not be imported by itself or by any other country. Mexico argued that such interference in trade between other parties was not permitted by GATT and was contrary to international law. The EEC argued that the very concept of "intermediary nation" needed to be rejected because it would affect the right of each contracting party to determine autonomously its own trade policy. The EEC refused to introduce trade measures against a state because of a third country's requirements or on the basis of that country's unilaterally defined standards. Similarly, Japan argued that its trade relations with Mexico should not be subject to

American domestic law. The American embargo was not "primarily aimed at the conservation of" dolphins within the meaning of Article XX(g) because an embargo on all yellow-fin tuna and tuna products was not a dolphin conservation measure but a sanctions mechanism to force other countries to adopt policies established unilaterally by the United States.

If one views the function of Article XX as preserving the rights of WTO members to legislate domestically in the listed subjects without observing GATT obligations, it follows that they retain their autonomy to legislate domestically or multilaterally in those areas. An international treaty, which modifies GATT obligations, would do so for those countries party to the newer treaty.[26] An intermediary embargo that is used to support a direct embargo based on the national origin of a product might be justifiable on the same basis as the direct embargo. However, no single state has the authority to dictate the terms of trade between other nations under international law or WTO law.

How do the subject matter and degree of global acceptance of the MEA at issue affect the permissibility of trade sanctions against non-parties? It has been argued that, in some situations, conservation and environmental agreements can modify the GATT without an explicit modification statement, even with respect to non-parties to such agreements. For example, McDorman argues that, with respect to CITES, GATT obligations must be modified even for countries not a party to CITES, given the completeness of the CITES regime, its obvious inconsistency with GATT, the narrowness of the exceptions to GATT thereby created and the overwhelming international support for CITES, which then had more signatories than GATT.[27] In his view, an expression of broad international support for

[26] See Vienna Convention, art. 41(1) and Joost Pauwelyn, *The Role of Public International Law in the WTO: How Far Can We Go?*, 95 Am. J. Int'l L. 535, at 547–50 (2001).

[27] Ted McDorman, *The 1991 U.S.-Mexico GATT Panel Report on Tuna and Dolphin: Implications for Trade and Environment Conflicts*, 17 N. Car. J. Int'l L. & Com. Reg. 461, at 484–85 (1992).

the modification of the GATT by environmental or conservation considerations could suffice to suspend the operation of the GATT rules. However, a treaty does not create either obligations or rights for a third state without its consent.[28] Moreover, the rights of the contracting parties can only be modified by agreement among the contracting parties themselves. MEA trade measures applied against non-parties are analogous to the type of unilateral measure the United States applied against Malaysia in *Shrimp 21.5*. Thus, they could be justified under Article XX(g) in the same fashion where they address transboundary or global environmental concerns. However, if they are aimed at extraterritorial environmental concerns, it is difficult to see how they would comply with customary international law or international environmental law. As a result, they would not be justifiable under any GATT interpretation that is consistent with these other branches of international law. However, if the subject matter and degree of global acceptance of the MEA permits the problem to be characterized as global, rather than extraterritorial, the measure could be justified under Article XX(g) as addressing a global issue.

3. The Less-Trade-Restrictive Alternative and MEAs

GATT and WTO jurisprudence have generally indicated that the preferred alternative to unilateral measures is to negotiate MEAs. MEA trade measures are likely to be found consistent with GATT if implemented in a non-discriminatory and transparent manner between parties the MEA. However, where the MEA is implemented so as to avoid WTO obligations, the implementing measures must be subject to WTO scrutiny. The GATT Article XX(b) requirement to use the least-WTO-inconsistent measure that is reasonably available can be employed as a general conceptual approach to addressing such implementation cases. I will refer to this standard here as the least-trade-restrictive test.

[28] Vienna Convention, art. 48. The major exception is set out in Article 38 of the Vienna Convention: "Nothing in articles 34 to 37 precludes a rule set forth in a treaty from becoming binding upon a third State as a customary rule of international law, recognized as such."

In *Tuna I*, it was not necessary for the Panel to decide whether the trade embargo was the least trade-restrictive means available to conserve dolphins. However, it implied that there were less trade-restrictive methods available to achieve that goal.[29] Moreover, it implicitly accepted Mexico's argument that multilateral negotiation would be the preferable and less trade-restrictive means of accomplishing international environmental goals.

The *Tuna II* Panel also found that a measure cannot qualify as necessary under Article XX(b) where there are other GATT-consistent alternatives available, which includes the negotiation of multilateral agreements. Moreover, measures designed to force other nations to change their environmental policies could neither be considered necessary under Article XX(b) nor primarily aimed at the conservation of natural resources under Article XX(g). The decision thus appeared to require the negotiation of multilateral agreements before a measure could be considered to be the least-trade-restrictive alternative available.

The *Shrimp* decision concluded that where an alternative course of action is reasonably available, in this case making an effort at multilateral negotiations, a measure cannot qualify under the Article XX *chapeau*. In *Shrimp 21.5*, the Panel indicated that one of the factors to consider in determining whether to permit a unilateral measure is whether a multilateral solution constitutes an alternative course of action that is reasonably open to the importing country. This appears to incorporate a less trade-restrictive test into the *chapeau* and apply the test to the area of international environmental protection. The Appellate Body did not disagree with the Panel on this issue in *Shrimp 21.5*.

In its interpretation of Article XX(g) and the *chapeau*, the Appellate Body in the *Shrimp* case adopted the interpretation of the Appellate Body in the *Reformulated Gasoline* case. One commentator has suggested that this interpretation makes the requirements of the *chapeau* synonymous with the "necessary" test under Article XX(b).[30]

[29] *United States—Restrictions on Imports of Tuna*, GATT BISD, 39th Supp. 155, GATT Doc. DS21/R (1991), 30 I.L.M. 1594 (1991) (Report by the Panel not Adopted), at 50.

The question that arises is whether a trade measure taken under a multilateral environmental agreement would have to pass a least-trade-restrictive test under the *chapeau* of Article XX. It is reasonable to assume that this principle would apply to the manner in which a state implements trade measures under a MEA. Otherwise, the implementation process could be subject to abuse. The implementation would have to be non-discriminatory and transparent, and comply with the requirements for procedural fairness. However, it is unlikely that the least-trade-restrictive test would be applied to second guess the substance of measures chosen by the parties to the MEA. The WTO would have to show deference in this regard to the parties to the MEA. Otherwise, the MEA would have to be renegotiated to comply with the opinion of a WTO panel, a result that would be impractical and exceed the jurisdiction of the panel.

NAFTA Article 104 applies a least-trade-restrictive test to MEAs. NAFTA Article 104 provides that the specific trade obligations set out in listed MEAs prevail over NAFTA, subject to the proviso that "where a Party has a choice among equally effective and reasonably available means of complying with such obligations, the Party chooses the alternative that is the least inconsistent with the other provisions of this Agreement." In order for a measure to be the least inconsistent with the other provisions of the NAFTA, it would have to be the least inconsistent with the free movement of goods and services between the parties; that is, the least trade-restrictive. It would be reasonable to apply a comparable least-trade-restrictive test to MEAs in the context of the Article XX *chapeau*.

C. A CONFLICT BETWEEN NAFTA AND GATT

Neither the GATT nor any GATT panel decision has clearly set out whether Article XX(b) or (g) prevail over international environmental agreements as between parties to both. The prevailing

[30] See Chris Wold, *Multilateral Environmental Agreements and the GATT: Conflict and Resolution?*, 26 ENVTL. L. 841 (1996).

view of public international law is that the later law supersedes the earlier and that the specific supersedes the general. Applying the latter principle, in the event of a conflict, the more specific trade obligations in the agreements listed in NAFTA Article 104 would supersede the GATT provisions under international law as between parties to both. However, the conflict can be avoided by interpreting GATT Article XX to permit the MEA measures. Article 104 thus represents a codification of what the likely outcome would be were any of the listed agreements challenged before a WTO panel.

The NAFTA provides no express permission or prohibition regarding the unilateral assertion of jurisdiction over extraterritorial environmental matters via the imposition of trade restrictions. However, Article 104 expressly permits the use of trade measures to pursue extraterritorial environmental goals where such measures have been authorized by an international environmental agreement. Since the NAFTA provides no express permission to use trade restrictions to unilaterally assert jurisdiction over extraterritorial environmental matters, but expressly permits such measures to be taken pursuant to universally accepted[31] multilateral agreements, the implication is that the NAFTA prohibits the unilateral use of trade restrictions to pursue extraterritorial environmental goals.

Unlike the GATT, the NAFTA *expressly* permits a state to use trade restrictions to address environmental matters that occur outside its national territory, by international agreement. In this regard, the distinction between measures taken under international agreements and measures taken unilaterally is key to determining whether trade restrictions may be employed. Article 104 thus codifies the requirement implicit in the *Tuna* decisions that such measures must expressly or implicitly be intended to prevail over trade obligations, by agreement among the affected trading parties.

Article 104 implies that, where there is a conflict between trade obligations under NAFTA and environmental obligations under

[31] This term refers to universal acceptance by the NAFTA parties, evidenced by inclusion in Article 104 or Annex 104.1.

other agreements, the NAFTA obligations prevail unless the competing agreement is listed in Article 104 or Annex 104.1. The anticipated inclusion of further bilateral and multilateral environmental agreements in Article 104, via Annex 104.1, implies further that such agreements between the NAFTA parties are to precede, and indeed replace, any resort to unilateral trade action.

Article 104 resolves the question of how to address MEA trade measures more explicitly and clearly than GATT. Extraterritorial environmental concerns must be addressed in the context of this provision. However, states that have a territorial connection with the resources in the latter category have the right to employ trade measures under Article XX(g) to preserve the resources. Article 104 implies that it is not permissible to employ unilateral trade measures to address transboundary or global environmental concerns in the absence of a listed agreement. However, NAFTA incorporates Article XX(g) and customary international law. As a result, in the wake of the *Shrimp 21.5* decision, there now exists a conflict between NAFTA Article 104 and Article XX(g).

The NAFTA conflicts clause provides one method of clarifying the relationship between MEAs and trade obligations. However, it is not the best way to resolve this question in the WTO context. The conflicts clause is a less flexible approach than leaving panels to apply the broad language of Article XX on a case-by-case basis. The conflicts clause requires negotiation each time a new MEA or international environmental issue arises, whereas the language of Article XX is sufficiently broad to obviate the need for ongoing negotiation. Moreover, the conflicts clause closes off options to take unilateral actions in situations of urgency that are consistent with customary international law and international environmental law.

The conflicts clause may function in the NAFTA context because there are only three parties involved and those parties have several bilateral and trilateral mechanisms in place to address transboundary environmental concerns in the region. This makes the identification and negotiation of issues that require resolution far more feasible and quick than it is among the WTO membership. The size

and diversity of the WTO membership, together with the increasing difficulty of achieving consensus among the members, would make it difficult to make a conflicts clause work in practice. A conflicts clause such as NAFTA Article 104 leaves insufficient flexibility to maintain consistency among the different branches of international law as they evolve. As the current situation with respect to NAFTA demonstrates, a conflicts clause may even create problems with respect to the internal consistency of the trade regime itself.

D. CONCLUSION

It is important to recall that the principle of *stare decisis* does not apply to decisions of WTO panels and that panel opinions on the potential GATT-consistency of measures taken under MEAs are only *obiter dicta*. Nevertheless, decisions rendered in the *Shrimp* cases will have persuasive value in future decisions of WTO panels and the Appellate Body. However, the primary focus of analysis must be on the provisions of the agreements themselves, which were drafted in a way that allows their interpretation to evolve over time to deal with shifting global priorities and the growing diversity of WTO membership.

Recent interpretations of existing GATT provisions have opened the door for multilateral environmental trade measures dealing with shared species and resources to be justified as exceptions under Article XX. While it appears unlikely that trade measures taken pursuant to a MEA against parties to the MEA will be challenged before the WTO, should such a case arise the measure would probably meet the standards set out in Article XX. Should measures be taken against non-parties, the treatment will be the same as for unilateral measures and the outcome of a WTO challenge will be determined in accordance with the *Shrimp* decisions.

There appears to be no need to introduce immediate changes to the WTO regime in order to deal with conflicts with MEAs. In particular, it does not appear to be either necessary or feasible to introduce a MEA conflicts clause in the WTO. While such provisions may be useful in regional trade agreements, they would be problematic in the WTO given the diversity of its membership.

WTO scrutiny of trade restrictions needs to be retained even with respect to MEA trade measures so that the WTO may supervise their implementation under the Article XX *chapeau*. It is necessary to scrutinize the implementation of MEA trade measures in order to ensure that WTO members do not abuse their rights under GATT Article XX(b) and (g) and similar provisions in other WTO agreements. Even if the WTO had a conflicts clause that determined that MEA trade obligations prevail over WTO obligations (or if the rules regarding conflicts between treaties led to the same conclusion), the implementation of the MEA obligations would still need to be subject to the requirements of the Article XX *chapeau* in order to safeguard against abuse.

It would be unwise to exempt trade measures implemented pursuant to MEAs from WTO scrutiny, because a WTO member could then purport to take a measure under a MEA and thereby preclude WTO scrutiny altogether. As long as the MEA requires that trade measures be implemented in conformity with the requirements of the Article XX *chapeau*, any apparent conflict between the MEA and WTO obligations can be resolved. Even if the MEA contains no explicit requirement in this regard, the MEA should be interpreted in a manner that is consistent with WTO obligations where the MEA parties are WTO members.

I argued in Chapter 5 that the subject matter of Article XX(g) covers measures that address transnational and global environmental problems. Article XX(g) also requires a jurisdictional nexus between the environmental problem and the country that implements a trade measure. Where there is no territorial nexus, the MEA provides a legal nexus that should satisfy this requirement. The implementing country must have a jurisdictional nexus in order to apply MEA trade restrictions against third parties or to otherwise apply trade measures outside the context of a MEA in order to meet the requirements of the *Shrimp* cases. Moreover a jurisdictional nexus is required in order to establish that the environmental problem affects the "essential interests" of the country in question. This must be established to invoke the doctrine of necessity in customary international law. Chapter 10 will argue that the doctrine of neces-

sity should be applied to unilateral environmental measures due to the effect that market power has on effective access to the right to use such measures under Article XX. The problem of unequal access to this right is the subject of the next chapter.

Appendix 1: MEAs that Contain Trade-Related Measures

Source: Matrix on Trade Measures Pursuant to Selected MEAs, WTO Doc WT/CTE/W/160/Rev.2 (2003).

Note: This is a representative list, rather than an exhaustive list.

(1) International Convention for the Conservation of Atlantic Tunas, opened for signature May 14, 1966, T.I.A.S. 6767 (entered into force Mar. 21, 1969) (The Resolution by ICCAT Concerning an Action plan to Ensure Effectiveness of the Conservation Program for Atlantic Bluefin Tuna, 1994, Article f, recommends non-discriminatory trade restrictive measures; other recommendations relate to the import ban of specific products or products from specific countries.)

(2) Convention on International Trade in Endangered Species of Wild Fauna and Flora (Washington), opened for signature Mar. 6, 1973, 993 U.N.T.S. 243 (entered into force July 1, 1975). (CITES regulates trade in endangered species by defining the conditions under which import and export permits may be issued for three categories of protected species that are affected by trade: Appendix I (species threatened with extinction); Appendix II (species that may become threatened with extinction if trade is not controlled); and Appendix III (species subject to regulation in the jurisdiction of an individual party that requests co-operation in the control of its trade.)

(3) Convention on the Conservation of Antarctic Marine Living Resources, opened for signature May 20, 1980, 19 I.L.M. 837 (1980) (tracking trade flows of certain species).

(4) Montreal Protocol on Substances that Deplete the Ozone Layer, opened for signature Sept. 16, 1987, U.K.T.S. 19 (1990) (entered into force Jan. 1, 1989). (Requires parties to ban trade in certain substances with non-parties that do not comply with the Protocol.)

(5) Convention on the Control of Transboundary Movement of Hazardous Wastes and their Disposal (Basel), opened for signature Mar. 22, 1989, U.N. Doc EP/IG.80/3, 28 I.L.M. 649 (1989) (Entered into force May 24, 1992). (*Inter alia*, requires export bans to countries that have import bans on specific types of hazardous waste and prohibits trade in certain waste with non-parties.)

(6) Convention on Biological Diversity, opened for signature June 5, 1992, UNEP/bio.Div./CONF/L.2, 31 I.L.M. 818 (1992) (entered into force Dec. 29, 1993). (Article 10(b) requires parties to adopt "measures relating to the use of biological resources to avoid or minimize adverse impacts on biological diversity," but parties are free to choose the specific measures they will use and they are not required to use trade measures. Article 22 provides that the CBD shall not affect the rights and obligations of any party under existing international agreements, except when those rights and obligations would cause serious damage or threaten biological diversity. This provision could be interpreted as permitting trade measures.)

(7) Cartagena Protocol on Biosafety, Jan. 29, 2000, UNEP/CBD /ExCop/1/3, at http://www.biodiv.org/biosafe, Oct. 23, 2003. (Regulates procedures for the transboundary movement of Living Modified Organisms, without changing the rights and obligations of parties under other international agreements, including the WTO.)

(8) United Nations Framework Convention on Climate Change, opened for signature June 4, 1992, 31 I.L.M. 849 (1992) (entered into force Mar. 21, 1994). (Does not require trade measures, but they might be used to implement the agreement. Article 3.5 provides that "measures taken to combat climate change, including unilateral ones, should not constitute a means of arbitrary or unjustifiable discrimination or a disguised restriction on international trade," which mirrors the language in the Preamble (*chapeau*) of GATT Article XX.)

(9) Kyoto Protocol, opened for signature Mar. 16, 1998, at http://unfccc.int/resource/convkp.html, Nov. 4, 2003. (Does not require trade restrictions, but provides for emissions trading and requires parties to implement policies and measures to minimize adverse effects on trade.)

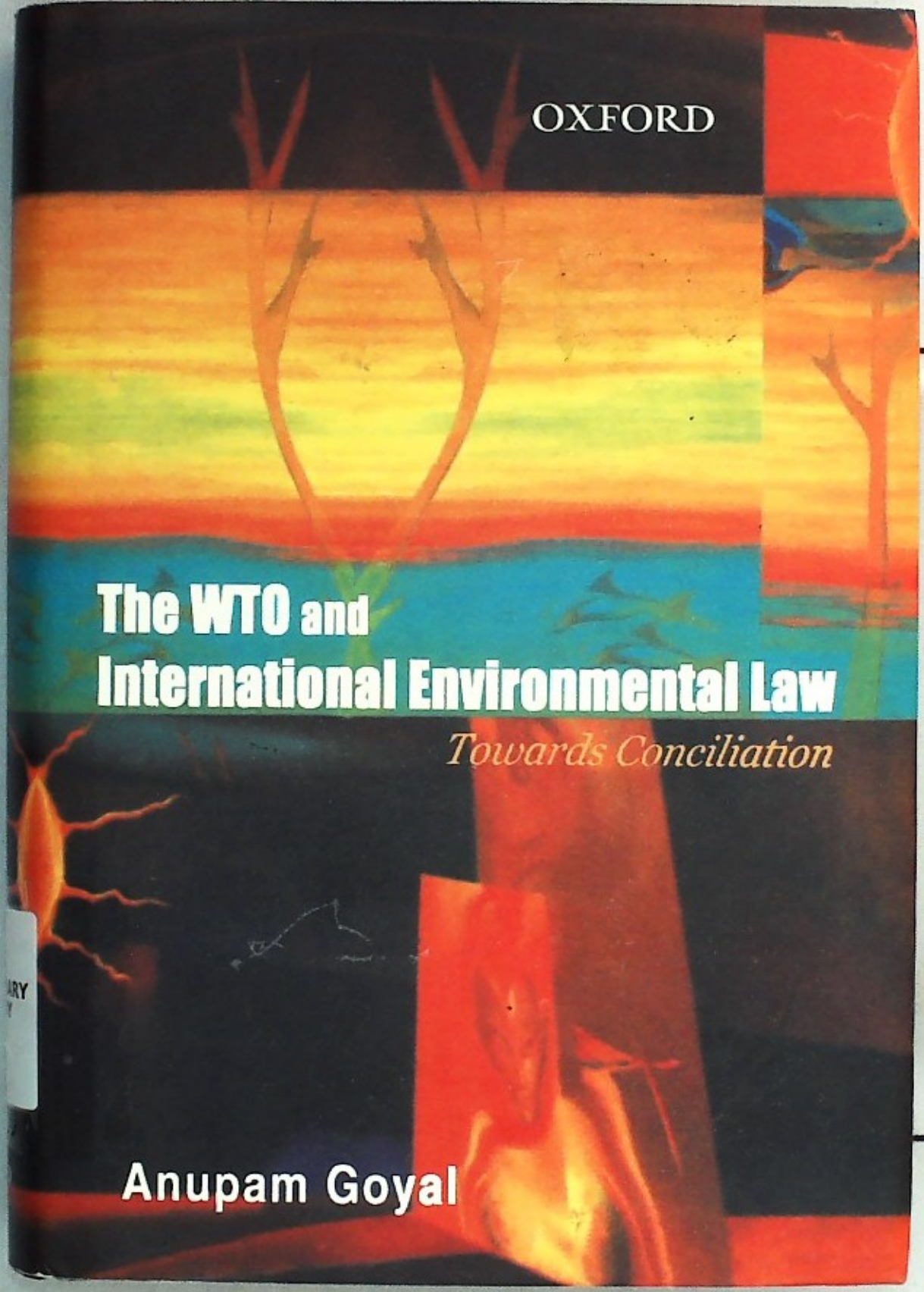
(10) International Tropical Timber Agreement, opened for signature Jan. 26, 1994, 33 I.L.M. 1014 (1994). (While the agreement does not authorize trade restrictions, it has trade-related objectives.)

(11) Rotterdam Convention on the Prior Informed Consent Procedure for Certain Hazardous Chemicals and Pesticides in International Trade, 1998. (Permits non-discriminatory import and export restrictions.)

(12) Draft Persistent Organic Pollutants Convention, reproduced in 37 I.L.M. 505 (1998). (Requires trade bans on prohibited substances.)

(13) International Plant Protection Convention 1979, entered into force Apr. 4, 1991. (Regulates the use of import restrictions related to phytosanitary requirements.)

(14) U.N. Fish Stocks Agreement, entered into force Dec. 11, 2001. (Permits regulations to prohibit landings and transhipments of fish catches that have been taken in a manner that undermines fish conservation and management.)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CONTENTS

Chapter 1

Trade and Environment Laws: Structure and Opposite Concerns

I. Advent of the WTO

After the second World War, world trade was governed by the General Agreement on Tariffs and Trade (GATT). The GATT essentially sought to lay down certain basic rules in respect of international trade in goods with a view to avoiding a recurrence of the trade wars which had characterized the world during the inter-wars period of 1919–39. The main objective of the GATT was to raise the standard of living of the people of the world and to secure progressive development of the economies of countries. The GATT has been revised from time to time to make it more responsive to the changing requirements of international trade and economic relations.

The Uruguay Round of trade negotiations (1986–94) was aimed at trade liberalization through the removal of the remaining barriers to free and fair trade. The end of the Uruguay Round of trade negotiations in 1994, rendered a profound change in the legal structure of the institutions for international trade. Since 1947, the GATT was the principal multilateral trade treaty, though it was only provisionally in force from a technical point of view. The Uruguay Round resulted in the creation of a powerful and effective international organization and a treaty structure namely the World Trade Organization—to carry on the work of the GATT. The institutional reforms of the Uruguay

Round include not only the WTO, but also substantial revisions of the dispute settlement procedures.[1]

(i) Legal Structure of the WTO

In the beginning of the WTO charter stand the preamble and the body of the WTO Agreement.[2] The charter is confined to institutional measures, but the charter explicitly outlines four important annexes that technically contain thousands of pages of substantive rules. The different annexes have different purposes and different legal impacts:

Annex 1 contains the 'Multilateral Agreements', which comprise the bulk of the Uruguay Round results and which are all 'mandatory' in the sense that these texts impose binding obligations on all members of the WTO. Annex 1A consists of GATT 1994, which includes the revised General Agreement with a new understanding, side agreements on twelve topics ranging from agriculture to preshipment inspection, important among them being the Agreement on Technical Barriers to Trade (TBT Agreement), Subsidies and Countervailing Measures (SCM Agreement). These are as follows:

(i) Agriculture;
(ii) Application of Sanitary and Phytosanitary Measures;
(iii) Textiles and Clothing;
(iv) Technical Barriers to Trade (TBT);
(v) Trade-Related Investment Measures (TRIMs);
(vi) Implementation of Art VI of GATT 1994;
(vii) Implementation of Art VII of GATT 1994;
(viii) Preshipment Inspection;
(ix) Rules of Origin;
(x) Import Licensing Procedure;
(xi) Subsidies and Countervailing Measures (SCM); and
(xii) Safeguards.

Annex 1B consists of the General Agreement on Trade in Services (GATS), which also incorporates a series of schedules of concessions.

[1] J. H. Jackson , W. J. Davey and A. O. Sykes, *Legal Problems of International Economic Relations*, St Paul, Minnesota: West Group, 2002, pp. 208–9.
[2] A. E. Appleton, *Environmental Labelling Programme: International Trade Law Implications*, London: Kluwer Law International, 1997, p. 87.

Annex 1C consists of the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs).

Annex 2 consists of the dispute settlement rules, which are obligatory upon all members, and which form a unitary dispute settlement mechanism covering all the agreements listed in Annex 1, Annex 2 and Annex 4, but not the TPRM procedures in Annex 3.

Annex 3 establishes the Trade Policy Review Mechanism (TPRM), by which the WTO will review the overall trade policies of each member on a periodic and regular basis, and report on those policies. The approach is not supposed to be 'legalistic,' and questions of consistency with the WTO and Annex obligations are not the focus; rather the focus is the general impact of the trade policies, both on the country being examined and on its trading partners.

Annex 4 contains four agreements that are 'optional,' and termed as 'plurilateral agreements'. Here, there is a slight departure from the single package ideal, but the agreements included tend to be either targeted to a few industrial countries, or to be more 'hortative' in nature without legal impact.[3] The four agreements deal with government procurement, trade in civil aircraft, bovine meat, and dairy products.

By adhering to the WTO Charter, countries become subject to all of the annexed agreements, except the plurilateral agreements, adherence to which is optional. There are also, as part of the April 1994 'Final Act' that established the WTO structure, an assortment of appended ministerial decisions, declarations, understandings and recommendations. By signing the Final Act, the representatives adopted these ministerial decisions and declarations. These instruments are of great importance as part of the Final Act for interpreting the WTO Agreement.[4]

(ii) Mandate of GATT 1947 and 1994

The General Agreement on Tariffs and Trade, first adopted in 1947 and later amended and incorporated with a variety of treaty instruments, provides an important 'code' of rules applying to government actions which regulate international trade. The basic purpose of the General Agreement is to constrain governments from imposing or continuing

[3] Jackson 2002, p. 257.
[4] Appleton, p.88.

a variety of measures that restrain or distort international trade. Such measures include tariffs, quotas, internal taxes and regulations which discriminate against imports, subsidy and dumping practices, state trading, as well as, customs procedures and a plethora of other 'non-tariff measures' that discourage trade. A very important rule which is known as the 'GATT Mandate' is the 'MFN' or the Most Favoured Nation clause of Art I, which provides that governments import or export regulations should not discriminate between products of other countries. Likewise Article III contains the 'national treatment' obligations, which specifies that imports shall be treated on the same footing as domestically produced goods under internal taxation or regulatory measures. Article II establishes that the tariff limits expressed in each contracting party's 'schedule of concessions' shall not be exceeded.

The General Agreement also has a number of exceptions, such as those for ensuring national security, protecting human, animal or plant life or health, public morals, conservation of natural resources, safeguards or escape clauses. It means that if a measure fulfils the requirement of any clause given the general exceptions, it is valid, even if inconsistent with the GATT provisions. Annex 1A to the WTO Agreement incorporates a document labelled GATT 1994 which is essentially GATT 1947 amended and changed through the Uruguay Round along with all the ancillary agreements pertaining to trade and goods.

(iii) The GATT Dispute Settlement System

GATT's dispute settlement system was provided in Art XXIII which contained very little procedural detail. Consequently, the GATT parties had to improvise and develop procedures through practice, over the years. Initially, the contracting parties considered and discussed disputes at their regular meetings. In some cases, working parties were involved. A working party in the GATT context is understood to mean, a body whose members are 'nations,' so that each nation may send a representative of its own choice. The panel members, usually three in number, were in fact often chosen from the available national representatives to GATT. Their reports were then to be adopted by a consensus in the GATT Council.

The GATT parties had to formally adopt a panel decision unanimously. If the parties adopted a decision, the losing party was required to bring the offending measure into conformity with the GATT. The

GATT system experienced some problems with the delays and failures to adopt reports because of various blocking tactics resorted to by losing parties that prevented a consensus in the GATT Council.[5]

(iv) Dispute Settlement Understanding under the WTO

Understanding on the rules and procedures governing the settlement of disputes is one of the principal functions of the WTO Agreement. Article 3.2 of the Dispute Settlement Understanding (DSU) in Annex 2 of the WTO Agreement, states that the dispute settlement system 'is a central element in providing security and predictability to the multilateral trading system.'

In ratifying the WTO Agreement, contracting members have pledged to obey its obligations. If a WTO member violates its obligations explicitly, then the affected parties have the right to challenge such violation before the WTO panel. The WTO dispute settlement is a two-tier system in which a panel assesses the facts and comes to a legal conclusion. The panel consists of three/five international trade lawyers or trade policy officials who are proposed by the WTO secretariat and usually agreed upon by the dispute partners consensually, but may not come from one of the disputing parties, as was possible under the GATT system.[6] All parties to the dispute can appeal against the panel's decision. The appellate body, which consists of three members for each case drawn at random from a pool of seven permanent members, will, however, not assess the facts anew or consider new facts. Rather, it is confined to an assessment of the panel's legal interpretation of the facts.[7] The GATT, on the other hand, did not offer the possibility of appealing against a decision.

If it is found that a complaint is justified, then the WTO Panel/Appellate Body report shall recommend that the offending members cease the violation of WTO rules. This is normally done by withdrawing the offending measures. After it adopts a report, the Dispute Settlement Body (DSB) monitors whether or not its recommendations are implemented. The DSU requires a losing respondent to indicate, what action it plans to take to implement the panel's recommendations. If immediate implementation is impracticable, then implementation is required within a reasonable period of time.[8] Such period is not to exceed 15 months.[9]

[5] Jackson 2002, p. 257

[6] If a developing country is involved in the dispute it can demand that one of the panelists is from the developing world. —DSU, Final Act, Article 8(10).

[7] Ibid., Article 17.

If the recommendations are not implemented, the prevailing party is entitled to seek compensation from the non-complying member or request the DSB authority to suspend concessions previously made to that member, that is, retaliation.[10] In this regard the DSU modifies the past GATT practice. Article XXIII permitted GATT contracting parties to authorize the prevailing party to retaliate if the losing party failed to end its violation of GATT rules. Such authorization was granted only once. Now under the DSU, suspension of concessions is to be authorized automatically in the absence of implementation or non-payment of compensation, unless there is a consensus in the DSB to the contrary.[11] However compensation and suspension of concessions are viewed as 'temporary measures' to be used when a report is not implemented in a reasonable time. The preference for withdrawal is found in the WTO Agreement itself, where Art XVI (4) provides that '[e]ach member shall ensure the conformity of its laws, regulations and administrative procedures with its obligations as provided in the annexed Agreements.' Thus, there appears to be an international law obligation to implement recommendations to withdraw inconsistent measures.[12]

Under the GATT dispute settlement system practice, prior to the conclusion of the Uruguay Round, after a panel issued its report, it was considered for adoption by the GATT Council. Traditionally, the decisions in the Council were made by consensus, which meant that any party—including the losing party—could prevent the Council from adopting a panel report. Many GATT panel's reports—including some environmental ones—were never adopted so they did not become binding. The DSU fundamentally changed this procedure. It eliminated the possibility of blockage by providing that a panel report shall be adopted unless there is an appeal or a 'reverse consensus,' that is, consensus not to adopt the report.[13] This would mean that even the

[8] Ibid., Article 21(3).

[9] Ibid., Article 21(3)(c).

[10] Ibid., Article 22(1).

[11] Ibid., Article 22(6).

[12] Jackson 2002, p. 267.

[13] DSU, Final Act, Article 16.

winning party would need to disapprove of the decision.[14] Therefore, the reports now almost automatically become approved.

The general philosophy of WTO dispute settlement is set out in Art 3 of the DSU. Among the principles that are enshrined in that Article are the following:

First, it is recognized that the system serves to preserve the rights and obligations of members and to clarify the existing provisions of the WTO agreements in accordance with the customary rules of interpretation of public international law. In this regard, it is also noted that the prompt settlement of disputes is essential to the functioning of the WTO and the maintenance of a proper balance between the rights and obligations of WTO members.

Second, it is agreed that the results of the dispute settlement process cannot add to or diminish the rights and obligations provided in the WTO agreements. In this regard, the DSU explicitly notes the right of members to seek authoritative interpretation of provisions pursuant to Article IX of the WTO Agreement, which itself provides that it is the exclusive means for interpreting the WTO Agreement.

Third, several provisions highlight that the aim of dispute settlement is to secure a positive solution to a dispute and that a solution that is acceptable to the parties and consistent with the WTO agreement is clearly to be preferred.

Fourth, although the DSU provides for the eventuality of non-compliance, it is explicitly stated in DSU Article 3.7 that 'the first objective of the dispute settlement mechanism is usually to secure the withdrawal of the measures concerned if these are found to be inconsistent with the provisions of any of the covered agreements'. Retaliatory action is described as the last resort.

(v) WTO's Ministerial Conferences

Article IV(1) of the WTO Agreement provides for holding a ministerial conference at least once every two years. The Ministerial Conference is composed of all the members. The task of the conference is to carry out the functions of the WTO and take necessary actions. The Ministerial Conference has the authority to take decisions on any of the matters under any of the Multilateral Trade Agreements.

[14] E. Neumayer, *Greening Trade and Investment: Environmental Protection Without Protectionism*, London: Earthscan Publications Ltd., 2001, p. 119.

(a) Singapore Ministerial Declaration, 1996

The WTO members met in 1996 for the first biennial meeting of the WTO at the ministerial level. The declaration brought new issues relating to investment, competition policy, trade facilitation and transparency in government procurement, on the WTO agenda.

Developed countries also tried to bring on the agenda, the core labour standards which could not succeed against stiff resistance from developing countries. Ultimately it was agreed that labour standards were a matter for the International Labour Organization (ILO) and that the WTO should have nothing to do with it. The conference rejected the use of labour standards for protectionist purposes and agreed that the comparative advantage of countries, particularly low wage developing countries, must in no way be put to question.[15]

(b) Geneva Ministerial Conference, 1998

The Geneva Ministerial Conference was held in 1998 which commemorated the 50th anniversary of the birth of GATT, the precursor of the WTO. At this meet, the ministers renewed their faith in the multilateral trading system. The conference welcomed the successful conclusion of negotiations on basic telecommunications and financial services. The implementation of the Information Technology Agreement was also taken note of. The declaration recognized its commitment to continue to improve efforts towards the objectives of sustained economic growth and sustainable development.[16]

(c) Seattle Ministerial Conference, 1999

The Seattle conference was held at a time when the mandate of the Uruguay Round resulting in the coming into force of WTO, had to be reviewed in two respects. Firstly the Agreement on Agriculture in the Uruguay Round mandated a renewal of negotiations in year 2000, to advance the process of trade reform and secondly, the review of the entire process of implementation of the Uruguay Round agreements.

But the conference collapsed and turned out to be an letter failure. The promised benefits to the developing states had failed to materialize and the commitments undertaken by the developed countries

[15] Singapore Ministerial Declaration, WT/MIN(96)/Dec., para. 4.
[16] Geneva Ministerial Declaration, WT/MIN(98)/Dec., para. 1, 2, and 4.

had been diluted significantly. Another dominant reason for the failure of the conference was the wide rift between the E.U. and the US on agriculture related subsidies.

(d) Doha Declaration, 2001

In November 2001, the ministers of WTO members met at Doha, and took some important decisions. Following the failure of the Seattle conference in 1999, it was felt that the WTO needed a successful conference in order to avoid any negotiation of trade policies on regional basis. The Declaration, known as Doha Declaration reiterated the themes enshrined in the preamble of the WTO Agreement and the prior ministerial conferences including those held at Marrakesh, Singapore, and Geneva.[17] The Doha Declaration brought the process back on track. Regarding agriculture, it affirmed that all countries would work towards the reduction of export subsidies in agriculture, with a view to finally phasing them out.[18]

The willingness of the US and E.U. on negotiations on Singapore issues concerning competition, investment, trade facilitation and transparency in government procurement were opposed to by the developing countries. At the end, the Declaration provided that with respect to these topics, negotiations would take place after the fifth session of the ministerial conference on the basis of a decision taken by a clear consensus at that session on the modalities of negotiations.[19]

The Doha Declaration made some concessions to developing countries. Implementation-related issues and concerns are listed in a separate ministerial decision. Among the implementation issues of concern to India, it proposed that the pace of dismantling textile export quotas and integrating textiles and clothing into the WTO framework could be accelerated.[20]

In respect of intellectual property, the key issue was the relationship of the TRIPs Agreement to public health, which was addressed in a separate declaration. The declaration affirmed that nothing in WTO's intellectual property right regime would impede the access of

[17] Doha Ministerial Declaration, WTO Doc. WT/MIN(01)/Dec./1, para. 2, 3.
[18] Ibid., para. 13.
[19] Ibid., para. 20, 23, 26, and 27.
[20] Decision on Implementation Related Issues and Concerns, WT/MIN(01)/W/10, para. 4.

needy populations to essential medicines.[21] The provisions of compulsory licensing have been strengthened in the declaration, which confers on every member, the right to grant compulsory licenses and the freedom to determine the grounds upon which such licenses are granted.[22]

(e) Cancun Ministerial Declaration, 2003

The fifth ministerial conference of the WTO was held in September 2003, at Cancun. The conference failed because of the developing countries' resistance against the efforts of the US and E.U. to force their way on Singapore issues inconsistent with the previous commitment of the US and the E.U. that these issues be based on explicit consensus.[23] At the Conference, the draft ministerial declaration, revised a second time, envisaged that negotiations on trade facilitation and transparency in government procurement would begin immediately after the Cancun meeting. Competition policy would be referred back to a working group of the WTO, with the understanding that it would consider 'possible modalities for negotiations'. The issue of investment would go in a phase of 'intensified clarification' so that 'modalities' for commencing negotiations would be agreed concurrently with similar milestones being reached in agriculture and non-agricultural market access.[24]

This Declaration made clear that the E.U. and the US were determined to disregard the Doha Declaration's stipulation that the explicit consensus of all members-states was required to begin negotiations on the Singapore issues. Negotiations on Singapore issues to be based on clear consensus, meant that each WTO member would be at liberty to take its own position on modalities that could prevent negotiations from proceeding until that member state was prepared to join.[25] India, leading the developing countries took the stand, that a majority of the membership of the WTO had rejected the launch of negotiations on these issues and sought a continuation for the clarification process.

[21] Declaration on TRIPs Agreement and Public Health, WT/MIN(01)/Dec./2, para. 4.
[22] Ibid., para. 5.
[23] *Supra* 19 and accompanying text.
[24] Draft Ministerial Declaration, JOB/03/150/Rev.2.
[25] The objections of Developed Countries to having a multilateral agreement on the Singapore issues are as follows: On having a multilateral agreement

But the second revision of the draft declaration had utterly disregarded that fact. 'Explicit consensus' had been ignored as a requirement for negotiations and effectively dismissed from all future deliberations of the WTO. This was a clear instance of the deliberate neglect of the views of a large number of developing countries and an attempt to thrust the views of a few countries onto many developing countries.

Another reason for the failure of the conference was the reasonable fear, on the part of the developing nations of some kind of collusion between the United States and EU on the issue of agriculturel, particularly by substituting 'amber box' subsidies into 'blue box' or 'green box' subsidies.[26] The draft declaration indicated that the E.U. and the US were not willing to make any significant cuts in their high levels of agricultural subsidies. The United States–European Union text on agricultural subsidy chose the path of vagueness. The text was ambiva-

on *investment*, there would be a serious impingement on the sovereign rights of the developing countries. Though every multilateral treaty impinges upon the sovereign rights of states but investments is seen as an area in which ceding sovereign rights would leave governments of developing countries, too little room for maneuvering in directing investments into areas of national priority. On the issue of *competition policy* as applicable to 'hardcore cartels', developing nations feel that there is no clarity on whether these would include export cartels. The Organization of Petroleum Exporting Countries (OPEC) is the best-known example of an export cartel that rigs prices by fixing production ceiling. On the issue of *transparency on the government procurement*, there can not be a universal determination of what constitutes transparent procedure. If a government offers an incentive for the level of indigenization in procuring a good that clearly would affect trade. *Trade facilitation* refers to simplifying procedural hassles in international trade, in terms of the documentation required by customs departments and so on. This too has an impact on trade. The developing countries may not have the resources — by way of technology or otherwise — to bring their procedures in line with those in the developed nations over the short or medium term.

[26] In WTO jargon, these are different types of subsidies. Amber box subsidies are deemed to be trade distorting. A market price support mechanism that sets no limit on the production comes under this category. Blue box subsidies are considered to be less trade distorting. For instance, while they directly link production to subsidies, they also set limits on production by way of quotas. Green box subsidies were initially considered non trade-distorting. Direct income support scheme to the farmers, unlinked to production is an example of it.

lent on the issue of domestic support. While urging that the 'most trade-distorting' forms of domestic support for agriculture should be phased out, it provides for the retention of the purportedly less damaging forms. The US for instance, provides most of its subsidies in the form of income support to farm families, without taking into account actual production levels. The E.U. also proposed to switch over from 'price support' to 'income support' in the form of payment to farmers on US lines. This overlooked the vigourous debate that has been underway within the WTO since 2000, on the precise influence of various forms of agricultural support on trade patterns.[27]

In the category of 'blue box' subsidies, the language adopted in the United States–European Union text was identical to that employed in WTO's Agreement on Agriculture, under Art 6(5). Direct payments made under this category were unfettered, provided those were based on fixed sown area and yields of various crops, and livestock payment were to be made on a 'fixed number of heads'. However, the text provided that the sum of the 'green box payments' and 'blue box payments' would be reduced, so those were significantly lower than the corresponding figure in the year 2004. This commitment was considered altogether too vague for the developing countries. Hence the European Union–United States proposal was rejected. Developing countries headed by India gave a counter proposal. The proposal urged that the 'blue box' payments be completely eliminated and that all trade-distorting domestic support be reduced by a proportion to be determined by mutual consultations. The 'green box' payments, which cover decoupled income support, should be subject to a strict regime of reduction, to be worked out through negotiations.

II. Global Environmental Problems and Evolution of International Environmental Law

At present, major environmental problems are not confined to an individual nation or some local area rather they have assumed global

[27] Conventional wisdom within the WTO holds that income support — unlike price support — is not trade-distorting or only minimally so. This overlooks the basic point that farmers who earn their living from government handouts rather than the land, can afford to sell their produce at rock bottom prices in the global market, effectively squeezing out the small peasants of the developing countries.

dimensions. The problem of environmental pollution concerns all countries irrespective of their size, level of development or ideology. Notwithstanding political division of the world into national units, the oceanic world is interconnected as a whole; and the winds that blow over the countries are also the same.[28] The major cause of environmental degradation is the uncontrolled and unregulated developmental activities without any regard whatsoever for the conservation of natural resources. This does not mean that industrial development and economic growth must cease. If it did, there would be disastrous consequences for mankind, especially the developing countries. The International Union for Conservation of Nature and Natural Resources (IUCN) clarifies that the development and conservation are equally necessary for our future survival.[29] In order to ensure the timeless prosperity of mankind in terms of both—the ecological and economic—the world community has made substantial efforts. Major landmarks in the development of international law relating environment are hereunder.

(i) Trail Smelter Arbitration, 1941

Trail Smelter Arbitration between the United States and Canada in 1941 constitutes the first significant event in the development of international law in the field of environment. The dispute had concerns of transfrontier air pollution, by sulphur dioxide fumes originating in Canada and causing damage in the United States. In this case, the arbitration tribunal declared that allowing the use of one's territory by a state in such a way, that causes serious injury to the person or property in the territory of another state is prohibited in international law.[30]

The United Nations Charter of Economic Rights and Duties of States reiterates that sovereign rights should only be used without causing damage to the legitimate rights of others. The principle has received wide acceptance by most commentators on international law

[28] *M. C. Mehta* v. *Union of India*, (1991) 2 SCC, 354.
[29] D. Hughes, *Environmental Law*, London: Butterworths, 1992, p. 14.
[30] *United States* v. *Canada* (*Trail Smelter* Arbitration), R. I. A. A. 1938, vol. III, p. 1905.

and modern state practice appears to be founded on it.[31] Since the states have accepted these rules, they constitute the *opinion juris* and because there has been no conflicting state practice, they actually are a part of customary international law.[32]

(ii) Stockholm Declaration, 1972

The profound impact of modern technology and damage to the environment caused by human activities in the first half of the twentieth century, raised fundamental questions about whether the earth could continue to support its rapidly growing population. By the late sixties, the focus had turned from concentrating on the natural environment to the interrelation of human activities. In 1968, Sweden proposed that the UN convene a special conference through which problems of the global environment could be properly addressed by the international community. The UN General Assembly endorsed the proposal and the first UN Conference on Human Environment was convened in Stockholm, from 5–16 June 1972. The conference resulted in the adoption of the Stockholm Declaration[33] which contains fundamental environmental protection principles of tremendous importance to mankind.

The principles contained in the Stockholm Declaration demonstrate that the world has just one environment. The first principle enunciates that man has the fundamental right to freedom, equality and adequate conditions of life, in an environment of quality that permits a life of dignity and well-being, and he bears a solemn responsibility to protect and improve the environment for present and future generations. Principle 21 of the Declaration confers responsibility on states to ensure that activities within their jurisdiction and control do not cause damage to the environment of the other states or of areas

[31] G. Singh, *Environmental Law: International and National Perspectives*, New Delhi: Lawman (India) Pvt. Ltd., 1995, p. 10. —Citing, UN General Assembly Resolution No. 1629 of 1961 provides that the fundamental principles of international law impose a responsibility on all States concerning actions which might have harmful biological consequences by increasing levels of radioactive fallout.
[32] G. Singh, *International Law*, New Delhi: Macmillan India Ltd., 2003, p. 559.
[33] Stockholm Declaration of the United Nations Conference on the Human Environment, 16 June 1972, UN Doc. A/Conf.48/14, reprinted in *I.L.M.*, 11, 1972, p. 1416.

beyond the limits of national jurisdiction. Principle 21 is reinforced by other principles especially Principle 22 which requires the states to cooperate, in developing international standards regarding liability and compensation for the victims within the jurisdiction or control of such states, to areas beyond their jurisdiction. Principle 7 contains the requirement that states shall take all possible steps to prevent pollution.

(iii) United Nations Environment Programme

The agreement arrived at, at the Stockholm conference between developing and developed countries on the issue of development and environment, resulted in the creation of the United Nations Environment Programme (UNEP), in 1972 itself. The UNEP was established to embrace all activities undertaken within the UN system related to the environment. The UNEP institutionalizes the conceptual framework of the Stockholm Declaration that the environment is the common concern of mankind. The institution of the UNEP is, in fact, born out of the common concern of mankind for the environment.

The UNEP's work programme emphasizes relationships between socio-economic driving forces, environmental changes and their impact on human well-being. Equipped with a stronger regional presence and marked by a process of continuous monitoring and assessment of its implementation, the UNEP's work focusses on the sustainable management and use of natural resources; sustainable production and consumption patterns; a better environment for human health and well-being; and globalization of the economy and the environment. The basic function of the UNEP may be classified as the dissemination of information, cultivation of understanding and collaborating with the environmental programmes of other countries. It provides functions of coordination, information, and reporting. The primary significance of the UNEP lies in the fact that it provides a forum acceptable to the developing countries which emphasize development as a vehicle for raising the quality of the environment.

(iv) Convention Concerning the Protection of the World Cultural and Natural Heritage, 1972

The United Nations Educational, Scientific and Cultural Organization (UNESCO), in its general conference adopted the Convention

Concerning the Protection of the World Cultural and Natural Heritage in 1972, with the aim of preserving the world heritage of mankind.[34] In the preamble of the Convention, UNESCO perceived that insufficient economic, scientific and technological resources of a country where the property was situated, was the major reason of its decay. The places of world heritage are of outstanding interest to all the nations of the world, so collective measures were needed for its preservation. In the environmental context, the Convention is important as it gives a broad definition to 'natural heritage' encompassing within its fold, physical and biological formations to threatened species of plants and animals and their habitats which are scientifically important.[35] While recognizing the sovereignty of states on whose territory the cultural and natural heritage is situated, it puts a duty on the international community to cooperate to protect the world heritage.[36]

The Convention clarifies that international protection of the world heritage is meant to establish a system of international cooperation and assistance, designed to support the state parties in their conservation efforts.[37] Part V of the Convention provides detailed rules as to the international assistance towards support of state parties to protect the cultural and natural heritage situated in their territory. An Intergovernmental Committee has been established in Part III of the Convention, to carry out the aims of the Convention.

(v) UN Convention on International Trade in Endangered Species of Wild Flora and Fauna, 1973

The Convention on International Trade in Endangered Species of Wild Flora and Fauna, (CITES) was signed in 1973.[38] The purpose of the CITES is to tackle trade-induced species loss. International trade in wild species is an important cause of species risk and loss in biodiversity. The contributory roles of destruction or land conversion of habitats and pollution in biodiversity are significant too. The esti-

[34] UNESCO Convention Concerning the Protection of the World Cultural and Natural Heritage, 1972, *I.L.M.*, 11, 1972, p. 1358.
[35] Ibid., Article 2.
[36] Ibid., Article 6.
[37] Ibid., Article 7.
[38] Convention on International Trade in Endangered Species of Wild Flora and Fauna, 3 March 1973, 27 U.S.T. 1087, 993 U.N.T.S. 243.

mated $5 billion annual trade in illegal traffic of wild species is sought to be curbed or minimized with the participation of a number of national governments.[39] Conservative estimates suggest that one in five of all animals are threatened, together with 10 per cent of all birds and plants.[40]

Of the large number of MEAs, CITES has probably the single most detailed control structures. It was the first international wildlife treaty to provide both express obligations and monitoring. CITES functions as a potential trade control mechanism primarily through the operation of two appendices, on potentially endangered species that are listed. Appendix I is intended as a list of those species which are currently threatened with extinction.[41] Appendix II contains a list of species for which there is some indications that they might become threatened.[42]

(vi) World Charter for Nature, 1982

The idea of the Charter was mooted in 1975 at the twelfth General Assembly of the IUCN. It was proposed that the IUCN should develop a Charter for Nature based on the proposition that all human conduct affecting nature must be guided and judged.[43] The proposal was accepted and an international group of experts was designed to prepare a draft Charter to serve as a code of conduct for managing nature and natural resources. The World Charter for Nature was adopted by the UN General Assembly in 1982.[44]

The World Charter for Nature proclaims that activities which are likely to cause irreversible damage to nature shall be avoided.[45] The Charter also comes to grips with the problem of global environmental change by imposing a requirement on states and ultimately their national territories that activities which are likely to pose significant

[39] P. K. Rao, *The World Trade Organisation and the Environment*, London: Macmillan Press Ltd., 2000, p. 63.
[40] Ibid.
[41] CITES, Article II(1).
[42] Ibid., Article II(2).
[43] UN General Assembly, Draft World Charter for Nature Report of the Secretary General, 36th Sess. At 14–15, Agenda item 23, Doc. A/36/539, (1981), Annex I, Appendix II.
[44] World Charter for Nature, 1982, *I.L.M.*, 22, 1983, p. 455.
[45] Ibid., Article 11(a).

risk to nature shall be preceded by an exhaustive examination. In case where the potential adverse effects of the activities are not fully understood, the activities shall not proceed.[46] In case the activities that may disturb the nature are to be undertaken, such activities shall be planned and carried out so as to minimize potential adverse effects.[47]

The World Charter is not a binding treaty. However, a large majority of the member states of the UN have supported the Charter. The purpose of the Charter is to provide a procedural and substantive protection to the global environment from the impact of industrialization.

(vii) Brundtland Report, 1987

The World Commission on Environment and Development was set up by the UN General Assembly in the year 1983. The Report of the World Commission on Environment and Development (Brundtland Report), 'Our Common Future,' was bought out in 1987, the document 'Caring for Earth: A Strategy for Sustainable Future' was developed by the second world conservation project comprised of the representatives of the IUCN, UNEP and Worldwide Fund for Nature (WWF).

The central theme of the report is the application of the principle of sustainable development. The Brundtland Report defines sustainable development as development that meets the needs of the present generation without compromising the ability of the future generations to meet their own needs.[48] The report emphasizes that sustainable development means an integration of economics and ecology in decision making at all levels. The document *Caring for the Earth* defines sustainability as a characteristic or state that can be maintained indefinitely whereas development is defined as the increasing capacity to meet human needs and improve the quality of human life.[49] This means that sustainable development would imply improving the quality of human life within the carrying capacity of the supporting ecosystem.

[46] Ibid., Article 11(b)
[47] Ibid., Article 11(c)
[48] World Commission on Environment and Development, *Our Common Future*, Oxford: Oxford University Press, 1987, pp. 92–3.
[49] IUCN, UNEP and WWF, *Caring for the Earth: A Strategy of Sustainability*, Gland: IUCN, 1990, p. 16.

(viii) Montreal Protocol on Substances that Deplete Ozone Layer, 1987

The problem of the depletion of the ozone layer has captured the attention of mankind. The 'ozone layer' which exists in the earth's stratosphere at an altitude of 12 to 50 kilometers is a concentration of ozone molecules. The primary function of the ozone layer is to absorb incoming ultraviolet rays from the sun, thus protecting the earth. Ultraviolet rays cause damage to our health and environment and excessive exposure to these rays can be devastating causing increased cases of cataracts, skin cancers, retinal deterioration and possible deterioration of the human immune system. The environmental effects of increased ultraviolet rays' exposure may include significant decreases in agricultural fields and unpredictable alterations in weather and precipitation patterns. The ozone-depleting compounds are believed to contribute to the global greenhouse problem, in which gases absorb reflected ultraviolet radiation, retain heat and thereby slowly increase the earth's ambient temperature.

The prime culprits in the destruction of the ozone layer are chlorofluorocarbons (CFCs) and halons. Both are inert, non-toxic, non-inflammable and immune to decomposition or oxidation in the atmosphere. Having identified ozone depletion as an area deserving priority treatment, the UNEP organized a conference on the protection of the ozone layer which resulted in the adoption of the Vienna Convention for the Protection of the Ozone Layer in 1985. The convention was merely a framework convention and did not contain substantive provisions. However, the convention provided the basis for the adoption of the Montreal Protocol on Substances that Deplete the Ozone Layer, in 1987.[50]

The Montreal Protocol is an international agreement to globally reduce the emission of substances known to harm the ozone layer. It contains measures which impose obligations on state parties to reduce

[50] Montreal Protocol on Substances That Deplete the Ozone Layer, 16 Sept 1987, S. Treaty Doc. No. 10, 100th Cong., 1st Sess. 1 (1987), *I.L.M.*, 26, 1987, p. 1541. London Amendments to the Montreal Protocol on Substances That Deplete the Ozone Layer, at London, 29 June 1990, *I.L.M.*, 30, 1990, p. 537, and Adjustments and Amendment to the Montreal Protocol on Substances That Deplete the Ozone Layer, at Copenhagen, 23-25 November, 1992, *I.L.M.*, 32, 1992, p. 874.

production and consumption of ozone-depleting substances, cooperate in developing alternative substances and impose prohibitions to restrict trade in these substances between parties and non-parties.

The Montreal Protocol has been amended in 1990, 1992, 1995 and 1997. The amendments have expanded the list of ozone-depleting substances and enhanced the phasing-out schedule of the ozone-depleting substances.

(ix) Basel Convention on the Transboundary Movements of Hazardous Wastes and their Disposal, 1989

The call for a global instrument to regulate international movements of hazardous wastes began with a growing understanding that developing countries were becoming victims of toxic wastes imperialism. The symbolic and political impetus behind the effort to control international waste traffic, was the hazards of illegal wastes trade on poor countries, which had little technical capabilities to manage the deadly cargo. The UNEP initiated activities to devise a regulatory approach to the problem in 1987 and eventually the Basel Convention was adopted in 1989.[51]

The convention did not define hazardous wastes in detail. Leaving that to national definition, it included three separate annexes to generally categorize hazardous wastes. Annex I listed the categories of wastes to be controlled, while Annex III listed characteristics which were deemed 'hazardous' under the convention. The convention covered wastes collected from households, and residues arising from their incineration, which were listed under a separate Annex II.

The objectives of the convention are to minimize the generation of hazardous wastes, control and reduce their transboundary movement, protect human health and the environment and dispose them of as close as possible to the place where they were generated.

(x) Earth Summit, 1992

The United Nations Conference on Environment and Development (UNCED), popularly known as the Earth Summit, was held in 1992 at Rio de Janeiro and participated by more than 100 countries. This was

[51] Basel Convention on Transboundary Movements of Hazardous Waste and Their Disposal, 22 March 1989, *I.L.M.*, 28, 1989, p. 649.

the largest UN Conference ever held and it put the world on a path of sustainable development. The Earth Summit was inspired and guided by the Brundtland Report. The major achievements of the Earth Summit lie in the form of five documents adopted by the majority of states. These documents are detailed below.

(a) Rio Declaration on Environment and Development, 1992

The Rio declaration[52] was conceived of as an Earth Charter. The declaration is a statement of broad principles to guide national conduct on environmental protection and development. The declaration consists of 27 principles which guide the behaviour of nations towards more environmentally sustainable patterns of development.

The important among them being Principle 12, requiring states to cooperate to promote a supportive and open international economic system that would lead to economic growth and sustainable development. The principles call upon the states to apply environmental measures based on international consensus to overcome global environmental problems. Principle 2 of the declaration puts a duty on the states that while exploiting their own resources pursuant to their own environmental and developmental polices, it is their responsibility to ensure that their activities do not cause damage to the environment of other states. The '*precautionary principle*' has been incorporated in Principle 15 according to which, where there are threats of serious or irreversible damage, lack of full scientific certainty shall not be used as a reason for postponing cost-effective measures to prevent environmental degradation. Principle 16 embodies the '*polluter pays principle*' according to which national authorities should endeavour to promote the internationalization of environmental costs and the use of economic instruments, taking into account the approach that the polluter should, in principle, bear the cost of pollution, with due regard to the public interest and without distorting international trade and investments. Principle 3 requires that the right to development must be fulfilled so as to equitably meet developmental and environmental needs of present and future generations. Lastly, principle 27 says that states and people shall cooperate in good faith and in a spirit of partnership in the fulfillment of the principles embodied in the declaration and in the further development of international law in the field of sustainable development.

[52] Rio Declaration on Environment and Development, 14 June 1992, UN Doc. A/Conf.151/26 (vol. 1), reprinted in *I.L.M.*, 31, 1992, p. 874.

(b) Agenda 21

Agenda 21 is a comprehensive blue print for local, national, regional and global actions to affect the transition to sustainable development in the twenty first century.[53] It is a voluntary action plan. The main goal of Agenda 21 is to halt and reverse the environmental damage to our planet and to promote environmentally sound and sustainable development in all countries on earth. It includes concrete measures and incentives to reduce the environmental impact of the industrialized nations, revitalize development in the developing nations, eliminate poverty worldwide and stabilize the level of the human population.

The main programme areas of Agenda 21 are grouped into the seven central themes, namely, the quality of life on the earth, efficient use of the earth's natural resources, the protection of the global commons, the management of human settlements, chemicals and management of wastes, sustainable economic growth and implementing Agenda 21.

(c) Forest Principles

The statement of 17 non-binding principles negotiated at Rio explicitly includes all types of forests. The preamble states, that forests are essential to economic development and maintenance of all forms of life. All types of forests embody complex and unique ecological processes which are the basis for their present and potential capacity to provide resources to satisfy human needs as well as environmental values. Thus, the sound management and conservation of forests is of concern to the governments of the countries to which they belong and are of value to local communities and to the environment as a whole.

The statement recognizes the vital role of forests in maintaining the ecological processes, protecting fragile ecosystems, watersheds and freshwater resources. Forests are rich storehouses of biodiversity and biological resources and are sources of genetic material for biotechnology products as well as photosynthesis.[54] It is stated that all types of forests play an important role in meeting energy requirements

[53] Agenda 21, the program of action adopted at UNCED, Rio de Janeiro, 1992.

[54] Forest Principles, 1992, Principle 2(d).

through the provisions of a renewable source of bio-energy, particularly in developing countries.[55]

The statement, therefore insists that national forest policies should recognize and duly support the identity, culture and the rights of the indigenous people, their communities and other communities and forest dwellers. Appropriate conditions should be promoted for these groups to enable them to have an economic stake in forest use, perform and promote economic an activities, achieve adequate levels of livelihood and maintain cultural identity.[56]

(d) Climate Change Convention, 1992

At the Rio Conference, the two legally binding conventions that is 'Convention on Climate Change' and 'Convention on Biodiversity' were signed by the representatives of more than 150 countries. The Climate Change Convention requires the member states to take up steps to reduce their emission of gases believed to contribute to global warming. The convention acknowledges that change in the earth's climate and its adverse effects are a common concern of mankind. It endeavours to come to terms with the problem of climate change which is caused primarily as a result of the greenhouse effect.

The temperature within a glass enclosure of a greenhouse is far warmer than the outside. The glass of the greenhouse is transparent to the short waves from sunlight but opaque to the long waves of radiation from inside. Thus the heat trapped inside the greenhouse continues to increase. This is called the greenhouse effect. In the environmental context, the greenhouse effect refers to the earth's atmosphere due to the presence greenhouse gases, such as carbondioxide, methane, nitrous oxide and chlorofluorocarbons (CFCs) all of which have a warming influence on the world's climate. These gases are emitted from millions of industrial smokestacks, motor vehicles, waste dumps and other sources. A simple example of the greenhouse effect can be seen when one parks one's car after rolling up the windows in the parking lot, on a hot summer day and on returning finds it as hot as an oven. This rapid warm-up of the car is due to the greenhouse effect. The sun's radiant energy passes through the car's windows, and some of this energy is then converted into heat

[55] Ibid., Principle 6(a)
[56] Ibid., Principle 5(a)

or infra-red radiation. Since this radiation because of its long wavelength cannot escape through the windows, it is trapped inside and the car becomes warmer. Molecules of greenhouse gases behave in the same way as the glass in a greenhouse. In a sense, the greenhouse gases form a glass window over the earth. They trap heat that otherwise would escape from the earth's surface into outer space.

The ultimate objective of the Convention on Climate Change is to achieve a stabilization of greenhouse gas concentrations in the atmosphere, at a level that would prevent dangerous anthropogenic interference with the climate system.[57] The convention describes climate change as a change which is attributed directly or indirectly to human activity that alters the composition of the global atmosphere.[58]

The Convention on Climate Change has been supplemented by the Kyoto Protocol 1997. The Kyoto Protocol came into effect in 2005. The parties listed in Annex B of the Protocol are bound to cut in on greenhouse gases and their emission by at least 5 per cent from the 1990 levels in the commitment period of 2008–12.

(e) Convention on Biological Diversity, 1992

The Convention on Biological Diversity (CBD) was negotiated under the auspices of the UNEP. The convention was open for signature at Rio.[59] It came into force in 1993. Although initially the United States was quite hesitant she has signed the convention recently. The main objectives of the convention are to provide for the conservation of biological diversity, the sustainable use of its components and fair and equitable sharing of the benefits arising out of the use of biological resources, knowledge and for matters connected therewith.

To advance these goals, the signatories have to develop plans for protecting habitat and species, provide funds and technology to help developing countries provide protection, ensure commercial access to biological resources for development, share revenues fairly among source countries and developers, establish safety regulations and accept liability for risks associated with biotechnology development. The convention is supplemented with Cartagena Protocol on Biosafety which was adopted in 2000.

[57] Climate Change Convention, 1992, Article 2.
[58] Ibid., Article 1.
[59] Convention on Biological Diversity, 5 June 1992, 31 I.L.M. 818 (1992).

(xi) UN Commission on Sustainable Development

The agreements signed at Rio created several international institutions. The chief among them is the United Nations Commission on Sustainable Development (UNCSD). The commission shall be a high level body composed of the representatives of the 54 member states of the UN Economic and Social Council (ECOSOC) and will report to the ECOSOC just as the UNEP does.[60]

The main task of the commission is to ensure the effective follow-up of the Rio Conference. The commission is to enhance international cooperation and rationalize intergovernmental decision-making capacity for the integration of environment and development issues and to examine the progress of the implementation of Agenda 21 at the national, regional, and international level.

(xii) ICJ on Environment Law

International Court of Justice or the ICJ contributed little to the evolution of environmental law till 1990. However, since then the ICJ has made significant contributions towards the building up of international environmental jurisprudence, banking chiefly, upon the Rio Declaration and the principle of 'sustainable development'. The cases involving the issues of environment are given below.

(a) Request for an Examination of the Situation (New Zealand v. France) Case, 1995

In this case, New Zealand approached the court for an order against the adverse impact on the environment resulting from the underground nuclear test that France conducted in the Pacific. Trance argued that such tests were illegal unless it could be shown that no pollution to the marine environment had resulted.[61] Having found no jurisdiction, the court gave no judgment on the issue but said that states are under an obligation to respect and protect the natural environment. However, in their dissenting opinions, three judges recognized the different facets of the environmental law. They noted that the trend in the developments from Stockholm to Rio 'has been to establish a comprehensive norms to protect the global environment.'

[60] Singh 2003, p. 573.
[61] *Request for an Examination of the Situation* (New Zealand v. France) *Case*, ICJ Rep. 1995, para. 8.

They also referred to international support for the precautionary principle and the concept of intergenerational equity and accepted that international law requires states not to cause or permit serious damage in accordance with Principle 21 of the Stockholm Declaration of 1972.[62]

(b) Advisory Opinion on the Legality of the Threat or Use of Nuclear Weapons, 1996

In its *Advisory Opinion on the Legality of the Threat or Use of Nuclear Weapons*, the court confirmed the obligation of states not to cause transboundary harm. The court categorically stated, 'The existence of the general obligation of States to ensure that activities within their jurisdiction and control respect the environment of other States or of areas beyond national control is now part of the corpus of international law relating to the environment.'[63] Recalling its order in the *Request for an Examination of the Situation* (*New Zealand* v. *France*) *Case* 1995, it held that states had an obligation to protect the natural environment against widespread, long-term and severe environmental damage in times of armed conflict[64] and to refrain from methods of warfare or reprisals intended to cause such damage according to terms of Principle 24 of Rio Declaration.[65] Although the treaties on protection of the environment did not take away or restrict a state's right of self-defence if attacked, states must nevertheless take environmental considerations into account when assessing what is necessary and proportionate in the pursuit of legitimate military objectives.[66]

(c) Case Concerning the Gabcikovo-Nagymaros Project, 1997

The ICJ in this case, substantially dealt with environmental issues. As against the argument of Hungary as to environmental damage involved in the completion of the project, the court accepted that grave and imminent danger to the environment could constitute a state of ne-

[62] P. W. Birnie, and A. E. Boyle, *International Law and the Environment*, New Delhi: Oxford University Press, 2004, p. 107.
[63] *Advisory Opinion on the Legality of the Threat or Use of Nuclear Weapons*, ICJ Rep. 1996, para. 29.
[64] Ibid., para. 32
[65] Ibid., para. 30.
[66] Ibid.

cessity, but it found no such danger to exist in this case.[67] The contention that the treaty between the parties had terminated was also rejected, but the court held that in implementing it and operating the works which had been constructed, the parties were obliged to apply new norms of international environmental law, not only when undertaking new activities but also to the continuing activities begun in the past.[68] The court referred to the concept of sustainable development and concluded that the parties must negotiate in good faith; look afresh at the effects on the environment; and find an agreed solution consistent with the objectives of the treaty and the principles of international environmental law and the law of international watercourses.[69] The court twice recalled its finding in the *Advisory Opinion on the Legality of the Threat or Use of Nuclear Weapons* 1996, for the great significance it attached to the environment's substantial and real role in the quality of life and health of human beings and future generations.[70]

(xiii) World Summit on Sustainable Development, 2002

The World Summit on Sustainable Development (WSSD) was held at Johannesburg in August–September 2002 after ten years of the Earth Summit.[71] The Johannesburg Summit ended with the adoption of the Johannesburg Declaration on Sustainable Development and the Johannesburg Plan of Implementation. The declaration reaffirmed the commitment to sustainable development and identified particularly the important linkages between poverty, the environment and the use of natural resources.

The plan of implementation is a major political outcome of the WSSD. The plan formulates the multilaterally negotiated, agreed and thus binding political commitments for sustainable development. The plan is structured in ten chapters providing a broad range of general and concrete commitments for sustainable development. The plan of implementation reaffirmed the commitment to the Rio principles and Agenda 21 achieving the internationally agreed develop-

[67] *Case Concerning the Gabcikovo-Nagymaros Project*, ICJ Rep. (1997), para. 54.
[68] Ibid., para. 112.
[69] Ibid., para. 140, 141.
[70] Ibid., para. 53, 112.
[71] Report of the World Commission on Sustainable Development, Sept. 2002, UN Doc. A/CONF. 199/20.

mental goals. The plan laid emphasis on the promotion and integration of three components of sustainable development, namely, economic development, social development and environmental protection, which have been treated as independent and mutually reinforcing pillars. The plan of implementation also emphasized the need to implement the principle of common but differentiated responsibilities and the precautionary principle contained in Principle 7 and Principle 15 of the Rio declaration respectively. The states were called upon to implement the *polluter pays principle* which insists on the internalization of the cost of pollution. The plan also recommended to the states to prevent the depletion of ozone layer, conserve biodiversity and combat desertification. The plan emphasized the need to evolve an international regime to promote and safeguard the fair and equitable sharing of benefits arising out of the utilization of genetic resources.

III. Sustainable Development

The concept of 'Sustainable Development' is the mainstay of international environmental jurisprudence. The concept is of pivotal importance; international environmental law itself has been developed on its basis. The term 'sustainable development' was brought into common use by the Brundtland Commission in its 1987 report *Our Common Future*. The report has given the definition of sustainable development as follows:

> Sustainable development is development that meets the needs of the present generation without compromising the ability of the future generations to meet their own needs.[72]

Sustainable development does not imply absolute limits to growth and it is not a new name of environmental protection. It is a new concept of economic growth. It is a process of change, in which economic and fiscal policies, trade and foreign policies, energy, agricultural and industrial policies, all aim to induce development paths that are economically, socially, and ecologically sustainable.

Sustainable development requires that the rate of depletion of natural resources should take into account the criticality of that

[72] WCED, *Our Common Future*, p. 43.

resource, the availability of technologies for minimizing depletion and the likelihood of substitutes being available. The adverse impacts on the quality of air, water and other natural elements are minimized so as to sustain the ecosystem's overall integrity. In essence, sustainable development is a process of change in which the exploitation of resources, the direction of investments, the orientation of technologies and institutional change are all in harmony and enhance both current and future potential to meet human needs and aspirations.[73]

According to the Brundtland Report, the concept of sustainable development contains within it, two key concepts:

(i) the concept of 'needs', in particular the essential needs of the world's poor, to which overriding priority should be given; and

(ii) the idea of limitations imposed by the state of technology and social organization on the environment's ability to meet present and future needs.[74]

In other words, these two concepts purport to specify the two pillars on which the edifice of sustainable development rests, namely, 'intra-generational equity' and 'inter-generational equity'.

(i) Inter-generational Equity: Mankind's Duty Towards Future Generations

The issue clarifies that the present generation does not have an absolute right to excessively exploit and indiscriminately use, rather misuse, natural resources at the expense of future generations. It is legally as well as morally obliged to preserve, conserve and save the environment for posterity. Future generations, like the present one, have the right to inherit from their predecessors, an ecologically sound and healthy environment.

The Stockholm Declaration stressed the need to defend and improve the environment for present and future generations as 'an imperative goal for mankind.'[75] The UN General Assembly also called upon man to use natural resources in a manner that ensures the preservation of the ecosystem for the benefit of present and future generations.[76] The World Commission on Environment and Development recommended the states to conserve and use the environment and natural resources for the benefit of the present as well as future generations.[77] The central theme of all documents that emerged from the Rio Conference is the prudent management of the global resources for the benefit of present and future generations. Principle 3 of the Rio Declaration proclaims that the right to development must be equitable to the developmental and environmental needs of present and future generations, Article 3 of the Convention on Climate Change, in a similar tone reads— 'the Parties should protect the climate system for the benefit of present and future generations of humankind, on the basis of equity and in accordance with their common but differentiated responsibilities and respective abilities, The Convention on Biological Diversity, and Agenda 21 which enumerates a set of priority actions to be taken by states during the ensuing twenty first century to make the world habitable, also explicitly stresses the need for inter-generational equity and responsibility for protecting the environmental claims and interests of future generations.

The theory of inter-generational equity vis-à-vis environment and the inter-generational responsibility of the present generation to be a 'trustee' for the environment of future generations and its obligations to pass on the earth in sound condition, to its unborn generations, is well articulated in the Goa Guidelines on Inter-generational Equity.[78] The theory of inter-generational equity formulated in the Goa Guidelines states as following:

> [A]ll members of each generation of human beings, as a species, inherit a natural and cultural patrimony from past generations, both as beneficiaries and as custodians under the duty to pass on this heritage to future generations. As a central point of this theory the right of each generation to benefit from and develop this natural and cultural heritage is inseparably coupled with the obligations to use this heritage in such a manner that it can be passed on to future generations in no worse condition than it was received from past generations.

[73] Ibid., p. 46.
[74] Ibid., p. 43.
[75] Stockholm Declaration 1972, proclamation 6.
[76] World Charter for Nature, 1982, *I.L.M.*, 22, 1983, p. 455.
[77] World Commission on Environment and Development, 'Legal Principles for Environmental Protection and Sustainable Development', *I.L.M.*, 25, 1986, p. 494.
[78] Goa Guidelines, 'International Law, Common Patrimony and Intergenerational Equity', *Envtl. Pol'y & L.*, 18, 1988, p. 191.

> —*[T]he principle of inter-generational equity requires conserving the diversity and the quality of biological resources, of renewable resources such as forests, water and soils which form an integrated system*—. The principle requires that we avoid actions with harmful and irreversible consequences for our natural and cultural heritage."[79] [emphasis supplied]

In the *Advisory Opinion on the Legality of the Threat or Use of Nuclear Weapons*, 1996, the ICJ showed substantial concerns towards the right of generations to come. The court considered that the quality of environment is essential to the sustenance of generations to come in future.[80] The ICJ perceived that nuclear weapons are inherently catastrophic since they use such explosives, which emit energy resulting from fusion or fission of the atoms. The release of immense amount of heat and energy from the explosion of these nuclear weapons coupled with the phenomenon of radiation, can destroy the whole fabric of the ecosystem leaving no scope for mankind—including future generations—to survive.[81]

The ICJ again, in a subsequent *Case Concerning the Gabcikovo-Nagymaros Project*, expressed apprehension to the risks posed to the present and future generations, emerging from unconsidered and environmentally insensitive growth.[82] Necessarily, referring to environmental instruments dealing with major global environmental problems, the ICJ said that the standards set out in those environmental instruments and norms emanating therefrom, must be given a proper weight when states continue their present activities or contemplate future activities.[83]

(ii) Intra-generational Equity: Obligation of Well-Off States Towards Have-Nots

It is not enough, however, to apply a theory of inter-generational equity only among generations. It also carries an intra-generational dimension. When future generations become living generations, they have certain rights and obligations to use and care for the planet that they can enforce against one another. Were it otherwise, the member

[79] Ibid., pp. 190-91.
[80] *Advisory Opinion on Use of Nuclear Weapons*, para. 29.
[81] Ibid., para 35.
[82] *Gabcikovo-Nagymaros Project*, para. 140.
[83] Ibid.

of one generation could allocate the benefits of the world's resources to some communities and the burdens of caring for it to others and still potentially claim on a balance to have satisfied principles of equity among generations.[84] So, 'intra-generational equity' is equally important on the path of sustainable development.

The problem of intra-generational equity must be approached in the light of different economic, environment, cultural and political circumstances prevailing within and between the countries. The inequality between people as a result of greed and the maldistribution of power is a major obstacle in the path to achieving sustainability. Unsustainable behaviour by the poor people is almost always due to factors such as loss of land, growing indebtedness or loss of access to markets, that leave them unable to support themselves properly. When wealthier people appropriate resources for themselves at costs far below their value for production, poor people who lose out by such appropriations, are powerless to hold the wealthy accountable. Having no resource, they place greater stress on their environments, by moving deeper into the forest, occupying marginal land unsuitable for agriculture or herding or adopting some other way of staying alive.[85]

The Brundtland Report also recognizes the inequalities between countries and stresses that several problems arise from inequalities and access to resources. The Report maintains that inequitable land ownership structures can lead to overexploitation of resources in the smallest holdings, with harmful effects on both environment and development. Accordingly, the Brundtland Report asserts that the future cannot be common in the sense of being equal, fair and just when the economic and ecological situations of lower and higher income countries are compared.[86] Undoubtedly, the inability of mankind to promote the common interest in sustainable development is often a product of the relative neglect of economic and social justice within and amongst nations. The Climate Change Convention, Agenda 21 and Biodiversity Convention also give expression to this proposition.

In furtherance of this proposition, it was conceived that the present standards of development enjoyed by the developed countries were

[84] E. B. Weiss, 'Our Rights and Obligations to Future Generations for the Environment', *Am. J. Int'l L.*, 84, 1990, p. 201.
[85] IUCN, UNEP and WWF, *Caring for the Earth: A Strategy of Sustainability*, Gland: IUCN, 1990, p. 16.
[86] WCED, *Our Common Future*, p. 72.

achieved through massive resource exploitation and environmental degradation. Now as to environment protection in which they have chalked out their own path to material well-being, the developing nations are asked to refrain from compounding this damage as well as to assist in its repair. So they should compensate the developing nations for the direct implementation protection costs and the indirect costs of forfeited development opportunities.[87] It is quite relevant here to mention that a GATT report has opined that the countries which are home to large tropical forests are currently exporting carbon absorption services to the rest of the world, free of charge, therefore, there is a certain logic to the view that they should be offered compensation.[88]

IV. Principle of 'Sustainable Development': Achieving International Customary Law Status

The principle of sustainable development is the rationale behind international environmental jurisprudence, and finds its existence right from the Stockholm Declaration of 1972, in the mandate for 'careful planning and management of natural resources for the benefit of present and future generations' to, the recent World Summit on Sustainable Development 2002, in its commitment to sustainable development of the international community. All major environmental instruments, explicitly impose on the concerned states, the obligation to carry their activities in the direction of sustainable development. Chief among them are the Rio Declaration, Agenda 21, the Climate Change Convention, Convention on Biological Diversity, Montreal Protocol on Substances that Deplete Ozone Layer and so on. Besides them there are other institutions and agreements—economic in character—namely. Food and Agricultural Organization, International Maritime Organization, World Bank, United Nations Educational, Scientific and Cultural Organization, which mandate to protect environment and promote sustainable development.[89] More importantly, 'sustainable development' receives mention, numerous times in the WTO and its Agreements.

[87] A. Gallagher, 'The "New" Montreal Protocol and the Future of International Law for Protection of the Global Environment', *Hous. J. Int'l L.*, 14(2), 1992, p. 356.

[88] GATT, 'Trade and Environment', GATT Doc. 1529, 3 February 1992, reprinted in *Wld. T. Mater.*, 4, 1992, p. 29.

The doubts are cast upon, as to sustainable development having achieved the status of customary international law.[90] Having its explicit reference in binding and non-binding agreements and mention in international institutions, the question arises, as what status, the concept of 'sustainable development' has, in international law. Has it achieved the status of a customary rule of international law or has it gone further, even to become inviolative? The answer seems to be positive. In modern international law, for a provision to become a rule of customary international law, two conditions are necessary:

(i) whether the concept/provision is of a fundamentally norm-creating character[91]; and if so
(ii) whether the norm has achieved the legally binding character i.e. *opinio juris*.

(i) Normative Character of Sustainable Development

The concept of 'sustainable development' provides for a regulation which connects, economic development with the conservation of the environment. Its implementation obliges the governments of the states to think in different terms with respect to the economy. They have to balance between the exploitation of natural resources and nature protection, industrial development and quality of air and water, use and development of land and conservation of their green cover, energy consumption and the risks of climate change etc.

For a norm to become the basis of a general rule of law indicates, the potential of the norm of achieving universal acceptance. In other words, what prevents a rule to get generality of acceptance is, that it has some inherent scope of inconsistent behaviour when applied to some states, due to certain varying factors such as social, historical, geographical, economic or others, applied on them but not on the remaining states. International environmentalism gained momentum

[89] Birnie and Boyle, pp. 57–8.

[90] Ibid., p. 13, 96. See also, A. E. Boyle, 'The Gabcikovo-Nagymaros Case: New Law in Old Bottles', in *Symposium: The Case Concerning the Gabcikovo-Nagymaros Project, Yb. Int'l Envtl. L.*, 8, 1997, p. 18.

[91] *North Sea Continental Shelf Case*, ICJ Rep. (1969), p. 56.

in the later part of the twentieth century, as the international community got alarmed at the quick and sudden deterioration of global environment for which the race of economic competition, has been responsible to some extent. The concept of sustainable development emerged as the result of environmental churning by the world community of unthoughtful human activity callous to the environmental considerations. It seemed that the international economic community had a phobia that economic considerations shall always succumb to the environmental considerations, if the concept is enforced. But the subsequent developments in the evolution of the environmental law prove that the phobia was unfounded. The Rio Declaration is of key importance in international law relating to the environment and other international instruments having environmental implications.[92] The Rio Declaration is impartial, providing against the misuse of environmentalism in respect of trade. Principle 12 accords the concern of free trade advocates, that environmental restrictions should not constitute disguised or arbitrary interference with the free trade. Similarly, in its chapter 2, Agenda 21 calls for a supportive international climate for achieving environment and development goals by promoting sustainable development through trade liberalization and making trade and environment mutually supportive.

In the *Case Concerning the Gabcikovo-Nagymaros Project*, the International Court of Justice (ICJ) accorded much weight to environmental protection as an obligation on the parties to the Treaty of 1977. Hungary and Slovakia (as successor of Czechoslovakia) concluded a treaty in 1977 to build a series of hydroelectric dams on the Danube River. However, Hungary suspended and abandoned the work on the project on a number of grounds including potential environmental harm. The ICJ considered that the project's impact and implications on the environment was a key issue. Mankind has for economic and other reasons continuously, interfered with the nature. The court could not ignore the imperatives of environmental protection when several times the environmental damage is irreversible in character.[93] In view of the growing menace to the present and future generations, there is a need to reconcile economic development with the protection of environment which is inherent in the concept of sustainable develop-

[92] Birnie and Boyle, p. 82–3.
[93] *Gabcikovo-Nagymaros Project*, para. 140.

ment.[94] However, the court did not sacrifice the completion of the project on environmental considerations. The ICJ did not consider that, in the completion of the project, there was an imminent peril to the environment, hence the drastic step as to the termination of the treaty on the part of Hungary was not feasible.[95] The potential ecological damage could be overcome by the joint efforts of the two parties.[96]

The judgment of the ICJ in *Gabcikovo-Nagymaros* case establishes that the protection of the environment has no absolute priority over the considerations of economic development unless the potential environmental damage is irreversible in character or environmental imperatives have preponderance. Environmental effects of economic development should be judged in the light of all relevant factors. Though the need of environment protection is high, it cannot frustrate rational development. A balance of the two competing interests must be sought, in which lies the essence of sustainable development. Thus the phobia of the economic community that economic obligations will always give way to the ecological considerations is baseless and comes out to be untrue.

It is not untenable that the principle behind the concept of sustainable development is of a fundamentally norm-creating character which is capable of forming the basis of a general rule of law.[97] Sustainable development does not mean that economic development should come to a standstill. A myopic vision may consider sustainable development as a hurdle to the growth, but that is not correct. The principle of sustainable development reconciles the two disciplines and functions as a bridge between them and potentially prevents them from running in opposite directions, that is, extreme mercantilism reading to a 'tragedy of commons' and extreme environmentalism leading to a 'stagnating of growth'. If the environment attenuates below the point and becomes irreparable, economic development too will come to an end. For a long lasting growth of the economy, environment protection is a precondition. Hence, sustainable development just ensures that development is sensitized to the environmental imperatives so that economic progress goes on forever. Hence, it has all the more a

[94] Ibid.
[95] Ibid., para. 54
[96] Ibid., para. 141.
[97] M. N. Shaw, *International Law*, Cambridge: Cambridge University Press, 1997, p. 76.

strong case for becoming a prominent principle of international law on which shall rest economic prosperity and environmental quality.

(ii) Legal Bindingness of Sustainable Development

Several international agreements specifically mention sustainable development as an instrument of policy towards the implementation of the treaty. These treaties are environmental, economic and financial in character. Most of them obligate the member states to follow sustainable development in their developmental programme in mandatory terms. Besides being a part of international conventional law, as to the question whether the concept of sustainable development has also achieved the status of customary international law, it is to be examined whether it has the element of *opinio juris sive necessitatis*.[98] A reference to the concept in instruments of diverse disciplines is evidence that sustainable development has become state practice. The belief that such practice of the states is legally obligatory, renders the principle a part of customary international law.

Determining the presence of *opinio juris* in a rule that states practice, involves examination of policies and conduct of states that are members of various international bodies, which include the United Nations, and its programmes and specialized agencies, the international courts, financial institutions. Further, one also needs to examine the states' authoritative statements, unilateral or multilateral declarations, agreements, legislative and other acts, court decisions and actions in international organizations relevant to particular issues.[99] The evolution of environmental/economic jurisprudence along the decisions of the ICJ and other important international courts, that is the WTO's Appellate Body, on the principle of sustainable development; prescribing of terms of sustainable development by Multilateral Development Banks (MDBs) for development funding; and endorsement of instruments having sustainable development as their basis, in the series of resolutions adopted by the UN General Assembly are pointers to *opinion juris* element of sustainable development. Moreover, further observations show that the principle of 'sustainable development' became the rationale of some ICJ decisions which necessarily infuse it with binding characteristics.

[98] Ibid.
[99] Birnie and Boyle, p. 16-17.

Since UN membership constitutes a majority of the world community, resolutions of the General Assembly may be said to be generally representative of world opinion. However, such resolution cannot be said to be instruments of international law-making, as they do not find their place in established sources of law under Art 38(1) of Statute of the ICJ. Though such resolutions are not binding, they may become so in the light of subsequent conduct of states. In the *Nicaragua Case*, the ICJ concluded that *opinio juris* behind the rule of non-intervention may, though with all due caution, be deduced from, inter alia, the attitude of the parties and states towards certain General Assembly resolutions and, in particular, from a resolution adopted without a vote and expressed in the form of a Declaration of Principles interpreting the UN Charter. In the Court's view, the consent to such a resolution is not merely the reiteration of the treaty commitment laid down in the Charter but an acceptance of the concerned rules, independent of the relevant charter provisions, it is not subject to all the constraints concerning their application that are prescribed in the charter.[100] The status of the rule of non-intervention, in customary law, was further confirmed by the fact that states had frequently referred to it as a fundamental or cardinal principle of international law, and that the International Law Commission had expressed this view during its work on the codification of treaties that it was a 'conspicuous example of a rule in international law...[101] in view of the decisions, the attitudes of states expressed in the debates of the UN or other international bodies and their voting on resolutions may be regarded as constituting the *opinio juris* required to confirm a customary rule as set out in the resolution or declaration.

The decision of the ICJ has invited criticism as reversing the normal process for the formation of a custom based on actual state practice accompanied by a psychological element of legal conviction, that is, that it took account of state practice only after first using the UN resolution as evidence of the *opinio juris*.[102] The criticism implies that the court misunderstood customary law, for necessarily finding a customary rule in UN resolutions and other majoritarian political documents independent of the practices of the states. In holding the

[100] *Case Concerning the Military and Paramilitary Activities in and against Nicaragua (Nicaragua and United States of America)*, ICJ Rep. 1986, para. 188.
[101] Ibid., para. 190.
[102] Birnie and Boyle, p. 24.

non-intervention rule as customary law the court was satisfied just with states' subscribing to the documents and resolutions even without any evidence having accepted the non-intervention rule.[103] The criticism may be genuine for those situations when intervention may become imminent for preventing the threat to international peace and security though, not wholly justified, for want of procedural requirements as per international law. Nonetheless, applying the ruling of the *Nicaragua Case*, so as to concede customary status to the principle of sustainable development for its endorsement in UN General Assembly's resolutions has little scope of provoking criticism as it has the vitality of universal acceptance. In determining a rule to have crystallized into customary law, reliance must be placed on its high utilitarian value, which the concept of sustainable development has, as it imposes restraints on developmental activities only so far as these would undermine the environmental basis for further development in the long run.[104]

The decision does indicate clearly that the principle of sustainable development has the potential to have become customary law. The UN General Assembly has endorsed the Rio Declaration, referring to it as containing 'fundamental principles for the achievement of sustainable development, based on a new and equitable global partnership'. It also called on the Commission on Sustainable Development and the UN Secretary General to promote the incorporation of the principles of the declaration in the implementation of Agenda 21 and in UN programmes and processes, and urged governments to promote their widespread dissemination.[105]

Treaties do not exhaust all modes of law-creation. Though resolutions may not answer the requirements of a treaty, nevertheless, if the fundamental requirement of a consensus is fulfilled by a resolution, which lays down a rule of conduct, a legal norm emerges. The vote of a state is in effect a public statement of its acceptance of the principle embodied in the resolution, creating an expectation that the

[103] A. D' Amato, 'Trashing Customary International Law', *Am. J. Int'l L.*, 81, 1987, p. 102.
[104] G. Handl, 'Environmental Security and Global Change: The Challenge to International Law', *Yb. Int'l Envtl. L.*, 1, 1990, pp. 24–5.
[105] UNGA Res. 47/190, 191(1992), 48/190 (1993); 'WCED, *Our Common Future*, (1987 ed.)' was endorsed by UNGA Res. 42/186, 187 (1987); 'Word Charter for Nature, 1982' was endorsed by UNGA Res. 37/7 (1982).

states will behave in conformity with the norm. An individual resolution may not have binding force, however, the repetition of resolutions on the same matter may be conceived as evidence of practice which may create customary international law.[106] The question arises as to how a single resolution differs from a repeated resolution. A state may vote for a resolution believing that it does not create a binding obligation or because of a political exigency. The prospect of being bound by a solitary resolution may arouse apprehension. But repeated resolutions containing the same principle are different. Such repeated assertion by resolutions expressing as they do, a deep conviction of the international community has a quality which distinguishes it from resolutions of passing concern, indicating the existence of an *opinio juris* behind the principle in repeated resolutions.[107]

(a) Authoritative Element of Sustainable Development

What makes international custom authoritative is that it is an amalgamation of the resultants of divergent states vectors (acts, restraints) and thus brings out what the legal system considers a resolution of the underlying state interests. Although the acts of states on the real-world stage often clash, the resultant accommodation has an enduring and authoritative quality because it manifests the latent stability of the system.[108] The role of *opinio juris* in this process is to simply identify which acts, out of many, have legal consequences. The *Gabcikovo-Nagymaros Project* case well illustrates the accommodation on the part of alleged erring states, in a clash relating to the environment. In terminating the *Gabcikovo-Nagymaros Project*, Hungary alleged that in implementing the project, Slovakia had failed to take account of the ecological problems or to do an adequate environmental impact assessment (EIA).[109] The dispute between Hungary and Slovakia, was relating to the alleged environmental insensitivity involved in the completion of the project, at the part of the Slovakia. On the other hand, Slovakia argued that environmental risk was not so high so as to

[106] R. Falk, 'The Status of Law in International Society', in ICJ Rep. 1966, p.129.
[107] G. H. Guttal, 'Sources of International Law: Modern Trends', in *International Law in Transition*, R. S. Pathak and R. P. Dhokalia (eds), New Delhi: ISIL, 1992, p. 196.
[108] D'Amato, p. 102.
[109] *Gabcikovo-Nagymaros Project*, para, 41.

warrant the end of the project. The ecological problems involved could be solved by certain modifications.[110] It was perceived that Slovakia had taken the view in its submission that sustainable development includes the principle that 'developmental needs are to be taken into account in interpreting and applying environmental obligations,' thereby indicating Slovakia's acceptance of sustainable development as the principle that harmonizes two vital and developing areas of law.[111]

Since 1989, the World Bank and other MDBs have sought to integrate environmental assessment into their lending policies.[112] The General Assembly calls on the World Bank and other development institutions to report to the CSD on the implementation of Agenda 21.[113] Although the World Bank, in its articles of agreement does not have an explicit obligation, like the European Bank for Reconstruction and Development (EBRD) to promote 'environmentally sound and sustainable development',[114] in practice it has been forced to take account of the needs of sustainable development, environmental protection in its lending decisions.[115] Similarly the Asian Development Bank (ADB) considered the relevance of new environmental objective and noted that the development environment in the developing and donor countries alike, reinforces the current emphasis of the ADB on sustainable development and the need to balance the objectives of economic growth with social and environmental initiatives.[116]

In 1990s there were cases, in which the ICJ gave special attention to environmental imperatives. In the *Request for an Examination of the Situation*, New Zealand asked the Court, inter alia, to order that France carry out an environmental impact assessment in accordance with international law before resuming underground nuclear tests in the Pacific. It further argued that such tests would be illegal unless the EIA showed that no pollution of marine environment would result.[117]

[110] Ibid., para. 44.
[111] Ibid., See also, *I.L.M.*, 37, 1998, p. 205.
[112] Birnie and Boyle, p. 86.
[113] UNGA Res. 47/191 (1992).
[114] Agreement Establishing the European Bank for Reconstruction and Development, Article 2(1)(vii), *I.L.M.*, 29, 1990, p. 1077.
[115] Birnie and Boyle, p. 60.
[116] ADB, The Bank's Medium-Term Strategic Framework (1995–8), 1995, p. 9.
[117] *Request for an Examination of the Situation*, para. 6.

The Court gave no judgement for want of jurisdiction, however, stated that the present order was without prejudice to the obligations of states to respect and protect the natural environment, obligations to which both New Zealand and France had in that instance reaffirmed their commitment.[118]

In the *Advisory Opinion on the Legality of the Threat or Use of Nuclear Weapons* the Court came out much more concerned and strong on the protection of the environment. The advisory jurisdiction of the Court was invoked to determine the legality of threat or use of nuclear weapons which was not directly related to the environmental concerns. Some states argued that environmental consideration in determining the legality was extraneous to the issue.[119] The Court rejected the argument recognizing that the environment is under daily threat and that the use of nuclear weapons could constitute a catastrophe for the environment. The environment is not an abstraction but represents the living space, the quality of life and the very health of human beings, 'including generations unborn'.[120] The Court considered that unique characteristics such as the phenomenon of radiation peculiar to nuclear weapons, render the nuclear weapons potentially catastrophic. Against this backdrop, the Court laid stress on the basis of sustainable development, that is, the obligation towards the future generations.[121] The court stated that the destructive power of nuclear weapons cannot be contained in either space or time as they have the potential to destroy all civilization and the entire ecosystem of the planet. The radiation released by a nuclear explosion would affect health, agriculture, natural resources and demography over a very wide area. Further, the use of nuclear weapons would be a serious danger to future generations. Ionizing radiation has the potential to damage the future environment, food and marine ecosystem, and to cause genetic defects and illness in all future generations.[122] Hence, the court viewed that norms relating to environment protection arising from treaties or otherwise may not deprive a state from exercising her right of self-defence but they surely condition the exercise of such right when assessing what is necessary and proportionate in the pur-

[118] Ibid., para. 64.
[119] *Advisory Opinion on Use of Nuclear Weapons*, para. 28.
[120] Ibid., para. 29. (emphasis added)
[121] Ibid., para. 35.
[122] Ibid.

suit of legitimate military objectives.[123] The court also took in this regard, a note of the terms of Principle 24 of the Rio Declaration, which provides that: 'Warfare is inherently destructive of sustainable development. States shall therefore respect international law providing protection for the environment in times of armed conflict and cooperate in its further development, as necessary.'[124]

The ICJ's most important judgement on environmental law is the decision in the *Case Concerning the Gabcikovo-Nagymaros Project*, in 1997. While suspending the work on the project in building a series of hydroelectric dams, one of the grounds on which Hungary based its argument was ecological necessity. The court accepted that grave and imminent danger to the environment could constitute a state of necessity, but it found no such danger to exist in this case. However, the court laid needed emphasis on the importance of the principle of sustainable development. The court acknowledged that continuous environmentally insensitive economic activities have created risk for mankind, that is, the present and future generations. To cope with it, new norms and standards have been developed in a number of instruments. These new norms must be taken into consideration when states are carrying their activities.[125] When referring to the instruments and norms, the court necessarily implied the principle of sustainable development as the basis of environmental instruments ranging from the Stockholm Declaration to the Rio Declaration. The court considered that the treaty sufficiently provided for environmental imperatives to be accommodated in its Art 15 ('shall ensure... that the quality of the water in the Danube is not impaired...') and Art 19 ('shall... ensure compliance with the obligations for the protection of nature...') and concluded that the Parties must negotiate and look afresh at the effects on the environment, and find an agreed solution consistent with the objectives of the treaty and the principles of international environmental law.[126] In other words, it can be said that instead of terminating the treaty the parties were to complete the project in accordance with the principle of sustainable development which could be accommodated under Art 15 and 19 of the Treaty.

Recalling from its previous decision in the '*Advisory Opinion on the Legality of the Threat or Use of Nuclear Weapons*' the court emphasized that

[123] Ibid., para. 30.
[124] Ibid.
[125] *Gabcikovo-Nagymaros Project*, para. 140.
[126] Ibid.

the environment is not an abstraction but represents the living space, the quality of life and the very health of human beings, *including generations unborn*.[127] Significantly, this passage was again repeated.[128] The court's vision was rounded out in the subsequent references, to the interests not only of states but also of mankind as a whole in environment protection.[129] This betrays the ICJ's reliance on the principle of sustainable development. In his separate opinion, Judge Weeramantry reflected on the importance of the principle of sustainable development. He stated,

> ... the principle of sustainable development ... [which] is a part of modern international law by reason not only of its logical necessity, but also by reason of its wide and general acceptance by the global community ... it reaffirms in the arena of international law that there must be both development and environmental protection, and neither of these rights can be neglected ... development and environmental conservation must go hand in hand.[130]

The WTO appellate body in *Shrimp/Turtle* case, laid heavy emphasis on the principle of sustainable development. Recalling the incorporation of the principle of sustainable development several times in the WTO and covered agreements, the appellate body stated,

> ...the preamble attached to the *WTO Agreement* shows that the signatories to that Agreement were, in 1994, fully aware of the importance and legitimacy of environmental protection as a goal of national and international policy. The preamble of the *WTO Agreement*—which informs not only the GATT 1994, but also the other covered agreements—explicitly acknowledges "the objective of *sustainable development*".[131] (emphasis supplied)." The Appellate Body again noted that the replacing of the phrase 'full use of resources of the world" set forth in the preamble of the GATT 1947 by the phrase 'optimal use of the world's resources in accordance with the objective of sustainable development' demonstrates the intention of the WTO negotiators of the importance of the principle of sustainable development, which must add colour, texture and shading to the interpretation of the agreements

[127] Ibid., para. 53.
[128] Ibid., para. 112.
[129] Ibid., para. 140.
[130] Ibid., See also, I.L.M. 37, 1998, p. 205, 207 and 213.
[131] *United States—Import Prohibition of Certain Shrimp and Shrimp Products*, WT/DS58/AB/R, 12 October 1998, para. 129.

annexed to the WTO agreement.[132] In the view of the Appellate Body, the decision of the ministers at Marrakesh to establish the Committee on Trade and Environment on the CTE was most significant. The Appellate Body once again recalled the intention of the Ministers in the preamble of 'Decisions on Trade and Environment' expressing their concern for the protection of the environment and the promotion of sustainable development.[133]

(b) Sustainable Development becoming the Basis of the ICJ's Decisions

The principle of 'sustainable development' became the basis of the decision of the ICJ in '*Advisory Opinion on the Legality of the Threat or Use of Nuclear Weapons*' and *Case Concerning the Gabcikovo-Nagymaros Project*. In the *Advisory Opinion on Nuclear Weapon* case, the court in its final finding reluctantly conceded the no-unlawfulness of the use or threat of nuclear weapons only in an extreme circumstance of self-defence, in which the very survival of a State would be at stake.[134] An otherwise use of nuclear weapons is unlawful.[135] The limitation of necessity and proportionality on the use of nuclear weapons chiefly flows from the environmental obligations of states towards future generations.[136]

Similarly, in *Gabcikovo-Nagymaros Project* case, the ICJ struck a good balance between environment protection and development. The court considered that the need of environment protection is high but does not have the overriding importance so as to frustrate rational development if the risk to the environment is not grave and imminent.[137] As environmental peril was not high in the completion of the *Gabcikovo-Nagymaros Project*, so rather than suspending the work on the project, the ICJ decided that further activities should go on after renegotiation and in environmentally sound way.[138] Here too, the court's decision is based on the concept of sustainable development. The court considered that the treaty of 1977 continues to govern the parties' relationship. It does not do so in static isolation but rather in dynamic conjunction with other rules and principles of international law relating to international watercourses, sustainable development

[132] Ibid., para. 152, 153.
[133] Ibid., para. 154.
[134] *Advisory Opinion on Use of Nuclear Weapons*, para. 105(2)E.
[135] Ibid., para 105(2)D.
[136] Ibid., para. 30, 35.
[137] *Gabcikovo-Nagymaros Project*, para. 54.
[138] Ibid., para. 140.

and environmental protection, as they evolve. Specifically, the court stated,

> ...that newly developed norms of environmental law are relevant for the implementation of the Treaty and that the parties could, by agreement, incorporate them through the application of Articles 15, 19 and 20 of the Treaty. These articles do not contain specific obligations of performance but require the parties, in carrying out their obligations to ensure that the quality of water in the Danube is not impaired and that nature is protected, to take new environmental norms into consideration ... By inserting these evolving provisions in the Treaty, the parties recognized the potential necessity to adapt the Project. The Treaty is not static, and is open to adapt to emerging norms of international law ... The awareness of the vulnerability of the environment and the recognition that environmental risks have to be assessed on a continuous basis have become much stronger in the years since the Treaty's conclusion.[139]

Hence the decision shows that the terms of an agreement concerning the utilization of resources warrants renegotiation, if their application results in significant harmful effects of an unreasonable nature, especially in doing harm to the environment. A balance between the two competing interests, that is, economic and ecological, must be sought. All of this is the essence of the principle of equitable utilization and according to the judgment in this case, the essence of the 'principle of sustainable development'. Although the ICJ's decisions do not create precedents, but in a series of judgements, the cognition of the principle of sustainable development necessarily points up the principle to have achieved the element of *opinio juris*. Unless the principle of sustainable development is accepted as legally binding, the whole corpus of international environmental law would come to an abrupt end.

V. Mutual Concerns of Trade and Environmental Laws

(i) Environmental Concerns Expressed by GATT/WTO

The fundamental legal principles upon which the current liberal trade regime rests are to be found in the text of GATT 1994 as well as its

[139] Ibid., para. 112.

predecessor, GATT 1947. The first requirement is the 'most favoured nation' requirement in Art I, which stipulates that all parties are to be treated alike. The second is to be found in Article III, which prohibits discrimination as between similar imported and domestic products thus laying down the 'national treatment' requirement. A third rule is articulated in Art XI, prohibiting quantitative restrictions on imports and exports, except in certain limited cases.

These rules, upon which more detailed rules in the successive GATT rounds were built, aim at the removal of barriers to trade. But seeking to remove the bases for differential treatment as between parties and products can run against certain other international objectives that can be met only by making such distinctions. In the case of environmental goals, it is sometimes necessary to treat countries differently, for example on the basis of how responsible their actions are in relation to the environment. Likewise, sometimes products deserve differential treatment on the basis of whether the products themselves, or their production and processing methods, are sustainable.

GATT 1947 made no express mention of the word 'environment.' The reason not to mention the word environment was that environmentalism was not much of a local issue, much less a global issue. By most standards, the Uruguay Round's most significant achievement was the formation of the WTO. Initially, environmental organizations were concerned about the WTO. Since the GATT was to be reconstituted into a functioning institutional structure, environmentalists wanted to make sure that the environment was included in the WTO working committees. The WTO Agreement (with GATT 1994 as its part) consciously makes some references to the concerns of environment.

(a) Preamble of WTO

In the preamble to the Marrakesh Agreement establishing the World Trade Organization or the WTO, a reference was made to the importance of working towards sustainable development. It states that WTO members recognize:

> that their relations in the field of trade and economic endeavour should be conducted with a view to raising standards of living, ensuring full employment and a large and steadily growing volume of real income and effective demand, and expanding the production of and trade in goods and services, while allowing for the *optimal use of the world's resources in accordance with the objective of sustainable development*, seeking both to protect and preserve the environment and to enhance the means for doing so in a manner consistent with their respective needs and concerns at different levels of economic development. (emphasis added)

The WTO takes into account environmental concerns and no longer allows the full use of the world's resources. The objective of 'full use of the resources of the world' set forth in the preamble of the GATT 1947 was no longer appropriate to the world trading system of the 1990s in the face of increasing environmental problems.

(b) Article XX on General Exceptions of GATT

Exceptions in Art XX of the GATT, allow Members to apply measures, inconsistent with obligations arising from GATT, which do not 'constitute ... arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade,' if those measures are, '(b) necessary to protect human, animal or plant life or health,' or '(g) relating to the conservation of exhaustible natural resources if such measures are made effective in conjunction with the restrictions on domestic production or consumption.'

The provision of the Article as well as its interpretation when trade disputes arose assumed importance over the years. Since its inception in 1947, Art XX does not specifically use the word 'environment.' However, the exceptions under Art XX(b) and (g) have most frequently been cited in trade disputes that involve the environment and natural resources.[140] Any supposed controversy about their environmental application has been settled after the recent *Shrimp/Turtle* case in 1998. The appellate body finding under Article XX(g) conveys the message that WTO members may use these exceptions to achieve

[140] *Thailand—Restrictions on Importation of and Internal Taxes on Cigarettes*, GATT Doc. DS10/R-37S/200, adopted 7 November 1990. See also, *Canada—Measures Affecting Exports of Unprocessed Herring and Salmon*, GATT Doc. L/6268-35S/98, adopted 22 March 1988; *United States—Restrictions on Imports of Tuna (Tuna I)*, GATT Doc. DS21/R-39S/155, unadopted 3 September 1991; *United States—Standard for Reformulated and Conventional Gasoline*, WT/DS2/AB/R, 29 April 1996; *United States—Import Prohibition of Certain Shrimp and Shrimp Products*, WT/DS58/AB/R, 12 October 1998.

environment protection, through trade restrictions, if properly applied.[141] The WTO Committee on Trade and Environment (CTE) in its Singapore report of 1996, has also stated that trade-related environmental measures taken pursuant to MEAs can be accommodated under Art XX.[142]

(c) SPS Agreement

The Agreement on the Application of Sanitary and Phytosanitary Measures (SPS Agreement) details general provisions relating to measures taken to protect human, animal and plant life or health from certain specified risks. The SPS measures are to be based on a risk assessment conducted pursuant to Art 5 of the Agreement. Article 5.2 specifying factors in assessing the risks, include '...available scientific evidence; relevant process and production methods; ... [and] relevant ecological and environmental conditions...'

(d) TBT Agreement

The WTO Agreement on Technical Barriers to Trade (TBT) governs the national laws on the environment. The TBT Agreement deals with government regulations on products (for example, auto-emission standards). Article 2.4 of the TBT Agreement requires that 'relevant international standards' be used as a basis for national regulations 'except when such international standards or relevant parts would be an ineffective or inappropriate means for the fulfillment of the legitimate objectives pursued...' According to Article 2.2, the term 'legitimate objectives' includes '*inter alia*, the protection of human health or safety, animal or plant life or health or the environment.'

(e) SCM Agreement

The Agreement on Subsidies and Countervailing Measures (SCM) introduces an environmental subsidy provision as one of the non-actionable subsidies. Under Art 8 of the Agreement on non-actionable subsidies, a direct reference is made to the environment. This provision permits governmental assistance to promote the adaptation of existing facilities to new environmental requirements. However, such subsidy provisions are subject to certain conditions such as the subsidy must be non-recurring and must be limited to 20 per cent of the cost of adaptation. Subsidies of this sort are defined as 'non-actionable'.

[141] N. L. Parkins, 'Introductory Note', *I.L.M.*, 38, 1999, p. 118.
[142] Report of the Committee on Trade and Environment, (Press/TE 014), WT/CTE/1, 12 November 1996, para. 174(ii).

(f) TRIPs Agreement

Uruguay Round Agreement on Trade-Related Aspects of Intellectual Property Rights makes explicit references to the environment. Article 27(2) of the TRIPs Agreement states that members may exclude from patentability, inventions whose prevention within their territory is necessary to protect among other objectives, human, animal or plant life or health or to avoid serious prejudice to the environment.

These provisions are designed to address the environmental concerns related to the protection of intellectual property. The agreement allows members to refuse the patenting of inventions which may endanger the environment—provided their commercial exploitation is prohibited as a necessary condition for the protection of the environment—as well as to exclude from patentability plants or animals.

(g) Establishment of Committee on Trade and Environment

The Ministerial Conference at Marrakesh in 1994 decided to establish a WTO Committee on Trade and Environment (CTE) designed to provide a forum for the GATT/WTO considerations of environmental matters. The CTE was charged with the task of determining the relationship between the provisions of the multilateral trading system and trade measures for environment purposes, including those pursuant to multilateral environmental agreements. The decision establishing the CTE recalled and restated the preamble of the WTO and emphasized on promotion of sustainable development and showed concerns of environmental objectives set forth in Agenda 21 and Rio Declaration.

The formation of the new Committee on Trade and Environment appears to signify a change in the GATT's approach to environmental issues. More than anything, a specialized committee should be an opportunity to redirect the trade and environment analysis within the GATT, which, so far, environmentalists see as having been comprised of a lopsided approach in favour of trade liberalization and not necessarily sustainable development.

The CTE is composed of all WTO Members and a number of observers from intergovernmental organizations, and reports to the WTO's General Council. In its Singapore Ministerial Conference in

1996, the CTE summarized the discussions which it held since its establishment and the conclusions, which it reached, in a report presented at the conference (CTE Report, 1996). Some important conclusions of the Report are: a range of provisions in WTO can accommodate the imposition of trade-related measures pursuant to obligations arising from MEAs for environment protection.[143] International cooperation provisions of MEAs relating to financial and technology transfer to help developing countries in tackling the environmental problems targeted by the MEAs are important.[144] Multilateral cooperation in the terms of MEAs constitutes the best approach for resolving global environmental problems.[145] The WTO Members are not expected to resort to WTO Dispute Settlement with a view to undermining the obligations they have undertaken, by becoming a party to a MEA.[146]

(h) Singapore Ministerial Declaration, 1996

The Singapore Ministerial Declaration appreciated the contribution of the Committee on Trade and Environment (CTE) in its assigned task. The declaration considered that the committee has been examining and will continue to examine inter alia, the scope of the complementary relation between trade and liberalization, economic development and environmental protection. A full implementation of the WTO Agreement will make an important contribution to achieving the objectives of sustainable development.[147]

(i) Seattle Ministerial Conference, 1999

The Seattle Draft Declaration called for new negotiation rounds. On the environmental count, it stipulated that further negotiations shall promote sustainable development and aim to make trade liberalization, economic development and environmental protection mutually supportive. It further stated that the Committee on Trade and Development and the CTE will take up the issue in their respective mandates, of developmental and environmental aspects of the negotiations in order to help achieve the objective that sustainable development is

[143] Ibid., para. 174(ii)
[144] Ibid., para. 173.
[145] Ibid., para. 171.
[146] Ibid., para. 178.
[147] Singapore Ministerial Declaration, WT/MIN(96)/Dec., para 16.

appropriately reflected throughout the negotiations. The two committees will report regularly to the Trade Negotiation Committee.[148]

(j) Doha Declaration, 2001

The declaration adopted at the Doha Ministerial Conference of the WTO members expressed concerns on the issue of environment. The ministers noted their conviction 'that the aims of upholding and safeguarding an open and non-discriminatory multilateral trading system, and acting for the protection of the environment and the promotion of sustainable development can and must be mutually supportive.' In this regard they stated that 'under WTO rules no country should be prevented from taking measures for the protection of human, animal or plant life or health, or of the environment at the levels it considers appropriate, subject to the requirement that they 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.'[149]

The environmental issues on which negotiations are agreed to be done are: the relationship between WTO rules and specific trade obligations set out in MEAs to which WTO members belong; information exchange between MEAs secretariats and the relevant WTO committees; and reductions on tariffs and non-tariffs barriers to environmental goods and services. The CTE was directed to give particular attention to the effect of environmental measures on market access; the relevant provisions of the TRIPs Agreement; and labeling requirements for environmental purposes. The declaration recognized the importance of technical assistance and capacity building in the field of trade and environment to developing countries, in particular the less-developed countries among them.[150]

A separate declaration was also addressed on the relationship between the TRIPs Agreement and public health. The TRIPs Council was supposed to examine the relationship between TRIPs Agreement to the Biodiversity Convention and the protection of traditional knowledge.[151]

[148] Seattle Draft Declaration, WT/MIN(99)/Dec., para. 21, 22.
[149] Doha Ministerial Declaration, WTO Doc. WT/MIN(01)/Dec/1, para. 6.
[150] Ibid., para, 31, 32 and 33.
[151] Declaration on TRIPs Agreement and Public Health, WT/MIN(01)/Dec. 2, para. 19.

(ii) Environmental Trade Provisions of MEAs

Certain Multilateral Environmental Agreements, MEAs, increasingly use trade measures to implement and enforce their objectives. The United Nations Convention on International Trade in Endangered Species of Wild Flora and Fauna (CITES) and the Montreal Protocol on Substances That Deplete the Ozone Layer (Montreal Protocol), the Basel Convention on the Control of Transboundary Movements of Hazardous Wastes and Their Disposal (Basel Convention), are chief among them, which rely on trade measures to achieve their environmental goals and to enforce the treaties provisions against parties and non-parties alike. In addition the Convention on Biological Diversity (Biodiversity Convention) also envisions certain trade measures.

The reasons and rationales behind employing trade measures often vary with the subject-matter of the agreement. Generally, many MEAs employ trade provisions to accomplish objectives that parties to the agreement deem to be in their individual and collective interests. These goals include:

(i) the attainment of the environmental objective of the agreement itself;
(ii) the encouragement of greater support among nations for the agreement;
(iii) the elimination of incentives that encourage non-party nations to take environmental and economic advantage of other nations that are parties to the agreement, that is, for non-parties to act as 'free riders'.[152]

Thus MEAs utilize trade measures to discourage or prohibit the transfer from one nation to another of the actual product or substances that is the 'target' of the agreement. So that MEAs may specifically seek to control the trade in endangered species, hazardous waste or substances that deplete the ozone layer or provide for biodiversity conservation, because trade in these areas has been deemed deleterious to the environment.

[152] The existence of non-parties to MEAs acting as 'free riders' poses several different problems for the parties to the agreement. In general, free riders derive the environmental benefits of the MEAs without having to pay any of the costs, which the industries in non-party country may enjoy as a result of the increased costs of compliance with the MEA in member nations. Non-parties may also seek to prosper by filling the market vacuum left behind by the various prohibitions imposed on parties.

(a) Convention on International Trade in Endangered Species of Wild Flora and Fauna

The CITES recognizes in its preamble that 'international cooperation is essential for the protection of certain species of wild fauna and flora against over-exploitation through international trade.' CITES, originally drafted in 1973 and currently in force with more than hundred parties, invokes trade restrictions and regulations to protect listed species of animals and plants threatened with extinction, and protects species deemed endangered unless trade is strictly regulated.[153] The convention prohibits, through a permit system, the import or export of listed wildlife and wildlife products unless a scientific finding is made that the trade in question will not threaten the existence of the species.[154] The objective is to eliminate the economic incentive to exploit a particular species by destroying the international market demand for the wildlife product. Articles III, IV, and V of the CITES regulate international trade in listed species with parties and non-parties. Article X allows trade in listed species with non-parties, if the non-party provides documentation that conforms with the provisions of CITES.

(b) Basel Convention

The objective of the Basel Convention as stated in its preambles, include the protection, 'by strict control, of human health and the environment against the adverse effects which may result from the generation and management of hazardous wastes and other wastes.' Parties have at least two obligations related to trade. Article 4(1)(a) acknowledges a party's right to prohibit the import of hazardous wastes, requiring it to notify other parties of any such decision. The preamble also recognizes this right: '[A]ny State has the sovereign right to ban the entry or disposal of foreign hazardous wastes and other wastes in its territory.' Article 4(5) provides that a '[p]arty shall not permit hazardous wastes or other wastes to be exported to a non-party or to be imported from a non-party.' The convention provides no further details or requirements regarding the import and export bans;

[153] CITES, Appendix I and II.
[154] Ibid., Article III 2(a)-3(a), IV(a).

each state party decides how it will structure, implement and enforce them.

(c) Montreal Protocol

The Montreal Protocol attempts to reduce the level of ozone-depleting substances (ODS) or 'controlled substances'[155] in the earth's atmosphere. The preamble states that the parties to the Protocol are '[d]etermined to protect the ozone layer by taking precautionary measures to control equitably, total global emissions of substances, that deplete it, with the ultimate objective of their elimination.' Article 2, 3 and 4 of the Protocol employs a system of consumption and production limitations for parties to the Protocol as well as measures limiting trade in ODS with non-parties.

The trade measures in question include Art 4(1), which provides that 'each Party shall ban the import of controlled substances...from any State not party to this Protocol.' Different substances are banned under different timetables. Under Art 4(2), with effect from 1 January 1993, parties must ban the export of ODS to non-parties. In the future, the import from non-parties of products containing ODS must be banned, and, if feasible, products from non-parties produced with, but not containing, ODS might be subject to an import ban. Parties are already obligated to discourage export to non-parties of technology for producing and using ODS. However, under Art 4(8), non-parties that can prove compliance with the protocol receive the same trade treatment as parties in compliance.

(d) Biodiversity Convention

The Convention on Biological Diversity (CBD) provides for the taking of certain non-specific measures. Article 8(1) calls for the regulation of processes and activities that adversely affect biodiversity (for example, certain cases of biotechnology may be deemed harmful to genetic diversity, thereby necessitating regulation in the form of denial patent to such innovations). Articles 15, 16 , and 19 of the CBD also seek to conserve and sustainably use biological diversity and to share equitably, the benefits from the use of genetic resources. Although the CBD habitat's conservation provisions lack specificity, its

[155] Montreal Protocol, Article 1(4). 'Controlled substances' include various forms of chlorofluorocarbons, halons, carbon tetrachloride and methyl chloroform.

rules relating to technology transfer and intellectual property rights are quite specific. These provisions are intended to provide the economic incentive for protecting habitat and to ensure the equitable distribution of the benefits of biotechnology.

(e) Biosafety Protocol

The Biosafety Protocol came into existence in the year 2000.[156] The protocol recalls in its preamble, Art 19, 17, and 8(j) of the Convention on Biological Diversity and the decision of the second conference of the parties to develop a protocol. The trade provision of the Biosafety Protocol can be found in Art 24, which stipulates obligations in relation to non-party states. It provides that: 'Transboundary movement of living modified organisms between Parties and non-Parties shall be consistent with the objective of this Protocol. The Parties may enter into bilateral, regional and multilateral agreements and arrangements with non-Parties regarding such transboundary movements.' However, the non-party state provisions of the Biosafety Protocol are not discriminatory. The non-party state provisions simply provide that transboundary movement between parties and non-parties shall be consistent with the objectives of the protocol. The arrangement to such effect could be done by bilateral, regional or multilateral agreements.

VI. International Trade and Environment: Apparent Conflict

Though there is no fundamental conflict between trade and environment, there are cases where countries have challenged domestic environmental laws, and GATT/WTO dispute resolution panels have concluded that several national environmental laws are inconsistent with GATT rules. However, no country has challenged the trade measures of a multilateral environmental agreement as inconsistent with GATT, though the domestic environmental laws have been challenged.

However, the conflict is perceived between environment protection and rules of GATT/WTO. There are certain areas where Trade

[156] Cartagena Protocol on Biosafety to the Convention on Biological Diversity, 29 January, 2000, *I.L.M.*, 39, 2000, p. 1027.

Related Environmental Measures (TREMs) provided by MEAs can be said to be in conflict with GATT/WTO. The MEAs namely, Montreal Protocol, CITES, and Basel Convention employ provisions in varying forms against non-parties to the environmental agreements.[157] These particular trade restrictions are potentially vulnerable to challenge as a violation of GATT's MFN principle. For example, a non-party to the MEA but a contracting party under GATT could challenge in CITES, the Basel Convention and the Montreal Protocol. The challenging nation could conceivably argue that its MFN's right under GATT to have its 'like products' treated equally, has been violated by the prohibitions imposed on its products by the trade provisions of the MEAs. As a result, a nation could argue that its products are being unfairly discriminated against by other GATT contracting parties simply because it has not joined the MEAs. Depending on how they are applied, such restrictions also might be said to breach national treatment obligation.

If a party to the MEAs is challenged by a contracting party to the GATT for violating one of the core GATT principles through its obligation to the MEAs, the challenged party has a recourse to the GATT general exception incorporated in Art XX. Nevertheless, the GATT panels' decisions, chiefly among them being *Tuna/Dolphin I* have cast considerable doubt on the effectiveness of the Article XX exception in defence of environmental objectives. The *Tuna/Dolphin I* panel's interpretation of the applicability of Art XX(b) and (g) to the protection of resources outside of a contracting party's jurisdiction may represent the most direct impact on the relationship between the GATT and the MEAs. In that decision, the *Tuna/Dolphin I* panel stated that Article XX(b) and (g) should be limited to protecting resources within the jurisdiction of the importing country.[158] This interpretation raises serious concerns about the ability of the MEAs' parties to effectively implement measures to protect the global commons.

The failure of the GATT to distinguish products based on their product related or non-product related product's production and processing methods (PPMs) is likely to have a profound impact on the ability of the Montreal Protocol to ensure compliance with its requirements that parties ban the import from non-parties of products 'containing' and/or 'manufactured with' ozone-depleting substances

[157] GATT Report, p. 11.
[158] *Tuna/Dolphin I*, para. 5.26, 5.30.

(ODS).[159] For example, an imported computer circuit board could be manufactured with the use of ODS in its regular production process but it may not contain ODS in its final form. If the circuit board, in all other respects, is identical to its domestic counterpart, each circuit board would be considered a 'like product' for purposes of the GATT's MFN and national-treatment requirements. Thus, any discrimination against the imported 'like product' based on its manufacturing process would be considered a violation of a contracting party's obligations under the GATT's Art I—MFN and Art III—national-treatment standards, if the ruling given in the *Tuna/Dolphin I* case is followed.

In *Tuna/Dolphin I*, the embargo provisions of the US Marine Mammal Protection Act (MMPA) for tuna caught in the Eastern Tropical Pacific (ETP) in a manner that harms dolphins, were held not justified by the panel because it distinguished the imported product from the domestic product on the basis of whether the imported PPMs were environmentally sound. The panel took the view that the 'end product' of tuna in the can was, quite literally, tuna in the can, and no distinction using trade measures should be made based on how the product was produced.[160] The panel noted that national-treatment 'calls for a comparison of the treatment of imported tuna as *a product* with that of domestic tuna as *a product*.'[161]

Similarly, Article 3 and 4 of the TRIPs Agreement includes MFN and national-treatment obligations. In contrast, the intent, if not the letter, of technology transfer provisions of multilateral environmental agreements is to provide more favourable conditions and perhaps less protective intellectual property rights than the TRIPs agreement. For example, Art 16(2) of the CBD demands, without qualification, that developing countries be provided access to and transfer of biotechnology 'under fair and most favourable terms, including on concessional and preferential terms where mutually agreed.' Thus, the technology transfer provisions might be considered inconsistent with the MFN and national-treatment obligations of the TRIPs Agreement.

[159] Besides 'free rider' problem, the parties to the Montreal Protocol were concerned that a party could commit to specific reductions within its boundaries and then use a non-party for all its ODS-use needs. The result would be no effective reduction in the world's use of ODS and a disincentive to the development of ozone-friendly substitutes.
[160] *Tuna/Dolphin I*, para. 5.14.
[161] Ibid., para. 5.15.

Chapter 7

Reconciling MEAs and GATT/WTO Through the Rules of Treaty Interpretation

I. Relationship between MEAs and GATT/WTO

The awareness of potential points of friction between the rules of the multilateral trading system and MEAs containing trade-related environmental measures (TREMs) is obvious. The debate became intense with the ruling of GATT panel in *Tuna/Dolphin I* case that made some environmentalists concerned, that the reasoning in that case could be applied to undermine TREMs in MEAs. Agenda 21 calls on the governments to '[d]evelop more precision, where necessary and clarify the relationship between GATT provisions and some of the multilateral measures adopted in the environmental area.' This sentiment has also been expressed in the OECD, which has called for further internationally agreed principles to guide the use of trade measures in MEAs.[1]

In order to promote sustainable development, the WTO Committee on Trade and Environment was given the responsibility of examining the relationship between the provisions of the multilateral trading system and trade measures for environmental purposes, including

[1] Report on Trade and Environment to the OECD Council at Ministerial Level, OECD/GD(95)63, para. 49.

those pursuant to multilateral environmental agreements, and if necessary, to make recommendations, and modifications in the provisions of the multilateral trading system. There are views which are skeptical about the existence of a real problem as between MEAs and WTO rules, as there have never been any challenges to the provisions in MEAs, and the membership in the WTO and MEAs overlaps to a very large extent. Such an attitude ignores the costs of the legal uncertainty and the 'chill effect' on elaborating trade measures in future MEAs. Given the wide spectrum of possible trade measures, there are definite legal problems that ought to be resolved.

This chapter seeks to explore the basis of the relationship between MEAs and GATT/WTO law, which is currently fraught with legal uncertainty. It is observed that the relationship between the two is grounded in compatibility rather than conflict, and that the problematic aspects of the relationship are due to the misappreciation of the rules of interpretation. So the relationship between the two is analysed from the standpoint of correct appreciation of the rules of treaty interpretation.

II. The Rules of Treaty Interpretation

It is evident that the relationship between GATT and international environmental agreements is an uneasy one, and that there is inadequate reflection in GATT policy of environmental objectives. Now the question arises as to whether there is in any sense a hierarchy of norms that would determine which rules would take precedence over others?

The rules of treaty interpretation under the Vienna Convention on the Law of the Treaties (Vienna Convention)[2] and general rules of interpretation are standard tools for resolving disputes between conflicting treaties. International law contains rules addressing the interaction between two regimes containing rights and obligations relating to the same subject-matter. There are good arguments on both sides of the issue of hierarchy. Trade lawyers consider clear breaches of GATT in the light of a vision of a world of liberalised trade. Environmental lawyers argue for priority for newer or more specific or more

[2] Vienna Convention on the Law of Treaties, 23 May 1969, UN Doc. A/CONF.39/27, 1155, U.N.T.S. 331, reprinted in *I.L.M.*, 8, 1969, p. 679.

universal, environmental agreements.[3] The international law of treaties provides some general rules which are of some value in assessing the worth of the competing arguments. These rules are to be found in customary international law and the Vienna Convention. The general rules are:

(a) later treaty takes priority over the earlier;
(b) more specific treaties take priority over the general—*generalia specialibus non derogant*;
(c) where a treaty says that it is subject to or is not considered incompatible with another treaty then other treaty will prevail;
(d) as between parties to a treaty who later become parties to a later, inconsistent treaty, the earlier will apply only where its provisions are not incompatible with the later treaty;
(e) as between a party to both earlier and later treaties and a party to only one of them, the treaty to which both are parts will govern the mutual rights and obligations of the states concerned;
(f) in determining which treaty is the earlier and which the later, the relevant date is the date of the adoption not that of its entry into force;
(g) the general rules are to be considered as residuary rules—that is to say rules which will operate in the absence of express treaty provisions regulating priority.

III. *Lex Posterior*

If a multilateral environmental agreement and the GATT relate to the same subject matter, then the Vienna Convention mandates that the treaty later in time prevails and this rule is known as *lex posterior*.[4] Since

[3] J. Cameron and J. Robinson, 'The Use of Trade Provisions in International Environmental Agreements and Their Compatibility with GATT', *Yb. Int'l Envtl. L.*, 2, 1991, p. 15.

[4] Vienna Convention, Article 30 reads:

> 1. Subject to Article 103 of the Charter of the United Nations, the rights and obligations of States parties to successive treaties relating to the same subject-matter shall be determined in accordance with the following paragraphs.

a majority of states are party to both the GATT/WTO and MEAs like Montreal Protocol, CITES, Basel Convention and Biodiversity Convention, the analysis is focused on Article 30(4).[5]

The GATT/WTO is stated to defeat MEAs via *lex posterior*, by resetting GATT's date to 1994, permitting it to leapfrog over all environmental treaties that use trade measures. However, since GATT rules are now applied only through the new 1994 treaty, this argument may only be available for agreements entered into after 1994. On this line it can be argued that the Convention on Biological Diversity (CBD) and the Basel Convention shall prevail over the GATT/WTO, with the conclusion of Biosafety Protocol,[6] and amendments to the Basel Convention,[7] which are later than GATT/WTO. However, it is not prudent to have ready recourse to the *lex posterior* rule. If the conflict appears to be resolvable, one should look for conflict clauses in both conflicting treaties for resolving the conflict and, in the absence of any clause whatsoever, one should try to interpret both treaties, especially

2. When a treaty specifies that it is subject to, or that it is not to be considered as incompatible with, an earlier or later treaty, the provisions of that other treaty prevail.
3. When all the parties to the earlier treaty are parties also to the later treaty but the earlier treaty is not terminated or suspended in operation under article 59, the earlier treaty applies only to the extent that its provisions are compatible with those of the later treaty.
4. When the parties to the later treaty do not include all the parties to the earlier one:
   (a) As between States parties to both treaties the same rule applies as in paragraph 3;
   (b) As between a State party to both treaties and a State party to only one of the treaties, the treaty to which both States are parties govern their mutual rights and obligations.
5. Paragraph 4 is without prejudice to Article 41, or to any question of the termination or suspension of the operation of a treaty under Article 60 or to any question of responsibility which may arise for a State from the conclusion or application of a treaty the provisions of which are incompatible with its obligations towards another State under another treaty.

[5] Ibid.

[6] Cartagena Protocol on Biosafety to the Convention on Biological Diversity, 29 January, 2000, *I.L.M.*, 39, 2000, p. 1027.

[7] *Infra* 17.

the later one, on the basis of Articles 31 and 32 of the Vienna Convention,[8] in order to see which treaty should take priority. When a conflict seems to appear, the first task of the interpreter is to go deep into the disputed issues, their objects and purposes. He should first see whether the two treaties can exist harmoniously. Then he should see if the conflict is covered by any event which is a 'subject to' clause,[9] 'priority claiming' clause[10] or '*lex specialis*' principle. In extreme cir cumstances,

[8] '1. A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its objects and purpose.
   2. The context for the purpose of the interpretation of a treaty shall comprise in addition to the text, including its preamble and annexes:
      (a) any agreement relating to the treaty which was made between all the parties in connexion with the conclusion of the treaty;
      (b) any instrument which was made by one or more parties in connexion with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty.
   3. There shall be taken into account, together with the context:
      (a) any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions;
      (b) any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation;
      (c) any relevant rules of international law applicable in the relations between the parties.
   4. A special meaning shall be given to a term if it is established that the parties so intended.' —Vienna Convention, Article 31.

'Recourse may be had to supplementary means of interpretation including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of Article 31, or to determine the meaning when the interpretation according to Article 31:
   (a) leaves the meaning ambiguous or obscure; or
   (b) leads to a result which is manifestly absurd or unreasonable.' — Vienna Convention, Article 32.

[9] When a treaty specifies that it is *subject to*, or that it is not to be considered as incompatible with, an earlier or later treaty, the provisions of that other treaty prevail. —Vienna Convention, Article 30(2). (emphasis added)

[10] A necessary corollary of 'subject to' provision is that if a treaty even of earlier in time provides in its provisions to have precedence over other (later or earlier) treaty, the provision of that treaty should prevail, and by necessary

when the two treaties do not come under any exception to *lex posterior* and in no way can the two exist together, *lex posterior* should be taken recourse to. When a treaty interpretation appears to be inconclusive, the *lex posterior* rule should be applied in the last resort.

There is a distinction between 'divergence and conflict' treaty provisions. Conflicts, in his view, should be construed strictly, such that they 'arise...only where a party to the two treaties cannot simultaneously comply with its obligations under both treaties.'[11] Such an attempt to limit the occurrence of actual conflict is inspired by the practical reality that there is no unified international legislative process and the fact that 'multipartite instruments..., although concluded between identical groups of parties, operate in different international organization.'[12] This description aptly applies to the situation regarding trade and environment where the challenge of achieving coordination between officials is a persistent one.

Relating to the Same Subject Matter

Article 30 provides for the application of the *lex posterior* principle. However in its opening Article 30 stipulates that '...rights and obligations of States parties to successive treaties relating to the same subject-matter shall be determined in accordance with...' paragraphs 2 to 5 of Article 30. The most significant problem in applying the Vienna Convention treaty interpretation rules is determining whether the treaties relate to the same subject-matter, which is a prerequisite under the Vienna Convention. Now the question arises whether MEAs dealing with certain specific global environmental problems and GATT/WTO, whose concern is chiefly economic, can be said to be concerned with the same subject-matter. The phrase in Article 30(1) 'relating to same subject matter' should be interpreted such that the subsequent rules only apply to treaties of the same level of generality. The history of the Vienna Convention indicates that the parties established rules for interpreting successive treaties, such as GATT 1947 and GATT 1944, rather than for completely separate agreements that overlap.

implication, *lex posterior* rule becomes inapplicable in respect of that treaty. E.g., Article 103 of the UN Charter.

[11] W. Jenks, 'The Conflict of Law-making Treaties', *BYIL*, 30, 1953, p. 426.

[12] Ibid., 404.

However one may say that the existence of trade measures in environmental agreements and the existence of environmental exceptions in the GATT suggest that certain provisions of the agreements relate to the same subject-matter. But it is difficult to conclude that MEAs and GATT/WTO relate to the same subject-matter, though there may be incidental overlapping. Whereas the subject-matter of GATT applies to the entire universe of products, with the goal of reducing tariff and non-tariff restrictions such as quotas and technical barriers to trade, a multilateral environmental agreement focuses on one environmental problem and tailors its measures, to reduce or eliminate that problem. It is doubtful whether the Montreal Protocol, CITES, Basel Convention and CBD's are mainly concerned with environmental issues, and the GATT/WTO are dealing with the same subject-matter. The expression 'relating to the same subject-matter' must be construed strictly.[13]

Therefore, one can very well argue that such treaties relate to different topics, because the subject of an environmental agreement relates to a particular environmental problem, whereas GATT/WTO relates to eliminating trade barriers. The Montreal Protocol in its pith and substance, deals with the ozone depletion problem. It has some trade measures in order to manage the global problem, such trade provisions are incidental in character and do not come in the vistas of GATT/WTO. Similarly the aim of the CITES is to save endangered species from extinction so that subtle links of ecological chain are not missed. The aim of the Basel Convention is the environmentally sound management of hazardous waste. The CBD dealing with the IPRs in context of transfer of technology for biodiversity conservation, or technology uses genetic resources. While the TRIPs Agreement deals with the questions relating to conditions for grant of patent and violation thereof, lawyers argue that the subject-matter between the CBD and the TRIPs Agreement, is not the same.[14]

IV. *Lex Posterior* Application and Difficulties

If a multilateral environmental agreement and the GATT are considered to relate to the same subject-matter, then Article 30 of the Vienna

[13] I. M. Sinclair, *The Vienna Convention on the Law of Treaties*, Manchester: Manchester University Press, 1984, p. 98.

[14] C. L. McDougall, *Intellectual Property Rights and the Biodiversity Convention: The Impact of GATT*, London: Friends of the Earth, 1995, p. 22.

Convention mandates that the treaty later in time prevails, the *lex posterior* rule. The application of this simple rule is not easy. The Vienna Convention does not state when a treaty is 'dated', and scholars are not in agreement. Some argue that a treaty is dated from the time of adoption and others, from the time of its coming into force. The order of priority is confused further by amendments to agreements, and, in case of GATT, by the negotiation of entirely new codes and a subsequent treaty.[15]

Regarding the GATT, the final act of the Uruguay Round does not clearly specify how different aspects of GATT relate to each other. For example, GATT 1947 is an integral part of GATT 1994, but the two documents are considered legally distinct.[16] Thus whether GATT 1947, with its core obligations of most favoured nation (MFN) principle, national-treatment obligation, and prohibition against quantitative restrictions, carries forward or retains its original date is uncertain.

Even if it is agreed that the relevant date is the adoption of the instrument, it is still not obvious how to deal with the rules of the GATT. On the one hand, the GATT 1947 is legally distinct from GATT 1994—thus prior in time relative to most MEAs. On the other hand, however, the Uruguay Round agreements including TRIPs Agreement were adopted on 15 December 1993—later than most MEAs. It can be argued that GATT/WTO trumps over the MEAs by resetting GATT's date to 1994. This allows the GATT/WTO to leap frog over all environmental treaties that use trade measures.

The CITES and Montreal Protocol are examples of frequently amended agreements. On the basis of the above argument if an amendment to a treaty is considered to give the treaty status anew, i.e. from the date of the amendment as is the case with GATT, certain MEAs shall prevail over the GATT/WTO as amendments have been done in

[15] C. Wold, 'Multilateral Environmental Agreements and the GATT: Conflict and Resolutions?', *Envtl. L.*, 26, 1996, p. 911.

[16] The agreements and associated legal instruments included in Annexes 1, 2 and 3 are integral parts of this Agreement, binding on all Members. —WTO Agreement, Article II(2). The General Agreement on Tariffs and Trade 1994 as specified in Annex 1A is legally distinct from the General Agreement on Tariffs and Trade, dated 30 October 1947, annexed to the Final Act Adopted at the Conclusion of the Second Session of the Preparatory Committee of the United Nations Conference on Trade and Environment, as subsequently rectified, amended or modified. —Ibid., Article II(4).

the Basel Convention and the CBD which are of a later date to the GATT/WTO.

(i) Amendment to the Basel Convention

The decision of the Third Conference of the Parties to the Basel Convention to amend that Convention[17] is such an example. According to Article 40 (4) of the Vienna Convention, it is the date of the adoption of the decision to amend a treaty that is decisive. The Basel Convention amendments come after the adoption of the Uruguay Round, although the adoption of the Basel Convention, itself, which contains other trade measures, precedes the Uruguay Round. Thus the Basel Convention should be considered to prevail over the GATT/WTO via the *lex posterior* rule, as it should be considered to have become a new treaty first as GATT 1947 is considered new GATT 1994.

(ii) Biosafety Protocol's Addition to Biodiversity Convention

Article 19(3) of the CBD called on parties to:

> ...consider the need for and modalities of a protocol setting out appropriate procedures, including, in particularl, advance informed agreement, in the field of the safe transfer, handling and use of any living modified organisms resulting from biotechnology that may have adverse effects on the conservation and sustainable use of biological diversity.

[17] Decision III/1 of the Third Meeting of the Conference of the parties to the Basel Convention (UNEP/CHW.3/35, 28 November 1995), amending the Convention so as to prohibit trade in listed substances with certain specified countries. The new Article 4A reads as follows:

1. Each Party listed in Annex VII [i.e., members of OECD, European Community and Liechtenstein] shall prohibit all transboundary movement of hazardous wastes which are destined for operations according to Annex IV A, to States not listed in Annex VII.
2. Each Party listed in Annex VII shall phase out by 31 December 1997, and prohibit as of that date, all Transboundary movements of hazardous wastes under Article 1(i)(a) of the Convention which are destined for operations according to Annex IV B to States not listed in Annex VII.

Consequently at the Second Conference of the parties to the CBD in 1995, it was agreed upon to develop a Biosafety Protocol for biosafety in the field of safe transfer, handling and use of genetically modified organisms.

Ultimately the Biosafety Protocol came into existence in the year 2000. The Protocol recalls in its preamble, Articles 19, 17 and 8(j) of the Convention on Biological Diversity and the decision of the Second Conference of the Parties to develop a Protocol. This proves that the Protocol is necessarily an addendum to the CBD. According to the argument that amendments of GATT 1947, has given the whole of GATT provisions a status of GATT 1994,[18] the conclusion of Biosafety Protocol to the Conservation of Biodiversity Convention should be considered to have infused the CBD with the status of the year 2000, that is later than the TRIPs Agreement. Hence according to the *lex posterior* rule, now the CBD would prevail over the TRIPs Agreement.

(iii) Montreal Protocol

The Montreal Protocol is an example of frequently amended agreement. Parties to the Montreal Protocol have accelerated the Schedules for phasing out ozone depleting chemicals. The relevant date for treaty interpretation should be the date, the amendments are adopted or entered into force. If an amendment to a treaty is considered to have given the treaty a new status, thus simply an addition of chemical in Appendices of the Montreal Protocol, shall give the Protocol a new status and in view of the 'later in time rule', the Montreal Protocol shall prevail over the GATT/WTO treaty.

If only the amending provision is considered new as against the amended treaty, such a situation would create absurd administrative hassles, if the amendments to the Montreal Protocol's schedules were later in time than the relevant GATT provisions. For example, assume that the core obligations of the GATT carry a 1994 date for the purpose of treaty interpretation. Now if the parties to the Montreal Protocol add the Carbon Pentachloride (CCl_5) in 'Group II' of Annex 'B' at the next conference of the parties, a party's import ban on CCl_5 would be consistent with GATT because the Montreal Protocol amendment would be later in time and such amendment would be deemed to have

[18] J. Schultz, 'Environmental Reform of the GATT/WTO International Trading System', *W. Comp.*, 18(2), 1994, p. 104.

given a fresh life to the trade measures relating to the CCl_5. On the other hand, the import ban on Carbon Tetrachloride (CCl_4) already listed in 'Group II' of Annex 'B' would violate GATT as it was included in the Annex 'B' of the 'London Amendment 1990'. In this case, the GATT is later in time and prevails over. Thus the problems would arise if parties added to or accelerated the schedules of the Montreal Protocol. In the latter case, restrictions to reduce consumption by fifty percent might be consistent with GATT while amended consumption percentage would be inconsistent.

(iv) CITES

The CITES is another example of a frequently amended agreement. The parties to CITES amend the appendices at each conference of the parties. Again the relevant date for treaty interpretation should be the date the amendments are adopted or entered into force. Such a situation would again create absurd administrative hassles, if amendments to the CITES appendices are later in time than the relevant GATT provisions. Assuming that the core obligations of GATT carry a 1994 date for the purposes of treaty interpretation, if the parties to CITES add the bluefin tuna to Appendix I at the next conference of the parties in 1997, a party's import ban on bluefin tuna would be GATT-consistent because the CITES amendment would be later in time. On the other hand, the import bans on Javan rhinos, where the number was about fifty total individuals, would violate GATT because the parties protected Javan rhinos in 1975. In this case, GATT is later in time and prevails. For a split listed species, trade restrictions for populations in one country might be consistent with GATT while those from another country might be inconsistent.

As regards Article 30(4) i.e. *lex posterior* rule, of the Vienna Convention, the problem is its assumption that a treaty is capable of being separated into at least two sets of legal relations, in other words, that it can become a series of different bilateral arrangements. In so far as both WTO rules and MEAs are concerned, both need to establish global standards, and are based on uniformity and not reciprocity *per se*. Hence, the provision does not seem helpful. Therefore, the *lex posterior* rule for dealing with conflicts of treaties as between WTO rules and MEAs provide neither clear nor helpful guidance. For legal and policy reasons, therefore, it is preferable to explore alternatives for applying these provisions. To constructively resolve the matter

between the two regimes, it is imperative that the interpretation and construing of the two agreements should be conducted in an objective manner, with deep insight and free from preoccupations. *Moreover, in interpreting a treaty, its total context must be considered, including any subsequent practice of the parties in applying the treaty.*[19] This includes the practice of the parties, and any institutions established under an agreement, in implementing the agreement.

V. Comparative Legitimacy of MEAs and GATT/WTO from the Perspective of Public International Law

A number of difficulties arise in determining any priority between the GATT/WTO and MEAs. The first and most obvious is that the two are dealing with different subject matters. The general rules are primarily focused on conflict and priority between treaties conserving the same subject matter. Here the treaties are dealing with environmental or conservation issues which contain implementation provisions in the form of trade instruments. Against the body of conservation and environmental protection law, containing those trade instruments, there is international trade law which for these purposes is contained in the rules of the GATT, designed to regulate a different subject-matter.

So, apart from the *lex posterior* rule (even if it considered that the two are dealing with the same subject-matter though they do not) there is additional and complementary framework for analysis in comparing the different nature of the trade and environment agreements. The GATT was conceived as a kind of contractual agreement, with no supporting, permanent organization, so it has lacked the status of an international legislative body. It cannot compete with the UN or the UN agencies, as the legitimate creator of what is described as international public law.[20] The Biodiversity Convention was negotiated and concluded under the auspices of UNEP. Similar is true for CITES and Basel Convention which were concluded under UN auspices. International organizations, or indeed groups of states dealing with a particular subject-matter, can make agreements *erga omnes*. Indeed environmental agreements, most particularly those dealing with the global commons, or matters of concern to the whole of international society, are the paradigm examples of agreements made in the global

[19] Vienna Convention, Article 31(3).
[20] Cameron and Robinson, p. 16.

public interest. Any proposals targeted at adjusting TREMs provided by MEAs to be in consonance with GATT/WTO, carry a political risk of creating an impression of 'judging' the legitimacy of MEAs in the light of the GATT/WTO law, despite any presumption of superiority of GATT/WTO law being unfounded in international law.[21] This clarification, specifically would have to reflect the legal fact that GATT/WTO law does not rank higher than international environmental law, despite prevalent institutional imbalances.

The agreements which are intended to operate *erga omnes* are distinct from those which are predominantly contractual treaties creating rights *in personam*.[22] Such *erga omnes* agreements are characterised by the leadership of a group of states determined to address a problem of universal concern and in some senses, these agreements are a substitute for the lack of a global legislature.[23] In relation to international agreements relating to waterways as stated by A. McNair

> 'Article 380 of the Treaty of Versailles of 1919 provided that, the Kiel canal and its approaches shall be maintained free and open to the vessels of commerce and war of all nations at peace with Germany on terms of entire equality. What was in question in this case was not whether the operation of the Treaty of Versailles conferred a right, or imposed a duty, upon a State not party to the Treaty...the question was whether or not Article 380...created objective law, produced effects of *erga omnes*.'[24]

These facts relate to the Wimbledon case. The Permanent Court of Justice in this case affirmed this rule, stating that the Treaty had created an international regime for the 'benefit of all the nations of the world.'[25]

The agreements relating to global commons, such as Montreal Protocol, Biodiversity Convention, CITES, and Basel Convention would seem to fall within this category. If they are considered as *erga omnes* they are established as higher law, above and superior to GATT. Thus it can be argued that Montreal Protocol for example, takes

[21] R. G. Tarasofsky, 'Ensuring Compatibility between Multilateral Environmental Agreements and GATT/WTO', *Yb. Int'l Envtl. L.*, 7, 1996, p. 62.
[22] A. McNair, *Law of Treaties*, Oxford: Oxford University Press, 1961, p. 256.
[23] Ibid.
[24] Ibid., p. 267.
[25] *The S.S. Wimbledon*, PCIJ Series A. No. 1 (1923).

priority over the GATT in relation to trade in ODS, because of the urgency in resolving the problem for the benefit of the whole of international society and because trade provisions were agreed upon in order to better carry out the objectives of the agreement. The same arguments could be made in respect of CITES, CBD and the Basel Convention.

VI. *Lex Specialis*

Customary international law provides the rule of *lex specialis*, whereby a more specialized treaty prevails over a more general one. Although not stated in the Vienna Convention, specific treaties or provisions control general treaties or provisions under the rule of *lex specialis*, even if the general provisions are later in time. Therefore, even if for the sake of argument it is considered that the two treaties relate to the same subject matter, *lex specialis* principle becomes applicable, and indicates that the two regimes can exist in harmony. *Lex specialis* principle is based on the premise that when general provisions and special provisions are face to face, special provisions get the status of exception to the general provisions, lest the special provisions be not swallowed down by the general provisions. In such situation it may be necessary to read and interpret the relevant provisions together, and where necessary restrict the ambit of the broader provision in favour of the narrower provision so that it is not swallowed up by the former. If one provision is general, and the other is limited or specific, then the former may be restricted to give sense and efficacy to the latter which may be treated as particularised and something in the nature of an exception to the general provision.

Lex specialis is described in the following words—'It does not merely involve that general provision do not *derogate* from specific ones, but also, or perhaps as an alternative method of statement, that a matter governed by a specific provision dealing with it as such, is thereby taken out of the scope of a general provision dealing with the *category* of subject to which that matter belongs, and which therefore might otherwise govern it as part of that category.'[26]

Since it has occasionally been observed that treaties prevail over custom through the doctrine of *lex specialis derogat generali*, then the

[26] G. Fitzmaurice, 'The Law and Procedure of the International Court of Justice 1951-4: Treaty Interpretation and Other Treaty Points', *BYIL*, 33, 1957, pp. 203, 236.

general nature of an earlier international agreement which in theory has no greater force than customary international law, should permit a later specific agreement to have recourse to the exact same doctrine.[27]

VII. Specificity of MEAs over GATT/WTO and Application of *Lex Specialis* Rule

Arguably, the provisions of multilateral environmental agreements are more specific than the GATT and its codes. Whereas the subject-matter of GATT applies to the entire universe of products, with the goal of reducing tariff and non-tariff restrictions such as quotas and technical barriers to trade, a multilateral environmental agreement focuses on one environmental problem and tailors its measures, to reduce or eliminate that problem. The Montreal Protocol in its pith and substance deals with the ozone depletion problem. Though it has some trade measures in order to manage the global problem, such trade provisions are incidental in character and do not come in the vistas of GATT/WTO. Similarly the aim of the CITES is to save endangered species from extinction so that subtle links of ecological chain do not miss. Thus CITES is an example of the specific having priority over the general. The same argument could be made in respect of Montreal Protocol, Basel Convention and the CBD. The aim of Basel Convention is the environmentally sound management of hazardous waste. The CBD deals with the IPRs in the context of transfer of technology for biodiversity conservation, or technology that uses genetic resources. The Biodiversity Convention focuses on the problem of biodiversity conservation, lest myopic and unthoughtful exploitation of genetic diversity results in the extinction of green cover of earth itself. In short, because GATT is more a general international agreement than are multilateral environmental agreements, the latter should control if there is conflict.[28]

However, it can be stated that in most cases, the MEAs' provisions are more detailed than what appears in the GATT/WTO. The specific listing of chlorofluorocarbons to be banned under the Montreal Proto-

[27] R. J. Zedalis, 'The Environment and the Technical Barriers to Trade Agreement: Did the Reformulated Gasoline Panel Miss a Golden opportunity?', *NILR*, 1997, p. 200.

[28] Wold, p. 913.

col together with their phase-out schedules, the particular species listed under CITES Appendix I along with the particularity of the trade restriction are some examples.[29] The suggestion may be that for detailed provisions which are general in character the rule of *lex specialis* might be inapplicable. But that is not correct. For a provision to be 'detailed' or to be 'general' are two different things. On the contrary, if the provisions of an instrument are given in detail, it testifies that they are more specific as they precisely determine the frontiers of the area within which they are applicable. Therefore, it can be said that even if the provisions of the MEAs are more detailed than GATT/WTO, *lex specialis* principle is applicable in their respect.

In respect of the Biodiversity Convention against TRIPs Agreement, it is observed that although the TRIPs Agreement is more specific in some ways (since it defines national obligations more precisely), the Biodiversity Convention can be argued to be more precise, since it deals with IPRs '*in the specific context of transfer of technology for biodiversity conservation, or technology that uses genetic resources*'. Sinclair's statement[30] suggests that the GATT and /or the WTO do not relate to the same subject-matter as the Biodiversity Convention even for the limited purpose of interpreting the intellectual property provisions of the two treaties. Although the TRIPs agreement is more specific than the intellectual property references in the CBD, it can still be that what is being addressed in the CBD is intellectual property rights in the very specific context of conservation and sustainable use of natural resources. Hence, the *lex specialis* rules do have a strong intellectual appeal in this context. Although this point appears to be a mere legal technicality, it is in fact significant, since such an interpretation would allow countries (particularly Third World countries) to justify special treatment for IPRs concerning plant genetic resources and the transfer of biotechnology on the grounds that such treatment is in line with the Biodiversity Convention. This line of argument means that TRIPs should not prevail over the Biodiversity Convention.

The *lex specialis* has the status of customary rule of international law.[31] Article 3(2) of the DSU mandates the Appellate Body to apply customary rules of interpretation relating to public international law,

[29] Tarasofsky1996, p. 63.
[30] *Supra* 13 and accompanying text.
[31] Tarasofsky1996, p. 63.

in clarifying the GATT/WTO Agreements.[32] It is the customary rule of interpretation that while interpreting it is provided that '[t]here shall be taken into account, together with the context: any relevant rules of international law applicable in the relations between the parties.'[33] The phrase, any relevant rule of international law indicates the customary rule of international law.[34] Therefore, though Article 30 of the Vienna Convention providing for *lex posterior* rule is designed to apply in those cases in which there is a conflict between successive international agreements speaking of the exact same subject, yet in situations of conflict between an earlier more specific international agreement and a later more general international agreement they are to be governed by other long standing rules, like that of the general not prevailing over the more specific.

VIII. Modification

An exception to *lex posterior* rule is provided in para. 5 of Article 30 of Vienna Convention. It reads, 'Paragraph 4 is without prejudice to Article 41, or to any question of the termination of suspension of the operation of treaty under Article 60 or to any question of responsibility which may arise for a State from the conclusion or application of a treaty, the provisions of which are incompatible with its obligations towards another state under another treaty.' It indicates that para. 4 (comprising para.3 i.e. *lex posterior* rule) becomes inapplicable where modification is provided or necessarily applicable by a multilateral treaty, even if such treaty comes into being later.

The sovereign freedom of parties to supplement or modify multilateral treaties in relation to themselves only, subject to the conditions under Article 41 of the Vienna Convention on the Law of Treaties, is likewise a general rule of international law to be taken into account in the interpretation of GATT/WTO law.[35] The necessary implication

[32] *United States—Standard for Reformulated and Conventional Gasoline*, WT/DS2/AB/R, 29 April 1996, p. 17.
[33] Vienna Convention, Article 31(3)(c).
[34] M. Schlagenhof, 'Trade Measures Based on Environmental Processes and Production Methods', *J.W.T.*, 29(6), 1995, p. 150, n. 213.
[35] 1. Two or more of the parties to a multilateral treaty may conclude an agreement to modify the treaty as between themselves alone if :
(a) the possibility of such a modification is provided by the treaty; or

of certain provisions of the 'Final Act' is that its provisions may be modified to give effect to some vital aspects of MEAs, i.e. CBD, Montreal Protocol, CITES, Basel Convention etc.[36] It is also argued that multilateral international agreements such as CITES, Montreal Protocol, Basel Convention should be held in their entirety. There should be no doubt about their validity under the GATT. A case may be made for an implied modification of the GATT by subsequent state practice or customary international law.[37]

IX. Modifying Provisions of GATT/WTO

(i) Preamble of WTO

The Appellate Body in the *Shrimp/Turtle* case noted that in recognition of the importance of continuity with the provisions of GATT system, negotiators used the preamble of GATT 1947 as the template for the preamble of the new WTO Agreement. Those negotiators believed, however, that the objective of 'full use of the resources of the world' set forth in the preamble of GATT 1947 was no longer appropriate to the world trading system of the 1990's.[38] As a result, they decided to qualify the original objectives of GATT 1947 with the following words:

> ...while allowing for the optimal use of the world's resources in accordance with the objectives of sustainable development, seeking both to protect and preserve the environment and to enhance the
>
> (b) the modification in question is not prohibited by the treaty and,
>
> (i) does not affect the enjoyment by the other parties of their rights under the treaty or the performance of their obligations;
>
> (ii) does not relate to a provision, derogation from which is incompatible with the effective execution of the object and purposes of the treaty as a whole.
>
> 2. Unless in a case falling under paragraph 1 (a) the treaty other wise provides, the parties in question shall notify the other parties of their intention to conclude the agreement and of the modification to the treaty for which it provides. —Vienna Convention, Article 41.

[36] *Infra* 44, 45 and accompanying text.

[37] T. J. Schoenbaum, 'Free International Trade and Protection of the Environment: Irreconcilable Conflict?', *Am. J. Int'l L.*, 86, 1992, p. 720.

[38] *United States—Import Prohibition of Certain Shrimp and Shrimp Products*, WT/DS58/AB/R, 12 October 1998, para. 152.

> means for doing so in a manner consistent with their respective needs and concerns at different levels of economic development, ...[39]

'[T]his language demonstrates a recognition by WTO negotiators that optimal use of the world's resources should be made in accordance with the objective of sustainable development.'[40]

Thus the amendment in the preamble of GATT 1947 rendered by the WTO, by substituting the phrase 'optimal use of resources' in place of 'full use of resources' was not unthoughtful rather well commited to global environment protection. It is an undisputed truth that only through the protection of global environment—including ozone conservation, protection of endangered species, environmentally sound management of hazardous waste and biodiversity conservation—aims of sustainable development can be achieved.

The Appellate Body in *Reformulated Gasoline* referred Article 31(1) of the Vienna Convention providing, 'A treaty shall be interpreted in good faith in accordance with the *ordinary meaning* to be given to the terms of the treaty in their context and in the light of its object and purpose.' The direction of Article 3(2) of DSU to Appellate Body to apply customary rules of interpretation of public international law reflects a measure of recognition that the General Agreement is not to be read in clinical isolation from public international law.[41] Moreover, Article 31 furthers specifies that '[t]he context for the purpose of the interpretation of a treaty shall comprise in addition to the text, including its *preamble* and...'[42] (emphasis added). Wordings of the preamble to WTO place environmental protection and sustainable development at the heart of the economic objectives of the trading system.[43] Thus 'sustainable development' as the objective of WTO enshrined in its preamble must be considered to have modifying effect on any other part of the 'Final Act' which has the potential of adversely affecting the sustainability envisaged by MEAs.

(ii) Establishing of Committee on Trade and Environment

The WTO Committee on Trade and Environment, established under the 'Final Act' was charged with the general task of 'identify[ing] the

[39] Ibid. (citing WTO preamble's 1st recital).

[40] Ibid.

[41] *Reformulated Gasoline Appellate Decision*, p. 17.

[42] Vienna Convention, Article 31(2).

[43] Tarasofsky1996, p. 66.

relationship between trade measures and environmental measures, in order to promote sustainable development,' with a view to making 'appropriate recommendations on whether any modifications of the provisions of the multilateral trading system [were] required.' By signing the 'Final Act', the representatives adopted a series of Ministerial Decisions and Declaration. Though those decisions do not fall under the dispute settlement provisions of the WTO Agreement, nevertheless they are most certainly of great importance both as part of the 'Final Act' and for interpreting the WTO Agreement.

The terms of the reference of the CTE include the examination of the relationship between the provisions of the multilateral trading system and:

(i) trade measures for environmental purposes, include those pursuant to multilateral environmental agreements;
(ii) charges and taxes for environmental purposes;
(iii) requirements for environmental purposes relating to products, including standard and technical regulations, packaging, labelling and recycling;
(iv) the transparency of trade measures used for environmental purposes and environmental measures and requirements which have significant trade effects;
(v) the dispute settlement mechanisms in multilateral environmental agreements;
(vi) the effect of environmental measures on market access, especially in developing countries; and
(vii) the issue of export of domestically prohibited goods.

Showing significance to the establishment of the CTE, the Appellate Body in *Shrimp/Turtle* case, viewed that the most significant was the decision of Ministers at Marrakech to establish a permanent committee on Trade and Environment (the 'CTE'). The Appellate Body further considered that in their Decision on Trade and Environment, Ministers expressed their intention, in part, as follows:

> ...*Considering* that there should not be, nor need be, any policy contradiction between upholding and safeguarding an open, non-discriminatory and equitable multilateral trading system on the one hand, and acting for the protection of the environment, and the promotion of sustainable development on the other...[44]

[44] *Shrimp/Turtle Appellate Decision*, para. 154. —Citing, Preamble of Decision on Trade and Environment, Final Act.

In this decision, Ministers took 'note' of the Rio Declaration on Environment and Development Agenda 21 and 'its follow-up in the GATT, as reflected in the statement of the Council of Representatives to the Contracting Parties at their 48th Session in 1992...' The Appellate Body further noted that this decision also set out the following terms of reference for the CTE:

(a) to identify the relationship between trade measures and environmental measures in order to promote sustainable development;
(b) to make appropriate recommendations on whether any modifications of the provisions of the multilateral trading system are required, compatible with the open, equitable and non-discriminatory nature of the system, as regard, in particular:
— 'the need for rules to enhance positive interaction between trade and environment measures, for the promotion of sustainable development, with special consideration to the needs of the developing countries, in particular those of the least developed among them; and
— 'the avoidance of protectionist trade measures, and the adherence to effective multilateral discipline to ensure responsiveness of the multilateral trading system to environment objectives set forth in Agenda 21 and the Rio Declaration, in particular Principle12; and
— 'surveillance of trade measures used for environmental purpose, of trade-related aspects of environmental measures which have significant trade effects, and of effective implementation of the multilateral discipline governing those measures.'[45]

Here the words '...adherence to effective multilateral discipline to ensure responsiveness of the multilateral trading system to environmental objectives...' And '...of effective implementation of the multilateral disciplines governing those measures' indicate that the provisions of Montreal Protocol relating to O_3 conservation, CITES relating to conservation of endangered species, Basel Conventions relating to protection against potential havoc from movement of hazardous wastes and CBD relating to conservation of biodiversity and their eventual trade measures were not considered by the negotiators of WTO as to be in confrontation of WTO. Rather Marrakech Dec-

[45] Ibid. —Citing, Decision on Trade and Environment, Final Act.

laration well considers the environmental objectives as an essential part of economic activities.

Among the terms of reference for the CTE, the reference to Agenda 21 and the Rio Declaration to ensure responsiveness of the multilateral trading system to environmental objectives set forth in these instruments are very important. Such provisions have a modifying effect on 'Final Act', where objectives of the Montreal Protocol, CITES, Basel Convention and CBD are addressed by the Rio Declaration and Agenda 21.

(a) Rio Declaration

There exists the customary obligation of a state to act diligently in controlling transboundary risks emanating from activities within the territory. The well established principle of the responsibility of states in the field of harm to the environment, is confirmed in Principle 2 of the Rio Declaration and goes back to *Trail Smelter Arbitration*,[46] and afterwards in *Request for an Examination of the Situation*,[47] and *Advisory Opinion on the Legality of the Threat or Use of Nuclear Weapons*[48] and suggests that this customary rule of international law has to be taken into account in the interpretation of a treaty. Therefore, the GATT/WTO provisions could be interpreted as allowing internationally agreed measures for the protection of the 'global commons'. Principle 7 of the Rio Declaration obligates the states to cooperate in a spirit of global partnership to conserve, protect and restore the health and integrity of the Earth ecosystem. Objectives of the Montreal Protocol, CITES, Basel Convention and CBD come well within the precincts of these principles, targeted at global environmental protection.

The Rio Declaration is imbued with the objective of sustainable development. Principle 15 of the Rio Declaration provides, 'In order to protect the environment, the precautionary approach shall be widely

[46] *United States v. Canada* (*Trail Smelter* Arbitration), R.I.A.A. 1938, , Vol. III, pp. 1905 *et seq*.

[47] *Request for an Examination of the Situation* (New Zealnd v. France) *Case*, ICJ Rep. 1995, para. 64.

[48] 'The existence of the general obligation of States to ensure that activities within their jurisdiction and control respect the environment of other States or of areas beyond national control is now part of the corpus of international law relating to the environment.' —*Advisory Opinion on the Legality of the Threat or Use of Nuclear Weapons*, ICJ Rep. 1996, para. 29.

applied by States according to their capabilities. Where there are threats of serious or irreversible damage, lack of full scientific certainty shall not be used as reason for postponing cost-effective measures to prevent environmental degradation.' Therefore, it can be said to have modifying effects on the phrase 'necessary' under GATT Article XX and 'necessity and serious prejudice to environment' of Article 27(2) of the TRIPs Agreement, so as to accommodate the precautionary principle.

The Ministerial Decision on 'Trade and Environment', which provided for the establishment of CTE, specifically referred Principle 12 of the Rio Declaration which states, in part:

> Unilateral actions to deal with environmental challenges outside the jurisdiction of the importing country should be avoided. *Environmental measures addressing transboundary or global environmental problems should, as far as possible, be based on international consensus.* (emphasis added)

The aforementioned MEAs are based on international agreed instrument and environmental measures, provided therein are based on international consensus (above, Ch. 4(XI)(B)(a)).

(b) Agenda 21

Global environmental objectives targeted by the Montreal Protocol, CITES, Basel Convention and the CBD are addressed by Agenda 21 also. The protection of 'global common' is the theme of Agenda 21. The sustainable management of the world's common global resources—its atmosphere and oceans is of vital interest to the future of humanity. Environmental changes to the atmosphere and oceans can fundamentally affect the habitability of the entire planet. Global climate, weather and the physical processes which give rise to life on earth are directly influenced by the atmosphere and oceans.

Agenda 21 specifically recognizes the objectives defined in the Montreal Protocol and its 1990 London and 1992 Copenhagen amendments for limiting the production and use of substances that deplete the ozone layer. Technologies and natural products that reduce the demand for these substances should be encouraged. Nations must also act cooperatively to develop strategies aimed at mitigating the adverse effect of ultraviolet radiation which is reaching the earth's surface as a consequence of depletion of the stratospheric ozone layer.

In matters of management of hazardous wastes Agenda 21 maintains that an international strategy should be developed for the environmentally sound management of hazardous waste. It projects the need to increase international cooperation in the environmentally sound management of hazardous waste, particularly in the control and monitoring of international movement of such wastes. Export of hazardous waste to countries that do not have the capacity to deal with those wastes in an environmentally sound way, should be prohibited globally. Regulations related to all these concerns are provided by the Basel Convention.

In regard to the CBD, Agenda 21 specifically recognises the rights and role of indigenous people in resource management and sustainable development. Chapter 15 of Agenda 21, further shows concern for biodiversity conservation and calls on governments to develop measures and arrangements to help biodiversity source countries and their people to share the benefits of the commercialisation of genetic resources.

One may argue that Agenda 21 is a 'soft law' instrument, thus not legally binding on signatories, and its effects on state behaviour is yet to be assessed.[49] However Agenda 21 must be regarded to have acquired the strength of 'hard law' for its environmental purposes addressed by MEAs because of its mentioning in the 'Ministerial Decisions and Declaration of Trade and Environment' of the 'Final Act'. The reason is that the 'Final Act' is an effective legal instrument—an example of 'hard law'. Thus the hardness has crept into the Agenda 21 too, for its environmental objectives addressed by MEAs, in the face of trade provisions.

X. Subsequent Practice

Article 31(3)(b) of the Vienna Convention provides, 'There shall be taken into account, together with the context: ...; any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation;'[50] Subsequent practice

[49] International environmental law exists in the form of hard as well as soft law. Hard law is 'firm and binding rules of law' such as treaty provisions while soft law consists primarily of recommendations or declarations made by international conferences or intergovernmental organizations. Such soft law fixes norms of behaviour and thus has a practical if not a formal effect.

[50] Article 31(3)(b).

gives guidance as to the correct interpretation of a treaty. '...[R]ecourse to the subsequent practice of the parties in relation to the treaty is permissible, and may be desirable, as affording the best and most reliable evidence...as to what its correct interpretation is.'[51]

(i) Observations of GATT Report on Trade and Environment

In the context of subsequent practice, the observations made by the GATT Secretariat in the Report conducted in 1992 are relevant. The Report examining trade and environment issues observed: 'When cooperation is not voluntarily forthcoming, positive incentives are the best way to achieve sustained inter-governmental cooperation. Positive incentives can include offers of financial assistance and transfers of environmentally friendly technology directly related to the problem at hand, as well as more broadly based offers, for example, to increase foreign aid, to lessen debt problems and to make non-discriminatory reduction in trade barriers.'[52] The argument for transfer of biotechnology to supplying states of the germplasm to the biotechnology industries of the user states for the conservation of the biodiversity stands on more sound footing because of the reciprocity element in such transfer.

At another place the Report observed: 'Given that the countries which are home to large tropical forests are currently exporting carbon absorption services (and biodiversity services) to the rest of the world free of charge, there is a certain logic to the view that they should be offered compensation [in form of biotechnology transfer].'[53] Though this observation was made for not threatening with restriction, the export of timber from developing countries, yet it is not very relevant to the compensation to supplying states, for taking germplasm so that genetic diversity could be conserved.

(ii) GATT/WTO Judicial Decisions

Under the WTO, there is an integrated Dispute Settlement Body, which deals with disputes arising from any WTO Agreements, on a

[51] Fitzmaurice, p. 210.

[52] GATT, 'Trade and Environment', GATT Doc. 1529, 3 February 1992, reprinted in *Wld. T. Mater.*, 4, 1992, p. 30.

[53] Ibid., p. 29.

case-by-case basis. Technically the Dispute Settlement Body (DSB) is not bound by its previous decisions, but we do find several times references to the previous decisions. In *Shrimp/Turtle* the Appellate Body several times refers to its decision in *Reformulated Gasoline*.[54] Even if it is accepted that the DSB decision in a particular case does not create precedents for future decisions, they do come under the concept of 'subsequent practice', as meant by Vienna Convention,[55] and are hence applicable and having interpretive value. GATT/WTO decisions from *Tuna/Dolphin I* to *Shrimp/Turtle Appellate Decision* have emphasized on the multilateral approach in imposing Trade-Related Environmental Measures (TREMs). The special note was taken by the recent *Shrimp/Turtle Appellate Decision*. The Appellate Body stated:

> [W]e note that WTO members in the Report of the CTE, forming part of the Report of the General Council to Ministers on the occasion of the Singapore Ministerial Conference, endorsed and supported: *... multilateral solutions based on international cooperation and consensus as the best and most effective way for governments to tackle environmental problems of a transboundary or global nature. WTO Agreements* and multilateral environmental agreements (MEAs) are representative of efforts of the international community to pursue shared goals, and in the development of a mutually supportive relationship between them, *due respect must be afforded to both*.[56] (emphasis supplied).

The GATT Report also laid stress on multilateral environmental agreements to resolve environmental policy issues. GATT Report observes, 'GATT rules could *never block the adoption of environmental policies which have support in the world community*.'[57] (emphasis added).

The natural inference is that TREMs agreed upon through international consensus have the validity to prevail over the GATT/WTO provisions when global environmental problem is in question. Therefore, it can be concluded that TREMs in pursuance of a MEA have legal justification. Montreal Protocol, CITES, Basel Convention and

[54] *Shrimp/Turtle Appellate Decision*, para. 115, 116, 118, 150.
[55] Article 31(3)(a), *supra* 8.
[56] *Shrimp/Turtle Appellate Decision*, para. 168. —Citing Report of the Committee on Trade and Environment, (Press/TE 014), WT/CTE/1, 12 November 1996, para. 171.
[57] GATT Report, pp. 5, 6.

the CBD are good illustrations of achieving international cooperation on environmental issues.

Under a balancing approach, trade measures specifically mandated by an international environmental agreement and imposed between parties to the agreement should be exempted from review, since the parties themselves have agreed that the benefits of such measures exceeded any harm. Hence, the trade measures that are specifically authorized by MEAs should be permitted if the agreement addresses a 'serious' environmental problem of 'potentially global scope,' and the trade measure is reasonably related to the purpose of the MEA.

(iii) Report of the CTE

The CTE Report, 1996 recommends multilateral solutions based on international cooperation and consensus as the best and most effective way to tackle transboundary or global environmental problems. The Report notes that a mutually supportive relationship between WTO rules and MEAs involves due respect being afforded to both.[58] The report also acknowledges that trade measures based on specifically agreed provisions are sometimes necessary to achieve the environmental objectives of an MEA, particularly where trade is related directly to the source of the environmental problem.[59] The report further suggests that trade measures in MEAs can be accommodated by the WTO by a range of provisions, including GATT Article XX.[60] Additionally after expressing the hope that the negotiators of future MEAs take 'particular care' over the applicability of trade measures to non-parties, the CTE advocates closer cooperation between the WTO and relevant MEA institutions, particularly to facilitate information exchange.[61] Finally with regard to trade-related disputes between MEA parties who are also WTO members, the report suggests that 'While WTO Members have the right to bring disputes to the WTO dispute settlement mechanism, if a dispute arises between WTO members, parties to an MEA, over the use of trade measures they are applying between themselves pursuant to the MEA, they should consider trying

[58] Report of the Committee on Trade and Environment, (Press/TE 014), WT/CTE/1, 12 November 1996, para. 171.
[59] Ibid., para 173.
[60] Ibid., para. 174(ii).
[61] Ibid., para 175.

to resolve it through the dispute settlement mechanisms available under the MEA.'[62]

The importance of the CTE Report as 'subsequent practice' for the suggestion to the interpretation that trade measures of MEAs be given effect to under the WTO in a range of its provisions including GATT Article XX is all the more important. Thus the TREMs provided in Montreal Protocol, CITES, Basel Convention and the CBD could be considered within the fold of the GATT/WTO. The CTE Report defining the relationship between MEAs and WTO has acquired more legal weightage after its cognizance by the Appellate Body in *Shrimp/Turtle* case.[63]

XI. Priority Claiming Clause

Priority claiming clauses are often included in treaties which are meant to replace one or more earlier treaties. Sometimes they are included in multilateral treaties to prevent contracting parties from concluding a new treaty which is contrary to the multilateral treaty. 'When a treaty specifies that it is subject to, or that it is not to be considered incompatible with, an earlier or later treaty, the provisions of that other treaty prevail.'[64] A necessary corollary of this provision must be that if a treaty even of an earlier time, provides in its provisions that it is to have precedence over other, later or earlier, treaties, the provision of that treaty should prevail; by necessary implication the *lex posterior* rule becomes inapplicable in respect of such a provision.

Priority Claiming Clause in Article 103 of the UN Charter vis-à-vis Lex Posterior

According to Article 103 of the UN Charter the Charter takes priority over any other treaty—earlier or later—to which member states are party. Article 103 is also mentioned in Article 30 of the Vienna Convention. Article 30(1) determines that the provisions of this Article are without prejudice to Article 103 of the UN Charter. The effect is that the *lex posterior* rule i.e. Article 30(3) [and (4)], has therefore to give priority to the UN Charter. Article 103 is included in the UN Charter

[62] Ibid., para 178.
[63] *Supra* 56 and accompanying text.
[64] Vienna Convention, Article 30(2).

and in paragraph 1 of Article 30 of the Vienna Convention in order to stress the importance of the UN Charter above other treaties and international instruments in the international community, even for states which are not member states of the UN It is worth noting that even if para.1 of Article 30 of the Vienna Convention were omitted, the effect would have been the same.

Hence, the explicit provisions concerning priority of agreements are extremely useful if the rules of the Vienna Convention i.e. *lex posterior* are unlikely to resolve the dispute between provisions of the two treaties.

XII. MEAs' Priority Claiming Clause

Certain MEAs like the CBD and CITES provide some provisions which claim priority over other treaties. The CBD provides that its provisions 'shall not affect the rights and obligations of any Contracting Party deriving from any existing agreement, except where the exercise of those rights and obligations would cause a serious damage or threat to biological diversity.'[65] Besides this, the CBD also provides that 'The Contracting Parties, recognizing that patents and other intellectual property rights may have an influence on the implementation of this Convention, shall cooperate in this regard subject to national legislation and international law in order to ensure that such rights are supportive of and do not run counter to its objectives.'[66] The CITES aptly illustrates that measures taken to protect the environment, particularly those based on ecological standards, should remain beyond the review of GATT.

(i) CITES' Priority Claiming Clause

Article XIV(2) of the CITES provides priority-claiming clause in case of conflict. If a conflict is perceived between TREMs provided by the CITES and GATT/WTO the latter should give way to the former. CITES Article XIV(2) expounds that CITES does not affect obligations of parties deriving from, *inter alia*, any agreement 'relating to other aspects of trade'. 'Other' in this case may refer to aspects of trade not related to conservation, thereby meaning that CITES does not interfere

[65] Biodiversity Convention, Article 22(1).
[66] Ibid., Article 16(5).

with GATT/WTO rules where those trade rules apply to ends not related to protecting endangered species. The suggestion, thus, is that CITES takes precedence over GATT/WTO rules if the latter interferes with the protection of endangered species from international trade.

To sum up, the *lex posterior* rule becomes inapplicable in case of a treaty providing provision which claims priority in case of conflict with any other treaty. In the line of argument in respect of Article 103 of the UN Charter, priority-claiming clauses provided by MEAs can be said to enable them to prevail over GATT/WTO in case of conflict.

(ii) Biodiversity's Convention's Priority Claiming Clause

(a) Deriving from Existing Agreement

Article 22(1) of the Biodiversity Convention provides that:

> The provisions of this Convention shall not affect the rights and obligations of any Contracting Party deriving from any existing agreement, except where the exercise of those rights and obligations would cause a serious damage or threat to biological diversity.

This provision indicates the precedence of the CBD over other agreements if the conservation of biodiversity is at stake. Here the question is whether 'existing' is same as earlier. The answer will be 'yes' if date of conclusion of the agreement is kept in mind. On the other hand the answer will be 'no' if determining time is not the date of the CBD conclusion, rather it is the date on which comparison of CBD is made with other agreement in a dispute. The meaning of the phrase 'existing' has become obscure and ambiguous. The applicability of this provision is unclear in the case of the TRIPs Agreement. The question is whether the phrase 'existing' refer only to those international agreements in place when the CBD was adopted.

Thus, it is difficult to apply Article 30(3) of the Vienna Convention, i.e. *lex posterior* rule, in that it is unclear how to consider the question of time. Even if it is agreed that the relevant date is the date of adoption of the instrument, it is still not clear how to deal with the rules of the GATT. On the one hand, the GATT 1947 is legally distinct from GATT 1994—thus prior in time in relation to most MEAs. On the other hand, however, the Uruguay Round agreements including TRIPs Agreement were adopted on 15 December 1993—later than most MEAs. By the same token, the Vienna Convention is silent on how to consider

the timing of a decision taken by the governing body of a treaty to create TREM. Article 19(3) of the CBD calling on member states to develop a Biosafety Protocol and the decision to the same effect taken at the Second Conference of the Parties to the CBD provides an additional set of problems. Biosafety Protocol 2000 has come into existence as a necessary addendum to the CBD.

To the extent that harm to biological diversity results from or is threatened by unrestricted trade, Article 22(1) of the CBD is claimed to have precedence over GATT/WTO rules. The solution to the problem of determining the implication of the phrase 'existing' lies in appreciating the phrase 'existing' rather in the light of other object and purposes of the CBD and not in accordance with its ordinary meaning (because ordinary meaning is creating obscurity).

It is a general rule of interpretation that a legal instrument should be interpreted to further its purposes and objectives.[67] An interpretation which frustrates them should be discarded, because that could not be intended by the framers of the Convention. If the phrase 'existing' is supposed to refer to earlier agreements only, then in face of the TRIPs Agreement, it shall lead to absurd results. Moreover, if that be so there was no point in inserting the phrase 'existing' as *lex posterior* rule was itself sufficient to achieve the same result which flows from giving meaning 'earlier to the CBD' to the phrase 'existing'. Hence such inapplicability of CBD i.e. imperatives of conservation of biodiversity shall be of no help if granting of IPRs results in depletion of biological diversity, because of no return tendency and apathy towards the conservation of biodiversity. So the ordinary meaning of 'existing' should be discarded as it has potential to do violence with the CBD itself. And the framers of the Convention could not be supposed to have done so. Therefore, the phrase 'existing' should be considered to be impregnated with the idea that the crucial date is the date of any probable dispute between it and the other treaty even if concluded later than the CBD.

Nevertheless, the Biosafety Protocol has infused the CBD with the element of being later. Now the phrase 'existing' can be considered to have acquired the post-TRIPs status, as Biosafety Protocol is an addendum of the CBD. So the phrase 'existing' even if meant to be earlier, will make the CBD triumph over the TRIPs Agreement from the vantage of the *lex posterior* rule too.

[67] Vienna Convention, Article 31(1).

(b) IPRs to be Supportive of and not Counter to CBD's Objectives

The Biodiversity Convention provides:

> The Contracting Parties, recognizing that patents and other intellectual property rights may have an influence on the implementation of this Convention, shall cooperate in this regard subject to national legislation and international law in order to ensure that such rights are *supportive of and do not run counter to its objectives*.[68] (emphasis added).

It can be assumed that Article 16(5) of the CBD perceived that absolute precedence of IPRs over the CBD may pose a threat to biodiversity itself, if deserving returns were not infused in the conservation of biodiversity. Therefore it prompted to strike the balance between the two. While on one hand the CBD showed sensitivity to IPRs,[69] at the same time, it rightly provided that the IPR regime should be supportive to, not prejudiced to the object and purposes of the CBD i.e., conservation of biodiversity.

It has been observed that natural genetic diversity is the rationale of biotechnology and an important facet of the IPRs. Thus Article 16(5) of the CBD is in the direction of sustainable development, an objective of the 'Final Act' too expressed in its preamble. So in view of the 'priority claiming' clause to be a necessary corollary to the 'subject to' principle,[70] Article 16(5) of the CBD shall prevail over the provisions of the TRIPs Agreement if any supposed conflict comes on the surface.

XIII. *Jus Cogens* and Environmental Imperatives

(i) *Jus Cogens*

Some principles of general international law are or ought to be so compelling because of their vitality and importance, that they might be recognized by the international community for the purpose of invalidating or forcing revision in ordinary norms of treaty or custom which are in conflict with them. Jurists have from time to time attempted to classify rules, or rights and duties, on the international

[68] Biodiversity Convention, Article 16(5).
[69] Ibid., Article 16(2).
[70] Vienna Convention, Article 30(2).

plane by use of terms like 'fundamental' or, in respect to rights, 'inalienable' or 'inherent'. Such classifications have not had much success, but have intermittently affected the interpretation of treaties by tribunals. In the recent past some eminent opinions have supported the view that certain overriding principles of international law exist, forming a body of *jus cogens*.[71]

The least controversial examples of the class are the prohibition of the use of force against another state, the law of genocide, the principle of racial discrimination, crimes against humanity etc. The major distinguishing feature of such rules is their relative indelibility.[72] Such norms are embedded in the concept of *jus cogens*. Conceptually, it invalidates ordinary state-made rules of international law which are in conflict with powerful norms, expressing fundamental expectations vitally important to override community interests. These particular and powerful norms are 'peremptory' when accepted as overriding by the international community as a whole. Despite its ambiguity, the concept has penetrated the consciousness of public international law discourse. Behind the concept lies the notion of world public order not exclusively controlled by nation-states, one that is foundational, guarding the most fundamental and highly-valued interests of international community.[73] They then form part of the general category *jus cogens*: a symbol for unwritten constitutional guidance to the positive law-making power of sovereign nation-states reflecting those interests most basic to international society.

The concept of *jus cogens* was accepted by the International Law Commission and incorporated finally in the Vienna Convention which provides, 'A treaty is void if, at the time of its conclusion, it conflicts with a peremptory norm of general international law. For the purposes of the present Convention, a peremptory norm of general international law is a norm accepted and recognized by the international community of States as a whole as a norm form in which no derogation is permitted and which can be modified only by a subsequent norm of general international law having the same character.'[74] It further provides, 'If a new peremptory norm of general international law

[71] I. Brownlie, *Principles of Public International Law*, Oxford: Oxford University Press, 1990, pp. 512-13.
[72] Ibid., p. 513
[73] G. A. Christenson, '*Jus Cogens*: Guarding Interests Fundamental to International Society', *Va. J. Int'l L.*, 28, 1988, p. 587.
[74] Vienna Convention, Article 53.

emerges, any existing treaty which is in conflict with that norm becomes void and terminates.'[75]

(ii) *Jus Cogens* in Environmental Context

If it is considered that the *jus cogens* character is applicable to the human right to environment, eyebrows might be raised on giving status of *jus cogens* to human rights of environment. However, denial thereof is not feasible especially in view of draconian global environmental hazards posed by human activity, as perpetual existence of mankind with nature's provided environmental essentiality for such continuing existence is fundamental for everything.

Certain environmental imperatives are a must for a particular creature to continue its life or to come into existence. The absence of any form of life on the moon, Mars or other planets testifies this. On Earth too, the extinction of certain species is imputed to drastic changes in the environment due to which they cannot survive. The continuing healthy existence of flora and fauna is a pre-condition of all industrial, economic commercial or other activities. Such continuing healthy existence of flora and fauna, in turn depends on good environmental health.

A particular rule of international law acquires the status of peremptory norm, when the rule in respect of the given subject matter seems to be so vital and important to the world community that derogation therefrom could not be imagined. On this premise, the *jus cogens* character can be said to be applicable on a regulation if it is very important for the continuing existence of the 'living world' where in *Homo sapiens* are a necessary component. Unregulated human activity in the long run, have the potential of concretizing the fear of reaching the situation from which there is no return. As Cree Indian said in 1909 '*only when the last tree has died, and the last river has been poisoned, and the last fish has been caught, will we realize that we cannot eat money*'. Hence, rules regulating them must be said to have achieved *jus cogens* character.

(iii) *Jus Cogens* Character of the Principle of 'Sustainable Development'

The principle of sustainable development is the centerpiece of MEAs. Sustainable development is as much about economic development as

[75] Ibid., Article 64.

it is about environmental protection. While these two aspects have to be integrated in order to achieve sustainable development, they remain distinct. Sustainable development does not imply a policy of no growth, rather it entails a compromise between the natural environment and economic growth. Some element of compromise is undoubtedly part of the concept.[76] The integration of environmental protection and economic development was an important objective of the UNCED Conference, expressed in Principle 4 of the Rio Declaration, which states, 'In order to achieve sustainable development, environmental protection shall constitute an integral part of the development process and cannot be considered in isolation from it.'

While Principle 12 of the Rio Declaration reflects the concerns of free trade advocates that environmental restrictions should not constitute disguised or arbitrary interference with free trade, the WTO has been slower in taking a full account of the needs of environment protection.[77] The GATT and to some extent the WTO, are obsessed with mercantilist ethos and thus insensitive to environment.[78] Nevertheless, the WTO and its covered agreements have given due accord to the principle of sustainable development (above Ch 1(V)(i)(a). The insertion of the principle of sustainable development in WTO jurisprudence, is not due to its sensitivity to environment altogether, rather the trade negotiators in Uruguay Round realized that nature and natural resources are the feeding treasures for economic growth and development of trade. The compelling integration of the principle of sustainable development in GATT/WTO as against its mercantilist ethos proves the concept of sustainable development to have achieved the status of *jus cogens*.[79]

Sustainable development offers a unifying concept for the exploitation of natural resources and the integration of environment and development. The rule of sustainable development has the peculiarity in that it deals with two different disciplines of law–economic and environmental—between whom, friction is looming large. Application of the principle of sustainable development facilitates one to

[76] P. W. Birnie and A. E. Boyle, *International Law and the Environment*, New Delhi: Oxford University Press, 2004., p. 44.
[77] Ibid., p. 86.
[78] O. Perez, *Ecological and Sensitivity and Global Legal Pluralism*, Oxford: Hart Publishing, 2004, pp. 51. *et seq*.

supplement the other and optimally balances the two. The principle of sustainable development is thus all the more important because it has the capability of coalescing two different branches of international law. Such a task can be performed by norms which are inherently objective in characteristics. The objectivity in the principle of sustainable development is the evidence of its ascending pre-eminence as a peremptory norm of international law.[80] The reasons for such a possible ascendancy are intuitively persuasive. 'Sustainable Development' is a *condition sine qua non* for human life on this planet in the long run. It stands to reason, therefore, that other legal arrangements would have to measure up to the principle. 'Sustainability' thus, would not simply safeguard individual state interests but world act as a restraint in the higher interest of the whole international community in preserving the ecological basis for human civilization.[81]

(iv) Examining *Jus Cogens* Character for MEAs' Provisions Concerning Global Environmental Hazards

The majority of the world's nations are signatory to the Multilateral Environmental Agreements like the Montreal Protocol, CITES, CBD, and the Basel Convention. The provisions of hese MEA's relating to global environmental hazards may be said to have existed as customary international law, independent of their place in respective treaties, because of their vital importance and the participation by the majority of the world community. The law has been settled that customary international law continues to exist and to apply separately from international treaty law, even where the two categories of law have an identical content.[82] The rules of *jus cogens* could be derived from customs or international treaties participated by large number of nations.[83] The Genocide Convention, 1948 is a good instance of a treaty

[80] Ibid., p. 593. See also, M. Sahovic, 'The Concept of International Law at the end of the Twentieth Century', in *International Law in Transition*, R. S. Pathak and R. P. Dhokalia (eds), New Delhi: ISIL, 1992, p. 90.
[81] G. Handl, 'Environmental Security and Global Change: The Challenge to International Law', *Yb. Int'l Envtl. L.*, 1, 1990, p. 25.
[82] *North Sea Continental Shelf Case*, ICJ Rep. (1969), p. 41. See also, *Case Concerning the Military and Paramilitary Activities in and against Nicaragua (Nicaragua and United States of America)*, ICJ Rep. 1986, para. 173-9.
[83] M. Akehurst, 'The Hierarchy of Sources of International Law', *BYIL*, 47, 1974-75, pp. 284-6.

becoming *jus cogens*. In judging whether the provisions of MEAs like the Montreal Protocol, Basel Convention, CITES or the CBD providing rules for regulating for certain global environmental hazards may be considered to have obtained the *jus cogens* character, the test is to see what the resulting situations would be if those rules were omitted.

Suppose obligations provided in Montreal Protocol relating to use of Ozone-Depleting Substances (ODS) are taken away, the economic and trade activities relating to ODS would be allowed to continue unhindered. The stratospheric ozone layer would deplete fast. The depletion of the ozone layer will have a serious impact on biological life and planetary processes. Such depletion increases the showering of ultraviolet (UV) rays on earth. The green cover of the earth, including aquatic organisms particularly phytoplankton and zooplankton, are quite sensitive to ultraviolet radiation. Their destruction would seriously affect the marine food chain, leading to a slash in species diversity and fish levels. These single-cell aquatic plants (phytoplankton) and eggs and larvae of aquatic animals (zooplankton) are found near the water's surface, and are therefore particularly vulnerable to an increase in solar radiation. Such an increase would seriously disrupt the reproductive capacities and shorten the life spans of these crucial links in the marine food chain.[84] Another facet of such an event would be that an ozone loss-induced reduction in phytoplankton may very well increase the level of atmospheric carbondioxide[85] since phytoplankton, which constitutes 75 per cent of marine plant mass and 25 per cent of terrestrial plant production, is extremely efficient in absorbing the carbondioxide.[86]

The necessary result of such absorption of CO_2 by the 'plant kingdom' maintains the oxygen level in the atmosphere. The result of such absorption is not limited in helping to prevent the increase in greenhouse effect, rather in the process of doing that, the *phytoplankton* continue to create oxygen on which life depends. Higher pollution

[84] Vienna Convention for the Protection of the Ozone layer, 1985, *I.L.M.*, 26, 1987, p. 1518.
[85] CO_2, is chief among the gases which absorb infra-red radiation and trap heat in the lower atmosphere, thereby interfering with earth's 'natural cooling mechanism', thereby creating greenhouse effect.
[86] R. Clarke, *The Greenhouse Gases*, UNEP/GEMS Env't. Libr. No. 1, Nairobi: UNEP, 1987, pp. 13–16.

level resulting from industrial, vehicular, transport or other activities has already been constricting the atmospheric ozone. However the equilibrium in the level of oxygen is maintained by the 'green cover' of earth through the mechanism of 'photosynthesis' and the accompanying chemical process.

Photosynthesis is the process by which simple carbohydrates like sugar are built up in the green leaf. The leaves look green because of the presence of the green pigment called chlorophyll. Chloroplasts (pigments of chlorophyll) in the presence of sunlight (as a source of energy) build up sugar with carbondioxide (CO_2). Now the important 'assimilation' process takes place with the 'photosynthesis' process. The process of 'photosynthesis' is accompanied by the absorption of CO_2 from the air and the liberation of oxygen—

$$6CO_2 + 12H_2O \text{ — — } C_6H_{12}O_6 + 6H_2O + 6O_2$$

Thus oxygen (O_2) escapes from the plant body and starch accumulates in the plants. The process is called 'assimilation'.

The observations prove that O_3-loss-induced eventuality would pose multifaceted hazards for '*life*' to continue. In brief, the relentless showering of UV rays consequent upon ozone depletion led by the unbridled use of ODS, results in the vanishing of aquatic and terrestrial vegetative organisms like phytoplankton, the necessary incident being fast reduction of 'photosynthesis' and 'assimilative' processes. Now the resulting situation would be two fold—the increasing greenhouse effect thereby accelerating the fever of the earth and the lowering down of the level of atmospheric oxygen, the very basis of life.

The aforesaid observations obviously conclude that continuous lapses in coping with ODS in face of another treaty may silently put the mankind at the threshold of nothing, if use of ODS, is not regulated. Thus it can be conclusively said that rules provided in the Montreal Protocol for regulating the use of ODS have acquired the character of *jus cogens*.

The same is true with regard to the provisions of CITES and the CBD, which relate to the protection of endangered species and the Biodiversity Conservation. The pervasive changes are perceived in landscapes that collectively alter the ecological context under which the species on earth have evolved. These changes are usually incremental, masking their effect, yet the changes they bring are profound and insidious. Most species in decline now are suffering the indirect and often subtle effects of changes in ecological processes, such as

patterns of disturbance. These changes are difficult to reverse, and they often pose unexpected threats to inconspicuous species. They also have tended to favour a different class of species, the weedy invaders and exotics, that themselves further threaten and displace native species. Because species losses generally lag behind these environmental changes, losses already imminent will take many years to play themselves out, further masking their cause and full scope. Although subtle and slow to our eyes, these changes ultimately pose greater threats to far more species than the direct threats of yesterday. Whenever conditions deviate significantly from those that prevailed historically, we can expect diversity to decline as those species adapted to historical conditions begin to suffer and sometimes go extinct. Besides this the conservation of biodiversity essentially conserves the 'green cover' of the earth.

Thus the provisions of CITES and the CBD relating to protection of endangered species and the conservation of biodiversity can also be said to have acquired *jus cogens* character. This shows that if the conflict between the GATT/WTO and MEAs is recognized somewhere, the GATT/WTO cannot prevail over the MEAs even on the basis of *lex posterior* rule or otherwise, where global environmental problems have the potential of extinguishing mankind itself. As in the words of Bell, 'Our anthropocentric proclivity must give way to the realization that the Earth is home to many different organisms, which, in some unknown interaction, maintain a proper balance so that one species, *Homo sapiens*, can thrive.'[87]

XIV. Co-Existence of the MEAs and WTO

It is beyond dispute that the relationship between MEAs and international trade rules ought to be synergistic and mutually supportive. Development and ecology are overlapping circles and the terrain of sustainable development is found where they overlap. Development and environment ought to be not an antithesis but a synthesis of each other. Both are complementary, inseparable and represent two faces of the same coin. A creative and constructive link between environment and development ensures sustainability to both. The same is true

[87] D. E. Bell, 'The 1992 Convention on Biological Diversity: The Continuing Significance of US objections at the Earth Summit', *Geo. Wash. J. Int'l L. & Econ.*, 26, 1996, p. 537.

for environment and trade as 'trade' is an essential incident of development. Taking a view, it can be said that 'economic wealth' very much depends on 'environmental health'.

Agenda 21 puts it as follows:

> International cooperation in the environmental field is growing, and in a number of cases trade provisions in multilateral environment agreements have played a role in tackling global environmental challenges. Trade measures have thus been used in certain specific instances, where considered necessary, to enhance the effectiveness of environmental regulations for the protection of the environment. Such regulations should address the root causes of environmental degradation so as not to result in unjustified restrictions on trade. The challenge is to ensure that trade and environment policies are consistent and reinforce the process of sustainable development.[88]

The World Conservation Union (IUCN), which was deeply involved in the development and negotiations of the CITES, sought and received an opinion from the Secretariat of GATT to the effect that the third IUCN draft proposal appeared to be consistent with the preamble of Article XX of GATT.[89] The negotiators of Montreal Protocol have obtained the opinion from the GATT Secretariat indicating that the trade restrictions they were seeking to include in the package of measures designed to protect the ozone layer would fall under the GATT Article XX(b) exception.[90]

In ensuring compatibility between the GATT/WTO and the MEA, the focus goes on Article XX of GATT and Article 27(2) of the TRIPs Agreement. This must be done according to the relevant provisions of the Vienna Convention, specifically Article 31.[91] That Article 31 is applicable to the interpretation of Article XX of GATT and Article

[88] Agenda 21, para. 2.20.

[89] Letter from G. Patterson, Assistant Director-General, Department of Trade Policy, GATT, to F. G. Nichols, Deputy Director-General, IUCN (24 February 1971), *described in* C. Wold, 'Multilateral Environmental Agreements and the GATT: Conflict and Resolutions?', *Envtl. L.*, 26, 1996, p. 845.

[90] D. M. Goldberg, 'The Montreal Protocol', in *The Use of Trade Measures in Select Multilateral Environmental Agreements*, R. Housman, D. M. Goldberg, B. Van Dyke, D. Zaelke, (eds.), Geneva: UNEP, 1995, p. 69.

[91] Vienna Convention, Article 31, *supra* 8.

27(2) of the TRIPs Agreement, has been affirmed by the Appellate Body in *Reformulated Gasoline* case. The Appellate Body noted about Article 31,

> ... it forms part of the 'customary rules of interpretation of public international law' which the Appellate Body has been directed, by Article 3(2) of the DSU, to apply in seeking to clarify the provisions of the General Agreement and other 'covered agreements' of the Marrakesh Agreement Establishing the World Trade Organization... That direction reflects a measure of recognition that the General Agreement is not to be read in clinical isolation from public international law.'[92]

Thus the TREMS should fall within the scope of GATT Article XX(b) and (g) and TRIPs Article 27(2).

The 'context' referred to in Article 31(1) and (2), can be determined by reference to the Preamble to the Agreement establishing the WTO, which explicitly states the 'optimal use of the world's resources in accordance with the objective of sustainable development', seeking both to protect and preserve the environment. These wordings place environmental protection and sustainable development at the heart of the economic objectives of the trading system. The preamble of the WTO showing the objective of sustainable development was re-mentioned in the Ministerial Declaration on establishing CTE in its opening address. This re-mentioning of the objective of 'sustainable development' is worth taking note of.

Some of the proposals made in the CTE have importance to synergise the GATT/WTO and MEAs. Those proposals for an interpretative understanding, would fall in the category of subsequent agreement, as contemplated by Article 31(3)(a) of the Vienna Convention. Thus there is growing evidence of influence of the notion of sustainable development in GATT/WTO practice itself.

Thus Article 31 of the Vienna Convention provides a useful basis for interpreting WTO rules in a manner that preserves the integrity of MEAs. The net result of applying Article 31 then, should be an interpretation of GATT Article XX and Article 27(2) of TRIPs Agreement in such a way that allows WTO members to implement TREMS required by MEAs. Thus it is essential that MEAs and GATT/WTO

[92] *Reformulated Gasoline Appellate Decision*, p. 17.

rules be recognized as being compatible and not in conflict. It has been demonstrated that under the international law of treaties, such compatibility already exists in law. By taking Article 31 rather than Article 30 of the Vienna Convention as the point of departure, constructive steps can be taken to make this *de jure* compatibility a reality.

Chapter 8

Conclusion

I. Compatibility between MEAs and GATT/WTO

There is no inherent conflict between trade and concern for the environment.[1] The continuing healthy existence of flora and fauna is a pre-condition for all human-led industrial, economic, commercial or other activities. Such continuing healthy existence of flora and fauna, in turn depends on good environmental health. Development and environment are not antithetic but congruous with each other. Both are complementary, inseparable and represent two faces of the same coin. In other words from the standpoint of far-sightedness, it can be said that 'economic wealth' very much depends on 'environmental health'. It is beyond and doubt, that economic activity is the life-blood of any human community irrespective of any political delineation. Equally important is clean environment, which acts as oxygen to the blood, without which life-blood will not slow for long. When environmental protection and free trade in the framework of environmentally sustainable development are linked, it means that a long-term perspective is adopted. Sustainable development is inherently intergenerational. This imposes limits on the extent of resource exploitation aimed at maximizing consumption, without concern for

[1] S. Charnovitz, 'The Environment vs. Trade Rules: Defogging the Debate', *Envtl. L.*, 23, 1993, p. 477. See also, C. Wold, 'Multilateral Environmental Agreements and the GATT: Conflict and Resolutions?', *Envtl. L.*, 26, 1996, p. 843.