



The Regulation of International Trade

Michael J. Trebilcock and Robert Howse
3rd Edition

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The Regulation of International Trade

The Regulation of International Trade is the definitive text tracing the origins and development of the world trade regime.

Drawing on a wide variety of classic and contemporary sources, the authors provide a critical analysis of the institutions and agreements that have shaped international trade rules, including the World Trade Organization, the North American Free Trade Agreement and the commercial aspects of the European Union.

Basic principles such as Most Favoured Nation and National Treatment are contextualized, and special sections cover areas such as agriculture, services and the growing debate over trade-related intellectual property rights.

The environment, labour rights and migration are also examined in light of the growing debate over globalization.

Drawing on previous, highly praised editions, but including up-to-date material on the Doha trade round and the growing body of WTO dispute resolution case law, this comprehensive text is an invaluable guide to students of economics, law, politics and international relations.

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*Michael J. Trebilcock
and Robert Howse*

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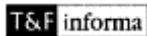
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Preface and acknowledgements

Since the publication of the second edition of this text, perhaps the most remarkable development has been the emergence of an extensive jurisprudence of international trade from the Appellate Body of the World Trade Organization. We set ourselves the task of incorporating the results of this jurisprudence into each of the chapters of this book, including an analytical discussion of rulings that have been particularly controversial, or have given rise to competing interpretations. In addition, we have reorganized the text so as to be able to treat systematically the evolving jurisprudence on two crucial legal norms of the multinational trading system—Most Favoured Nation and National Treatment. The present edition reflects all of the WTO case law that has emerged from the Appellate Body, as well as from the level of first instance (the panels), up to late 2004. We have also inserted discussion of several later rulings that are of special importance to the trading system, but which only became public after the manuscript was already in production.

A further development that has continued and arguably intensified since the last edition of this text is the proliferation of regional and bilateral comprehensive trade agreements. We discuss the significance of this trend in Chapter 6 on tariffs and regional trading blocs. However, we have not attempted to provide a comprehensive overview of the legal provisions or institutional arrangements for each of these new agreements. We do nevertheless attempt in particular chapters to address some of the important generic features that many of these agreements have in common, for instance investor—state dispute settlement provisions (Chapter 14) or ‘TRIPs-plus’ obligations (Chapter 13).

The previous edition was published just before the Seattle WTO Ministerial in 1999, where it became especially evident that the ambitious Uruguay Round project of transforming the GATT free trade regime into a system of mandatory global economic regulation and deregulation had serious legitimacy difficulties. Anyone familiar with our treatment of, for example, intellectual property, subsidies, and sanitary and phytosanitary issues in the previous edition will understand that these difficulties came as no surprise to us. In the case of developing countries, whereas export-led growth based on open markets was the orthodoxy of the 1990s, much of the best economic literature today questions whether free trade and non-interventionist domestic policies will work for all developing countries all of the time. Questions have also been raised about the overall continuing contribution of multilateral trade agreements to the enhancement of economic welfare, most notably by the studies of Berkeley economist Andrew Rose. We have attempted, in a balanced and open-minded fashion, to incorporate these challenges to the free trade orthodoxy in the relevant chapters of this book, whether Chapter 1 on the history and theory of free trade, or for example Chapter 15 on trade and development.

At the time this book went to press early 2005, fragile and limited progress on the issue of agricultural trade suggested that it might be possible to see substantial movement towards closure of the Doha Round of multilateral trade negotiations by the end of 2005. Much work, however, remains to be done, and there are issues both of institutional

architecture and of political will that lurk in the background—some of this we sketch out in the conclusion to this edition.

Finally, writing a volume of this scope and ambition presents an ever-increasing challenge. Specialized literatures in many sub-fields of international trade regulation have ballooned, whether trade and intellectual property, dispute settlement procedures or investment protection. More and more institutions and regimes are producing significant norms and policies for the trading system—whether the UN Human Rights Commission, the International Labour Organization or the Biosafety Protocol. We persist in the belief that a comprehensive overview of the multilateral trading system is of importance and use to both policy-makers and practitioners, as well as serious students—perhaps even of greater importance and use, in an environment of rapidly increasing legal and institutional complexity. At the same time, we do not doubt that we have made numerous errors of both commission and omission in performing this task. We thus welcome comments and corrections from readers, which may be sent to either or both of our email addresses: rhowse@umich.edu or michael.trebilcock@utoronto.ca.

We would like to acknowledge the excellent research assistance of Sara Bickler, Ana Frischtak, Jennifer Smith, Sandy Gill, Michelle Grando and Shiva Giri, and to thank Barry Appleton, Petros Mavroidis, Don Regan, Elizabeth Tuerk, Robert Wai, Craig Scott, Susan Esserman, Gary Horlik, Henrik Horn, Dan Tarullo, Mark Barenberg, Ellen Gould, Alice Palmer, Alan Sykes, Joseph Weiler and Scott Sinclair for responding to queries or providing useful comments on the previous editions. We alone are obviously responsible for all shortcomings, errors and omissions.

Preface, second edition

The first edition of this book went to press between the December 1993 finish to the Uruguay Round negotiations and the Marrakesh meeting, at which those results were formalized. The second edition has given us an opportunity to refine and deepen our understanding of the WTO Agreements negotiated in the Uruguay Round, as well, of course, as to reflect subsequent developments. These developments include the (now stalled) negotiations on a Multilateral Agreement on Investment, the finalization of negotiations on basic telecommunications and financial services under the GATS, and three years of dispute settlement at the WTO, including a number of important rulings by the new Appellate Body. We have also added separate chapters on areas of emerging importance such as trade and labour rights, trade and competition, and health and safety and other technical standards. The dispute settlement policy chapter has been substantially rewritten in light of three years of WTO practice; funding provided by a Canadian Social Science and Humanities Research Council grant to Robert Howse permitted more extensive reflection on the place of dispute settlement and its jurisprudence in the multilateral trading order than would otherwise have been possible, and those familiar with the first edition of the book will notice in this chapter a considerable evolution in our thinking.

We are grateful for the very constructive comments and criticisms of a number of colleagues who have used various parts of the first edition in their work, including in a number of cases classroom teaching. These include: Petros Mavroidis, Henrik Horn, Joseph Weiler, Armand de Mestral, Larry Herman, Benedict Kingsbury, Pierre Sauve, Ernst-Ulrich Petersmann, Kalypso Nikolaides and Dan Trefler. Several of our colleagues at the Faculty of Law have been of great assistance on specific chapters, especially Brian Langille (trade and labour rights), Rosemary Coombe (trade-related intellectual property rights) and Craig Scott (trade and environment, dispute settlement). Superb research assistance and advice was provided by Dan Markel, a JD student at Harvard Law School, and two graduate students at the Faculty of Law, University of Toronto, Jason Levine and Julie Soloway. In the production of the second edition of this book, we benefited from the superb administrative and secretarial skills of May Seto and Margot Hall. All errors and shortcomings are our own.

Preface, first edition

This book is intended to introduce serious students of law, economics, politics and public policy to the institutions and rules that govern trade between sovereign states. Although we are legal academics, we have not written a traditional legal treatise. Instead, we have sought to bring to bear on our analysis of rules and institutions a wide range of disciplinary perspectives. This includes perspectives not only from the various branches of economics (whether trade theory itself or the theory of finance and industrial organization), but also from contemporary political and ethical philosophy and the international relations and political economy literatures.

Although we do discuss extensively the domestic legal regimes of some of the major trading states, most of the law dealt with in this book is international law. There is, of course, an age-old debate as to whether international law is really law in the true sense of the word, as it is not subject to authoritative enforcement by a sovereign. The GATT/WTO, the main legal and institutional framework for multilateral free trade, has frequently been judged against a domestic law benchmark and found wanting. Some theorists of international relations question whether rules and institutions matter at all, except as reflections of much more fundamental power relationships.

Our own perspective is that rules, norms and institutions matter a great deal. We see their function as the provision of a framework or structure that permits long-term mutually beneficial cooperation between states. Hence, we tend to take a neo-liberal or new liberal institutionalist view of international relations. This book is not, however, intended as an application or vindication of this particular theory of international relations, which would require a sustained discussion of the theory of international economic cooperation not well suited to an introductory text. Still, in examining the function and evolution of particular rules and norms, we have not hesitated to take stances based on a neo-liberal view nor to be critical of alternative policy stances premised on power-based realist or positivist views of international economic relations.

In general, we see the evolution and maintenance of an open, liberal trading order as to the mutual benefit of states. This view is not premised upon a naïve or unquestioning adherence to the economic theory of the gains from trade. On the contrary, throughout our analysis we are highly sensitive to the qualifications to and limits on the case for free trade, as well as the complexities involved in determining the domestic interest in these matters—including concerns about unemployment, worker adjustment, the quality of life, and values of human rights and environmental protection. We examine, in a wide range of areas, the multiple challenges that increased economic integration and interdependence pose for domestic and international policy-making. While we frequently see the need to evolve new rules and institutions, or to clarify existing rules and strengthen existing institutions, we also conclude that the basic building blocks of the liberal trading order are not fundamentally defective, and that a protectionist retreat from an open system is likely to reduce both domestic and global welfare.

Compared to the immediacy and directness of the concerns that often result in demands for protectionism—whether job loss within a community or outrage at another state’s environmental policies—the basic rules and norms of the global trading order that constrain protectionist responses often appear arcane or obscure. This applies as well to the jurisprudence that has evolved, especially in the GATT, to interpret those rules and norms. We believe that this impression is inaccurate and that in fact there is considerable clarity and coherence to the rules, with interpretation and application to diverse and rapidly changing circumstances being no more difficult and no easier than with respect to other areas of law. But this impression has partly been created because of the often unnecessarily inaccessible and complex presentation of the rules and jurisprudence by trade law experts and officials, and their frequent lack of interest in reaching a broader intellectual and policy community. Ernst-Ulrich Petersmann notes comments by non-experts that ‘anyone who reads the GATT is likely to have his sanity impaired’ and that there are ‘only ten people in the world who understand the GATT and they are not telling’.¹ This book is a modest attempt to show that, to the contrary, international trade law is no more impenetrable or obscure than any other sophisticated body of contemporary law, when it is clearly explained in terms of fundamental concepts, principles and rules.

The topics covered and general organization of this book reflect a number of years’ experience in co-teaching an introductory course in international trade regulation at the University of Toronto. The course has typically attracted senior undergraduates both in law and in economics, and we have also been fortunate to have the participation of graduate students in both disciplines, many of whom bring perspectives from undergraduate studies and work experience in a wide variety of countries, both developed and developing. Without this sustained and ongoing dialogue with a very diverse and demanding group of students, this book would not have been possible.

We wish to acknowledge excellent research assistance from a number of students or former students at the Faculty of Law, University of Toronto, including Evan Atwood, Ari Blicher, Richard Braudo, John Loukidelis, Karen Powys-Lybbe, Presley Warner, Dan Markel, Julie Soloway and Jason Levine. In addition, on particular chapters, several colleagues and students read earlier drafts or otherwise assisted us with their reflections and advice. In particular, we wish to thank Isis Calder, Kevin Davis, Gary Horlick, Brian Langille, James Odek, Elie Perkins, Craig Scott and Diane Varleau. May Seto coordinated the production process for the manuscript with great skill.

1

The evolution of international trade theory, policy and institutions

AN INTELLECTUAL HISTORY OF INTERNATIONAL TRADE THEORY AND POLICY¹

The central question that must be confronted at the outset of any study of international trade is: why do we need a theory of international trade at all? Why is the analysis of the economic, political and social implications of exchange between traders in two national markets different from the analysis of the implications of exchange between traders within a single national market?

Early thinking on foreign trade

In a marvellously accessible and illuminating intellectual history of free trade, *Against the Tide*,² Douglas Irwin traces views on the virtues and vices of foreign trade back to early Greek and Roman writers. Their views generally reflected a high degree of ambivalence about trading with foreigners, mainly for non-economic reasons. First, merchants or traders of whatever origins were often regarded as of an inferior social class. This general hostility to merchants and commercial activity was accentuated in the case of foreign traders, where contact with strangers could disrupt domestic life by exposing citizens to the bad manners and corrupt morals of barbarians. On the other hand, some early writers (such as Plato) acknowledged the gains from specialization or division of labour, although they were reluctant to extend the implications of this acknowledgement explicitly to foreign trade.

Other writers (such as Plutarch) took the view that God created the sea, geographic separation and diversity in endowments in order to promote interactions through trade between the various peoples of the earth. This doctrine of universal economy was developed by philosophers and theologians in the first several centuries AD, although dominant strands in medieval scholastic thought (reflected, for example, in the writings of St Thomas of Aquinas) continued to be suspicious about commercial activity and to worry that contact with foreigners would disrupt civil life. Natural law philosophers of the seventeenth and eighteenth centuries (such as Grotius) sought to resurrect the doctrine of universal economy, justifying a largely unconstrained freedom to trade on the basis of the law of nations (*jus gentium*).³

Mercantilism

However, none of these early views on international trade were primarily based on economic arguments, although (as we will see) they have continued to recur in one form or another even in contemporary debates over free trade. In the seventeenth and eighteenth centuries a school of thought often referred to as mercantilism emerged in Britain and the Continent that was explicitly economic in its foundations. While not hostile to commercial activity generally or to international trade in principle, mercantilists argued for close government regulation of international trade for two principal reasons: (1) to maintain a favourable balance of trade, which argued for aggressive export but restrictive import policies (although how foreigners were to pay for imports without the ability to export was never adequately explained); and (2) to promote the processing or manufacturing of raw materials at home, rather than importing manufactured goods, which would displace domestic production and employment; hence arguments for export taxes on exported raw materials and import duties on imported manufactured or luxury goods.

The origins of the economic case for free trade

These two central tenets of mercantilist theories of international trade were fundamentally attacked and undermined, at least as a matter of theory, if not as a matter of policy, in the second half of the eighteenth century. The first argument for restricting foreign trade reflected a concern that international trade may give rise to an inadequate supply of circulating monetary gold as a result of balance of payment deficits. Silver and gold were mainstays of national wealth and essential to vigorous commerce. Hence the appropriate policy goal was perceived to be the maintenance of a continuing surplus in the balance of payments, i.e. sell more to foreigners than one buys from them. Imperial rivalries also led to political concerns about the transfer of *specie* into foreign hands and in part explain colonization efforts in the eighteenth and nineteenth centuries where colonies were seen as a source of raw materials and an outlet for manufactured goods. However, David Hume, in 1752, demonstrated that, through the *price-specie*-flow mechanism, international trade was likely to maintain an equilibrium in the balance of payments. If a country found itself with surplus currency, domestic prices would tend to rise relative to prices of foreign commodities, and money would flow out of the country. If a country found itself with a shortage of currency, domestic prices would become depressed and would attract foreign currency until the shortage had disappeared.⁴

Adam Smith, in the *Wealth of Nations* (1776), mounted a broader assault on mercantilist theories, in particular the second or commodity composition argument for restricting trade, and argued that the case for gains from specialization in domestic economic activities applied equally to specialization in international trade:

What is prudence in the conduct of every private family can scarcely be folly in that of a great kingdom. If a foreign country can supply us with a commodity cheaper than we can make, better buy it of them with some part of the produce of our own industry.⁵

Thus, to take some simple examples, if countries with tropical climates can produce bananas or pineapples more cheaply than countries with temperate climates, the latter should purchase these products from the former. Conversely, if countries with industrialized economies can produce hydro-electric plants or communications systems more cheaply and of better quality than those that could be produced by countries that enjoy a cost advantage in producing tropical goods, the latter should buy these products from the former. In domestic economic activities, most of us accept that it makes no sense for an individual to try to produce all his or her own food, clothing, medical services, dental services, home construction services, etc., but rather to specialize in producing some goods or services for others and perhaps for some limited subset of his or her own needs, while purchasing requirements to meet remaining needs from others who specialize in their production. It is equally easy to appreciate the force of this argument for free trade within nation-states. For example, in a large federal state like the USA, Michigan specializes in producing automobiles (*inter alia*), Florida citrus fruit and tourism, Texas oil and beef, and California wine and high technology products. If each state of the USA were to have attempted to become self-sufficient in these and all its own needs, the USA would today be immeasurably poorer. It equally follows, on Smith's theory, that similar specialization is likely to generate mutual gains from trade in international exchanges—the division of labour is limited only by the extent of the market. It is important to note that on Smith's theory, *unilateral* trade liberalization would be an advantageous policy for a country to pursue, irrespective of the trade policies pursued by other countries.

The theory of comparative advantage

A central question left open by Smith's Theory of Absolute Advantage (as it came to be called) was: what if a country has no absolute advantage over any of its potential trading partners with respect to any products or services? Is international trade of no relevance or value to it? David Ricardo, in his book *The Principles of Political Economy*, published in 1817, answered this question with a shattering insight that continues to form the basis of conventional international trade theory today. His insight has come to be called the Theory of Comparative Advantage. He advanced this theory by means of a simple arithmetic example. In his example, England could produce a given quantity of cloth with the labour of 100 men. It could also produce a given quantity of wine with the labour of 120 men. Portugal, in turn, could produce the same quantity of cloth with the labour of 90 men and the same quantity of wine with the labour of 80 men. Thus, Portugal enjoyed an absolute advantage over England with respect to the production of both cloth and wine, i.e. it could produce a given quantity of cloth or wine with fewer labour inputs than England. However, Ricardo argued that trade was still mutually advantageous, assuming full employment in both countries: when England exported to Portugal the cloth produced by the labour of 100 men in exchange for wine produced by 80 Portuguese, she imported wine that would have required the labour of 120 Englishmen to produce. As for Portugal, she gained by her 80 men's labour cloth that it would have taken 90 of her labourers to produce. Both countries would be rendered better off through trade.

Another way of understanding the same intuition is to imagine the following simple domestic example.⁶ Suppose a lawyer is not only more efficient in the provision of legal

services than her secretary, but is also a more efficient secretary. It takes her secretary twice as long to type a document as it would if the lawyer typed it herself. Suppose, more specifically, that it takes the lawyer's secretary two hours to type a document that the lawyer could type in one hour, and that the secretary's hourly wage is \$20, and that the lawyer's hourly rate to clients is \$200. It will pay the lawyer to hire the secretary and pay her \$40 to type the document in two hours while the lawyer is able to sell for \$200 the hour of her time that would otherwise have been committed to typing the document. In other words, both the lawyer and the secretary gain from this exchange. These examples, in an international trade context, generalize to the proposition that a country should specialize in producing and exporting goods in which its comparative advantage is greatest, or comparative disadvantage is smallest, and should import goods in which its comparative disadvantage is greatest.

An unfortunate semantic legacy of Ricardo's demonstration of the gains from international trade, perpetuated in the terminology of much subsequent trade literature and debate is that in international trade *countries* are trading with each other. This, of course, is rarely the case. As in purely domestic exchanges, *private economic actors* (albeit located in different countries) are trading with each other. In its most rudimentary form, all that international trade theory seeks to demonstrate is that free international trade dramatically broadens the contract opportunity set available to private economic actors and hence the mutual gains realizable from exchange as parties with different endowments of specialized resources or skills are able to reap the gains from their differential advantages and disadvantages through trade.

It may be argued that in international exchanges, in contrast to domestic exchanges, part of the gains from exchange are realized by foreigners, and that a country would be advantaged by capturing all the gains from exchange for itself. However, this raises the question of whether the domestic gains foregone by foreign trade are greater or less than the additional gains from purely domestic exchange. As a matter of simple economic theory, the gains to domestic consumers from foreign trade will almost always be greater than the additional gains to domestic producers from purely domestic trade. This is so because higher domestic than foreign prices will entail a transfer of resources from domestic consumers to domestic producers (arguably creating matching decreases and increases in welfare), but *in addition*, some domestic consumers will be priced out of the market by the higher domestic prices and will be forced to allocate their resources to less preferred consumption choices, entailing a deadweight social loss. An alternative way in which to conceive of the net domestic loss from foregone foreign exchange opportunities is to ask what compensation domestic producers would need to offer domestic consumers to render them indifferent to these foregone opportunities. Presumably only domestic prices that matched foreign producers' prices would achieve this end.

The Factor Proportions Hypothesis

While Ricardo's theory of comparative advantage still constitutes the underpinnings of conventional international trade theory, his theory has been refined in various ways by subsequent analysis. Ricardo's theory, for example, assumed constant costs at all levels of production which led to the conclusion that a country would specialize completely in the goods where its comparative advantage was greatest (wine in the case of Portugal) or

its comparative disadvantage smallest (cloth in the case of England), but this hypothesis rarely seemed to fit the facts. For example, Portugal produced both wine and some cloth. Ricardo's theory was thus modified to take account of increasing opportunity costs. For example, by releasing resources from cloth-making it would not necessarily follow that the addition of these labour inputs to wine-making would continue to increase wine production in constant proportions, especially if the factor proportions in the two activities were different, e.g. cloth-making is labour-intensive while wine-making is land-intensive. In other words, once more than one factor of production was taken into account, it became obvious that combining land and labour at ever-increasing levels of output would not necessarily entail similar costs, as the land brought into production at higher levels of output may well (and typically would) be less productive and require more intensive use of labour. On the other hand, the opposite phenomenon may sometimes be true, that is, that decreasing costs may be associated with increased scale of operations or levels of output, and may lead to complete international specialization.

Recognition of these considerations led to a reformulation of Ricardo's theory of comparative advantage—often referred to as the Factor Proportions Hypothesis (or the Heckscher-Ohlin Theorem, after two Swedish economists who formulated the theorem in the 1920s). According to the Factor Proportions Hypothesis, countries will tend to enjoy comparative advantages in producing goods that use their more abundant factors more intensively, and each country will end up exporting its abundant factor goods in exchange for imported goods that use its scarce factors more intensively.

While the Factor Proportions Hypothesis seems to explain adequately patterns of international specialization in many activities, particularly agriculture and natural resources, it tends to provide a less satisfactory explanation of patterns of specialization in manufacturing activities in modern industrialized economies, where it is common to observe countries specializing in different segments of the same or closely analogous product markets, and simultaneously exporting and importing products in these sectors. Intra-industry trade has accounted for a very high percentage of the total increase in international trade in recent decades.⁷ The Factor Proportions Hypothesis assumes that all countries have access to identical technologies of production and that the list of goods which are traded is somehow exogenously given and unaltered by economic activity. However, patterns of specialization and comparative advantage are not exclusively exogenously determined, but are likely to turn in part on a number of endogenous variables, such as savings and capital accumulation rates in different countries; the levels and patterns of investment in specialized human capital, reflecting the country's commitment to investments in education and research and development; and public infrastructure such as transportation and communication systems, which again reflect patterns of collective investments. On this view, comparative advantage is a much more dynamic notion than the static notion implicit in the original formulation of the Factor Proportions Hypothesis, and moreover recognizes the role that governments can play, through a variety of public policies, in shaping comparative advantage over time.

It is also important to note that classical trade theory, as described above, assumed that physical output from production was (subject to transportation costs) mobile across nations but that factors of production, while in most cases mobile within countries, were immobile across nations. While this obviously remains true of land, it has become dramatically less true of financial capital, technology, human capital, and even people, in

large part because of advances in communication and transportation technologies. Thus, trade theory has historically focused on *international trade in goods* (a focus reflected in the initial preoccupations of the GATT), and not international mobility of services, capital or people. This focus has been increasingly challenged, as reflected in a rapidly changing trade policy agenda.

The Product Cycle Theory

Largely reflecting the less static and more dynamic conception of comparative advantage noted above, in the 1960s Raymond Vernon of the Harvard Business School formulated a Product Cycle Theory of trade in manufactured goods to explain patterns of international specialization in manufacturing.⁸ According to Vernon's Product Cycle Theory, the USA and other highly developed and industrialized economies, reflecting their superior access to large amounts of financial capital and highly specialized forms of human capital, would enjoy a comparative advantage in the research and development-intensive stage of product innovation. This stage would focus initially on servicing a small, domestic, custom-oriented market. The second stage in the product cycle would see production expanded to cater to a mass domestic market. The third stage would see products exported to other countries and perhaps parent companies setting up subsidiaries in other countries to undertake manufacture there (the phenomenon of the Multinational Enterprise). A further stage in the product cycle would see the production technology becoming highly standardized and adopted by producers in other countries, particularly countries with lower labour costs, and products perhaps then being exported by these countries back to the USA or other countries where the innovations had originated. According to Vernon, quasi-rents could be earned by domestic firms early in the product cycle, but these rents would be dissipated as the product moved to later stages in the cycle, and comparative advantage shifted to other countries.

The Product Cycle Theory of international trade in manufactured goods seems to explain reasonably well patterns of specialization observable in many countries in the 1950s and 1960s. It has become less compelling over the last two decades, as an increasing number of countries, like Japan and other newly industrializing countries (NICs), have acquired many of the same comparative advantages as the older industrialized economies in early stages of the product cycle, through access to large domestic and international sources of capital that have become increasingly mobile, and through investments of their own in the human capital required to achieve a comparative advantage in the early stages of product innovation and manufacture.

The growing recognition that comparative advantage is not exclusively ordained by nature but is in significant part, at least in manufacturing and services, the product of deliberate government policies has led to an increased focus in many domestic policy settings on issues of so-called industrial policy and, at an international level, concerns and accusations over whether foreign governments' domestic policies are unfairly shaping or distorting comparative advantage.⁹ These are issues that we take up in more detail in various contexts later in this book. However, beyond these issues, several long-standing qualifications to the case for free trade, in both economic and non-economic terms, should be briefly noted at this juncture.

Qualifications to the case for free trade

Reciprocity

While classical trade theory emphasized the advantages of unilateral trade liberalization over the protectionist base case, taking the trade policies of trading partners as a given, it is obviously the case that a country is likely to realize additional economic advantages from trade liberalization if it can persuade its trading partners liberalize their trade policies too, thus generating benefits on both the import and the export sides. This raises complex strategic issues for the first country. The modern trade literature distinguishes two kinds of reciprocity—passive and aggressive reciprocity¹⁰ Pursuing a strategy of passive reciprocity, a country might simply decline to reduce any of its existing trade restrictions until its trading partners agree to reduce some of their trade restrictions. However, if the trading partners appreciate that it is in the first country's interests to liberalize trade whatever the former do, they may choose to withhold any concessions in the hope of gaining the benefits of the first country's trade liberalization for free. This is a classic Prisoner's Dilemma problem, which may inhibit trade liberalization and lead to an inefficient outcome in which everyone is worse off. On the other hand, the trading partners may realize that it could be difficult from a political standpoint for the first country to liberalize on the import side without being able to enlist the support of its export-oriented producers and moderate the effects of contraction in its import-sensitive industries with growth in its export industries. In this case, a strategy of passive reciprocity may produce a mutual agreement on trade liberalization.

A strategy of aggressive reciprocity might take any of several forms.¹¹ Where two countries have previously negotiated a reciprocal trade agreement, in the absence of a supranational authority with the ability to enforce the agreement, the threat of retaliation for breach of or defection from the agreement may be the only effective means of ensuring that the agreement is effectively self-enforcing.¹² Retaliation here is likely to entail withdrawal of previous concessions in the hope that this (or the threat thereof) will induce the breaching country to fulfil its prior commitments. Where countries must deal with each other indefinitely, this tit-for-tat strategy may solve repeated Prisoner's Dilemma games by ensuring cooperation rather than defection.¹³

More controversial forms of aggressive reciprocity (unilateralism) entail threats by one country to withdraw previous concessions or impose new trade restrictions if trading partners persist in engaging in policies that are perceived by the first country to impact unfairly on its interests—e.g. subsidies in the case of imports, or distribution tie-ups in the case of exports. Adam Smith himself was prepared to contemplate retaliatory reinstatement of previous trade restrictions where foreign countries were maintaining restrictions on imports, although he was concerned that where there was no certainty that retaliation ('revenge') would induce removal of the restrictions, retaliation would simply impose unnecessary costs on domestic consumers.¹⁴ The most prominent contemporary example of such a strategy is the discretionary retaliation provisions of the so-called 'Super 301' regime adopted by the USA in the Omnibus Trade and Competitiveness Act of 1988 which may be invoked where a foreign country's policies are found by the US Trade Representative to be 'unreasonable or discriminatory' and to burden or restrict United States commerce.¹⁵ Here the threat of retaliatory trade restrictions is primarily

designed to induce foreign countries to modify policies or practices that the US government believes are unfairly impeding US exports into foreign markets (the so-called ‘crowbar’ theory of trade policy). A major problem with this form of aggressive reciprocity (unilateralism) is that it often reflects very divergent understandings of existing obligations—on the one hand, that a foreign country is cheating on at least the spirit of previous reciprocal commitments, or on the other hand, that the country threatening retaliation is attempting to coerce new unreciprocated trade or other concessions from foreign countries and is itself cheating on prior commitments by threatening their withdrawal. While in some circumstances the threat of retaliation may involve ‘cooperative’ solutions to trade disputes, in other cases ‘feuds’ (counter-retaliation) or ‘stalemates’ may ensue.¹⁶ Where cooperative solutions do emerge, they may reflect bilateral ‘deals’ that are antithetical to a non-discriminatory international trading order and may conduce to ‘collusive’ or managed forms of trade that diverge substantially from the liberal trade ideal. However, some authors argue that, once one takes into account the transaction costs entailed in monitoring for cheating on, and ensuring compliance with, complex international agreements that lack an effective third-party enforcement mechanism, these arrangements may be the best that can be achieved. While falling short of the (unattainable) first-best liberal trade ideal, they may prevent the world trading system from degenerating into total autarchy or anarchy.¹⁷

In any event, while reciprocity in any of its various forms played a marginal role in the classical economic theory of trade, it is absolutely crucial to understanding the evolution of the institutional arrangements, both domestic and supranational, that govern international trade, which are reviewed later in this chapter.

The optimal tariff

A second qualification to the case for free trade, recognized at a relatively early stage in the evolution of trade theory, is the concept of the so-called *optimal tariff*. On this theory, countries that account for a very high proportion of international demand for a certain good may, through their governments acting as ‘cartel’ managers for consumers, possess a significant degree of monopsony power, which they can exercise to their advantage by the imposition of a tariff which changes the terms of trade by forcing firms in exporting countries to reduce the price of their products and in effect absorb the tariff. Consumers in the importing countries continue to pay the same price for the goods, but their governments capture additional revenue from foreign exporters through the tariff. Bagwell and Staiger, in a recent book,¹⁸ argue that the centrality of principles of reciprocity and non-discrimination in the GATT can be explained as an attempt by countries (particularly larger countries) to escape from a terms-of-trade driven (non-cooperative) Prisoner’s Dilemma where each country, acting unilaterally, has incentives to adopt trade policies (e.g. tariffs on imports, taxes on exports) that externalize a high proportion of the costs of its trade policies onto foreigners. While maximizing national welfare, these policies are likely to reduce global welfare and, if replicated by foreign countries, are also likely to reduce national welfare. The beggar-thy-neighbour trade policies adopted by many countries during the Great Depression are viewed as exemplifying this danger.

Infant industries

A third and equally long-standing qualification to the conventional case for free trade pertains to the case of *infant industries*.¹⁹ As John Stuart Mill argued,²⁰ along with other writers like Alexander Hamilton in the USA in the late eighteenth century and Friedrich List in Germany in the late nineteenth century, in the early stages of a country's economic development there may be a case for the imposition of protective tariffs or quotas to allow infant industries, in particular infant manufacturing industries, to develop, by servicing a protected domestic market, to a scale and level of sophistication that will subsequently permit them both to compete with imports and even more desirably to become effective exporters in their own right. This argument has exerted a significant and enduring influence on international trade theory and policy over the past century and a half. It was centrally relied on by the USA and Canada in maintaining a high tariff policy throughout most of the nineteenth century and the first quarter of the twentieth century. It has been relied on by less-developed countries (LDCs) in the post-Second World War era to justify 'special and differential status' under the GATT in protecting their domestic markets and promoting import substitution policies. It is also, more controversially, claimed to have been a central strategic element in the rise of Japan as a major industrial power. In part, the infant industry argument rests on the proposition that an advanced, mature economy cannot be predominantly dependent upon agriculture or natural resources for its exports, but requires a substantial manufacturing base, partly in order to diversify its economic activities and employment base, reducing the risks associated with excessive reliance on a narrow base of commodity exports, which may be subject to high price (and income) volatility and deteriorating terms of trade relative to manufactured imports, and partly for non-economic reasons associated with national pride in being on the technological frontier along with other advanced countries and providing a concomitant number and range of challenging employment opportunities to its more highly educated or trained citizenry. However, it bears pointing out that some countries have sustained high standards of living without substantial manufacturing sectors, e.g. New Zealand and Denmark through agriculture, Middle Eastern oil-producing states through natural resources. Moreover, it has proven extraordinarily difficult to specify with analytical rigour the key parameters of the infant industries exception—why private capital markets cannot identify long-term opportunities; why governments are better able to do so; whether there are positive externalities from investments in infant industries that are not captured in private investment calculi; whether governments are likely to be vulnerable to capture by rent-seeking special interests in the initial decision to promote, and subsequent decisions to sustain, an infant industry.²¹

Strategic trade theory

A contemporary variant on the infant industry argument entails an elaboration on, and application to, the international trade context of the concept of imperfect competition initially developed by Edward Chamberlin and Joan Robinson in the 1930s. Here, it is argued that many modern manufacturing industries fall somewhere between the polarities of the neo-classical economic concepts of monopoly and perfect competition, i.e. essentially oligopolistic industries where prices do not necessarily reflect costs and where quasi-rents can be realized by firms (and hence countries) able to acquire strategically

dominant positions in industries in which increasing returns to scale imply that there is room for only a handful of firms in the global market. In this respect, it is argued that an important role can be played by domestic governments through research and development subsidies, export subsidies, procurement policies, related industrial policies, and import restrictions designed to allow firms to realize economies of scale initially in a protected domestic market, in promoting so-called Schumpeterian industries. This has led to the emergence of Strategic Trade Theory,²² where it is argued that governments can promote their national interests by assisting firms to establish pre-emptive, first-mover, positions in markets, and to realize learning-curve advantages, in part by maintaining entry barriers to potential competitors. Again, this is a highly controversial aspect of modern international trade theory. Subsequent research has revealed that strategic theory is highly sensitive to a number of key variables: the number of firms in the domestic industry, ease of entry, whether firms choose prices rather than quantities in order to maximize profits, whether targeted industries draw upon a common critical factor of production, the extent of foreign ownership in targeted sectors, and the potential reactions of governments of foreign countries and competitors or potential competitors based there.²³ Nevertheless, the dramatic growth of export sectors in many of the so-called 'Asian Tigers' in recent decades is often attributed to strategic trade policies.

Revenue-raising considerations

Another long-standing qualification to the case for free trade relates to the *revenue-raising* potential of customs duties. In many industrialized countries, it was not until early in the last century that income taxes (direct taxes) provided the primary source of government revenues. Until this time, customs duties and, to a lesser extent, export taxes were a major source of government revenues. Even today, in developing countries with large informal economies where internal income taxes are difficult or impossible to administer and collect, import and export taxes constitute a major source of government revenue-raising capabilities.

National security considerations

A long-standing non-economic qualification to the case for free trade relates to *national security* considerations. These may arise on both the import and the export sides. With respect to imports, it is argued that there may sometimes be a case for restrictions in order to protect domestic industries which, even though not internationally competitive, may be required in the event of war or other international disruption. Thus, industries such as the steel and shipbuilding industries have often been protected on this basis, although the concept of national security has proven highly elastic, being invoked to justify restrictions on such unlikely imports as clothes pegs from Poland, on the grounds that domestic productive capabilities in clothes pegs would be required in the event of hostilities with the (former) communist bloc countries. On the export side, national security considerations have sometimes been invoked to restrict exports of strategically sensitive products or military materiel to 'unfriendly' foreign countries.

Objections to free trade

The public perturbations leading up to and surrounding the Seattle Ministerial meetings of the WTO in late 1999, and subsequent civil disturbances in Washington, Quebec City, and Genoa, confirmed dramatically, unambiguously, and probably irreversibly that trade negotiations and trade disputes have moved out of the quiet and obscure corners of trade diplomacy and become matters of ‘high politics’. Despite these disturbances, it is important to bring some measure of rigorous detachment to the evaluation of the criticisms that have been widely and vehemently directed at the WTO, especially by the NGO community. The WTO and international trade liberalization generally are accused of creating a global monoculture, increasing inequality, harming the environment, health and safety, human rights, and leading society (undesirably) away from self-sufficiency. Another common allegation is that the WTO is undemocratic and unaccountable and improperly constrains domestic political sovereignty.²⁴ Here we will argue that these objections are mostly unfounded.²⁵ (Note: What follows on the globalization debate was drafted by Michael Trebilcock; Robert Howse shares many of these observations but also has a different perspective on some of these matters.)

CLAIM 1: GLOBALIZATION IS LEADING TO A GLOBAL MONOCULTURE

This claim comes in various strands, some more critical than others. Naomi Klein in her book, *No Logo*, argues: ‘Despite the embrace of polyethnic imagery, market-driven globalization doesn’t want diversity; quite the opposite. Its enemies are national habits, local brands and distinctive regional tastes.’²⁶

In an economic vein, Thomas Friedman, in *The Lexus and the Olive Tree*²⁷ argues that there are no longer any ideological alternatives to free market capitalism, (although pacing of adjustment may vary), if a country wants to achieve higher standards of living. He terms a country’s acceptance and application of this ideology the “Golden Straightjacket” and argues that, while the Golden Straightjacket improves a country’s prospects for growth and higher average incomes, it also constrains political and economic choice by limiting available options. He notes:

To fit in the Golden Straightjacket a country must either adopt, or be seen as moving toward, the following golden rules: making the private sector the primary engine of its economic growth, maintaining a low rate of inflation and price stability, shrinking the size of its state bureaucracy, maintaining as close to a balanced budget as possible, if not a surplus, eliminating and lowering tariffs on imported goods, removing restrictions on foreign investment, getting rid of quotas and domestic monopolies, increasing exports, privatizing state-owned industries and utilities, deregulating capital markets, making its currency convertible, opening its industries, stock and bond markets to direct foreign ownership and investment, deregulating its economy to promote as much domestic competition as possible, opening its banking and telecommunications systems to private ownership and competition and allowing its citizens to

choose from an array of competing pension options and foreign-run pension and mutual funds.²⁸

Francis Fukuyama in *The End of History*²⁹ argues apocalyptically that the final triumph of economic and liberalism is occurring and, while this is generally to be welcomed, he worries that it may presage a material blandness and homogeneity and lack of engagement with great ideas that ideological conflicts in the past have provoked.

In responding to these claims of cultural, social and economic homogenization, it must be re-emphasized that it is crucial to the basic economic theory of international trade that comparative advantage results from exploiting differences, not similarities, in production. Indeed, international trade enables countries to accentuate rather than minimize their differences by specializing in economic activities where endowments permit a degree of specialization that confers comparative advantages on them relative to other countries, who in turn should pursue a similar strategy of specialization, thus creating the potential for mutually beneficial trade. This is observable not only across countries but also within countries. Largely unconstrained internal trade has not obliterated, but rather accentuated these differences. Largely unconstrained international trade has had, and will have, similar effects on differences among nations. The stringency of the Golden Straightjacket is also greatly exaggerated by Friedman. Capitalist regimes vary greatly from one country to another e.g. Japan, Singapore, China, Sweden, Germany, Canada, and the USA.

Second, the claim that diversity is the enemy of efficiency is false. While it may be true that in some industries like fast foods and hotel chains, many consumers want assurances of quality consistency across multiple locations, in many, perhaps most industries, the most successful competitive strategy is to differentiate one's products from those of other providers, whether this is in men's and women's fashions, automobiles, consumer durables, restaurants, etc. Merely mimicking rivals' product offerings and then competing strictly on price and cost is often a recipe for economic oblivion, as opposed to offering consumers with distinctive preferences what they want. That corporations could, or want to, homogenize all consumer preferences globally is belied by the huge and proliferating diversity of product and service offerings that one sees in markets all over the world.³⁰

Third, as to what exactly the litmus test is for the claim of increasing homogenization of culture is far from clear. *The Economist* argues that brands are not as powerful as Klein suggests. In fact, consumers' brand loyalty has been declining in recent years, and many previously established brands are suffering in terms of both customer loyalty and value.³¹ While it may be the case that certain aspects of popular culture such as mass entertainment and mass consumer products have achieved a degree of world-wide consumption appeal, the claim sometimes made that every place is becoming every place else and that there is no point even in leaving home is belied by the most casual observations derived from travelling in various parts of the world, such as Latin America, Africa, the South Pacific, Western Europe, and Central and Eastern Europe, where cultural, social, and economic differences in both production and consumption remain huge.

Indeed, these differences, in many respects, translate into disparities that are unconscionable in the modern world. As Amartya Sen argues in his recent book, *Development as Freedom*³², the basic goals of development can be conceived of in

universalistic terms where individual well-being can plausibly be viewed as entailing certain basic freedoms, irrespective of cultural context: freedom to engage in political criticism and association; freedom to engage in market transactions; freedom from the ravages of preventable or curable disease; freedom from the disabling effects of illiteracy and lack of basic education; freedom from extreme material privation. According to Sen, these freedoms have both intrinsic and instrumental values. While obviously different countries and cultures will seek to vindicate these freedoms in different ways, the challenge facing most poor developing countries in the world today is to realize these basic freedoms as most citizens of developed countries have already been privileged to do. More homogeneity of values, especially liberal values, would also seem a small price to pay for avoiding the huge human costs of ethnic and religious conflicts³³ that, despite Fukuyama's claim, seem, if anything, to be proliferating in many parts of the world.

Fourth, the WTO in its rules and trade dispute rulings is not unsympathetic to efforts by countries to protect culturally distinctive activities from foreign competitive encroachment, e.g., domestic film, television, and magazine industries. Article IV of the GATT explicitly allows for quotas on foreign films. In addition, Canada negotiated for itself a more general, qualified exemption for its cultural industries under the Canada-US Free Trade Agreement and NAFTA. While the WTO Appellate Body in the *Split-Run Periodicals*³⁴ case struck down features of Canadian policies designed to promote the domestic magazine industry, its decision still leaves open to the Canadian government a wide range of measures to support this and similar culturally sensitive industries—indeed superior mechanisms than those employed in the past, which have focused on subsidizing or protecting domestic inputs, rather than subsidizing distinctive informational outputs.³⁵

Finally, if one was really to avoid the consequences of cosmopolitanism, trade barriers would hardly be enough—there would also be a need for strict censorship laws, exit visas, limits on immigration and ethnic and religious diversity, and other measures aimed at maintaining the insulation of communities from external influences, with highly uncongenial implications for repressiveness and intolerance. As Sen argues,³⁶ citizens in developing (and other) countries should be assured of the right to freely choose which traditional cultural values and practices to preserve, which to modify, and which to abandon. This is a freedom which others have no right to deny to them.

CLAIM 2: TRADE LIBERALIZATION EXACERBATES INEQUALITIES OF WEALTH WITHIN AND AMONG NATIONS

Despite what some globalization critics argue, most economists find empirically that open economies tend to grow faster.³⁷ Indeed, amongst developing countries, it is difficult to identify countries with strong growth records that are not aggressive exporters (and concomitant importers). Table 1.1 (drawn from Williamson),³⁸ illustrates this fact.

Whether trade liberalization exacerbates income inequalities within or between countries is more controversial. In a recent survey of the evidence, Williamson reports a dramatic divergence in incomes around the globe over the past two centuries, which has been driven overwhelmingly by the rise of between-nation inequality, not by the rise of inequality within countries, as depicted in Figure 1.1 (drawn from Williamson).³⁹

While it is true that the earnings of low-skilled American workers relative to high-skilled workers have declined in recent years, most empirical studies show that increased

trade with low-wage developing countries may account for at most 20% of this reduction, and most of

Table 1.1 Trade-policy orientation and growth rates in the third world, 1963–92

	<i>Average annual rates growth of GDP per capita (%)</i>		
<i>Trade policy orientation</i>	<i>1963–73</i>	<i>1973–85</i>	<i>1980–92</i>
Strongly open to trade	6.9	5.9	6.4
Moderately open	4.9	1.6	2.3
Moderately anti-trade	4.0	1.7	–0.2
Strongly anti-trade	1.6	–0.1	–0.4

Sources and notes: adapted from Lindert and Williamson (2002a: Table 3) based on World Bank data. In all periods the three strongly open economies were Hong Kong, South Korea and Singapore. The identities of the strongly anti-trade countries changed over time. In 1963–73, they were Argentina, Bangladesh, Burundi, Chile, Dominican Republic, Ethiopia, Ghana, India, Pakistan, Peru, Sri Lanka, Sudan, Tanzania, Turkey, Uruguay and Zambia. For the two overlapping later periods, the strongly anti-trade countries were the previous 16, *plus* Bolivia, Madagascar and Nigeria, *minus* Chile, Pakistan, Sri Lanka, Turkey and Uruguay.

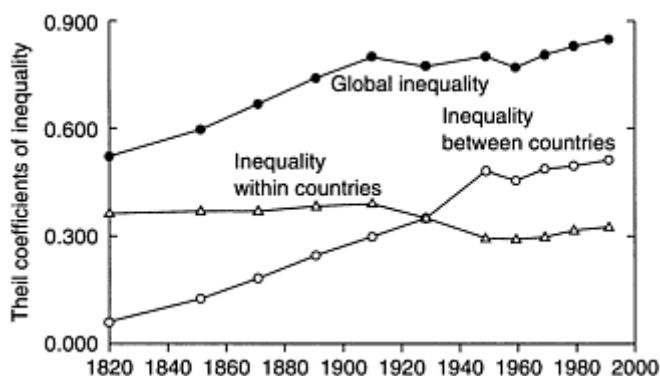


Figure 1.1 Global inequality of individual incomes, 1820–1992.

the increase in the wage gap between skilled and unskilled workers is attributable to technological change and rapidly declining rates of unionization.⁴⁰ The return to highly specialized human capital in an increasingly knowledge-based economy has increased while the demand for much low-skilled labour has been reduced by technological innovation. Moreover, as Paul Krugman⁴¹ and many other economists have pointed out, the growth rate of living standards essentially equals the growth rate of domestic productivity—not productivity relative to competitors, but simply domestic productivity. Even though world trade is larger than ever before, national living standards are overwhelmingly determined by domestic factors rather than competition for world markets. In the case of the USA, exports are only 10% of GNP, which means that the USA is still almost 90% an economy that produces goods and services for its own use. To the extent that international trade increases domestic productivity, it will enhance domestic incomes on average. In terms of employment effects, jobs lost in import-impacted sectors will typically be replaced by jobs in export-oriented sectors.⁴² Thus, international trade has little to do with declining relative living standards of unskilled workers in the USA; to the extent that it does, an argument needs to be made as to why mostly poor, developing countries should be denied the opportunity of utilizing their comparative advantage in low-wage, low-skilled labour by investing in manufacturing sectors that capitalize on this advantage, or indeed in pursuing outsourcing opportunities for higher skilled but relatively lower cost labour, and in pursuing export-led growth policies, which in turn enable them to buy developed countries' exports. However, in recognizing this comparative advantage, it is important not to exaggerate it. Data show almost a one-to-one relationship between labour productivity and labour costs in manufacturing across a wide range of countries.⁴³ Thus, it is a fallacy to assume that low wages are the driving force behind today's global trade. This relationship also explains why internationally most firms are not seeking to relocate e.g. to Bangladesh, despite its low wages. While international trade theory suggests that international trade will generate a tendency to factor price equalization, this is only true, *inter alia*, after adjusting for differences in factor productivity.⁴⁴ Nevertheless, international trade will tend to increase the incomes of workers of given skill categories (adjusting for productivity differences) in developing countries.

It bears emphasizing, in this context, that the outstanding examples of developing countries that (despite setbacks in the late 1990's) have dramatically increased the average real incomes of citizens (often by factors as large as six or eight) in recent decades have been the so-called Asian Tigers, beginning with Japan and followed by countries such as Taiwan, South Korea, Hong Kong, Singapore and more recently China, all of which have pursued relatively open, export-led growth policies. In contrast, developing countries that have pursued extreme forms of import substitution policies have generally experienced disappointing and, in many cases, disastrous results. These results have been exacerbated by the protectionist policies maintained by most developed countries towards goods of potential export interest to developing countries such as textiles, clothing and footwear and processed agricultural and natural resources. Even today, tariffs against imports from developing countries are substantially higher than for imports from other developed countries. Economic estimates have found that the costs of protection inflicted on developing countries by developed countries largely negate the entire value of foreign aid in recent years. This is not to suggest that open trade and

investment policies are sufficient in themselves to launch developing countries on a strong growth trajectory. As Hufbauer and Schott⁴⁵ point out, between 1975 and 1990, the dollar value of two-way trade between OECD countries and low-income countries tripled from \$59 billion to \$200 billion. Yet the per capita income gaps between OECD countries and low-income countries actually increased over this period (from 30 times higher to 58 times higher), reflecting the higher productivity of labour in developed economies. However, if income differences are measured not as differences between average incomes of each country but as the distribution of individual incomes globally, the distribution has narrowed considerably.⁴⁶ One recent study finds that, measured by the benchmark of \$2.00 a day or less, adjusted for purchasing power, the proportion of the world's population in poverty dropped from 56% in 1980 to 23% in 2000—about 1.1 billion in 2000 compared to 1.9 billion in 1980.⁴⁷

Clearly, a range of domestic policies other than trade policies that promote higher levels of capital investment, investments in human capital, healthcare and infrastructure, as well as high-quality public sector institutions, are important determinants of growth. Again, many of these policies have been important in the growth record of the high-performing East Asian economies. In addition, it is important to note that the benefits of growth in these countries have also been reasonably equitably distributed by virtue of policies of land redistribution, investments in public education, healthcare, and public housing, and the encouragement of small- and medium-sized businesses (SMEs).⁴⁸ More generally, the empirical evidence suggests that extreme levels of inequality have a negative impact on growth at all stages of development⁴⁹ and that, over a large sample of countries and over long time periods, the income of the poor rises one-for-one with overall growth—a relationship that holds in poor countries as well as rich countries, in economic crises, and in open trading regimes.⁵⁰

A related claim that is often made is that trade and investment liberalization threatens to gut the welfare state⁵¹ that, not coincidentally it is argued, evolved in many developed countries in the post-war decades, along with progressive trade liberalization in order, in part, to provide a cushion for the economic instabilities and risks associated with the latter for many citizens. Now the concern is that, with increased capital mobility and increased mobility of highly skilled workers, this social contract may be put in jeopardy as the better endowed firms and individuals in the community exit or threaten to exit in order to avoid the taxes required to underwrite the social programs that are perhaps even more necessary in the present and the future than in the past to cushion shocks to less advantaged citizens, given the increasing speed of economic change and the transition costs it entails.⁵² While these are legitimate concerns, the facts largely belie the claim that economic globalization has to date had major deleterious effects on the welfare state in most developed countries.⁵³ Data show social expenditures in fact increasing or at worst remaining constant as a percentage of GNP in most OECD countries, and tax levels rising in most of these countries. In 2000, average general government receipts as a percentage of GDP in the OECD and the G-7 exceeded 40 per cent, up from 1990.⁵⁴ Additionally, data show a dramatic increase in social regulation (environmental, health and safety, human rights, and employment regulation) in most of these countries over the past three decades, in part reflecting the fact that a cleaner environment and greater safety are normal economic goods, the demand for which rises with increasing prosperity, itself in

part engendered by greater international trade.⁵⁵ Thus, there is no evidence to date of any significant contraction in the scale of the welfare state in most developed countries.

CLAIM 3: TRADE LIBERALIZATION TRUMPS ENVIRONMENTAL, HEALTH AND SAFETY CONCERNS

There are two strands to the argument that trade liberalization adversely impacts environmental, health and safety concerns. According to the first, trade liberalization generally is harmful to the environment. The second strand asserts that, under the WTO dispute settlement system, trade liberalization takes precedence over environmental, health and safety concerns.

LeGrain⁵⁶ argues that the impact of trade liberalization on the environment depends on the balance of five factors. First, comparative advantage will lead to some countries attracting more environmentally damaging industries than others. Second, environmentally friendly technology will become more widely available. Third, economic growth resulting from trade will lead to increased environmental strain unless production methods change. Fourth, demand for a cleaner environment will increase when people become wealthier. Fifth, countries may or may not choose to lower environmental standards to attract foreign investment. Krueger and Grossman⁵⁷ find that, while growth is initially harmful to the environment, this effect generally begins to reverse itself as countries get richer (the so-called Kuznets curve). Furthermore, evidence suggests that trade liberalization can pay for the damage it causes, because the gains from trade far exceed the cost of paying or redressing resultant environmental damage.⁵⁸

Evidence suggests that fears of an environmental 'race to the bottom', whereby environmental standards decline to attract investment, are unfounded.⁵⁹ Wheeler⁶⁰ examined pollution levels in the United States and China, Brazil and Mexico, the three developing countries receiving the most foreign direct investment during the 1990s, and found that in each case particulate pollution is declining. He then draws on empirical evidence to show why the 'race to the bottom' has not materialized. Specifically, studies show that pollution control costs are often not high, regardless of a country's income, and consequently do not provide firms with a strong incentive to relocate due to environmental factors. Also, where there is not strong regulation, local communities use other mechanisms, such as negotiation or forms of protest, to ensure that factories meet environmental standards or to extract compensation for environmental degradation. Additional pressure may be brought by environmentally conscious consumers or financial institutions who want to avoid possible liability. Evidence also indicates that investors' reactions to environmental news impact stock value. Consequently, there is a powerful incentive for multinational companies to abide by OECD environmental standards globally. Finally, environmental regulation improves as a country's income increases. Wheeler qualifies his criticism of the 'race to the bottom' theory with three points: severe short-term pollution in some areas is still possible, information asymmetries may prevent effective environmental controls, and it is likely that average pollution intensity (emissions/output) will initially increase as the industrial production in developing countries rises relative to that in developed countries. Wheeler argues that trade sanctions are not the most effective way to avoid or mitigate the impact of these pitfalls because sanctions impact companies that are environmentally friendly as well as those that are

not; they put jobs at risk; and many developing countries are incapable of meeting high environmental standards.

While Wheeler and some other trade scholars⁶¹ oppose the use of trade sanctions against countries with low environmental standards, in cases where these standards entail cross-border pollution or threaten the global environmental commons, as we elaborate in a later chapter, we believe that there is a limited role for such sanctions in internalizing the costs of these externalities and inducing international cooperation on appropriate collective measures and compliance therewith, provided that trade sanctions in this context are not a disguised form of protectionism and do not discriminate among countries where the same conditions prevail (as required by Article XX of the GATT).

In evaluating the claim that trade liberalization trumps environmental, health and safety concerns in the WTO dispute settlement system, it is important to emphasize that only a handful of cases have come before the WTO's Dispute Settlement Body that implicate environmental or health and safety concerns. Furthermore, some of the specific cases with respect to which critics allege that the WTO disregarded environmental or health and safety concerns actually involved disguised protectionism or gratuitous restrictions on trade. By way of context, it is important to note that, by virtue of successive rounds of GATT negotiations, tariffs have now been reduced to zero or trivial proportions in many sectors (down from over 40% in 1947 to less than 5% on average currently), so that remaining barriers to trade are often internal regulatory measures of Member States. The WTO is necessarily seized with the task of determining when a regulation genuinely serves an environmental or health and safety purpose, or when, on the other hand, it is a disguised restriction on trade where a complainant country formally complains of its adverse trade effects. Julie Soloway, in detailed case studies of informal disputes in these areas in the three NAFTA countries, concludes that perhaps as many as 24 of the 25 cases of environmental or health safety regulation that she studied yielded no consumer welfare benefits but were merely disguised forms of protectionism.⁶² Even if this assessment is unduly harsh, it suggests that this is not an imaginary problem.

The *Reformulated Gasoline*⁶³ case involved regulations under the US Clean Air Act that entailed the progressive removal of pollutants from gasoline but imposed laxer (plant-specific) base starting points on US gasoline refiners than refiners in Venezuela and Brazil exporting gasoline to the USA. The WTO Appellate Body held that there was no basis for differential treatment. In the *Thai Cigarette*⁶⁴ case, a ban on imported cigarettes, not accompanied by any ban on domestically produced cigarettes, was held to be discriminatory and an unjustifiable restriction on trade. In the two *Tuna/Dolphin*⁶⁵ cases decided by WTO panels before the creation of the WTO Appellate Body as a result of the Uruguay Round Agreement, the environmental community has more cause for criticism, in that the panels ruled on narrow and unjustifiable grounds that an import ban on tuna caught by fishing methods that killed or maimed dolphin was unjustifiable because it was directed to environmental concerns outside the territorial jurisdiction of the USA or was predicated on changing another country's environmental policies. However, critics of the WTO often fail to note that the Appellate Body in the subsequent *Shrimp/Turtles*⁶⁶ case, in effect, overruled the two panel decisions in the earlier *Tuna/Dolphin* cases and held that there was no territorial constraint on a country adopting environmentally related trade measures in response to another country's environmental policies (in this case shrimp fishing techniques that killed or maimed a particular species

of sea turtle that was an endangered species under CITES). However, the USA was found by the Appellate Body to be in breach of its GATT obligations, in that it had negotiated exemptions with some foreign countries and not with others from the ban on shrimp imports. But there was no rational relationship between these exemptions and whether countries did or did not maintain safeguards against shrimp fishing techniques that endangered sea turtles. Thus, the USA had acted in an arbitrary and discriminatory fashion. The United States later revised its guidelines for certifying shrimp imports and the Appellate Body found the USA in compliance with WTO and GATT rules.⁶⁷

In the *Beef Hormones*⁶⁸ cases, the EU ban on the sale or importation of beef that had been reared on certain growth hormones was struck down both by the panel and the Appellate Body because it was not based on a risk assessment as required by the WTO Agreement on Sanitary and Phytosanitary Standards. Alternatively, if the ban was based on a risk assessment, the available risk assessments at the time that the ban was adopted all indicated that there were no ascertainable risks to human health from this product. Similarly, in the *Japanese Agriculture*⁶⁹ case, where imports of various fruits from the USA and elsewhere were banned because of a concern that they could spread disease through codling moth unless they met various stringent border tests, both the panel and the Appellate Body found that these border requirements were based on no risk assessment at all and were thus in violation of the SPS Agreement. In the *Australian Salmon*⁷⁰ case, a ban on the importation of fresh, chilled or frozen salmon was found to violate the SPS Agreement both because the ban was based on no risk assessment at all and because, inconsistently, it allowed imports of other kinds of fresh, chilled or frozen fish that presented at least as high a risk of spreading disease. Finally, in the *French Asbestos*⁷¹ case, a broad asbestos ban including a ban on imports of asbestos and products containing asbestos was upheld by the Appellate Body.

Thus, with the exception of the two *Tuna/Dolphin* cases (in effect, subsequently overruled by the Appellate Body), all of these decisions by the WTO's Dispute Settlement Body seem to be sensible and restrained, unless one believes that the WTO and its Members should give up entirely on the task of attempting to screen out disguised forms of regulatory protectionism.

CLAIM 4: TRADE LIBERALIZATION ADVERSELY IMPACTS LABOUR STANDARDS AND HUMAN RIGHTS

Some critics of trade liberalization argue that increasing international competition leads to a 'race to the bottom in terms of labour standards and human rights'. However, evidence indicates that trade liberalization generally promotes human rights. Sykes⁷² points out that, since there is general agreement that trade promotes growth, and human rights are likely income-elastic, trade liberalization can provide a country with the means to support human rights. Further, liberalization spreads ideas and may introduce human rights concepts to people who would not otherwise be aware of them. Turning to the empirical data, Sykes finds that richer countries have better economic, political and civil rights, suggesting 'policies which promote real income growth will also tend to promote human rights across a broad range of concerns'.⁷³ Although Sykes acknowledges that he only examines correlation, not causation, he emphasizes that the available evidence does not suggest that liberal trade adversely impacts human rights on a systemic level. Indeed, more generally, over the past three decades, there has been a large increase in the number

of countries that have replaced authoritarian or autocratic regimes with democratic regimes.⁷⁴

That is not to say that human rights abuses (or violation of core labour standards analogous to human rights)⁷⁵ should be ignored based on the argument that some day a poor country will be wealthy enough to uphold human rights on its own. In the case of violations of basic or universal human rights, particularly extreme cases such as war crimes, apartheid, genocide, torture or forced labour, it seems indefensible to exclude trade sanctions as a possible policy instrument (perhaps under the 'public morals' exception of Article XX of the GATT).⁷⁶ In terms of the WTO approach to trade sanctions in such cases, again it is important to ensure that the measures are not discriminatory restrictions on trade or disguised protectionism.⁷⁷ In our view, this should not require that countries apply sanctions to all, or none, of the countries engaged in universal human rights violations—this would make the perfect the enemy of the good. The problem of 'under-reach' should be left to organizations other than the WTO, such as the International Labour Organization (ILO), or United Nations Human Rights committees. However, the WTO should address cases of 'over-reach' where sanctions on one industry and not another seem principally attributable to the fact that the imposing country has an industry to protect in the former case but not in the latter.

CLAIM 5: SELF-SUFFICIENCY IS PREFERABLE TO DEPENDENCY⁷⁸

Proponents of self-sufficiency believe in protecting local production of food staples, arguing that local production supports jobs, builds community and protects national food security.⁷⁹

There are several responses to this argument. First, what distinguishes food production from other necessities, such as clothing, footwear, pharmaceuticals, automobiles and steel? Second, what distinguishes self-sufficiency at the national level from self-sufficiency at the state, local or family level? Clearly the USA ought not to demand that Texas diversify to produce wine, or that Michigan and Kansas diversify to produce citrus fruit. If each Member State of the EU aspired to be self-sufficient in food, it would fundamentally contradict the entire European economic integration enterprise. Furthermore, few people would advocate family self-sufficiency so that each family produces all its own food (and other requirements), returning us all to members of hunter-gatherer or peasant societies.

Third, even adopting a national perspective and focusing on food, it would be surprising if the social pathologies said to be afflicting the agricultural sector are due to international trade. Agriculture has been and remains the most protected sector in the international economy. The empirical evidence suggests that agricultural protectionism in the USA, Western Europe and Japan entails average costs of over a \$ 1000 per household per year for the countries concerned—a large and regressive hidden 'tax' on ordinary consumers of basic staples.⁸⁰ Apart from these costs to consumers, it is agricultural protectionism, not liberalization, that has promoted excessive mono-cropping and use of fertilizers and irrigation, as most starkly exemplified by the European Union's Common Agricultural Policy, which over the post-war years has turned Europe from the largest importer of temperate zone agricultural products into the second largest exporter, and accounts for nearly half of the EU budget.⁸¹ Moreover, it is important to remember that there are communities and farming families on both sides of the trade equation. For

developing countries with a comparative advantage in food production, developed countries' emphasis on self-sufficiency is viewed as an excuse for protectionism that prevents developing countries from fully realizing their growth potential by denying them effective market access for their exports. The case for agricultural protectionism on natural security grounds—that we cannot risk being held hostage by potential enemies in war-time for basic necessities of life—is also unconvincing. Greater economic interdependency with respect to essential products is likely to reduce the risk of war—the primary historical rationale for the creation of the European Community.

CLAIM 6: THE WTO IS AN UNDEMOCRATIC AND UNACCOUNTABLE FORM OF GLOBAL GOVERNMENT THAT IMPROPERLY CONSTRAINS DOMESTIC POLITICAL SOVEREIGNTY⁸²

Every international treaty, whether it pertains to nuclear disarmament or nuclear non-proliferation, land-mines, human rights, war crimes, the law of the sea, or the environment, to the extent that the commitments made by signatory states therein are effectively binding necessarily constrains domestic political sovereignty. This is the price of a world where nations collectively agree to address issues cooperatively that entail ramifications beyond their exclusive territories. In the case of the WTO, all Member States have voluntarily assumed their obligations, representing the quintessential form of government with the consent of the governed. While amendments to the GATT or covered agreements must be approved by two-thirds of the Membership of the GATT, such amendments are not binding on non-consenting Members. Further, Members have agreed that, in order for these commitments to be effectively enforceable, neutral third parties shall adjudicate disputes between Members regarding alleged violations of commitments.

This process of adjudication initially took the form of diplomatic conciliation but has since evolved increasingly in the direction of formal legal adjudication. The roster of panelists from whom panels are drawn in particular cases must be approved by consensus of all Members. The seven Members comprising the Appellate Body constituted as a result of the Uruguay Round to hear appeals from panel decisions must be approved by consensus of all Members. In the event of a Member State failing to comply with a decision of a panel or Appellate Body, if adopted by the General Council of the WTO, now applying a negative consensus rule (only a consensus of all Members favouring rejection leads to non-adoption), retaliation by the aggrieved Party may be authorized by the Council against the non-compliant Party in the form of trade sanctions. This system has worked remarkably well over the decades in ensuring a relatively high level of compliance with decisions by panels and more recently the Appellate Body.

However, some criticisms of the WTO's dispute settlement process are warranted.⁸³ Reflecting perhaps the diplomatic origins of dispute settlement under the GATT, the closed, non-transparent nature of current dispute settlement processes is inconsistent with a fully elaborated international rule of law. In particular, initial and subsequent written submissions of disputing Parties should be made publicly available, with exceptions for confidential information, at the time that they are filed with the Dispute Settlement Body (DSB), and the oral hearing component of the process should equally be open to the public with provision for in camera hearings for confidential information. In addition, non-governmental parties, including NGOs, affected business firms and trade

associations, should have limited rights of standing as intervenors or *amicus curiae* in dispute settlement proceedings, as third-country governments do already, at least to the extent that they are permitted to file short written submissions and respond briefly to any questions from members of the panel or Appellate Body in the oral proceedings by way of clarifying or elaborating on their written submissions. Permitting private parties to initiate complaints before the WTO Dispute Settlement Body raises a host of much more complex questions, including the capacity of the dispute settlement process to handle a much higher volume of complaints, the potential for strategic abuse of the process by competitors, and the possibility that private firms or trade associations will challenge environmental and health and safety regulations more frequently than public interest groups. Thus, the dispute settlement process should remain, for the present time, a state-driven process, with provision for *amicus* briefs, which are likely to be a particularly important legitimization mechanism in 'trade and' disputes involving major public policy issues.

With respect to the criticism that panelists and Appellate Body Members lack expertise or sensitivity in matters relating to environmental, health and safety, labour and human rights issues, it bears pointing out that the quasi-judicial review role played by the DSB is not markedly different from the judicial review role played by all-purpose courts with respect to specialized agency decisions in domestic administrative law and calls for a similar degree of substantial, but not complete, deference—in effect by requiring some minimum level of rationality in agency decision-making where disparate impacts on foreign suppliers are entailed. The Appellate Body in *Beef Hormones*, *Shrimp/Turtles*, and *Australian Salmon* has largely adopted this perspective by, for example, recognizing that a respondent need not undertake its own risk assessment but may base its measures on others' risk assessments; by accepting that it is sufficient that the risk assessment is supported by a respectable minority of scientists; and by applying a very narrow consistency requirement across regulations dealing with similar risks. In many respects, the Appellate Body's approach resembles the proportionality test adopted in Canadian Charter jurisprudence. Moreover, under the rules governing the dispute settlement process both in general and in specific contexts such as the SPS Agreement, panels may appoint individual scientific advisors or advisory groups of scientific advisors and have sometimes done so, although they should do so more systematically. In similar vein, panels and the Appellate Body in disputes implicating environmental, health and safety, human rights and labour issues should be more proactive in seeking the advice of other international agencies with major mandates in these areas, where these exist. Again, WTO Policy Committees, such as the Committee on Trade and the Environment, should be open to submissions by NGOs and other interested private parties.

Claims that the WTO is undemocratic in the negotiating processes that give rise to trade agreements and obligations should be directed at Member States policy-making processes, not at the WTO as an institution. Here, indeed, there may well be room for improvements. Trade treaties, often negotiated over protracted periods of time and over a very wide range of complex issues, inevitably involve delicate political trade-offs across issues. Once an agreement has been reached, while ratification or implementation may require legislative action in Member countries, this cannot realistically entail picking and choosing among various elements of the agreement without serious risk of the entire agreement and the negotiating processes that led up to it completely unravelling (as

recognized in US 'fast track' approval processes), rendering ratification or implementation actions an imperfect form of democratic accountability. Thus, in terms of public input into the negotiating positions taken by Member States and revisions to these positions and trade-offs across issues as negotiations proceed, the negotiating positions of Member States in future will need to be more open to public scrutiny and input than in the past. In Canada, in past trade negotiations, a large number of industry-specific advisory groups have been constituted by the Canadian government to advise it during the negotiating process, but these groups are not inclusive of all relevant constituencies. However, negotiations themselves cannot realistically be extended beyond government representatives to a host of non-governmental and private sector actors from all over the world without reducing the process to total functional paralysis. Thus, while representatives of governments should remain the chief negotiators, this should not exempt them from being more pro-active and imaginative in structuring an appropriately inclusive domestic consultative process during negotiations. This imperative also has application to the development of government positions in dispute resolution proceedings and WTO Policy Committee deliberations. But, to restate the principal point, this is not a concern that the WTO as an institution for the most part can resolve, but a concern that interested groups and citizens must resolve within their own political communities. That is to say, democratic decision-making begins at home, not in Geneva.

AN INSTITUTIONAL HISTORY OF INTERNATIONAL TRADE POLICY

The advent of free trade

Trading relationships between merchants from different nation-states go back to the dawn of recorded history. Trade was important to many ancient and medieval powers: Athens, Ptolemaic Egypt, the Italian city-states of Venice, Florence and Genoa, and the German Hanseatic League. Trade regulation through the imposition of tolls (a major source of state revenue) has almost as long a history, as do trade agreements between nation-states—a commercial treaty between the kings of Egypt and Babylonia existed in 2500 BC.⁸⁴

However, a functional understanding of modern international trade policy on an institutional level necessarily involves some appreciation of the broader forces at work for free trade in the European economies during the late eighteenth and early nineteenth centuries. From this perspective, international trade institutions need to be seen as one aspect of a more general process leading to access to larger, more unified markets, such that by the mid-nineteenth century only national frontiers remained as effective barriers to trade.⁸⁵ This process included the repeal of laws banning the export of certain materials previously considered essential to national welfare, the abolition of local regulations regarding manufacturing techniques, the adoption of (national) standards in weights and measures, and the end of restrictions on personal economic freedom (continuing bans against unions being a conspicuous exception to the general trend). Nation-building itself was in part an effort to ensure free trade within domestic borders where such had not

existed before: the dismantling of internal tolls and levies was an essential precondition to industrial development in the European economies.⁸⁶

By the mid-nineteenth century, then, most of the advanced European countries had established free trade within their borders. But many nations continued to practice internationally what they had eschewed internally: protection (trade barriers) continued between nations as they vied for wealth and power in international relations. The first major break with these mercantilist-protectionist policies of the past came in Britain with the repeal of the Corn Laws in 1846, spearheaded by Prime Minister Sir Robert Peel, a late convert to the cause of trade liberalization, and Lord Cobden. The repeal of these laws was in part promoted by the increasing intellectual currency of the ideas of Smith and especially Ricardo, and partly by the practical urgency of responding to the desperation of the Irish Famine. Political agitation fed by the wealth and power of commercial and manufacturing interests also played a role, as it would elsewhere in Europe later in the century.⁸⁷ The repeal of the Corn Laws was quickly followed by the unilateral removal or reduction of hundreds of tariffs on most imported goods, ushering in, in Britain, a period of resolute commitment to the principle of free trade that extended into the early years of the twentieth century.

While British trade policy reflected the insights of classical trade theory that *unilateral* trade liberalization enhanced national welfare over the protectionist base case, Britain also, over the course of the century, negotiated a number of free trade treaties with other countries, beginning with the Cobden—Chevalier Treaty of 1860 with France.⁸⁸ France in turn, in 1862, negotiated a comprehensive trade treaty with the *Zollverein*, the German customs union, as well as with a host of other European nations in the following decade.⁸⁹ These treaties were notable for their espousal of the Most Favoured Nation (MFN) principle, which later became one of the cornerstones of the GATT. Under this principle, countries negotiating trade concessions with one another agreed that they would extend to each other any more favourable concessions that each might subsequently negotiate with third countries. The MFN principle encouraged multilateralism while discouraging trade discrimination and, because of its presence in most French treaties, free trade swept Europe during the 1860s.⁹⁰

Treaties were not the only institutional results of trade policy in this period. At the same time that countries were negotiating cuts in tariffs, they signed conventions, mainly in the realm of transportation and communication, which helped to facilitate trade in other ways. For example, in 1868 the Rhine was declared a free way for ships of all nations, thus greatly facilitating the transport of goods throughout central Europe.⁹¹ Trading nations also promoted international commerce by setting up organizations to sell domestic products abroad. Commercial attaches date from this period, as do state-run international chambers of commerce. Exhibitions were arranged to show off national wares, and commercial museums were set up to inform manufacturers of the requirements and tastes of foreign markets.⁹²

However, the heyday of free trade was relatively brief and peaked over the period from about 1850 to 1885. In the 1870s, Europe suffered a severe and sustained recession, and also found itself facing increasing competition from non-European grain producers. In 1879, Germany retreated from the principle of free trade, when Bismarck raised tariffs substantially on a number of imported items, partly in response to the economic stringencies of the time, and partly in response to the intellectual influence of writers like

Friedrich List, who had returned from the United States persuaded of the virtues of a high-tariff policy, particularly in manufacturing sectors, in order to promote infant industries. Germany's retreat from free trade was quickly followed by France and a number of European countries, with Britain alone remaining emphatically committed to free trade.⁹³

It is perhaps prudent to reflect here on the character of European free trade during the nineteenth century in light of its sudden decline with the advent of hard times. It is important that the history of international trading institutions is not seen as the inevitable result of economic rationality and the triumph of superior economic thought. On the one hand, free trade did not disappear completely after 1879. Germany continued to negotiate trade treaties, although now economic ends tended to be subordinated to those of foreign policy. But perhaps this was no great change of course—free trade was always as much a tool of foreign policy as of economic development. Prussian attempts to establish the *Zollverein* were at least partly motivated by its nation-building aspirations. Similarly, historians have noted that Germany's treaties with France were part of a policy to isolate Austria (Prussia's main competitor for hegemony in the German world), and an attempt to gain French neutrality with respect to Germany's disputes with Denmark.⁹⁴ The Gobden—Chevalier treaty may also have been a product of foreign policy desiderata. It was intended, at least in part, to mollify Great Britain over French meddling on the Italian peninsula.⁹⁵

Moreover, if it is a mistake to see treaties as motivated only by considerations of economic efficiency, so too would it be wrong to understand the pursuit of markets solely through the instrumentality of trade treaties. Throughout the nineteenth century, the European powers had pursued colonial acquisitions as a means of exploiting the gains from trade.⁹⁶ With the onset of depression, and the collapse of the free trade treaties in the late 1870s, this policy was pursued with a vengeance.⁹⁷

Thus, the world began the previous century with the European powers, with the exception of Britain, preferring in large part to reap the gains from trade other than through free trade with other advanced economies. The story had rarely ever been otherwise in the United States. There, with considerable variations over time, a high-tariff policy generally prevailed throughout the nineteenth century, largely promoted by the Republican Party and influenced by the thinking and writings of prominent Americans like Alexander Hamilton, who had vigorously promoted the infant industry rationale for trade protection, in addition to revenue-raising considerations which for much of the nineteenth century were an important function served by tariffs.

The decline of the international trading order

As the world entered the twentieth century, Britain found its economic hegemony rapidly diminishing, and hence its ability to impress the case for free trade on its major trading partners. The advent of the First World War massively disrupted international trading relationships, and the terms of settlement of the war in part contributed to a general outbreak of beggar-thy-neighbour policies in the 1920s, including competitive exchange rate devaluations and trade restrictions.⁹⁸ The Most Favoured Nation system of trade treaties fell into disuse, and trading powers dealt with each other bilaterally instead. In the late 1920s, as the Great Depression set in, many domestic economies, and the world

economy at large, largely collapsed. The economic privations of the time prompted many countries to adopt extreme forms of trade protectionism in an attempt to preserve domestic production and employment. The most notorious of such attempts was the enactment by the US Congress of the Smoot-Hawley Tariff in 1930, which raised duties on imports to an average of 60%, and quickly provoked similar retaliatory measures by most of the USA's major trading partners. In the view of most economic commentators, this seriously exacerbated the conditions of the Great Depression, as international trade ground to a virtual standstill.⁹⁹ However, a major shift in policy was signalled by the US Administration in 1934, when President Roosevelt was successful in persuading Congress to pass the Reciprocal Trade Agreements Act, which authorized the Administration to negotiate trade-liberalizing agreements on a bilateral basis with its trading partners. In the ensuing years, 31 such agreements were concluded. However, the outbreak of the Second World War decisively shattered visions of a more cooperative international trading environment.¹⁰⁰

By 1944, it had become reasonably clear to the Allies that the war would shortly be won, and policy-makers, particularly in Britain and the USA, turned their minds to strategies for reconstructing the world economy after the war. Hence, in 1944, in Bretton Woods, New Hampshire, USA, an agreement bearing that name was concluded between Britain and the USA that was designed to lay the groundwork for a cooperative international economic environment following the war. The Bretton Woods Agreement envisaged the creation of three key new international economic institutions: the International Monetary Fund (IMF), which would be charged with maintaining exchange rate stability, and assisting countries facing balance of payment crises to deal with those crises through access to special drawing rights to be provided by the IMF, rather than by resorting to trade restrictions; the International Bank for Reconstruction and Development (IBRD), commonly referred to as the World Bank, whose mandate initially was to provide reconstruction capital from countries like the USA, whose economies had not been devastated by the war to the shattered economies of Europe and Japan—the success of the Marshall Plan that the USA subsequently adopted in promoting this objective meant that the World Bank was quickly able to redefine its focus as providing development capital to less-developed countries; and the International Trade Organization (ITO), whose mandate was to oversee the negotiation and administration of a new multilateral, liberal world trading regime.¹⁰¹

The formation and evolution of the GATT¹⁰²

Following the end of the war, the IMF and the World Bank were duly created, but the ITO did not come into existence, largely as a result of opposition in the US Congress, which was concerned that both the Organization and the many provisions in the Havana Charter that would have created it, would excessively constrain domestic sovereignty.¹⁰⁸ Instead, a provisional agreement, negotiated in 1947 among some 23 major trading countries in the world as a prelude to the ITO and the adoption of the Havana Charter, i.e. the General Agreement on Tariffs and Trade (GATT), in fact became the permanent institutional basis for the multilateral world trading regime that has prevailed to this day.¹⁰³ Under the GATT, some eight negotiating rounds have now been successfully concluded, the last round (the Uruguay Round), involving more than 100 countries,

ending in December 1993.¹⁰⁴ The current Doha Round of multilateral negotiations, involving more than 140 countries, was launched in November 2001 and is scheduled to conclude in 2005. The first six of these rounds, ending in 1967 with the Kennedy Round, focused primarily on reciprocal negotiation of tariff concessions. These negotiations were extremely successful and have led to the reduction of average world tariffs on manufactured goods from 40% in 1947 to 5% today. The Tokyo Round that ended in 1979, while also entailing substantial tariff cuts, for the first time directed substantial attention to various non-tariff barriers to trade, such as government procurement policies, subsidy policies, customs valuation policies, and technical standards. In all of these areas, Collateral Codes to the GATT were negotiated on a conditional MFN basis, meaning that only signatories to the Codes were subject to the rights and obligations created by the Codes.¹⁰⁵ The Tokyo Round closed with the world economy and many domestic economies under increasing pressure from a number of sources, including two oil price shocks, a major world recession in the early 1970s and another beginning in the early 1980s, and the rise of Japan and other NICs, such as Singapore, Hong Kong, Taiwan, South Korea and Brazil, as major competitive threats in manufactured products. These pressures provoked the rise of the so-called 'New Protectionism' beginning in the early 1970s, with countries increasingly resorting to non-tariff barriers to trade, such as quotas, voluntary export restraint agreements, orderly marketing agreements, industrial and agricultural subsidies, and more aggressive unilateral invocation of trade remedy laws, particularly antidumping and counter-vailing duty laws. In addition, the Short Term Agreement on Cotton Textiles that had been initiated by the USA in 1961 had, by 1973, been generalized to the Multi-Fibre Arrangement (MFA), which permitted countries to negotiate bilateral agreements with exporting countries restricting exports of both natural and synthetic textiles and clothing. This arrangement has been particularly burdensome for many NICs and LDCs which had viewed textile and clothing manufacture, drawing on large pools of unskilled labour and relatively standardized technology, as an attractive entry point into the process of industrialization.

Throughout this period, LDCs in general have played a marginal role in GATT negotiations, which many viewed as a rich man's club. In 1964, LDCs formed the United Nations Conference on Trade and Development (UNCTAD), to address what were perceived to be the special and distinctive economic needs of the LDCs. In 1968, in response to UNCTAD recommendations, Part IV was added to the GATT, providing for so-called 'special and differential status' for LDCs and in particular exempting LDCs from any obligation of reciprocity with respect to trade concessions of developed countries while at the same time urging developed countries to provide unilateral trade concessions to LDCs on trade items of export interest to them. This in turn led to the adoption of the Generalized System of Preferences, where developed Member countries of the GATT from the early 1970s onwards granted special trade concessions to LDCs, without seeking reciprocal trade concessions. The special and differential status secured by LDCs under the GATT reflected widely prevalent thinking in many developing countries that import substitution policies (in effect infant industry promotion policies) were essential to the economic development of these countries, in order to diversify their economic base, provide expanding sources of employment and reduce dependency on often highly volatile international commodity markets for primary products. With respect to the latter, UNCTAD also promoted the adoption of a variety of international

commodity agreements in sectors such as coffee, cocoa, rubber and tin, in an attempt to stabilize commodity prices and mitigate what were perceived to be deteriorating terms of trade with respect to the exchange of LDC commodities for industrialized countries' manufactured goods.¹⁰⁶

The Uruguay Round of multilateral trade negotiations under the GATT, which lasted from 1986 to 1993, proved the most difficult, contentious and complex round of negotiations to have taken place under the auspices of the Agreement, in part because of the increasing strains on the world trading system noted above and in part due to the breadth of the negotiating agenda. The Uruguay Round, for the first time, attempted seriously to address the issue of liberalizing international trade in agriculture which had hitherto largely escaped GATT discipline. In addition, the Uruguay Round also sought to reverse the pattern of protectionism with respect to textiles and clothing that had evolved under the MFA. In addition, several new issues previously viewed as falling outside the ambit of the GATT, were addressed, for the first time including in particular international trade in services, trade-related intellectual property issues (TRIPs), and trade-related investment issues (TRIMs).¹⁰⁷

In an extensive review¹⁰⁸ of the evolution of patterns of comparative advantage and international trade policy in the post-Second World War period, Ostry points out that the USA as the hegemonic economic power following the war was initially prepared to accept asymmetric tariff reductions as part of its contribution to post-war reconstruction. However, with the resurgence of Western Europe and Japan, the USA began to insist on more symmetry in tariff concessions (in the Kennedy and Tokyo Rounds). With rapid and continuing rates of technological diffusion, a declining share of world trade, a loss of comparative advantage in some mass production and technology-intensive sectors, and rising trade deficits with Japan and other NICs, the USA in recent years has become increasingly concerned about what it perceives as a lack of reciprocity in international trading relations, and hence has evinced a greater willingness to pursue strategies of unilateralism and regionalism in addition to or instead of exclusive commitments to the multilateral system. In particular, 'system frictions', involving different traditions of government intervention in domestic economies and of forms of industrial organization, have increasingly redirected the focus of international trade policy and conflicts beyond or within the borders of nation-states and to divergences in domestic policies that arguably create 'unfair' forms of comparative advantage (or 'unlevel playing fields'). With tariffs now in many cases reduced to minimal levels, the new issues addressed in the course of the Uruguay Round likely portend an increasing and broader focus in the future on domestic policy divergences as potential distortions of international trade—a very different agenda from that which initially preoccupied the founders of the GATT.

The formation of regional trading blocs

Running parallel with the evolution of the multilateral trading system under the GATT in the post-war period has been another institutional development of considerable significance—the rise of regional trading blocs. While many of these arrangements have been created, to date by far the most important has been the European Union. The European Union finds its genesis in the Marshall Plan adopted by the USA for the reconstruction of war-torn Europe, motivated not only by economic objectives but also

importantly by political concerns to promote a degree of economic integration that would make the devastating military conflicts of the first half of the twentieth century less likely to recur. Efforts at formal economic integration began with the European Coal and Steel Community, which was formed in 1952 and was charged with promoting the rationalization and integration of the European steel industry. In 1957, the Treaty of Rome, which contemplated a much more ambitious agenda of economic integration, was entered into, initially by six Member countries, France, Germany, Italy, the Netherlands, Belgium and Luxembourg, and subsequently by the United Kingdom, Denmark, Greece, Ireland, Portugal and Spain, followed by Austria, Sweden and Finland. In 2004, Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, the Slovak Republic and Slovenia also joined the EU, with other Eastern European candidate countries to follow. In the early years, attention was principally focused on the removal of border impediments to trade, especially tariffs and quotas, but over time the European Union has increasingly committed itself to a much more substantial level of economic and political integration, which would provide for the free movement of goods, services, capital and people within the Community. In 1986, the Community adopted the Single European Act, which set out an ambitious agenda of policy measures with a view to realizing a single European market by 1992.¹⁰⁹ The Maastricht Treaty, ratified in 1993, provides for further forms of economic and political integration. Apart from the European Union, the European Free Trade Association (EFTA) was formed in 1959, with its initial Membership comprising Austria, Denmark, Norway, Sweden, Switzerland and the United Kingdom. The remaining Members of EFTA have pursued a policy of mutual and substantial tariff reductions, although EFTA has had much more modest ambitions, in terms of degrees of economic integration, than the European Union.

On the other side of the Atlantic, the conclusion of the Canada—US Free Trade Agreement (FTA) in 1988 marked an important step in the development of an American regional trading bloc. While the FTA is much less integrating than the European Union, it does provide for the removal of all tariffs over a ten-year period as well as most other border measures, for largely unrestricted movement of capital and direct investment, and for the liberalization of some trade in services. In 1992, largely building on and superceding the FTA, a North American Free Trade Agreement (NAFTA) was concluded by the USA, Mexico and Canada (subsequently ratified in all three countries and subsequently, in adapted form, adopted by Canada and Chile). Currently a Free Trade Agreement of the Americas (FTAA) is under negotiation among the members of NAFTA and more than 30 Caribbean and Latin American countries.

Other regional trading blocs have emerged or are beginning to emerge in Latin America (Mercosur), the Caribbean (CARICOM), Asia and the Pacific Rim (APEC), and Eastern and Southern Africa (COMESA).

The rise of regional trading blocs in the post-war period, alongside the evolution of the multilateral system under the GATT, raises major conceptual and policy issues which will be pursued in greater detail later in this book.¹¹⁰ While some analysts believe that these trading blocs and the multilateral system can be viewed as complementary and mutually reinforcing, other analysts consider them inherently discriminatory and a major threat to the future stability and integrity of the multilateral system and to the vision of a cooperative and non-discriminatory world economic order that animated the architects of the Bretton Woods Agreement at the end of the Second World War.¹¹¹ Tensions between

unilateralism, regionalism and multilateralism recur in various contexts that are addressed throughout this book.

THE BASIC ELEMENTS OF THE GATT/WTO, THE NORTH AMERICAN FREE TRADE AGREEMENT AND THE EUROPEAN UNION

The remainder of this chapter is intended to provide a brief orientation to, or topography of, the GATT/WTO (the heart of the multilateral world trading regime) and the two major regional trading blocs in the world: the North American Free Trade Agreement between the USA, Canada and Mexico, and the European Union. The intention is merely to highlight the principal elements of these arrangements, and not to explore them in detail. A number of subsequent chapters in this book will pursue a more detailed analysis of many of these elements. However, given the complexity of these arrangements, there is virtue in having a general road map at hand before embarking on detailed analyses of particular principles or provisions.

The General Agreement on Tariffs and Trade¹¹²

The original GATT of 1947 has now become the GATT of 1994 and the WTO Agreement is an umbrella agreement, establishing the WTO structure, including GATT 1994 and many other Agreements to which all Member States (no longer ‘Contracting Parties’) must, with few exceptions, subscribe.

Tariffs

The preamble to the GATT commits Members to enter 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’. Article XXVIIIbis further provides that

members recognize that customs duties often constitute serious obstacles to trade and that negotiations *on a reciprocal and mutually advantageous basis*, directed to the substantial reduction of the general level of tariffs are of great importance to the expansion of international trade.

Members commit themselves under this Article to sponsoring such negotiations from time to time either on a selective product-by-product basis or by the application of such multilateral procedures as may be accepted by the Members.

Once tariff concessions are agreed to in a particular set of negotiations, these become ‘tariff bindings’ which are set out in particular Members’ tariff schedules that constitute an Annex to the GATT. By virtue of Article II of the GATT, all Parties must adhere to these ‘tariff bindings’ by not imposing customs duties in excess of those set forth in each country’s tariff bindings schedule. This is subject to an exception provided for in Article XXVIII, where at scheduled three-yearly intervals, any Member that has made previous

tariff concessions can reopen these concessions with other Members who have a substantial interest in the concession, with a view to modifying or withdrawing the concession, but in that event, other concessions must be offered so that a general level of reciprocal and mutually advantageous concessions not less favourable to trade than those existing between the Parties prior to such reopening is maintained.

Obviously, for tariff concessions to be credible, some agreed customs valuation, classification and administration system is necessary, otherwise a country in agreeing to reduce, for example, a 20% tariff on imports of a particular category to 10% could negate the concession by arbitrarily revaluing imported goods of this category upwards by 100%, or by reclassifying them into a higher tariff category, or by imposing administrative charges pertaining to the processing of inbound goods that may operate as a *de facto* tariff. Article VII of the GATT requires that the value for customs purposes of imported merchandise should be based on its 'actual value', which in turn is defined as the price at which such merchandise is sold or offered for sale in the ordinary course of trade under fully competitive conditions. This definition proved vague and easy to circumvent, and a special Customs Valuation Code was negotiated during the Tokyo Round (and modestly revised during the Uruguay Round) which stipulates that, in the ordinary course of events, the 'transaction value' as between an exporter and an importer shall be the value for customs purposes, subject to some limited exceptions where the Parties are not dealing with each other at arm's length. Similarly, most of the Members have agreed to harmonize their systems of customs classification (the HS), based on the Brussels Nomenclature, which reduces room for ambiguity or debate as to the proper tariff classification of a particular good. Finally, Article VIII of the GATT restricts the imposition of fees or charges relating to the administrative processing of inbound goods to the approximate cost of services rendered, which shall not represent an indirect protection to domestic products or a taxation of imports for fiscal purposes.

The principle of non-discrimination

The principle of non-discrimination—often viewed as the cornerstone of the GATT—is referred to in the preamble to the Agreement and is amplified in two key provisions: Article I, adopting the Most Favoured Nation principle; and Article III, adopting the principle of National Treatment.

The Most Favoured Nation principle

Under Article I of the GATT, with respect to customs duties or charges of any kind imposed by any country on any other Member country, any advantage, favour, privilege, or immunity granted by such country to any product originating in any other country shall be accorded immediately and unconditionally to a like product originating in the territories of all other Members. Thus, notwithstanding that tariff concessions may be principally negotiated between country A and country B, which may be the principal suppliers and purchasers of the products in question respectively, if either country A or country B makes a binding tariff concession to the other, it must extend exactly the same concession to all other Member countries of the GATT, without being able to demand *quid pro quos* as a condition for this extension of the concession, at least if these were not part of the initial negotiations. However, the MFN principle is subject to some important

exceptions. Article I itself in effect grandfathers preferences that were in force between certain Member countries at the time of the inception of the GATT, subject to a rule that freezes the margin of preference, so that it cannot be subsequently increased. This exception has become less important over time as MFN rates have been negotiated down and differences between the preferential rates and the MFN rates progressively reduced.

A second exception is much more important. Article XXIV permits the formation of regional trading blocs, in the form of either customs unions or free trade areas, subject to two basic conditions: namely that the general incidence of duties after the formation of such an arrangement not be higher than the average levels of duties prevailing on the part of Member countries to such an arrangement prior to its formation, and that duties and other restrictions on trade must be eliminated with respect to substantially all the trade between the constituent Members of the regional trading bloc. It is under this provision that the European Union, the Canada-US FTA and NAFTA find their legitimacy. By definition, these arrangements would otherwise violate the MFN principle, because they clearly contemplate more favourable duty and related arrangements among constituent Members than with respect to external trading partners.

Various regional arrangements either in existence or contemplated at the time of the formation of the GATT, including the possible emergence of a European Economic Community, compelled the initial Contracting Parties to recognize this major exception to non-discriminatory multilateralism. As we will see in later chapters, one view of regional trading arrangements is a pragmatic and positive one: that if full multilateral trade liberalization is not immediately possible, partial forms of trade liberalization on a regional basis may be better than nothing, in that they may sustain or nurture over time forward momentum on trade liberalization. This is often referred to as the 'bicycle theory' of trade liberalization. A contrary view argues that partial trade liberalization may be worse than none at all.¹¹³ This view emphasizes a crucial distinction between trade diversion and trade expansion. A simple example will illustrate the distinction. Suppose at one point in time, country A maintains a tariff of 20% on textile imports from both countries B and C. Suppose that some of country C's textile producers are 25% more efficient than A's, and that some of country B's textile producers are 15% more efficient than A's. In this scenario, C's more efficient textile producers will successfully surmount A's 20% tariff barrier and sell textiles into A's market 5% cheaper than A's producers. B's producers, on the other hand, will find that the 20% tariff more than neutralizes their 15% efficiency advantage over A's producers and renders their product 10% dearer in A's market than textiles produced in C. If countries A and B at a subsequent point in time agree to form a free trade area and to abolish all tariffs between them but to maintain tariffs against external parties, including the 20% tariff on textiles that A formerly had in place against C, C finds itself in a position where it can still sell textiles 5% more cheaply than A's producers, but they are now 10% dearer than those produced by B. Conversely, B's producers can now sell textiles into A's market 15% cheaper than A's producers, and 10% cheaper than C's (in effect the tariff retained by A against C neutralizes the efficiency advantage that C's producers enjoy over B's of 10% and imposes a further 10% penalty on C relative to B). The result of the formation of a free trade area in this example is that production of textiles will shift from C, the most efficient producer among the three countries, to a less efficient producer, B. In other words, trade has been diverted from C to B, despite C's comparative advantage over both B and A. In this

example, partial trade liberalization has actually further distorted the efficient allocation of resources. In addition to the issue of trade diversion, preferential trade arrangements typically involve extremely complex rules of origin designed to determine whether goods qualify for preferential treatment—a complexity that is intensified by global forms of production where components of many goods are manufactured or processed in many different countries.

In considering institutional arrangements to promote regional economic integration, it is useful to think of an integration continuum. First, there are *free trade areas* (like the NAFTA), where two or more countries agree to remove border restrictions on goods among themselves but each reserves the right to maintain whatever external trade policy it wishes with respect to non-member countries. A particular problem raised by this kind of arrangement is importation of goods through low-tariff member countries and transshipment to higher-tariff member countries, which can only be resolved with complex rules of origin. Second, there are *customs unions* where, in addition to removing border restrictions on trade in goods among member countries, member countries also agree to harmonize their external trade policies *vis-à-vis* non-member countries. Third, there are *common markets* or *economic unions* (like the European Union) where, in addition to removing border restrictions on trade in goods among member countries and harmonizing external trade policy, free trade in or free movement of services, capital and people, as well as perhaps a common monetary policy, might be contemplated. Fourth, there are *federalist structures*, like the USA, Canada, Australia and Germany, where economic units form a single state, with the central government being vested with the dominant jurisdiction over economic functions, but with some agreed division of economic powers between the central and sub-national levels of government, with constitutional or other arrangements designed to guarantee internal free movement of goods, services, capital and people, and minimization of internal barriers to trade. Finally, there are *unitary states* where, over a given geographic region, one government, to all intents and purposes, possesses exclusive jurisdiction over all significant economic functions, so that problems of intergovernmental coordination of economic policies within the geographic area are eliminated.

The National Treatment principle

The MFN principle set out in Article I of the GATT is designed to constrain discrimination by Members among different foreign exporters, i.e. playing favourites among foreigners. The principle of National Treatment set out in Article III of the GATT addresses another form of discrimination, namely where a Member adopts internal or domestic policies designed to favour its domestic producers *vis-à-vis* foreign producers of a given product, even though the latter may all be treated in a uniform way. The principle of National Treatment dictates that, once border duties have been paid by foreign exporters, as provided for in a country's tariff schedules, no additional burdens may be imposed through internal sales taxes, differential forms of regulation, etc. on foreign exporters where domestic producers of the like product do not bear the same burden. The particular application of the National Treatment principle to given situations has been the source of a number of important GATT and WTO panel and Appellate Body decisions, where difficult decisions arise as to whether a domestic law, regulation or administrative

policy, which may be neutral on its face, nevertheless has either the intent or the effect of imposing differential burdens on foreign exporters. A specific example of this problem has been addressed in the GATT Code on Technical Standards, initially negotiated during the Tokyo Round, and substantially elaborated in separate WTO Agreements on Technical Barriers to Trade and Sanitary and Phytosanitary Measures during the Uruguay Round, which attempt to promote harmonization of domestic product standards that might otherwise discourage international trade.

An explicit exception to the National Treatment principle is contained in Article 111:8 of the GATT, which permits government agencies to favour local producers in purchasing goods for governmental purposes and not with a view to commercial resale. However, this provision is now subject to a detailed government procurement code, initially negotiated during the Tokyo Round and expanded during the Uruguay Round, requiring many departments and agencies of government (although in federal systems, not sub-national levels of government) with regard to government procurement contracts over a certain size to respect the National Treatment principle, and avoid preferences in favour of local producers or unreasonable tendering processes that unfairly disadvantage foreign producers from tendering on government contracts.¹¹⁴

Quantitative restrictions

The original framers of the GATT contemplated that it would heavily constrain most border restrictions on trade other than tariffs, so that border restrictions would principally take the form of tariffs which could then be negotiated down over time. In particular, Article XI of the GATT prohibits the use of quotas or import or export licences (i.e. quantitative restrictions) on the importation or exportation of goods into or out of any Member State. Quantitative restrictions on imports clearly protect domestic producers. Less obviously, restrictions on exports may provide local producers for the domestic market with privileged access to 'captive' inputs, or protect local processing plants if exportation of raw materials is constrained. The theory behind Article XI was that, if quantitative border restrictions could be avoided, the greater transparency and commensurability of tariffs relative to quantitative restrictions would make their reduction through successive rounds of negotiation more tractable. However, Article XI was markedly unsuccessful in this ambition, and increasingly so over time.

Exceptions to Article XI

First of all, Article XI itself, until recently, contained a major exception for quantitative restrictions on agricultural imports where these are maintained in order to protect domestic supply management or agricultural marketing board schemes. Under the WTO Agreement on Agriculture, these restrictions must be converted into tariff equivalents which in turn are subject to minimum required levels of reduction over a six-year period. In addition, Article XII permits the imposition of quantitative restrictions (albeit, by virtue of Article XIII, on a non-discriminatory basis) if a country is facing serious balance of payments problems. Article XVIII of the GATT also permits LDCs to impose quantitative restrictions either for balance of payments reasons or for infant industry reasons against a very relaxed set of criteria. Finally, a major defining characteristic of

the rise of the so-called New Protectionism has been the dramatic escalation in the use of quantitative restrictions, typically negotiated on a bilateral basis under threat of unilateral action, and in clear violation of either the letter or the spirit of Article XI and Article XIX (relating to safeguard actions, discussed below). These proliferating forms of quantitative restrictions have occurred under the MFA, and on a more *ad hoc* basis through voluntary export restraint agreements (VEAs) or orderly marketing agreements (OMAs) in sectors such as steel and automobiles. Under the WTO Agreement on Textiles and Clothing, special restrictions on textile and clothing imports are subject to reduction over specified time periods.

The safeguard provision

Under Article XIX (often referred to as the safeguards or escape clause) if, as a result of unforeseen developments and of the effect of obligations incurred by a Member under the GATT, including tariff concessions, any product is being imported into the territory of that Member in such increased quantities or under such conditions as to cause or threaten serious injury to domestic producers of like products in that territory, the Member is entitled to suspend or modify obligations or concessions on a temporary basis in order to alleviate the injury. However, where safeguard action is taken, in the form of either the reinstatement of a tariff or the imposition of quantitative restrictions, it must be taken on a non-discriminatory (i.e. non-selective) basis, and the Party taking such action must offer compensation (in the form of offsetting trade concessions) acceptable to other Parties whose trade is prejudiced by such action, failing which the latter may retaliate by imposing trade restrictions of equivalent value on exports from the country invoking the safeguard clause. Article XIX was initially envisaged as a kind of safety valve permitting Members to buy temporary breathing-space to moderate adjustment costs when confronted with unexpected surges of imports that were causing serious injury to domestic producers. However, the requirements that action be taken on a non-discriminatory basis and be accompanied by compensating concessions have rendered it an unattractive option for Members with import-impacted sectors relative to bilateral arrangements like the MFA, VERs and OMAs, extracted under threat of unilateral action, principally through the imposition of antidumping or counter-vailing duties or in the case of the USA unilateral action under Section 301 of the Omnibus Trade and Competitiveness Act of 1988. Article XIX has been substantially refined and elaborated in the WTO Agreement on Safeguards which largely prohibit these bilateral restrictions.

Trade remedy laws

Article VI of the GATT recognizes the right of Members to take unilateral action under domestic trade laws where domestic industries are being materially injured because of unfair foreign trading practices, specifically either dumping or subsidization.

Dumping occurs in its most typical form where foreign producers are selling goods into another country's market at prices below those which they would normally charge in their home market (perhaps because they have a protected home market). Where this pricing practice is causing material injury (or a threat thereof) to domestic producers of like products, antidumping duties in the amount of the difference between the export-

market price and the home-market price may be imposed on the imported goods. Many Members of the GATT have enacted antidumping laws, and over the past three decades, such laws have been invoked with increasing frequency, especially by such countries as the USA, Canada, Australia and the EC. Article VI has now been amplified by an antidumping code initially negotiated during the Kennedy Round and modestly revised in the course of the Tokyo and Uruguay Rounds.

In the case of countervailing duties, the complaint is not the private pricing practices of foreign producers, but rather that foreign governments are unfairly subsidizing the production of foreign exports, artificially advantaging them in importing countries' markets. Where foreign government subsidization of foreign exports is causing material injury to a domestic industry producing like products, domestic trade laws enacted in many countries permit the unilateral imposition of countervailing duties on the subsidized imports so as to offset or neutralize these foreign subsidies. Again, over the late 1970s and 1980s, as a characteristic of the New Protectionism, countervailing duties, along with antidumping duties, began to be more frequently invoked, although in the case of countervailing duties almost exclusively by the USA. A special code on subsidies was initially negotiated during the Tokyo Round and extensively revised during the Uruguay Round, partly with a view to disciplining the invocation of countervailing duty laws and partly with a view to providing an alternative multilateral dispute resolution track for adjudicating disputes over all forms of subsidies that may have trade effects.

The issue of subsidies is one of the most sensitive and complex subjects in international trade law. At one level, objections to subsidies are obvious, in that a subsidy can be devised to replicate the effects of almost any tariff. For example, if country A agrees to reduce tariffs on country B's widget exports from 20% to 10%, and binds itself to this concession, this concession can effectively be undermined by country A then providing subsidies to its own domestic producers of widgets in the amount of 10% of production costs. Conversely, if country A declines to negotiate a reduction of its 20% tariff on country B's widget exports, but country B seeks to undermine the reciprocal bargaining process contemplated for tariff reductions under Article XVIIIbis by unilaterally subsidizing its exports of widgets into country A's market in the amount of 10% of production costs, country A's right to elect which tariffs to bind itself to would be undermined. On the other hand, given that almost all significant domestic policies of governments, e.g. investments in physical infrastructure, education, health, research and development, telecommunications, law and order, directly or indirectly affect the pattern of economic activities that evolve in each country, and by extension the pattern of international trade activities to which each country contributes, the charge of unfair subsidization has no natural limits. A burgeoning political discourse has emerged over the last decade or so surrounding the notion of 'fair' (or 'unfair') trade, or 'level playing fields'. Professor Jagdish Bhagwati has described the rise of fair trade discourse as 'the truly greatest threat since the 1930s' to the world trading system.¹¹⁵

Article XVI of the GATT requires a Member that grants or maintains any subsidy which has the effect of increasing exports or reducing imports to notify the Members of the nature and extent of the subsidization and its likely effects on trade and, where serious prejudice is caused or threatened to the interests of any other Member, to discuss with that Party the possibility of terminating the subsidization. With respect to export subsidies, Article XVI provides that where export subsidies are granted on a primary

product, these should not result in the exporting country gaining 'more than an equitable share of world export trade in that product', relative to pre-existing shares. With respect to export subsidies on non-primary products, a number of signatories agreed to forsake these where such a subsidy would result in export sales at lower prices than domestic sales. The WTO Subsidies and Countervailing Measures Agreement attempts to provide much more precise definitions of prohibited, actionable and non-actionable subsidies.

For clarity of understanding, it is helpful to keep in mind a basic taxonomy of subsidy scenarios. The first scenario is one where country A subsidizes its exports into country B's market. This is the scenario which has classically attracted the potential for countervailing duties under Article VI and complementary domestic trade remedy laws. These subsidies could relate exclusively to exports or to all domestic production, wherever consumed. The second scenario is where country A subsidizes its exports into country C's market, and in so doing displaces country B's exports from country C's market. In this scenario, the subsidized goods are not moving from country A to country B and thus cannot be countervailed by country B, so that country B is remitted to a complaint under the WTO Subsidies Agreement for resolution under the multilateral dispute resolution process. The third subsidy scenario is the case where country A is subsidizing its domestic producers to service principally country A's own domestic market, and in so doing displaces country B's exports from country A's market. Again, as in scenario two, the subsidized goods are not moving from country A to country B so as to attract possible countervailing duties in country B, so that country B is again remitted to the multilateral dispute resolution process.

The considerable, and apparently growing, attraction of antidumping and countervailing duties for import-impacted sectors, relative to the safeguard regime contemplated by Article XIX, reflects the fact that selective (i.e. discriminatory) action is permitted, no compensation is required in the form of counterbalancing trade concessions, and the duties are imposed automatically by administrative rather than political decision (unlike safeguard actions which ultimately require executive political action, typically following discussions and negotiations with affected foreign country governments).

State trading enterprises

Under Article XVII of the GATT each Member undertakes that its state trading enterprises shall, with respect to purchases or sales involving either imports or exports, act in a non-discriminatory manner and make such purchases or sales solely in accordance with commercial considerations. This provision does not apply to imports of products for immediate or ultimate consumption in governmental use and not otherwise for resale.

This provision recognizes that state trading enterprises have the potential for distorting international trade through explicit or implicit subsidy policies or artificial pricing strategies. For example, a state enterprise selling into export markets may artificially subsidize its exports. Conversely, a state enterprise in its purchasing policies may explicitly or implicitly favour domestic producers over foreign producers of the same products. Article XVII, in its initial conception, was principally addressed to a significant number of state-owned enterprises or state-sanctioned monopolies that existed in the jurisdictions of Members at the time of the formation of the GATT, even though these

countries were largely committed to market economies. Article XVII is not nearly as well equipped to address the systemic problems of countries which are Members of the GATT, or aspire to be, that are predominantly centrally planned or command economies, or which are in the process (as with Eastern European countries and China) of transition from command to some form of market economy. In these countries, because prices, input costs and wages have traditionally been set by command or administrative fiat, determining, as is required by Article XVII, whether a state enterprise is operating according to 'commercial considerations' involves the intractable counterfactual exercise of determining what the country in question would import or export if there were fully functioning markets.

In consequence, where in the past command economies have participated in the GATT, they have done so on special terms that have involved either specific commitments to increase imports from non-communist countries, or have entailed expectations of partial liberalization of the trade and payments system. Special arrangements of this nature have applied in the case of Poland, Hungary and Romania, and to a much more limited extent to the former Yugoslavia.¹¹⁶ As well, in many instances, Members have not granted full MFN status to these countries despite their Membership in the GATT, and the terms of accession in the case of some of these command economies have permitted imposition of discriminatory safeguards or quantitative restrictions, which were frequently invoked by European Community countries in particular.

With the fall of the communist bloc, the issue of normalizing the GATT/WTO Membership of the former command economies has come to the fore. China's readmission to the WTO in 2001 is an important step in this process.

Less-developed countries

'Special and differential status' is accorded to LDCs under the GATT both with respect to actions which they are permitted to take and with respect to actions that developed countries are expected to take towards them. Under Article XVIII, LDCs have been given broad latitude to impose restrictions on imports, typically through quantitative restrictions such as quotas and licences, for balance of payments reasons or in order to foster infant industries. Under Part IV of the GATT, added in 1964, Article XXXVI:8 provides that developed 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 less-developed Contracting Parties. Article XXXVII in turn provides that developed countries commit themselves to according high priority to the reduction and elimination of barriers to products currently or potentially of particular export interest to less-developed Members. These latter provisions led to the introduction of the Generalized System of Preferences in the early 1970s and the unilateral adoption of special preferences by industrial countries with respect to some exports of LDCs. The degree of success of either of these two elements of the special and differential status accorded to LDCs under the GATT will be the subject of a more detailed discussion in a later chapter.¹¹⁷ For the moment, it is sufficient to note that, with respect to the first element in this status, i.e. authorization of import substitution—infant industry promotion policies by LDCs—this reflects a debate going back to John Stuart Mill about the case for protectionism in this context (discussed

above). The second element in the special and differential status, i.e. non-reciprocal trade concessions by developed countries, raises the strategic question of whether countries will find themselves willing to engage in unilateral trade liberalization, and reflects the long-standing debate about the virtues of unilateral trade liberalization relative to reciprocal trade liberalization.

General exceptions to GATT obligations

Under Article XX of the GATT, a number of dispensations from GATT obligations are provided with respect to the adoption or enforcement by Members of measures, for example, necessary to protect public morals; necessary to protect human or animal health or life; necessary to secure compliance with laws or regulations which are not inconsistent with the GATT; imposed for the protection of national treasures; or relating to the conservation of exhaustible natural resources, provided that none of these measures are an arbitrary or unjustifiable discrimination between countries where the same conditions prevail or a disguised restriction on international trade.¹¹⁸ Under Article XXI of the GATT, various national security exceptions are provided for that permit a Member to take any action which it considers necessary for the protection of its essential security interests relating to fissionable materials and traffic in arms and munitions or which reflects the exigencies of war or other emergency in international relations.¹¹⁹ Article XXV(5) provides that, in exceptional circumstances not otherwise provided for in the Agreement, the Members may waive an obligation imposed on a Member by the GATT, provided that any such decision is approved by a two-thirds majority of the votes cast and such majority comprises more than half of the Members. This waiver provision has been invoked on a number of important occasions, including the 1955 US agricultural waiver application and the Canada-US Auto Pact in 1965.

The federal state clause

International trade commitments entered into by federal states, such as the USA, Canada, Australia and Germany, have posed a problem in international trade law to the extent that commitments made by national levels of government do not constitutionally bind subnational levels of government who, of course, are not direct signatories of the GATT. Unitary states see this problem as resulting in an unfair form of asymmetry in reciprocal commitments. Article XXIV(12) of the GATT provides that 'each Member 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 within its territories'. This clause has been strictly interpreted in several GATT panel decisions and provides very limited grounds for excuse for non-compliance by federal states.¹²⁰

The governance of the WTO

With the failure of the initial Members to endorse the creation of the ITO and the Havana Charter of which it was part, the GATT, at least on its surface, was born with an anaemic institutional structure relative to many other international organizations, such as the International Monetary Fund and the World Bank. These other organizations were seen

as largely addressing and coordinating matters of external economic and political relations, while the ITO and Havana Charter were perceived as possessing the potential for constraining many domestic policies and hence trenching, to a greater extent, upon domestic political sovereignty. However, over the course of time, various institutional structures evolved that appear to have proven reasonably serviceable in the management of the GATT. A committee of ministers of trade from Member countries met periodically, although most of the effective collective decision-making was channelled through the Council of Representatives, which met on a monthly basis in Geneva, and was drawn from permanent GATT delegations of Member countries, with each country entitled to one vote. The Council of Representatives was supplemented by various specialized committees and working parties as well as dispute resolution panels appointed on an *ad hoc*, case-by-case basis. The full-time staff of the GATT/WTO is headed by a Director-General, appointed on a fixed-term basis by consensus of the Contracting Parties. Article XXV(4) of the GATT dictates that decisions of the Members shall be taken by a majority of the votes cast, except as otherwise provided for in the Agreement. Article XXXIII allows for the accession of new members, if supported by a vote of a two-thirds majority of all Members. Article XXX provides for amendments to the GATT provisions. Part I of the Agreement containing the Most Favoured Nation principle and the principle of tariff bindings may only be amended by consent of all the Members. Other provisions may be amended by a two-thirds majority of all the Members, but amendments become binding only with respect to those Members which accept the amendment. Under the WTO Agreement establishing the World Trade Organization (WTO), at the culmination of the Uruguay Round, governance of the GATT is now vested in the WTO. A Ministerial Conference composed of representatives of all Members must meet at least every two years. Otherwise governance issues are vested in the General Council of the WTO (replacing the Council of Representatives), which also functions as the Dispute Settlement Body and the Trade Policy Review Body.

With respect to specific disputes between Members (which it must be emphasized are governments, not private parties), Article XXII imposes an obligation on Members to accord sympathetic consideration to complaints of other Parties and adequate opportunity for consultation with such Parties. If the Members cannot resolve a dispute through mutual negotiations, perhaps assisted by mediation of a third party, including the Director-General of the GATT or his or her staff, the dispute must then be addressed within the framework of Article XXIII, now substantially elaborated in the WTO Understanding on Rules and Procedures Governing the Settlement of Disputes. Under this Article, if a Member considers that any benefit accruing to it directly or indirectly under the GATT is being 'nullified or impaired' by a policy or practice of another Member, the complaining Party can refer its complaint to the Members as a group, previously the Council of Representatives, now the General Council of the WTO acting as the Dispute Settlement Body, which will appoint a panel to investigate the complaint and make recommendations to the Council for resolution of the dispute. Panels typically comprise three individuals, drawn from countries other than the disputing Parties, who meet privately with the disputing Parties to ascertain the facts and the precise nature of the allegations, and if possible to resolve the dispute informally. If this is not possible, the panel will make recommendations to the Council as to the resolution of the matter. The Council makes decisions on panel recommendations on a consensus basis, previously

requiring consensus in favour of adoption of a panel's recommendations but now, under the Uruguay Round Dispute Settlement Understanding requiring consensus in favour of rejection. Under the Understanding, panel decisions may now be appealed on matters of law to a standing Appellate Body of seven members. If the Council adopts the recommendations of a panel or the Appellate Body then a Member is required to modify or withdraw its policy or practice to bring itself into conformity with the Council's decision. If it fails to do so, the Council may authorize retaliatory action by the aggrieved Party in the form of a suspension of trade concessions or other obligations, the level of which is subject to arbitration. Despite a number of seemingly odd features of, this dispute resolution process, when compared with domestic adjudication processes, in many respects it has worked reasonably well over the years. Several hundred complaints have been investigated since the inception of the GATT, as we will see in a later chapter. There has been a high compliance rate with panel recommendations and Council decisions, despite the hypothetical ability of losing Parties (until recently) to veto adoption of adverse panel recommendations. Moreover, aggrieved Parties have rarely found it expedient to pursue retaliatory action against Parties adversely affected by panel or Council decisions.

The WTO Agreements

On 19 December 1993, Member countries of the GATT reached a wide-ranging and ambitious agreement on many trade and related issues, after seven years of negotiations which were characterized by much higher levels of rancour and controversy than any of the previous MTN rounds. While the Uruguay Round seemed often at the point of collapse, the WTO Agreement eventually reached signifies substantial progress on a number of important issues.

With respect to goods, substantial average cuts in tariffs (of about 38%) were agreed to. In the case of agricultural products—a key area of controversy—the EU agreed to significant cuts over time in export subsidies, and Member countries agreed to abandon quantitative restrictions, which are to be replaced by tariffs. In the case of textiles and clothing, the MFA will be dismantled by degrees, with quantitative restrictions again being replaced by tariffs, which are to be reduced over time. The general safeguard regime has been significantly strengthened by adoption of firm time-limits for safeguard measures and for limiting their readoption; by improving multilateral notification and surveillance; and by requiring existing grey-area measures to be brought into compliance with the new regime or terminated. A modestly revised Antidumping Agreement was also negotiated, as well as a much more fully elaborated Subsidies and Countervailing Measures Agreement. A revised Government Procurement Agreement provides for somewhat greater coverage of government contracting than the Tokyo Round Code. With respect to intellectual property, substantial harmonization of domestic intellectual property regimes around norms prevailing in the USA and a number of other industrialized countries was agreed to. Agreements on Sanitary and Phytosanitary Standards and Technical Barriers to Trade were also negotiated.

With respect to international trade in services, a process for liberalization largely based on scheduled commitments that Members are prepared to make and to which the National Treatment principle presumptively applies, has been set in motion. With respect

to trade-related investment measures, local sourcing and minimum export requirements as conditions for approval of foreign investments have been prohibited.

With respect to the governance of the GATT, a World Trade Organization (WTO), now with over 140 Members, has been created to oversee an integrated dispute settlement regime and to undertake a proactive trade policy surveillance role. In addition, Membership of the WTO now entails commitment to most of the GATT Agreements which are fully integrated into the GATT/WTO, and no longer operate on a conditional MFN basis as was the case with most of the Tokyo Round Codes, where only signatories to each code were subject to its obligations and entitled to its benefits (a so-called ‘single undertaking’).

The Doha Declaration¹²² of November 2001 lays out the work programme for a new round of negotiations on the WTO Agreements. The work programme includes the following elements: implementation-related issues and concerns, agriculture, services, market access for non-agricultural products, trade-related aspects of intellectual property rights, the relationship between trade and investment, the interaction between trade and competition policy, transparency in government procurement, trade facilitation, WTO rules, dispute settlement understanding, trade and environment, electronic commerce, small economies, trade, debt and finance, trade and transfer of technology, technical co-operation and capacity building, least-developed countries, and special and differential treatment.

The Canada-US Free Trade Agreement and the North American Free Trade Agreement¹²³

History

Canada and the USA have a long and tangled history of bilateral arrangements pertaining to trade.¹²⁴ In 1854, both countries agreed to the Reciprocity Treaty which provided for a measure of free trade with respect to Canadian exports of certain agricultural products and natural resources and US access to Canadian inshore fisheries. However, the USA cancelled this treaty in 1865, in part reflecting US unhappiness with what was perceived to be Canadian complicity with Britain in supporting the Confederacy side in the US Civil War, and in part due to opposition by US agricultural interests. In 1879, Prime Minister John A. MacDonalld announced the National Policy, which entailed high levels of tariff protection for manufacturers in central Canada, complemented by policies to support western settlement and provide markets for their goods, which would be encouraged through the development of a national transportation system. In 1911, the Liberal government led by Sir Wilfred Laurier negotiated a tentative free trade agreement with the USA, partly in response to dissatisfaction by farmers in western Canada with the high cost of domestically produced farm implements. However, debate in Parliament forced Laurier to call an election, during which the Conservatives strongly opposed a free trade agreement with the USA on the grounds that this would mean increased competition for Canadian farmers because of the earlier US growing season; would jeopardize relations with Britain; and would risk importing US economic difficulties such as unemployment. The Liberals lost the election, and the agreement was never ratified.

In 1934, the US Congress, on the initiative of President Roosevelt, enacted the Reciprocal Trade Agreements Act, and in 1935, pursuant to this Act, a Canada—US bilateral agreement was negotiated which provided for some modest tariff reductions. In 1948, Canadian and American negotiators negotiated a comprehensive bilateral free trade agreement, but Prime Minister William Lyon Mackenzie King refused to present the agreement to Parliament for adoption on the grounds that it would ultimately lead to union with the USA and separation from Britain. In 1965, Canada and the USA negotiated the Auto Pact which provided for conditional duty-free trade between Canada and the USA in original equipment, auto parts, accessories and most types of motor vehicles.

In a 1975 report entitled *Looking Outward*, the Economic Council of Canada proposed that Canada contemplate substantial trade liberalization with the USA. In 1978, the Senate Committee on Foreign Affairs took a similar position. In 1983, the Department of External Affairs issued a Review of Foreign Trade Policy recommending that the government consider the advisability of sectoral free trade with the USA in urban transport equipment, textiles, agricultural equipment and petrochemicals. In 1986, the Macdonald Royal Commission on the Economic Union and Development Prospects for Canada, after undertaking an extensive review of all of Canada's trade policy options, strongly recommended that Canada initiate negotiations with the USA to secure a comprehensive bilateral trade agreement. The Mulroney Conservative government, which was elected in 1984, initiated formal negotiations with the USA in 1986. Negotiations culminated in the Canada-US FTA, which was signed by the two countries on 2 January 1988 and subsequently ratified by the legislative bodies in both countries. As of 1988, two-thirds of Canada's imports came from the USA and three-quarters of its exports went to the USA. About one-fifth of US imports came from Canada and one-quarter of US exports went to Canada. The trading relationship has substantially expanded over the past decade and a half and is the largest bilateral trading relationship in the world. Subsequent to the FTA, the USA, Canada and Mexico entered into negotiations to secure a North American Free Trade Agreement (NAFTA), in large part by extending the Canada—US FTA to Mexico. An agreement was reached on 12 August 1992 and subsequently ratified in all three countries. Because the FTA is now largely subsumed in the NAFTA, we will confine our overview to the latter.

Trade in goods

Most tariffs between the three countries will be eliminated over a ten-year period, in accordance with stipulated phase-out schedules, with a few products subject to a 15 year transition period. Most import and export restrictions, in particular quotas and import licences, will be eliminated (Chapter 3, Article 300). Canada—US bilateral tariffs will continue to be phased out under the ten-year FTA schedule. Only goods originating within the three countries are entitled to the benefit of the reduced tariffs provided for by the NAFTA. Goods which are wholly obtained in either or both countries are deemed to originate in the country from which they are exported and are entitled to NAFTA treatment (Article 401). Goods incorporating third-country materials generally qualify for NAFTA treatment, provided sufficient processing has occurred to cause them to have a tariff classification different from that of the component materials (Article 402). In other

cases, special content rules must be satisfied as well (Article 402). With respect to automobiles, 62.5% of NAFTA content (rather than 50% under the FTA) is required to qualify for preferential treatment (Article 403). Textiles and clothing must be produced from yarn spun in North America or from fabric made from North American fibres to qualify for preferential treatment (Chapter 4). There are some limited exceptions to these latter rules, through a system of tariff rate quotas (TRQs), which allows preferential treatment of exports up to agreed ceilings even though the rules of origin are not met. The textile and clothing provisions of the Agreement also contain a safeguard mechanism enabling a country to impose trade restrictions to provide temporary relief during a transition period. These rules of origin in the auto, textile and clothing sectors have particular potential for creating trade diversion rather than trade expansion and seem principally motivated by concerns that, in their absence, foreign firms would use Mexico, with its low-cost labour, as a platform to access the North American market.

With respect to agriculture, the USA and Mexico have agreed to eliminate all nontariff barriers to trade and to convert these to tariffs or TRQs (Chapter 7, Section A). Tariffs will be eliminated over ten years. Extended periods are provided in the case of sensitive products, such as corn and dry bean exports to Mexico, and orange juice and sugar exports to the USA. Canada and Mexico have agreed to remove all tariff and non-tariff barriers to agricultural trade over ten years except with respect to dairy products, poultry, eggs and sugar. The agricultural provisions also contain a special safeguard provision that can be invoked during the first ten years of the Agreement if imports exceed specified trigger levels. The use of export subsidies for agricultural products is generally discouraged and permitted only in response to non-NAFTA country subsidies, but subject even in this event to consultation procedures. The Agreement provides for efforts at harmonization of grade and quality standards with respect to agricultural products.

Sanitary and phytosanitary (SPS) measures maintained or introduced by any NAFTA country are permitted provided they are not a disguised form of trade restriction and are based on scientific principles and a risk assessment (Chapter 7, Section B). Where possible, NAFTA countries commit themselves to using relevant international standards and to working towards equivalent SPS measures without reducing any country's chosen level of protection of human, animal or plant life or health.

NAFTA members can undertake safeguard action during the transition period if NAFTA imports are a substantial cause or threat of serious injury to a domestic industry (Chapter 8, Article 801). Safeguard action can only be taken once and for a maximum period of three years (Article 801(21)). Where a country takes a multilateral (GATT) safe-guard action, NAFTA partners must be excluded unless their exports account for a substantial share of total imports (among the top five suppliers) and contribute importantly to the serious injury or threat thereof (Article 802).

With respect to government procurement (Chapter 10), National Treatment obligations are adopted with respect to purchases by government departments or agencies over US\$50,000 for goods and services and over US\$6.5 million for construction services. With respect to federal government enterprises, these thresholds are raised to US\$250,000 and US\$8 million respectively. Each country must give sufficient notice of procurement opportunities to ensure equal competitive conditions for foreign and domestic firms and must set up bid-challenge procedures to enable suppliers to challenge awards.

Trade in services

With respect to trade in services (Chapter 12), both the National Treatment and MFN principles are adopted. The Agreement provides that no local presence is required to provide covered services. A number of reservations have been entered with respect to which services are covered and which are not (Article 1206). With respect to licensing and certification of professionals, the Agreement provides that entry requirements should be related solely to competence and endorses a qualified mutual recognition principle (Article 1210). In the case of land transportation services, the Agreement provides for full access to each country's rail services and for cross-border provision of bus and trucking services to be phased in over a transitional period (Annex 1212). Coastal shipping restrictions are exempted from the Agreement.

The Agreement recognizes the right of establishment with respect to banking, insurance, securities and other financial services, and adopts the National Treatment and MFN principles with respect to financial services generally (Chapter 14). Canada committed itself to extending the FTA exemption from the 25% non-resident ownership restriction rule in the case of the USA to Mexico and the exemption from the aggregate asset ceiling on foreign banks operating in Canada. Mexico reserved the right to impose aggregate and individual market share limits on foreign firms in the financial services sector during a transitional period expiring in the year 2000.

North American firms will have access to and use of public telecommunications networks and services on a reasonable, non-discriminatory basis including the right to have private lines, attach terminal equipment, interconnect private circuits, perform switching, signalling and processing functions, use operating protocols of the user's choice, and operate private intra-corporate communications systems (Chapter 13). Foreign ownership restrictions in voice-mail and other value-added services will be eliminated.

Cross-border trade with Mexico in electricity and natural gas is substantially liberalized under the NAFTA although the Mexican state monopoly in the petroleum industry is maintained (but relaxed with respect to some petrochemicals). Energy trade between Canada and the USA continues to be governed by the FTA. Exceptions to free trade in energy relate to conservation, price stabilization and natural security, but permitted restrictions must be applied on a proportional sharing basis between the two countries so as to ensure that the burden of restrictions applies equally to domestic and foreign markets (Chapter 6).

The Agreement also provides for a regime of temporary entry visas for business persons into any NAFTA country (Chapter 16).

Investment

Both the National Treatment and MFN principles are adopted (Chapter 11). Performance requirements of foreign investors are generally prohibited (Article 1106). A NAFTA member may not expropriate investments of a NAFTA investor except for a public purpose and on payment of compensation reflecting fair market value (Article 1110). Canada has reserved the right to continue reviewing foreign investments above a \$150 million threshold as provided in the FTA. Mexico is committed to raising its foreign investment review threshold to \$150 million within ten years of the implementation of

the Agreement. The investment provisions do not apply to Mexico's petroleum, basic telecommunications and rail sectors, US airlines and radio communications, or Canada's cultural industries. The Agreement also provides that no NAFTA country should lower its environmental standards in order to attract investment (Article 1114). NAFTA investors may seek binding arbitral determinations in international fora for violations of these investment obligations and enforce arbitral awards in domestic courts (Chapter 11, Section B).

Competition policy, monopolies and state enterprises

Each country commits itself to maintaining laws regulating anti-competitive practices (Chapter 15). In the case of state enterprises and domestic monopolies, these enterprises are not to discriminate against other NAFTA firms or citizens in buying or selling goods and services and are to follow normal commercial considerations in their contractual activities (Article 1502). A trilateral committee is to be created to review the relationship between competition laws and trade matters, including presumably trade remedy laws (Article 1504). A side-agreement initiated by Canada commits the member countries to attempting to negotiate new legal regimes on dumping, subsidies and countervailing duties within two years of the implementation of the Agreement (although this has failed to yield any tangible results).

Intellectual property

The Agreement has an extensive set of provisions protecting patent, copyright and trademark rights, and providing for their effective enforcement (Chapter 17). These provisions largely parallel the Uruguay Round Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS).

Institutional arrangements

The Agreement provides for the creation of a NAFTA Trade Commission, to be supported by a full-time Secretariat, and complemented by various working groups and committees (Chapter 20). Dispute resolution provisions provide that five-person binational panels drawn from a roster of nominees from the disputing countries will adjudicate on disputes between two member countries of the NAFTA, with the third member reserving the option of either participating in the proceedings or pursuing its own process of consultation and dispute resolution (Chapter 20, Section B). In an interesting innovation, disputing countries must select panellists from the other disputing country's roster of nominees (Article 2011). Where complaint procedures are open to a NAFTA country under either the GATT or NAFTA, a complainant country is entitled to choose which regime it pursues its complaint under, except where the complaint pertains to health, safety or environmental standards, where the respondent country can insist on dispute resolution under the NAFTA (Article 2005). In this event, the Agreement provides for the creation of scientific boards to provide expert evidence to panels adjudicating on questions pertaining to health, safety and environmental standards.

The NAFTA renders permanent a special and temporary dispute resolution process initially adopted under the FTA for antidumping and countervailing duty determinations (Chapter 19). Under this mechanism, if an aggrieved Party so demands, binational panels must be struck as an alternative to pursuing domestic judicial review processes. These binational panels, which comprise five experts drawn from permanent lists provided by each Party (two from each Party with agreement normally on a fifth person as Chairperson), may only review final domestic antidumping and countervailing duty determinations for consistency with applicable domestic laws using domestic standards of judicial review. The decision of a panel is binding on the Parties, except for a limited right to request a threeperson 'Extraordinary Challenge' committee, comprising judges or former judges from the countries in dispute, to review a panel's decision. Each Party reserves the right to change or modify its antidumping or countervailing laws, provided that any such amendment expressly stipulates that it shall apply to goods from the other Party. Where a Party complains that such an amendment is inconsistent with the other Party's obligations under the GATT or with the object and purpose of the NAFTA, that Party may request that the amendment be referred to a panel for a declaratory opinion. Where the declaratory opinion reports an inconsistency, the Parties must consult and seek a mutually satisfactory solution to the dispute, including remedial legislation with respect to the statute of the amending Party. If remedial legislation is not enacted within nine months from the end of the 90-day consultation period provided for and no other agreement has been reached, the complaining Party may take comparable executive or equivalent legislative action, or terminate the Agreement with regard to the amending Party on 60 days' written notice.

Side-accords on environmental and labour standards

Subsequent to the negotiation of the NAFTA, the Clinton Administration initiated a further set of negotiations on environmental and labour standards that resulted in trilateral side-accords that set up an elaborate institutional machinery to ensure that existing environmental and labour laws in each of the three countries are effectively enforced with the possibility of fines and trade sanctions as penalties for non-compliance. The accords also provide for consultative mechanisms designed to promote a higher degree of harmonization of standards in these areas in the future.

The framework of economic integration in the European Union¹²⁵

The 'constitution' of the European Union is the Treaty Establishing the European Community, usually known as the Treaty of Rome.¹²⁶ It states the basic principles of economic union—the free movement of goods, persons, services and capital—and contains a variety of legal norms aimed at the realization of these freedoms. In addition to provisions that prohibit customs duties on imports from Member States, quantitative restrictions and 'equivalent measures' are prohibited (Article 30), as are certain state aids to industry.

The Treaty imposes constraints on Member States' governments as well as positive obligations. However, even where the Treaty of Rome requires further positive action in the form of cooperation between governments, this is much more than a 'best-efforts'

exhortation. In fact, it has the status of a juridical norm. To those accustomed to Anglo-American understandings about the rule of law, this may at first appear strange, since court action is not generally available to force governments to bring into being positive policy measures. It is, however, quite consistent with Continental notions of constitutional law as embodying the most general legal norms. In turn, these norms are realized by the enactment of secondary or derivative norms by governments.

The Treaty of Rome establishes several institutional mechanisms for the realization of the Treaty norms: the European Court of Justice (ECJ), the European Commission, the Council of Ministers and the European Parliament. Some of the most important 'economic union' provisions in the Treaty of Rome are directly enforceable by the European Court. These allow a citizen (or in some instances a corporation) in a Member State to apply to the judiciary for relief against measures of her own or another State that violate provisions of the Treaty. While direct enforceability or application only exists for some aspects of the Treaty, it has been of major importance in making the Union something more than a common market or customs union. In most free-trade agreements, dispute settlement is an intergovernmental process. As a result, dispute settlement has strong political and diplomatic dimensions. By contrast, the Treaty of Rome is in significant respects a *supranational constitution*, conferring enforceable legal rights on Union citizens.¹²⁷

In addition, a number of provisions of the Treaty are explicitly enforceable by the European Commission, but are subject to judicial review. This is, in particular, the case with competition policy and the prohibition of state aids (subsidies) that distort competition within the Union. The Commission is an executive body consisting of representatives appointed from the Member States, but obliged by law to act independently of their governments. Appointments must be acceptable to all Member States.¹²⁸ The Commission must always have a member from each Member state. Decisions of the Commission must be approved by a simple majority of the Members. In practice, where the Commission makes decisions in individual cases with respect to subsidization, it depends to a large degree on the advice of an extensive technical staff of European civil servants. Decisions of the Commission (e.g. with respect to state aids) are directly binding on Member States, and do not require any kind of political approval or agreement by the governments of the Member States of the Union. The Member States may, however, by unanimous vote, override Commission decisions on some matters (a highly unlikely occurrence).

With respect to harmonization of regulatory regimes through European law, the Commission plays a crucial role, as does the Council of Ministers. The Council consists of political representatives from all major States. It makes regulations and directives upon the initiative of the Commission. Regulations are directly binding in the legal systems of the Member States, whereas implementation of directives requires domestic legislation. Directives allow some flexibility as to the manner of implementation by the Member States, although there is some protection against the possibility that Member States will misimplement or fail to implement them. In those circumstances, the directive may become directly enforceable in court, even by an individual or firm, if it is adequately specific to give rise to a determinate legal meaning.¹²⁹ In addition, the Commission or another Member State can take a recalcitrant Member State to the European Court to force it to implement a directive properly. In some instances, the key issue will be

whether the domestic implementing legislation adequately achieves the result intended by the directive. The important point is that directives are not just exhortations to national political authorities to make ‘best efforts’, but are legally binding with respect to *result*. Whether a given domestic statute *achieves* a result is a question of *law* to be determined by independent supranational authorities.

Directives generally no longer require unanimous approval of the Council. Instead, under the Single European Act of 1986, they must be endorsed by a weighted majority of votes. Harmonization through unanimous agreement between Member States proved to be difficult because of hold-out problems.¹³⁰ The practice of weighted majority voting has been further refined and expanded in later instruments, including the Treaty of Nice (see below).

Non-discrimination norms vs. legitimate public purposes

The major legal limits to non-tariff barriers with respect to goods are contained in Articles 30 and 34 of the Treaty of Rome. They prohibit quantitative restrictions and ‘all measures having equivalent effect’ on imports and exports. Article 36, in turn, provides specific derogations from these strictures, based on public objectives related to health and safety, public security and morality, and protection of national cultural treasures, among others.¹³¹

Early in the jurisprudence of the Union, the scope of Articles 30 and 34 was extended beyond measures that discriminated on their face against non-domestic products to those that merely had a disparate impact. Thus, in the *Cassis de Dijon* case,¹³² the Court held that a German law that prohibited the sale of the liqueur cassis with less than 25% alcohol content violated Article 30. It prevented the import of French cassis which had an alcohol content below 20%. However, the Court suggested that, where measures are not facially discriminatory but have a disparate impact, they may be saved if they are ‘necessary in order to satisfy mandatory requirements relating in particular to the effectiveness of fiscal supervision, the protection of public health, the fairness of commercial transactions, and the defence of the consumer’.

The test of necessity involves consideration of whether alternative measures less restrictive of intra-Union trade might adequately satisfy the ‘mandatory requirements’ at issue.¹³³ Hence, if the goal was to ensure that consumers were not misled by an assumption about the domestic product into thinking that the foreign product contained an equivalent amount of alcohol, labelling requirements would suffice. Similarly, in the *German Beer Standards* case,¹³⁴ the Court impugned a German law which required any product sold with the label ‘Beer’ in Germany to meet German purity standards. The Court reasoned that consumers could be informed of the difference between beers through the use of appropriate labelling requirements. Where health risks are claimed as a basis for content requirements that affect trade, and where less stringent requirements are in place elsewhere in the Union, the Court places some burden on the defendant Member State to produce empirical evidence of the risks in question.

State aids

State aids (e.g. subsidies) are dealt with under a separate regime from that in Articles 30, 34 and 36 of the Treaty of Rome. The major relevant provision is Article 92(1) which prohibits 'any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings, in so far as it affects trade between Member States'. Certain derogations are permitted, including aid to underdeveloped areas or 'to remedy a serious disturbance in the economy of a Member State'.¹³⁵ Article 93 makes the Commission responsible for monitoring and enforcement of the state aid prohibitions. A process is mandated whereby the Commission must be informed of any new state aid with sufficient advance notice to determine its consistency with the Treaty. Moreover, it can require the subsidizing State to amend an aid programme to make it consistent with the Treaty. Decisions of the Commission are reviewable by the Court.

Placing review of state aid measures in the hands of the Commission reflects the fact that an approach which emphasizes legal rules and orders is unsuited to dealing with the complex subsidy and tax incentive programmes of advanced, mixed economies. Furthermore, the procedure of *ex ante* review takes into account the possible consequences for workers and other relatively vulnerable constituencies if an existing aid programme were suddenly to be declared invalid by the Court. Finally, the possibility of adjustment to an aid programme through negotiation between the Commission and the granting State allows for positive-sum solutions. These solutions might involve, for instance, aid earmarked to sustain existing production in a surplus capacity sector being modified in the direction of a managed exit approach.

Harmonization

The 'Europe 1992' initiative, launched by the coming into force of the Single European Act in 1987, reflects the fundamental recognition that negative constraints on government actions that impede economic mobility are far from sufficient to achieve economic union. An essential thrust of the move towards completion of the internal market by 1992 is the harmonization of regulatory regimes with respect to financial services, securities, insurance, company law, and telecommunications, as well as community-wide standards with respect to product safety, technical specifications, etc. The importance of this aspect of 1992 is well illustrated by Hufbauer:

Differing national technical and licensing regimes create major obstacles to a unified market. These are by far the most important barriers, for they restrict market entry on a grand scale. The Cecchini Report puts the gains from opening market entry, and the consequent intensification of competition and realization of scale economies, at about \$240 billion. Differing product standards and certification procedures hamper the Europe-wide acceptance of numerous items ranging from autos to pharmaceuticals to packaged cereals.¹³⁶

Various initiatives of the harmonization enterprise being undertaken appear to fall short of truly centralized regulation, in that they involve a process of mutual or reciprocal recognition. In this process, if a firm, product or service complies with domestic regulatory requirements in the Member State which is its 'home', it is allowed into the market of other Member States without being subject to further or different regulatory requirements by the other States. While this approach allows regulatory control to be retained at the level of Member States, a *sine qua non* is the setting of minimum, community-wide standards for regulation. Depending on the area, this can entail quite detailed Community-level regulatory requirements. Moreover, as disputes or concerns emerge whereby the receiving State is dissatisfied with the degree of regulatory protection afforded by the 'home country' regime, an ongoing institutional mechanism exists to promulgate new or better-defined Community-level standards or rules. The endpoint of the process of mutual recognition may indeed be detailed, unified regulation. This is consistent with the fact that mutual recognition was regarded as a means of speeding up harmonization by generating, from the bottom up, the requirements of harmonization rather than engaging in predicting all the requirements of a uniform regulatory regime.

The Maastricht Treaty and the Treaty of Amsterdam

The Treaty on European Union,¹³⁷ better known as the Maastricht Treaty, was signed by the heads of government of the European Union in February 1992 and has now been ratified by all Member States. It was intended as a blueprint for a fundamental deepening of European integration. Undoubtedly, the most radical and ambitious aspect of Maastricht was its framework for the creation of a single European currency by the end of the last century, to replace national currencies of the Member States, and its establishment of a European Central Bank (ECB). The plan for European monetary union envisaged as a prerequisite for a single currency the alignment of macroeconomic policies of Member States, including the achievement of price stability (low inflation) and the elimination of excessive budget deficits (Article 109j).

In addition, the Maastricht Treaty called for the creation of a common European foreign and security policy (Title V). Where the Council takes a common position on foreign policy, individual Member States are to be bound by it in their own conduct (Title V, Article J.2). However, this requirement is of limited significance, since unanimity is required for Council decisions on foreign policy (Article J.8.2).

Another important feature of Maastricht was a strengthening of the social agenda of the Union, with the Council being given the explicit mandate to adopt directives binding on Member States with respect to working conditions, occupational health and safety, and equality in employment. Importantly, qualified majority voting applies with respect to adoption of these directives by the Council (Protocol on Social Policy, Article 2.2). However, with respect to social security, protection of workers in the case of termination of employment, and the work conditions of *Gastarbeiter*, the unanimity rule applies (Article 2.3).

The Treaty also established immigration policy (i.e. with respect to immigration into Community countries from outside the EC) as a matter of common interest, with

measures implementing joint action on these matters to be adopted by the Council according to the qualified majority voting rule (Title VI, Articles K.1, K.3).

Finally, the Maastricht Treaty envisaged a number of institutional changes that address (albeit in a rather modest way) concerns about the Union's 'democratic deficit'. An Office of Ombudsman was established under the aegis of the European Parliament to address citizen complaints about 'maladministration' by non-judicial Union institutions and officials (Article 138(e)). Also, the Parliament was given a specific mandate to be proactive—it can request the Commission to submit a proposal to it on any matter where Union action is required to implement the Treaty. In addition, the number of matters on which co-decision (i.e. approval by the European Parliament) is required, as opposed to mere consultation between the Commission and the Council, has been somewhat expanded.¹³⁸

A number of obstacles emerged to implementing the Maastricht Treaty. First of all, Britain only agreed to Maastricht on condition that it was able to opt out of the social policy and monetary union provisions of the Treaty. Particularly on the single currency and monetary union, this opt-out represented a calculated wager that a more pro-European stance would emerge in Britain, and the opt-out would thus be temporary.

Perhaps more importantly, the virtual collapse of the existing arrangements for coordination of exchange rates within the European Union (the European Monetary System (EMS))¹³⁹ in the autumn of 1992 and the summer of 1993, in the presence of overheated speculative market activity anticipating currency realignments, cast a shadow on the capacity to move forward with much more radical plans for monetary integration. While some supporters of European monetary union saw these crises in the EMS as reinforcing the logic of moving to a single currency in order to eliminate exchange rate instability, many observers have viewed the crises as suggesting that the political pressures on individual countries to adopt different monetary policies remained too great to allow the degree of common macroeconomic policy discipline needed to sustain fixed exchange rates, let alone a single currency.¹⁴⁰ In fact, monetary union has been largely adopted, as discussed in Chapter 5 on trade, exchange rates and the balance of payments, with the euro becoming the exclusive currency of EU Member States in 1999, with the exception of the UK, Denmark and Sweden.

Furthermore, the initial rejection of the Maastricht Treaty in a referendum in Denmark in the spring of 1992, and its near rejection in a French referendum in September 1992,¹⁴¹ have slowed the pace of ratification, although the Union authorities seem determined to find a way around these setbacks. For instance, a set of modifications and qualifications with respect to Denmark's obligations under Maastricht eventually succeeded in securing Denmark's ratification of the Treaty. But the populist backlash against the deepening of European integration has led to sober second thoughts in European political circles more generally about the appropriate pace of deepening. One range of concerns that deserves noting is that the provisions respecting immigration policy in the Maastricht Treaty have served as a flashpoint for rejection by the right and far-right in a number of European countries, most notably France and Germany, where immigration is already an extremely sensitive political issue. Some commentators worry that the possibility of loss of national control over immigration policies raised by Maastricht might serve to fuel growing antiimmigrant and racist sentiment in some EC Member States.¹⁴²

It should be emphasized that, while Maastricht became the main focus for public antiUnion sentiment, less attention was paid to the increasing activism of the European Commission and Council in implementing the Europe 1992 agenda of harmonization of regulations and standards in many important areas of economic activity (e.g. financial services). An increasing number of harmonization measures, in matters such as product standards and environmental control, are being justified as necessary for the completion of the internal market. The principle of subsidiarity, as explicitly recognized in the Maastricht Treaty, is that the Union should only act where 'the objectives of the proposed action cannot be sufficiently achieved by the member states' (Article 3b). However, this principle is only to apply to matters that do not fall within the 'exclusive competence' of the Union, and therefore does not limit the scope of Union action with respect to completion of the internal market.

The Treaty of Amsterdam (signed in October 1997 and in force from 1999) provides mechanisms to allow sub-groups of Members of the EU to conclude agreements among themselves and also contains some measures dealing with the 'democratic deficit', including an expansion of the co-decision role of the European Parliament. The Treaty also incorporates the Schengen Agreement, whereby all EU Members except the UK and Ireland eliminated their border controls within their common area (the UK and Ireland may continue to impose border controls).

The Treaty of Nice (2000) extended weighted majority voting to more subject matters of EU regulation, and also set out the weighted votes that each Member would have, reflecting the expansion of the EU membership anticipated in 2004. The treaty also provides for a framework for creation of political parties at the European level, with the intention of giving greater coherence and effectiveness to the European Parliament. It contains new rules to facilitate 'enhanced cooperation' between sub-groups of the EU Membership, again anticipating that with expansion of the EU there may be groups of Member prepared to go faster and further in the integration process than others ('flexibility'). The Treaty of Nice also seeks to relieve the work-load of the European Court of Justice by expanding the role of the Court of First Instance. Finally, in connection with Nice, the European Union adopted a Charter of Rights.

The 2001 Laeken Declaration provided for the creation of a European Constitutional Convention, made up of representatives from Member governments, national parliaments, and the European institutions. Former French President Valéry Giscard D'Estaing was named the head of the Convention. A draft constitution was debated in the Convention during 2003; however, negotiations broke down over issues such as the voting weight to be accorded to different countries, large and small, after expansion (with some member states using the Convention as an opportunity to re-open what had been agreed on these matters in the Nice Treaty), although a compromise seems now to have been reached, subject to ratification by referenda in a number of member states. The constitution is mainly aimed at consolidating the institutional arrangements of the EU, and streamlining its governance, in recognition that the EU will be a much larger and more diverse entity after expansion.

2

The Most Favoured Nation principle

The Most Favoured Nation (MFN) obligation calls for a country to grant to every other country with which it has signed an MFN treaty the most favourable treatment that it grants to any other country with respect to imports, exports and related regulations. Although the expression ‘most favoured nation’ suggests that some sort of special treatment or privilege is accorded to the country entitled to MFN treatment, the idea underlying the principle is the opposite, that is the main objective of the principle is to prevent discrimination, by generalizing concessions made to a specific trading partner. The MFN principle is often referred to as the cornerstone of the multilateral trading system.

HISTORY

The MFN clause went through several stages of development until its introduction in the General Agreement on Tariffs and Trade 1947 (the GATT).¹

First stage: eleventh century to eighteenth century

The genesis of the MFN clause arguably dates back to the year 1055, when Emperor Henry III of the Holy Roman Empire granted the city of Mantua all customs privileges granted to whatsoever other town.² In the twelfth and thirteenth centuries, the clause was used to guarantee equality of treatment for the rival trading cities of the Mediterranean in their commercial relations with the Arab princes of northern Africa.³

In its first stage, the clause was unilateral in form. However, as world trade expanded in the fifteenth and sixteenth centuries, nations could not afford to fall into a position of disadvantage in the markets of their neighbours.⁴ Thenceforth, the bilateral clause, which is reciprocally binding on both parties to the treaty, became the standard form. The Paris Peace Treaties (at the end of the Second World War) contain one of the latest manifestations of the unilateral clause. In these treaties, Austria, Bulgaria, Germany and Hungary ‘conceded to the Allied and Associated Powers, without reciprocity, complete and unconditional most-favoured-nation and national treatment, for a limited time, on a very extensive scale’.⁵

Second stage: eighteenth century to 1825

The phrase ‘most favoured nation’ appeared for the first time in the eighteenth century,⁶ and the clause began to develop into its modern form during this period. At this stage, the clause was unconditional, ‘which meant that the generalization of concessions was not

contingent upon the receipt of concessions equal to those exchanged by the original parties to a commercial treaty'.⁷

Third stage: 1825 to 1860

The third stage began with the signing of a treaty between France and the United States in 1778 containing a 'conditional' MFN clause. This form of the clause would dominate from 1825 to 1860.⁸ Pursuant to the conditional clause, if countries A, B and C sign several bilateral MFN treaties between themselves, concessions made by country A to country B will be extended to C only if country C grants A concessions equivalent to those made by B to A at the time of the granting of those concessions.

The United States was the main country responsible for the propagation of this form of the clause. It was the view of the United States that granting the same privileges to a nation which had not paid any compensation would destroy the equality of market privileges which the MFN clause was intended to secure.⁹

Fourth stage: 1860 to the First World War

The conditional MFN policy was virtually abandoned in the fourth stage of development of the clause, which began with the signature of the Cobden Treaty of 1860 between France and England. According to Snyder, '[a] wave of liberal economic sentiment carried the unconditional clause to the height of its effectiveness. Until the First World War the clause remained the almost universal basis of a vast system of commercial treaties.'¹⁰

Fifth stage: 1918 to 1929

The fifth period begins with the end of the First World War. In the years following the war, France attempted to introduce a system of reciprocity which successfully undermined the movement in support of a multilateral commercial convention. In December 1918, the French Minister of Commerce declared that the government had renounced all commercial conventions which contained the MFN clause. At the Genoa Conference in the spring of 1922, 'France succeeded in stalling off the movement in support of the most-favoured-nation clause.'¹¹ Despite the efforts of the League of Nations, economic depression, among other factors, hampered the full revival of the clause during this period.¹²

The abandonment of the conditional clause by the United States would also occur during this period. The definite change of policy occurred in 1925 when a commercial treaty between the United States and Germany containing the unconditional MFN clause was ratified. This treaty was declared a model for subsequent commercial treaties before the Committee on Foreign Relations of the United States Senate.¹³

According to Viner, the change in policy was motivated by structural changes in the US economy. In earlier years, when the main objective of American commercial policy was to secure the domestic market for American manufactures, and the exports of the United States consisted predominantly of agricultural products and raw materials, the United States proved successful with its conditional interpretation of the MFN clause.

Because at that time ‘foreign countries were dependant on the United States for their supplies of many of these commodities’, they were ‘little likely to apply discriminatory tariff duties to them’.¹⁴ Nevertheless, in the last decades of the nineteenth century, manufactured and partly manufactured products acquired increasing importance in American exports and the situation began to change to the disadvantage of the United States.¹⁵

Sixth stage: 1929 to the Second World War

The sixth stage of development, from 1929 to the end of the Second World War, witnessed a general decline in the use of the clause. In 1930, the United States enacted the Smoot—Hawley Tariff Act, raising tariffs to their highest rates in the twentieth century.¹⁶ The Tariff Act was followed by a wave of discriminatory protectionism and retaliation, which caused the MFN clause to fall into disuse.¹⁷ Exchange controls, clearing agreements, import quotas and monopoly purchase superseded tariffs as the most important methods of trade restrictions and created effective conditions of commercial discrimination. The popularity of such devices was due to the evasions of the MFN clause they made possible.¹⁸ According to Hyder, the trend towards discrimination was further manifested in the movement to extend regional and imperial preferences.¹⁹

In light of these facts, in 1940, Snyder concluded that, although ‘no nation has seen fit to declare its outright abandonment of most favoured nation treatment’, under ‘prevailing conditions this simply means that the clause has been preserved in theory alone’.²⁰

Seventh stage: Second World War to 1947

In this period, the MFN clause resumed its importance and contributed to the beginning of a new era of trade liberalization. It was widely agreed that the pre-war economic nationalism and protectionist policies which led to uneconomic diversions of world trade had strongly contributed to the outbreak of the war. On account of this, the Allied Nations sought to establish international institutions that would liberalize international trade and limit restrictive practices. The GATT reflected this sentiment.

Moved by strong opposition to preferential arrangements, the US negotiators insisted on a strong statement in Article I of the GATT of the unconditional MFN principle.²¹ The United States was successful in its efforts.²²

RATIONALES FOR THE MFN PRINCIPLE

The political rationale for the MFN principle is based on the belief that the ‘MFN principle promotes better international relations since it avoids the bitterness and tensions that may result from discriminatory policies’.²³ The MFN principle inhibits governmental temptations to rely on short-term *ad hoc* policies based on political considerations which could increase tensions among nations.²⁴

Despite the importance of political considerations for governmental policy, the contemporary literature has focused largely on the economic implications of the MFN clause.

The MFN clause finds support in the classical theory of international trade. According to this theory, discrimination between foreign suppliers distorts the working of the price mechanism. 'When governments apply trade restrictions uniformly without regard for the origin of goods, the market system of goods allocation and production will have maximum effect.'²⁵ On the other hand, when governments discriminate between exporters, they cause 'a misallocation of resources by inducing a shift of resources toward those relatively less efficient producers who are favored and away from those more efficient producers who are disfavored'.²⁶

However, under certain circumstances, discrimination may be efficient. Hudec notes that:

The possibility of an efficiency-increasing outcome lies in the fact that a discriminatory tariff reduction does two things at the same time. It reduces the tariff between domestic producers and the favored foreign producers, and it also creates an artificial advantage for the favored foreign producers over other foreign producers. The former effect will produce an efficiency gain ('trade creation') to the extent it allows more efficient foreign producers to supplant less efficient domestic producers, while the latter effect will distort trade ('trade diversion') to the extent it permits favored foreign producers to displace disfavored foreign suppliers who are more efficient. The economic consequence of any discriminatory tariff reduction will depend on which of these two effects predominates, and this in turn will depend on the relative efficiencies of the three relevant groups of producers of the product in question (domestic, favored-foreign and disfavored foreign) and the size of the original MFN tariff on that product.²⁷

Therefore, in circumstances where an MFN tariff reduction is unattainable, a tariff reduction in favour of certain countries may be better (i.e. more efficiency-maximizing) than a situation of higher MFN tariffs.²⁸ This is often proffered as the rationale for regional trading blocs.

Gatsios notes that, while the MFN principle is justified to the extent that it yields positive effects on world production, it becomes more controversial to the extent that it impacts on world income distribution. In terms of the world income distribution effect, it is often argued that the 'MFN principle favours the more developed (and more cost-efficient) countries'.²⁹

Arguably, one of the main virtues of the MFN clause is its multiplier effect, that is MFN treatment 'causes a generalization of liberalizing trade policies, so that overall more trade liberalization occurs'.³⁰ However, if, on the one hand, the automatic extension of concessions caused by the MFN clause contributes to the generalization of liberalizing trade policies, on the other hand the opportunities for free-riding generated by the clause may result in less trade liberalization. According to Schwartz and Sykes, the MFN clause facilitates free-riding on the part of participant nations, which may result in mutually beneficial deals not being struck.³¹ In the absence of the MFN clause, free-riding would not be an available option. Therefore, a 'country that secured a discriminatory concession would realize the full benefit of it and could look to no other source for the

counterconcession required to induce it'.³² In addition, the perceived lack of reciprocity resulting from the application of the MFN principle may make it more difficult for governments to convince domestic interests that trade liberalization is in their interest.³³

The MFN obligation also impacts on the bargaining game by protecting the value of concessions against future erosion, and eliminating the threat of discriminatory arrangements. Schwartz and Sykes note that:

A trading regime without a MFN obligation creates an opportunity for a subset of trading nations to threaten to create a discriminatory arrangement—even one that was not genuinely in their joint interests—unless other nations make concessions to stop it. The possibility of such threats, followed by counterthreats, retaliation, and so on, might make for an uncertain and unstable trading regime that would unravel and threaten the political gains from reciprocal trade negotiations. With the MFN obligation in place, by contrast, nations are disabled from making threats to discriminate.³⁴

In addition, the presence of the MFN clause in a treaty—for example between countries A, B and C—protects the value of concessions by preventing country B from making a better concession with respect to the same goods to country C without extending this concession to A.³⁵ In the absence of the MFN obligation, a concession received by A from B can be undermined if country B later makes a better concession with respect to the same goods to country C. According to Schwartz and Sykes, '[f]aced with this uncertainty, country A would offer less for the concession in the first place (as would country B for the reciprocal concession), and fewer valuable deals would be struck'.³⁶

In a recent economic analysis of the theoretical foundations of the MFN principle, Bagwell and Staiger³⁷ succinctly identify three sets of considerations that bear on its economic effects. First, it constrains bilateral opportunism in sequential negotiations whereby countries A and B may be discouraged from providing concessions to one another out of concerns that one or the other may subsequently grant even more favourable concessions to country C, hence undermining the value of the concessions exchanged between A and B. Second, it contains bilateral opportunism between A and B aimed at disadvantaging non-participating third parties (e.g. C) by diverting trade from them to A or B (a variant of the terms-of-trade Prisoner's Dilemma problem that motivates much of the authors' analysis). This is the converse of Hudec's argument that leads to a justification for regional trading blocs. Third, it creates free-rider problems by generalizing concessions exchanged between A and B to non-reciprocating third parties (e.g. C), hence attenuating incentives for A and B to exchange concessions in the first place by reducing their subsequent bargaining leverage with C, and requires that the MFN principle be complemented by a principle of reciprocity.

The GATT's multilateral institutional structure and its long-term perspective allowed governments to establish more complex arrangements for assuring basic reciprocity and minimizing the negative effects of free-riding.³⁸ For example, in five negotiating rounds under the GATT prior to the Kennedy Round (1964–67), a balance between the concessions that participants made and the concessions they received was achieved by negotiating tariff concessions on a product-by-product basis under the Principal Supplier

rule.³⁹ According to Finger, product-by-product negotiations resulted in very high internalization rates, in the sense that the benefits of trade concessions were confined, to a very large extent, to Parties offering countervailing concessions, with very little free-riding (pursuant to the MFN principle) on the part of exporters who offered no reciprocal concessions. In addition, in multilateral negotiations involving many countries, commitment can always be withheld until the final offers of all participants are known; this may preserve some aspects of conditionally and reciprocity.

GATT 1:1 AND EXCEPTIONS

Article 1:1 of the GATT embodies the principal MFN obligation of the world trading system.⁴⁰ According to Article 1:1:

With respect to customs duties and charges of any kind imposed on or in connection with importation or exportation or imposed on the international transfer of payments for imports or exports, and with respect to the method of levying such duties and charges, and with respect to all rules and formalities in connection with importation and exportation, and with respect to all matters referred to in paragraphs 2 and 4 of Article III, any advantage, favour, privilege or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties.

The principle embodied in this provision is qualified by a number of exceptions:

- 1 Historical preferences in force at the time of the coming into effect of the GATT are grandfathered under paragraphs 2 and 4 of Article I of the GATT, although subject to the requirement that the margin of preference cannot subsequently be altered in such a way as to exceed the difference between the MFN rate and preferential rates existing as of 10 April 1947. These provisions contemplate that the absolute, not proportional, difference between MFN and preferential rates must be maintained when MFN rates are reduced or raised. For example, if the MFN rate is 20% and the preferential rate 10% on imported widgets, and the MFN rate is subsequently reduced to 15% (a 25% reduction), the preferential rate can be reduced to 5% and not 7.5% (which would be a 25% reduction). This exception has become less important over time as MFN rates have been negotiated down and differences between the preferential rates and the MFN rates progressively reduced. In addition, many of the preferences referred to in paragraph 2 have been subsequently changed or terminated.
- 2 The Generalized System of Preferences (GSP) provided for in Part IV of the GATT in favour of developing countries entails preferences that would otherwise violate the MFN principle. An instrument called the 'Enabling Clause' (1979) provides that the GSP may function 'notwithstanding' Article I:1 of the GATT. The Enabling Clause and its relation to Article I:1 have recently been the subject of interpretation by the

Appellate Body in the *EC—Tariff Preferences* case. This case will be discussed in detail in Chapter 15 on developing countries.

- 3 Antidumping and countervailing duties may be imposed selectively by importing countries pursuant to Article VI of the GATT, the Antidumping Agreement and the SCM Agreement.
- 4 Quantitative restrictions imposed pursuant to Article XII or Article XVIII of the GATT for balance of payments reasons may, by virtue of Article XIV, temporarily deviate from the principle of non-discrimination in respect of ‘a small part of a country’s external trade’ where the benefits to that country substantially outweigh any injury which may result to the trade of other countries.
- 5 National security exceptions, recognized in Article XXI of the GATT, may justify the imposition of trade restrictions on a discriminatory basis.
- 6 Where retaliation is authorized under the nullification and impairment provision of the GATT (Article XXIII) or the safeguard provision (Article XIX:3(a)), such measures will typically be selective and hence discriminatory.
- 7 Article XXV: 5 of the GATT provides that in exceptional circumstances not otherwise provided for in the Agreement, the Members may waive an obligation, including the MFN obligation, imposed on a Member by the GATT, provided that any such decision is approved by a two-thirds majority of the votes cast and such majority comprises more than half of the Members. A waiver of MFN has been provided to the European Community for instance in order to facilitate the provision of trade preferences on a non-GSP basis to a select group of developing countries in the Lomé Convention. This waiver was the subject of adjudication in the *Bananas* dispute.
- 8 Under Article XX of the GATT, dispensations from GATT obligations, including the MFN obligation, are provided with respect to the adoption or enforcement by Members of measures, for example, necessary to protect public morals; necessary to protect human or animal health or life; necessary to secure compliance with laws or regulations which are not inconsistent with the GATT; imposed for the protection of national treasures; or necessary for the conservation of exhaustible natural resources, provided that none of these measures constitute an arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade.
- 9 By far the most important exception to the MFN principle is the authorization of customs unions and free trade areas under Article XXIV of the GATT, provided that two basic conditions are met, i.e. trade restrictions are eliminated with respect to ‘substantially all the trade’ between the constituent territories, and customs duties shall not be higher thereafter than the duties prevailing on average throughout the constituent territories prior to the formation of a customs union or free trade area. Subject to these two conditions, constituent territories are permitted to establish more favourable duty and other arrangements among themselves than pertain to trade with non-Member countries. The interpretation of this exception by the Appellate Body (AB) of the WTO in the *Turkey—Textiles* case is analysed in Chapter 6 of this book, in the discussion of regional trading blocs.

INTERPRETATION AND APPLICATION OF THE MFN PRINCIPLE

Article I:1 of the GATT

Davey and Pauwelyn⁴¹ identify several interpretive issues with respect to Article I. These issues include: (1) the scope of coverage of Article I:1; (2) the meaning of ‘any advantage, favour, privilege or immunity’; (3) the meaning of ‘accorded...unconditionally’; and (4) the interpretation of the concept of ‘like product’. This section covers not only these issues, but also other important interpretive issues identified in the GATT/WTO case law with respect to Article I of the GATT and other MFN provisions contained in the various WTO Agreements.

The scope and ‘object and purpose’ of Article 1:1

In *Canada—Autos* the Appellate Body (AB) asserted that the object and purpose of Article I ‘is to prohibit discrimination among like products originating in or destined for different countries’.⁴² According to the AB, ‘the prohibition of discrimination in Article I.1 also serves as an incentive for concessions, negotiated reciprocally, to be extended to all other Members on an MFN basis’.⁴³

Article I:1 covers duties and charges levied on goods or on the international transfer of payments related to those goods; the methods of levying such duties and charges; all rules and formalities related to importation and exportation; internal taxation; and internal regulations of the type covered by Article 111:4.

Importantly, but sometimes overlooked, Article 1:1 applies to exportation as well as importation.⁴⁴ *Japan—Semi-Conductors*⁴⁵ is an example of the application of Article 1:1 to exportation. In *Japan—Semi-Conductors*, the European Economic Community (EEC) brought a complaint against Japan based on an arrangement concerning trade in semiconductor products between Japan and the United States. This arrangement was linked to the suspension of antidumping procedures initiated in the United States against imports of Japanese semiconductors, and a Section 301 proceeding initiated by the US semiconductor industry against Japanese import barriers. The agreement included measures for monitoring Japanese exports and improving access to the Japanese market. Hudec notes that the ‘bilateral agreement was viewed by other governments as, in effect, a cartel between the two dominant producers of semiconductors, harmful to third countries because it raised the price of computer inputs for local computer industries’.⁴⁶ The EEC argued that Japan’s failure to apply export restrictions to smaller export markets violated the MFN obligation in Article I:1.⁴⁷ The panel declined to rule on the question of whether the Japanese measures were inconsistent with Article I:1, for it had already found that the measures were inconsistent with Article XI:1.

With respect to customs duties, a decision by the panel in *Spain—Unroasted Coffee*⁴⁸ determined that Article I:1 applies equally to bound and unbound tariff items.

As for duties and charges, the first interpretation of the scope of this phrase was delivered as early as 1948. The case involved discriminatory application of consular taxes.⁴⁹ Cuba applied consular taxes to all imports. However, these taxes were higher on goods imported from the Netherlands than on goods from other countries. The

Netherlands claimed that ‘charges of any kind’ in Article I:1 include consular taxes. Accordingly, in the Netherlands’ view, Cuba’s application of the discriminatory tax of 5% (the normal rate was 2%) to goods imported from the Netherlands was inconsistent with Article I:1. The Chairman ruled that consular taxes are covered by the phrase ‘charges of any kind’ in Article I:1.

The phrase ‘all rules and formalities’ has been interpreted to include the application of countervailing duty rules. In *US—MFN Footwear*,⁵⁰ the panel determined that the rules and formalities applicable to countervailing duties, including those applicable to the revocation of countervailing duty orders, are rules and formalities imposed in connection with importation within the meaning of Article I:1.

*India—Tax Rebates*⁵¹ was the first GATT case to deal with the reference in Article I:1 to Article III, paragraphs 2 and 4. Prior to partition in 1947, India granted rebates of excise duties on several commodities produced in its territory when these commodities were destined for exportation. After partition, the new government maintained the excise duties as well as the rebates applicable to exports. However, with a view to maintaining prepartition revenue levels (when goods destined to Pakistan were still internal sales), India denied tax rebates on exports to Pakistan.⁵² Pakistan claimed that the reference in Article I:1 to ‘matters referred to...in Article III’ included internal taxes on products being exported. Accordingly, in Pakistan’s view, India violated Article I:1 by denying tax rebates on exports to Pakistan. The Chairman ruled in Pakistan’s favour, asserting that the MFN principle contained in Article I:1 is applicable to any advantage, favour, privilege or immunity granted with respect to internal taxes.

‘Advantage, favour, privilege or immunity’

Article I:1 covers any advantage, favour, privilege or immunity granted to both Members and non-Members of the WTO. The interpretation of ‘advantage’ has been briefly discussed in several cases. The analysis of the panel in *US—MFN Footwear* focused largely on this matter, and has been cited by later panels as providing a broad interpretation of the term ‘advantage’.

US—MFN Footwear

In *US—MFN Footwear*, Brazil claimed that, when implementing its Article VI obligations with respect to a countervailing duty order on non-rubber footwear from Brazil, the United States denied Brazil MFN treatment as required by Article I:1. The case involved three countervailing duty laws of the United States. Section 303 of the Tariff Act of 1930 provided for the imposition of countervailing duties on imports of dutiable products found to be subsidized. This legislation did not provide for an injury determination and was therefore inconsistent with Article VI. In order to bring its legal regime into compliance with Article VI:6(a), the United States introduced an injury requirement into Section 331 of the Trade Act of 1974—which applied to products from Contracting Parties entering the United States duty-free—and into Sections 701 and 104 of the Trade Agreements Act of 1979—which applied to dutiable products from signatories to the Subsidies Agreement.

Pursuant to Section 331 of the 1974 Act, whenever a dutiable product subject to an outstanding countervailing duty order, imposed under Section 303 of the Tariff Act of 1930 without the benefit of an injury test, was subsequently accorded duty-free treatment, the outstanding (pre-existing) order was automatically, independently from a specific request, submitted to an injury review. Where the injury review was negative, the outstanding order was revoked effective as of the date the product acquired duty-free status.

Section 104 of the 1979 Act established a transitional procedure valid for three years after the accession of the United States to the Subsidies Agreement. With the introduction of Section 104, dutiable products subject to outstanding countervailing duty orders, imposed under Section 303 of the 1930 Act without the benefit of an injury test, became eligible for an injury review upon accession of the exporting country concerned to the Subsidies Agreement. Under this procedure, if the results of the injury review were negative, the countervailing duty order was revoked effective as of the date the review was requested.

In the panel's view, the automatic backdating—to the date the product was accorded duty-free treatment—under Section 331 of the 1974 Act of the effects of a revocation of a pre-existing countervailing duty order constituted an 'advantage' within the meaning of Article I:1. The panel determined that this same advantage was not accorded by Section 104(b) of the Trade Agreements Act of 1979.⁵³ Accordingly, the panel ruled that the United States had acted inconsistently with Article I:1 of the GATT.

The panel also ruled on the question of whether an advantage granted to a product under a certain rule or procedure could offset less favourable treatment under another rule or procedure. The United States had argued that countries subject to the Section 331 procedure could have advanced the opposite argument from that advanced by Brazil, that is those countries could have argued that they were treated less favourably than the signatories to the Subsidies Agreement because the signatories to that Agreement could avail themselves of the three-year period for requesting an injury review under Section 104(b). The panel concluded that Article I:1 does not allow balancing more favourable treatment under some procedures against less favourable treatment under others.⁵⁴

EC—Bananas III

In *EC—bananas III*, the panel dealt with the question of whether the EC's licensing procedures for the importation of bananas denied the complainants advantages that were enjoyed by other supplying countries. The EC applied different import licensing procedures for traditional ACP bananas,⁵⁵ and for non-traditional and third-country bananas. Applications for imports of traditional ACP bananas were required to state the quantity and origin from which operators intended to source their bananas, and to be accompanied by an ACP certificate of origin testifying to their status as traditional ACP bananas. Import licences for third-country and non-traditional ACP bananas were allocated in several steps, based on: (a) three operator categories; (b) three activity functions; and (c) export certificate requirements for imports from Costa Rica, Colombia and Nicaragua.

First, the EC allocated licences among the three operator categories, A, B and C. Category A comprised any operator that had been marketing bananas from third countries

or non-traditional ACP countries since before 1992; this category was allocated 66.5% of the total licences to import bananas from third countries and non-traditional ACP countries at in-quota tariff rates. Category B was comprised of any operator that had marketed bananas from the EC or traditional ACP countries during a preceding three-year period; 30% of the total licences to import bananas from third countries and non-traditional ACP countries at the in-quota tariff rate were allocated to category B. Any operator that started marketing bananas from other than the EC or traditional ACP countries in 1992, or after, fell under category C; this category received 3.5% of the total licences to import bananas from third countries and non-traditional ACP countries at the in-quota tariff rate.

After allocating licences to operator categories, the EC allocated licences to individual operators within the categories. This allocation was done based on activity function rules. Activity function rules pertained only to category A and B operators. In order to qualify for category A or B, an importer must have performed at least one of the marketing activities (primary importer,⁵⁶ secondary importer⁵⁷, or ripener⁵⁸) during the three-year data period determining the reference quantities of bananas.

The last step in the allocation of licences to import bananas from third countries and non-traditional ACP countries concerned only those operators seeking licences to import bananas from BFA countries (Colombia, Costa Rica, Nicaragua and Venezuela). The Framework Agreement on Bananas (BFA) authorized the four BFA countries to issue special export certificates for up to 70% of their country-specific allocations. Export certificates gave the BFA countries the power to decide which companies could take advantage of the country-specific shares and export bananas to the EC. Without an export certificate, exportation was forbidden and licences to import bananas from Colombia, Costa Rica and Nicaragua (Venezuela chose not to issue export certificates) were not granted by the EC to category A and C operators.

The panel determined that the licensing procedures applied to traditional ACP banana imports, when compared to the licensing procedures (including the operator category and activity function rules) applied to third-country and non-traditional ACP imports, constituted an 'advantage' which the EC did not accord to third-country and non-traditional ACP imports.⁵⁹ In addition, the panel found that by allocating 30% of the licences to import third-country and non-traditional ACP bananas at in-quota tariff rates to operators who purchased and sold traditional ACP bananas (category B operators), the EC accorded an 'advantage' to traditional ACP bananas which it did not accord to like products from all Members.⁶⁰ Furthermore, the panel found that, because the export certificates allowed quota rents⁶¹ to be distributed⁶² to suppliers from BFA countries (such opportunity not being available to non-BFA third countries), 'the requirement to match BFA export certificates with EC import licenses in connection with the country-specific allocation of tariff quota shares under the BFA is an advantage or privilege in the terms of Article I.1 in respect of rules and formalities in connection with importation'.⁶³

On appeal, the AB, upholding the panel's findings, referred to the broad definition given to the term 'advantage' in *US—MFN Footwear*.⁶⁴ According to the AB, the activity function rules were an 'advantage' within the meaning of Article I:1. The AB stated:

On the first issue, the Panel found that the procedural and administrative requirements of the activity function rules for importing third-country and

non-traditional ACP bananas differ from, and go significantly beyond, those required for importing traditional ACP bananas. This is a factual finding. Also, a broad definition has been given to the term ‘advantage’ in Article I:1 of the GATT 1994 by the panel in *United States—Non-Rubber Footwear*. It may well be that there are considerations of EC competition policy at the basis of the activity function rules. This, however, does not legitimize the activity function rules to the extent that these rules discriminate among like products originating from different Members. For these reasons, we agree with the Panel that the activity function rules are an ‘advantage’ granted to bananas imported from traditional ACP States, and not to bananas imported from other Members, within the meaning of Article I:1. Therefore, we uphold the Panel’s finding that the activity function rules are inconsistent with Article I:1 of the GATT 1994.⁶⁵

The AB also upheld the panel’s finding that the export certificate requirement provided an advantage within the meaning of Article I:1. According to the AB, such advantage stemmed from the fact that the ‘EC export certificate requirement accord [ed] BFA banana suppliers, which [were] initial holders of export certificates, preferential bargaining leverage to extract a share of the quota rents for their fruit exported to the European Communities, and [gave] them a competitive advantage over other Latin American suppliers’.⁶⁶

‘Unconditionally’

Article I:1 of the GATT provides for an unconditional MFN obligation, that is any concessions accorded to one country must be unconditionally and without payment extended to all WTO Members.

Belgium—Family Allowances

‘Unconditionality’ was one of the main issues in *Belgium—Family Allowances*.⁶⁷ In *Belgium—Family Allowances*, Denmark and Norway submitted a complaint regarding the application of a Belgian law imposing a charge on foreign goods purchased by public bodies when those goods originated in a country whose system of family allowances did not meet specific requirements. The panel ruled that Article I:1 prohibits the imposition of discriminatory internal taxes. The panel noted that Belgium had granted an advantage—exemption from the levy—to some countries (Luxembourg, the Netherlands, France, Italy, Sweden and the United Kingdom), but not to others (Denmark and Norway). According to the panel, under the GATT such an advantage must be granted unconditionally to all Contracting Parties. In the panel’s view:

The consistency or otherwise of the system of family allowances in force in the territory of a given contracting party with the requirements of the Belgian law would be irrelevant in this respect, and the Belgian legislation would have to be amended insofar as it introduced a discrimination between countries having a given system of family allowances and those

which had a different system or no system at all, and made the granting of the exemption dependent on certain conditions.⁶⁸

This ruling could be interpreted to mean that pursuant to Article I, Members cannot impose a condition on the granting of an advantage that results in discrimination between countries. It is not clear from the text of the report whether the existence of a condition, or requirement to be fulfilled, could *per se* result in a violation of Article I, or whether a finding of discrimination linked to the condition is essential to establish a violation of Article I.

According to Jackson, this ‘case can be interpreted to support the proposition that although treatment can differ if the characteristics of goods themselves are different, differences in treatment of imports cannot be based on differences in characteristics of the exporting country that do not result in differences in the goods themselves’.⁶⁹ If *Belgium—Family Allowances* stands for this proposition, measures according different treatment to imports based on differences in production and process methods (PPMs) may violate Article I.

US—Tuna (Mexico)

In *US—Tuna (Mexico)*,⁷⁰ Mexico alleged, *inter alia*, that the US Dolphin Protection Consumer Information Act (DPCIA) violated Article I of the GATT by establishing discriminatory and unfavourable specified conditions for a specific geographical area. The DPCIA restricted the use of labels containing the term ‘Dolphin Safe’ to certain tuna products. Products containing tuna harvested in the Eastern Tropical Pacific Ocean (ETP) by a vessel using purse-seine nets that did not meet certain specified conditions for being considered dolphin-safe were expressly prohibited from carrying the ‘Dolphin Safe’ labels. In order to have access to the labels, ETP tuna had to be accompanied by documentary evidence showing that it was not harvested by using a certain fishing technique which consists of encircling dolphins with purse-seine nets.

The panel analysed whether the imposition of specific requirements on tuna caught in the ETP was consistent with Article I. It was uncontentious that the ETP was the only region where tuna was caught by intentionally encircling dolphins with purse-seine nets. According to the panel:

By imposing the requirement to provide evidence that this fishing technique had not been used in respect of tuna caught in the ETP the United States therefore did not discriminate against countries fishing in this area...The labelling regulations governing tuna caught in the ETP thus applied to all countries whose vessels fished in this geographical area and thus did not distinguish between products originating in Mexico and products originating in other countries.⁷¹

The panel examined the conditions imposed on certain tuna suppliers with a view to determining whether discrimination was taking place. The panel found that the conditions imposed did not result in discrimination.⁷² Based on the panel’s findings, it is possible to conclude that the term ‘unconditionally’ in Article I of the GATT does not mean that no conditions can be imposed on supplier countries in order for them to have access to a

privilege. It seems that conditions can be imposed, as long as they do not result in discrimination.

Indonesia—Autos

In *Indonesia—Autos*,⁷³ the European Communities, Japan and the United States brought a complaint against Indonesia concerning a series of measures adopted by Indonesia with respect to motor vehicles and parts and components thereof. The complainants argued that the Indonesian National Car Programme⁷⁴ conferred advantages of the type covered by Article I:1 and that these advantages were conditional.

Analysing the claimants' argument under the heading 'unconditional advantages', the panel noted that GATT case law is clear to the effect that any advantage 'cannot be made conditional on any criteria that is not related to the imported product itself'.⁷⁵ The panel cited *Belgium—Family Allowances* as an example of a case where a panel had condemned a measure that discriminated against imports based on a factor not related to the product itself, in that case whether the product originated from a *country* that was on a list of jurisdictions that had social security provisions conforming to certain criteria. The distinction here appears to be between conditions that relate to the product, as opposed to those that relate to its country of origin, quite apart from any feature of the product.

This finding in *Indonesia—Autos* can be interpreted as standing for the proposition that whenever a condition, which is not related to the product itself, is imposed on supplier countries, discrimination will be found. Such finding can also be interpreted to mean that discriminatory restrictions on trade based on PPMs would not be consistent with Article I. However, *Indonesia—Autos* offers no definition of what it means for a condition to be related to a product; the conditions under which a product is produced may well be product-related, as they may affect consumers' perceptions of the product itself. It may well be the case that in *Indonesia—Autos*, what the panel had in mind was a distinction between conditions or criteria that are origin-neutral—only addressed to products—as opposed to ones that are addressed to *where* the product originates, the latter being impermissible. This interpretation is reinforced by the ruling of a subsequent panel in the *Canada—Autos* case, discussed below. According to the panel in *Indonesia—Autos*, the granting of customs duties and sales tax exemptions to imported cars and parts and components was dependent on several conditions such as the meeting of certain local content targets, whether PT Timor Putra Nasional (TPN) had made a deal with the exporting company to produce a National Car, and whether the parts and components would be used in the assembly in Indonesia of a National Car. In the panel's view, the existence of these conditions was inconsistent with the provisions of Article I:1, which provides that tax and customs duty benefits accorded to products of one Member be accorded to imported like products from other Members 'immediately and unconditionally'.⁷⁶

In isolation, this finding could be interpreted as meaning that the mere imposition of conditions would *per se* constitute a violation of Article I. However, in the next paragraph the panel linked the conditions to the *existence of discrimination*. This can be understood as an indication that a condition must result in discrimination *between countries* in order for a violation of Article I to be found. According to the panel, the

February and June 1996 car programmes discriminated between imports in the allocation of tax and customs duty benefits based on various conditions and other criteria not related to the imports themselves; hence those programmes were inconsistent with the provisions of Article I.

In the words of the panel:

Indeed, it appears that the design and structure of the June 1996 car programme is such as to allow situations where another Member's like product to a National Car imported by PT PTN from Korea will be subject to much higher duties and sales taxes than those imposed on such National Cars... The distinction as to whether one product is subject to 0% duty and the other one is subject to 200% duty or whether one product is subject to 0% sales tax and the other one is subject to a 35% sales tax, depends on whether or not PT TPN had made a 'deal' with that exporting company to produce that National Car, and is covered by the authorization of June 1996 with specifications that correspond to those of the Kia car produced only in Korea. In the GATT/WTO, the right of Members cannot be made dependent upon, conditional on or even affected by, any private contractual obligations in place.⁷⁷ The existence of these conditions is inconsistent with the provisions of Article I:1 which provides that tax and customs duty benefits accorded to products of one Member (here on Korean products) be accorded to imported like products from other Members 'immediately and unconditionally'.⁷⁸

We note also that, under the February 1996 car programme, the granting of customs duty benefits to parts and components is conditional on their being used in the assembly in Indonesia of a National Car. The granting of tax benefits is conditional and limited to the only Pioneer company producing National Cars. And there is also a third condition for these benefits: the meeting of certain local content targets. Indeed under all these car programmes, customs duty and tax benefits are conditional on achieving a certain local content value for the finished car. The existence of these conditions is inconsistent with the provisions of Article I:1 which provides that tax and customs duty advantages accorded to products of one Member (here on Korean products) be accorded to imported like products from other Members 'immediately and unconditionally'.

For the reasons discussed above, we consider that the June 1996 car programme, which introduced discrimination between imports in the allocation of tax and customs duty benefits based on various conditions and other criteria not related to the imports themselves and the February 1996 car programme, which also introduced discrimination between imports in the allocation of customs duty benefits based on various conditions and other criteria not related to the imports themselves, are inconsistent with the provisions of Article I of GATT.⁷⁹

Canada—Autos

In another case involving measures affecting the automotive industry, the WTO Dispute Settlement Body was required to interpret the meaning of ‘unconditionally’ in Article I. In *Canada—Autos*,⁸⁰ the measures at issue included Canadian regulations—the Motor Vehicle Tariff Order 1998 (MVTO 1998) and Special Remission Orders (SROs)—granting duty-free treatment to certain automobiles and other motor vehicles pursuant to the 1965 Canada-US Auto Pact. Under the MVTO 1998, import duty exemptions were available to manufacturers of motor vehicles on imports from any country entitled to MFN tariffs, subject to the manufacturer meeting three conditions.

First, the importer must have produced in Canada, during the base year 1963–64, motor vehicles of the category it was importing.⁸¹ Second, the ratio of the net sales value of the vehicles produced in Canada to the net sales value of all vehicles of that class sold for consumption in Canada in the period of importation must have been equal to or higher than the ratio in the base year, and the ratio must not in any case have been lower than 75:100. Third, the importer must have achieved a minimum amount of Canadian value added (CVA) in its local production of vehicles (and, in certain instances, parts). The CVA had to be equal to or greater than the CVA that existed in vehicles produced in a defined base year.

Through the SROs Canada designated other companies, in addition to those qualifying under the MVTO 1998, as eligible to import motor vehicles duty-free. The SROs provided for the remission of duties on imports of motor vehicles when specified production-to-sales ratio requirements and CVA requirements were fulfilled. Pursuant to the Canada—US Free Trade Agreement, Canada stopped designating any additional manufacturers after 1989.

Using language from the *Indonesia—Autos* panel report, Japan argued that the import duty exemption was inconsistent with Article I:1 because, by conditioning the exemption on criteria unrelated to the imported product itself, Canada failed to accord the exemption immediately and unconditionally to like products originating in the territories of all WTO Members. Japan contended that the word ‘unconditionally’ in Article I:1 means that subjecting an advantage granted in connection with the importation of a product to conditions not related to the imported product itself is *per se* inconsistent with Article I:1, regardless of whether such conditions are discriminatory with respect to the origin of products.

The panel rejected Japan’s interpretation. In the panel’s view, ‘whether an advantage within the meaning of Article I:1 is accorded “unconditionally” cannot be determined independently of an examination of whether it involves discrimination between like products of different countries’.⁸² Therefore, the panel made it clear that the existence of a condition is not sufficient to establish a violation of Article I. Horn and Mavroidis interpret the panel’s statement as standing for the proposition that ‘only one form of conditional treatment is MFN-inconsistent: the one that is not origin neutral’.⁸³

The panel also analysed the *Indonesia—Autos* statement invoked by Japan and concluded that ‘the fact that conditions attached to such an advantage are not related to the imported product itself does not necessarily imply that such conditions are discriminatory with respect to the origin of imported products’.⁸⁴ This is an important

statement in that it makes clear that PPM measures are not *per se* inconsistent with Article I; a finding that such measures *discriminate* between supplier countries is necessary.

Horn and Mavroidis are critical of the panel's interpretation of the word 'unconditionally'. They believe that the panel's reading of 'unconditionally' would make MFN-consistent a regulation distinguishing between, for example, beef with and without hormones (such distinction not finding any support in the Harmonized System of Tariff Classification), even if the regulation had a very different *de facto* impact on different exporters to the country.⁸⁵ Such concern, however, seems unfounded, because if the regulation *de facto* differentiates between like products originating in different countries in such a way as to appear to constitute discrimination, such regulation will likely be found to be *de facto* discriminatory, violating the MFN obligation enshrined in Article I:1. In addition, in Horn and Mavroidis's view, 'the Panel's reading of unconditionality opens the door to regulatory distinctions at the border beyond those reflected in Arts. XX and XXI of the GATT'.⁸⁶ However, it does not seem to be the objective of Article I to ban regulatory distinctions *per se*, in other words to ban regulatory distinctions that are not discriminatory (*de jure* or *de facto*). Articles XX and XXI typically apply after a measure is found to violate a GATT obligation such as that enshrined in Article I. Therefore, if a measure aiming at achieving one of the policy objectives listed in Article XX is found to discriminate (*de jure* or *de facto*) against the like products of certain countries, this measure may still be found to be consistent with the GATT, provided that conditions in the *chapeau* are met.

The panel also made clear that 'the word "unconditionally" in Article I:1 does not pertain to the granting of an advantage *per se*, but to the obligation to accord to the like products of all Members an advantage which has been granted to any product originating in any country'.⁸⁷ Such obligation means that the extension of an advantage may not be made subject to conditions with respect to the situation or conduct of the WTO Members.⁸⁸ These findings by the panel were not re-examined by the AB, since the panel's interpretation of the term 'unconditionally' was not appealed.

In the *EC-Tariff Preferences (GSP) case (European Communities—Conditions for the Granting of Preferences to Developing Countries)* Report of the Panel (WT/DS246/R), the European Community argued that Article I:1 of the GATT allowed it to condition treatment of like products on objective, origin-neutral criteria, and that the additional tariff preferences it provided to developing countries deemed to have drug enforcement challenges were conditions of this nature (the EC also defended its measures as authorized by the Enabling Clause that provides an exemption from MFN with respect to GSP schemes; see the chapter on Trade and Developing Countries). With respect to Article I:1 of GATT, the EC claimed that the requirement to provide MFN treatment 'unconditionally' in Article I:1 of the GATT meant only that MFN treatment must not be conditioned on compensation or benefits provided reciprocally by the WTO Member in question. India argued that 'unconditionally' meant without any conditions whatsoever. The majority of the panel (there was one dissenting panelist, a highly unusual occurrence) agreed with India on the doctrinal point, even though the adopted panel ruling in *Canada-Autos* panel report here, the majority neglected its duty to take into account previous adopted panel reports. The majority saw 'no reason not to give [the term 'unconditionally'] its ordinary meaning' in the *New Shorter Oxford English Dictionary*.

However, the panel in *Canada-Autos* had understood that the notions of ‘conditional’ and ‘unconditional’ MFN were to be given their specialized meanings in trade law and practice (see Vienna Convention on the Law of Treaties, 31:4 and the decision of conditional vs unconditional MFN clauses in this chapter). The interpretation by the *EC-Tariff Preferences* panel of ‘unconditionally’ in Article I:1 of the GATT was not judicially considered in the appeal of the panel ruling; strictly speaking, the approach of the Appellate Body, focusing on the Enabling Clause as the legal framework for GSP preferences, rendered the panel’s interpretation of Article I:1 moot. Given the failure of the panel to perform its duty to consider prior adopted panel rulings (in this case, *Canada-Autos*), it is argued that little precedential authority should attach to the *EC-Tariff Preferences* panel’s interpretation of ‘unconditionally’ in GATT 1:1. (See Robert Howse, ‘The Death of GSP? The panel ruling in the India-EC dispute over preferences for drug enforcement,’ *BRIDGES January 2004*, whence the above is derived).

US—Certain EC Products

In *US—Certain EC Products*, the United States increased the bonding requirements on imports from the European Communities in order to secure the payment of additional import duties to be imposed in retaliation for certain EC measures. Examining the consistency of the increased bonding requirements with GATT Article I, the panel stated:

We find that the 3 March additional bonding requirements violated the most-favoured-nation clause of Article I of GATT, as it was applicable only to imports from the European Communities, although identical products from other WTO Members were not the subject of such an additional bonding requirements. The regulatory distinction (whether an additional bonding requirement is needed) was not based on any characteristic of the product but depended exclusively on the origin of the product and targeted exclusively some imports from the European Communities.^{89,90}

It is possible to argue that by referencing *Indonesia—Autos*, the panel in *US—Certain EC Products* agreed with the proposition that a condition must result in discrimination in order for a violation of Article I to be found. This was a straightforward case because the condition was origin-based, which clearly resulted in discriminatory treatment of products originating in the EC.

‘Like products’

One of the main interpretive issues regarding Article I:1 relates to the concept of like product. The importance of the definition of like product lies in the fact that, according to Article I:1, advantages accorded to one product must be accorded to another product only when the other product is a like product.⁹¹ As Horn and Mavroidis note, ‘[t]he legal consequence of establishing likeness is the requirement to treat goods in a non-discriminatory manner, unless the Member concerned can demonstrate that another GATT provision allows it to opt for discriminatory treatment’.⁹²

One of the main problems with respect to the concept of like product is to establish rules on the basis of which products may be differentiated. When determining whether products are like, panels have taken into account factors such as tariff classification,⁹³ physical characteristics, end-uses, and consumers' tastes and habits.

In cases where the tariff classification system of a country allegedly discriminates between like products, panels have analysed (1) whether the importing country classifies the products in question under distinct tariff categories, and (2) whether other countries maintain the same distinctions in their own tariff classification systems.⁹⁴

Importantly, the 'Harmonized System (HS) for classification of products provides a framework for common scheduling of fiscal border measures (essentially tariffs, but also other measures)'.⁹⁵ Adoption of the HS by WTO Members may, therefore, reduce differences in tariff classification. In addition, when products are classified under the same HS category, panels could, at least *a priori*, assume them to be like. However, although most WTO Members *de facto* follow the HS, not all WTO Members are signatories to the International Convention on the Harmonized Commodity Description and Coding System, the treaty governing the HS.⁹⁶ Furthermore, the 'HS imposes a discipline only up to the first six digits in the classification scheme. When Members schedule their commitments beyond the six-digit level they are unconstrained by their HS obligations'.⁹⁷

In general terms, if other states maintain the same distinctions in their tariff classification systems, the case against likeness is strengthened. In Fauchald's view, while tariff classification systems play an important role in determining likeness in cases involving tariff issues, classification for customs purposes should not be given much weight in determining likeness in cases involving complaints with respect to internal taxes and government regulations.⁹⁸ Such difference in approach, according to Fauchald, can be explained by the fact that the purpose of Article I differs with respect to internal taxes and regulations on the one hand, and customs duties on the other. According to Fauchald, 'when interpreting the concept "like products" in relation to internal taxes and government regulations in Article III and I, it should be borne in mind that the purpose of these provisions is wider than just protecting tariff concessions'.⁹⁹

In general, Article I like product cases demonstrate that in order to determine likeness, '[t]hough the items need not be exact duplicates, it is not enough that they are able to simply be used instead of, or displace the sales of, each other. Basically the products involved must be understood to be largely the same'.¹⁰⁰

Hudec argues that distinguishing products on the basis of their objective characteristics results in a narrow interpretation of the like product concept. According to Hudec, this narrow interpretation should be applied when analysing claims involving tariff discrimination under Article I:1. Such approach is justified by two considerations: (1) the need to ensure tariff protection manageability; and (2) the need for reciprocity in tariff negotiations. With respect to the first consideration, Hudec notes that, as the GATT/WTO allows Members to maintain tariffs, 'it must also accept the tools of tariff protection. Specifically, governments managing a policy of tariff protection need to be able to draw lines between products in order to...confine tariff liberalization to those products for which the removal of protection will be found acceptable to domestic interests'.¹⁰¹

As for the second consideration, Hudec notes that, for political reasons, it has been considered necessary to conduct tariff negotiations on the basis of the reciprocity principle.¹⁰² In this context, a narrow interpretation of the like product concept allows governments to differentiate between products in such a way that only the countries ‘paying’ for a tariff concession benefit from it. Hudec notes that to the extent countries are allowed to discriminate against free-riders, ‘the reciprocity dimension of tariff negotiations is in conflict with the non-discrimination rules of Article I.1’.¹⁰³ This conflict, however, has been tolerated by WTO Members because of the objective of lowering tariffs. Actions to minimize the conflict have been taken such as initiating tariff negotiations only after a general political agreement has been reached that the important parties will make a roughly equal contribution, and allowing only ‘a limited type of discrimination against countries that decline to offer reciprocal payment’.¹⁰⁴ What would be the limit to this discrimination? According to Hudec, ‘a product distinction will be objected to when it is closer to an explicit distinction between countries than it is to a distinction between products according to their objective characteristics’.¹⁰⁵

There are two caveats to Hudec’s position with respect to the interpretation of the concept of like product in cases involving claims of tariff discrimination. First, as the panel in *Japan—Alcoholic Beverages I*¹⁰⁶ noted, Article I:1 has generally been construed ‘as prohibiting “tariff specialization” discriminating against “like” products’.¹⁰⁷ Choi argues that a narrower interpretation of the like product concept could be accepted as a way of dealing with the negative effects of the free-rider problem.¹⁰⁸ However, according to him, because the free-rider problem has been substantially reduced through many negotiating rounds, the like product concept currently functions mainly ‘as a tool for prohibiting “tariff specialization” aimed at discriminating between “like” products’.¹⁰⁹ Second, as the AB noted in *Canada—Autos*,¹¹⁰ the object and purpose of the MFN clause is not only to prohibit discrimination among like products originating in or destined for different countries, but also to extend tariff concessions to all Member states. The latter is, in fact, the reason why the MFN clause has been considered the cornerstone of the multilateral trading system. If the WTO Members were allowed to differentiate unreservedly between products in such a way as to deny concessions to Members who are not willing to ‘pay’ for the concessions, the MFN obligation in Article I could not be considered unconditional, and, consequently, the objective of extending tariff concessions negotiated reciprocally to all other Members would be jeopardized.

In contrast, in Hudec’s view, a broader interpretation of the like product concept—one that would prohibit product distinctions between directly competitive products—should be adopted with respect to Article I:1 claims involving internal measures which discriminate against certain countries. In this context, likeness should be defined ‘in terms of the competitive relationship between the products in question’.¹¹¹ Such an approach would be justified by the economic policy of elimination of market distortions caused by internal measures.¹¹² In the next chapter, we consider, at length, the arguments for and against the adoption of a similar economic or competition-based interpretation of ‘like product’ in the context of the National Treatment principle (Article III).

Similar considerations enter into play with respect to whether a parallel interpretation of ‘likeness’ should be adopted in the case of Article I. If a central purpose of the MFN principle is to constrain measures (tariff or non-tariff) that disturb the competitive relationship or equilibrium between or among foreign sources of imports by

discriminating *de jure* or *de facto* among these foreign sources, then a test of 'like product' that focuses on substitutability among these foreign products, or more technically on high cross-elasticities of demand by consumers in the importing country between or among these foreign products, will capture an economically relevant concept of 'likeness'. Unlike the case of Article 111:4 (National Treatment), adopting an economic test of this nature for 'likeness' under Article I does not risk producing the controversial result that regulatory distinctions between products for non-commercial reasons (e.g. environmental externalities) would be impugned; this is because, as rightly interpreted by the panel in *Canada—Autos* (see below), Article I permits conditions or criteria to be placed on the treatment of 'like products' provided the conditions or criteria are *de jure* and *de facto* non-discriminatory as to the country of origin. Zedalis also argues for a broad interpretation of the like product concept. Moreover, he does not differentiate between claims involving tariff discrimination and claims involving internal measures. According to Zedalis, the objective of Article I 'seems to be to avoid actions that put GATT parties *inter se*, or in relation to non-GATT trading partners, in a different position from the one that would obtain under the natural efficiencies of production possessed by each state'.¹¹³ In light of this objective, it is reasonable to conclude that in Article I, 'likeness encompasses products that can be used in place of others, that is, products that are interchangeable'.¹¹⁴ Choi also argues for a broader scope for likeness,¹¹⁵ but suggests that a broad interpretation of the likeness concept in Article I should not encompass the concept of 'directly competitive or substitutable',¹¹⁶ referred to in Article 111(2)—a position that is inconsistent with an economic or competition-based conception of likeness.

Because Article I:1 provides for MFN treatment of like products with regard to internal measures through a reference to Articles III:2 and III:4 (National Treatment), a question arises as to whether the concept of like product for purposes of claims under Article I involving internal measures (internal tax measures and international regulations) should correspond to the concept of like product for purposes of claims under Articles III:2 and III:4. According to Davey and Pauwelyn, '[t]o avoid a different product coverage under two provisions dealing with the same measure, it would arguably be appropriate when dealing with Article III.4 measures (internal regulations) to maintain the same definition of likeness under both Article I.1 and Article III.4'.¹¹⁷ However, these commentators note that a broader definition of the concept of like product than that which has been applied to claims under Article III:2 could arguably be applied to claims under Article I involving internal tax measures.¹¹⁸ Such an argument is based on the assumption that the concept of like product in Article III:2, first sentence, must be more narrowly construed than the concept of directly competitive and substitutable product in the second sentence, since the obligation in the first sentence (identical taxation) is stricter than the obligation in the second (taxation that is not 'dissimilar'). Zedalis also supports this interpretation. According to him, while Article III:2, first sentence, and Article III:4, among others, 'favor a conception of like products that include goods which are identical with, or very closely similar to, those with which comparisons are made', Article I has 'the potential to encompass even goods that can take the place of, or can be seen as interchangeable with, other goods'.¹¹⁹

Australia—Ammonium Sulphate

*Australia—Ammonium Sulphate*¹²⁰ relies upon tariff classifications to determine likeness. In this case, the working party noted the distinction between ‘like products’ and ‘directly competitive or substitutable products’. *Australia—Ammonium Sulphate* involved a complaint brought by Chile against Australia alleging that Australia had violated Article I:1 because it had discontinued a domestic consumption subsidy to sodium nitrate, the type of fertilizer exported by Chile, while maintaining a subsidy on ammonium sulphate, a fertilizer imported by Australia from other countries. The subsidy to ammonium sulphate fertilizers enabled these fertilizers to undersell the Chilean sodium nitrate fertilizer. Chile contended that the two types of fertilizers were like products; hence, granting a domestic consumption subsidy to one, but not to the other, violated the MFN principle.

The working party noted that the GATT distinguishes between ‘like products’ and ‘directly competitive or substitutable products’. According to the working party, the MFN clause is limited to like products. Without providing a definition of like products, the working party reached the conclusion that the two types of fertilizers were not like products because the Australian tariff classification system, as well as other tariff classification systems, listed the two products as separate items and accorded them different treatment.

Germany—Sardines

*Germany—Sardines*¹²¹ was an early GATT case involving the concept of like product in the context of Article I:1. The case, however, was decided under Article XXIII (Nullification or Impairment). According to Hudec, the tariff distinction in *Germany—Sardines* was a classic example of an objectively-based distinction of virtually no commercial significance.¹²²

The background of the dispute involved more favourable treatment—lower tariffs and exemption from quantitative restrictions—to German imports of the types of sardines exported by Portugal than to the types exported by Norway. Norway brought a complaint alleging that the measures taken by Germany were inconsistent with Articles I:1 and XIII:1 of the GATT. This complaint reflected long-standing efforts to secure equal treatment for Scandinavian sardines *vis-à-vis* Portuguese sardines.¹²³

The panel determined that the difference in treatment was not based on the origin of the goods but on the assumption that preparations of *clupea pilchardus*, *clupea sprattus* and *clupea harengus* (the different species of sardines) were not like products within the terms of Article I and XIII. According to the panel, there was not sufficient evidence that the two parties had agreed expressly or tacitly to treat the different species as if they were like products. On the contrary, the evidence showed that in the course of the Torquay negotiations the German delegation treated preparations of the various types of *clupeae* as if they were separate products. Germany had listed the different species of sardines under separate tariff headings. As for Norway, the panel found that it had relied on an understanding with Germany regarding like treatment, that is the Norwegian government relied on assurances, which it considered it had obtained in the course of the negotiations,

rather than on the automatic operation of the MFN clause. In addition, the panel noted that the GATT distinguished between like products and directly competitive or substitutable products, and that the MFN obligation concerned only the former.

The panel concluded that there was not sufficient evidence in the record to support a finding that Germany had failed to carry out its obligations under Articles I:1 and XIII:1 of the GATT.¹²⁴ However, the panel considered that the measures taken by Germany had nullified the validity of the assumption which governed the position of the Norwegian delegation during tariff negotiations, and had substantially reduced the value of the concessions obtained by Norway. Therefore, in the panel's view, Germany had impaired a benefit accruing to Norway under the General Agreement, violating Article XXIII of the GATT.¹²⁵

EEC—Animal Feed Proteins

Physical differences played an important role in *EEC—Animal Feed Proteins*.¹²⁶ In this case, the panel's analysis focused on two points: first, the fact that the tariff classification systems of other countries made the same product distinctions; second, the differences between the notions of like products and directly competitive and substitutable products.

EEC—Animal Feed Proteins involved a complaint against a compulsory purchase programme of skimmed powder milk for use in feedingstuffs. This programme was adopted by the EEC in March 1976 with the objective of reducing surplus stocks of skimmed powder milk. Sellers of vegetable proteins were forced to mix milk powder with their animal feeds. The United States filed a complaint under the GATT against this programme arguing, *inter alia*, that the EEC scheme afforded products of other countries better treatment than like products originating in the United States. According to the United States, the scheme focused on specific vegetable proteins, which accounted for most of the US exports, and excluded other like products such as animal, marine and synthetic proteins. In light of this, the United States argued that the EEC scheme violated Article I:1 of the GATT.

The first step in the panel's analysis was to determine whether all products used for the purpose of adding protein to animal feeds could be considered like products. Taking into account factors such as the number of products and tariff items assigned different duty rates and tariff bindings, the varying protein contents, and the variety of origins of the protein products, the panel concluded that the various protein products could not be considered like products. The panel noted the difference between the concepts of like products and directly competitive and substitutable products. According to the panel, only the former is covered by Article I (a view with which we disagree). The panel concluded that, although directly competitive and substitutable, animal, marine and synthetic proteins were not like vegetable proteins. Therefore, the EEC scheme's coverage of some types of protein feed commonly produced by some countries, but not other types commonly produced by other countries, was not inconsistent with Article I of the GATT.

Spain—Unroasted Coffee

*Spain—Unroasted Coffee*¹²⁷ differed from the rulings discussed above in that the panel did not seem to take the objective characteristics of the products in question into account when dealing with the like product issue. Nevertheless, tariff classifications did play an important role in determining likeness.

The complaint by Brazil was based on a July 1979 decree, which modified and amended the tariff treatment and the sub-tariff classification applied to Spanish imports of unroasted coffee. According to the new system, which was effective as of 1 March 1980, imports of unroasted coffee were subdivided into five tariff lines to which different duty rates applied. Prior to this date, imports of unroasted coffee entered Spain under the same designation subject to a single tariff rate. After the July 1979 decree, some types of coffee, which were exported mainly by Brazil, were charged higher duties than other types of coffee, which came largely from Spain's former colonies. Brazil argued that the application of different tariff rates to different types of unroasted coffee violated Article I:1 because all types were like products.

Dealing with the matter of whether the various types of unroasted coffee could be regarded as like products, the panel considered relevant the facts that unroasted coffee was mainly, if not exclusively, sold in the form of blends combining various types of coffee, and that *unroasted* coffee in its end-use was universally regarded as a well-defined and single product intended for drinking. (The panel did not exclude the possibility that speciality *roasted* coffees might be distinguished by end-users, and therefore justify different tariff classifications.)¹²⁸ Furthermore, the panel noted that no other GATT Contracting Party applied different tariff rates to different types of coffee.

The panel determined that organoleptic differences such as differences in taste and aroma, especially in the case of agricultural products, could not justify differences in tariff treatment; but it must be remembered that the reason for this was that, since the coffee in question would be an input into a blend, such distinctive characteristics would be unrecognizable or distinguishable by the consumer, the end-user.¹²⁹ In light of the foregoing, the panel concluded that the several types of coffee were like products, and hence the tariff regime for unroasted coffee introduced by Spain was not in compliance with Article I:1.¹³⁰

Although the panel seems to have attached great importance to the fact that other countries applied the same tariff rate to all types of coffee, the panel recognized the right of a Contracting Party to introduce into its tariff system new classifications or sub-classifications, as appropriate. However, the panel also noted that, whatever the tariff classification adopted, Article I requires that the same tariff treatment be applied to like products.¹³¹ The panel seems to have adopted the view that Article I does not tolerate any form of discrimination, even the kind of discrimination that may result from tariff negotiations conducted on the basis of the principle of reciprocity. In Hudec's view, however, those statements merely reflect the panel's position that the changes in the Spanish tariff classification system occurred as a means of preserving the favoured market position of Spain's former colonies, rather than as a means of ensuring reciprocity in tariff negotiations.¹³² According to Hudec, *Spain—Unroasted Coffee* is inconsistent with normal GATT practice towards tariff distinctions.¹³³

In Hudec's view, this panel decision marked a change in the interpretation of the concept of like product. The two prior panel decisions, *Australia—Ammonium Sulphate*¹³⁴ and *Germany—Sardines*,¹³⁵ leaned towards allowing governments to distinguish between products on the basis of objective characteristics such as botanical species of coffee.

Japan—SPF Dimension Lumber

In *Japan—SPF Dimension Lumber*,¹³⁶ the panel rejected Canada's argument that certain types of softwood lumber were competitively equivalent, regardless of the particular species of evergreen tree from which they were made, and hence they should be considered like products for purposes of Article I:1.¹³⁷ Canada argued that Japan had structured its tariff classification system in such a way that Canadian exports of SPF dimension lumber to Japan were submitted to a customs duty of 8 %, whereas other comparable types of dimension lumber, such as hemlock-fir, the variety exported by the United States, enjoyed the advantage of a zero-tariff duty.

Canada argued that SPF dimension lumber was like other types of dimension lumber entering Japan with zero duty. Therefore, the different tariff treatment applied to Canadian dimension lumber violated Article I:1 of the GATT. Canada noted that, for example, both types of dimension lumber (the variety exported by Canada and the variety exported by the United States) followed the same standard form of measurements, quality-grading and finishing, and both were exported to Japan to be used in home construction. Canada pointed out that Japanese laws and regulations treated dimension lumber as a single manufactured product with no limitations on the use of any particular species.

The panel noted that the GATT left wide discretion to the Contracting Parties with respect to the structure of national tariffs and the classification of goods in the framework of such structure. The panel emphasized that although tariff differentiation is a legitimate means of trade policy, it might also be used in such a way as to discriminate between like products originating in different Contracting Parties. Therefore, a Contracting Party that feels prejudiced by tariff differentiation may challenge such practice, bearing, however, the burden of proving that such tariff arrangement has been diverted from its normal purpose so as to become a means of discrimination in international trade. According to the panel, when examining such a complaint, panels must consider, simultaneously, the internal protection interest involved in a given tariff specification, as well as its actual or potential influence in the pattern of imports from different extraneous sources.

The panel found that dimension lumber was not a category for tariff classification purposes in Japan, nor was it part of any internationally accepted customs classification. The panel concluded that the concept of dimension lumber was not an appropriate basis for establishing likeness of products under Article I:1 of the GATT.

In Council discussion when this panel report was adopted, Canada raised the concern that the panel's

interpretation could lead to pre-eminence being given to the tariff classification of a contracting party when determining 'like products' under Article I...this interpretation could well preclude a contracting party

from exercising its rights under Article I.1 for equal treatment of like products if the products involved were not specifically identified in the tariff classification system of the importing contracting party. The Harmonized System of tariff classification was not designed with Article I.1 rights in mind... Tariff classification systems cannot identify specifically each and every possible product which may be imported. In the tariff classification system of contracting parties it is regularly the case that an individual tariff line or description will cover a wide range of different products, particularly in the example of lines which read 'other' or 'not elsewhere specified.' Additionally, there are new products continually entering the marketplace which are not identified in tariff schedules.¹³⁸

According to Hudec, the panel may also have relied upon the fact that, notwithstanding its effect on Canada-United States competition, tariff distinction by wood species did not generally create pronounced differences in tariff treatment by country.¹³⁹

Indonesia—Autos

In *Indonesia—Autos*, Indonesia argued in its defence that there was no car and its parts and components that matched the requisite physical and non-physical characteristics of the Timor S515 (the only designated National Car) and its parts and components to be considered a like product to them. According to Indonesia, 93% (by value) of the components and parts of the Timor were tailor-made, and could not be used in other makes and models.

The panel held that its findings regarding the concept of like product under Article III:2 applied to Article I. This finding could be interpreted to stand for the proposition that the concept of like product is essentially the same under Articles I and III of the GATT. It might also be the case that because the term 'like products' in Article III:2, first sentence, has been interpreted narrowly (because of the reference to 'directly competitive or substitutable products' in the second sentence of Article III:2), where two products are found to be like under Article III:2, first sentence, they would automatically be found to be like under Article I:1. Similarly, as the concept of like product in Article I:1 is arguably broader than in Article III:2,¹⁴⁰ if two products are found not to be like under Article III:2, they could still be found to be like under Article I:1.

According to the panel, as the Timor, Escort, Optima and Corolla models were all in the same market segment, the differences in consumers' tastes and habits were not sufficient to render these products unlike. Accordingly, the panel found that the vehicles imported from the claimants were like the National Cars imported by Indonesia from Korea. The panel's finding that the products were like relied heavily on a single factor, namely consumers' tastes and habits.

The panel also found that the parts and components imported from the complainants were like imports from Korea. In making this finding, the panel considered (1) the fact that some parts and components were exactly the same for all cars, and (2) the fact that the parts which Indonesia contended were custom-made for the National Car could be produced by the complainants' companies. Likeness in this case was determined on the

basis of the similar physical characteristics of the products in question. Importantly, when determining likeness, the panel compared not only the two categories of products that were at that specific moment being imported into Indonesia (the actual trade flow), but also the product imported from Korea with a product that could hypothetically be produced by one of the other supplier countries (competitive opportunity).

De facto discrimination

As the AB stated in *Canada—Autos*, the object and purpose of Article I has largely been understood as being ‘to prohibit discrimination among like products originating in or destined for different countries’.¹⁴¹ Discrimination can take place through a measure that explicitly differentiates between products on the basis of their origin (*de jure* discrimination). In other cases, a measure can make distinctions that are not explicitly linked to the origin of the products, but which nevertheless result in discrimination between products originating in different countries. Such discrimination has often been referred to as *de facto* discrimination. The question of whether Article I and other MFN provisions contained in the WTO Agreements prohibit not only *de jure* but also *de facto* discrimination has been a matter of recent debate, although considerations regarding *de facto* discrimination have appeared in earlier GATT cases. An important question is whether *mere* disparate impact always constitutes *de facto* discrimination. Almost by definition almost every classification of goods will benefit some countries and not others, depending on existing patterns of production, market differentiation and so on. Thus, one might argue that *de facto* discrimination must involve a determination that the nature of the disparate impact is such as to undermine the purpose of Article I. The issue will involve determining whether there is an objective rational non-trade-related basis for distinguishing between the products in question: if not, then there would be a presumption that the distinction had been designed, although facially neutral with respect to origin, to procure the result of favouring imports of some countries over those of others. A similar issue arises in the application of the National Treatment principle (discussed in the next chapter).

In *EEC—Minimum Import Prices*,¹⁴² the panel was asked to rule on whether an EEC measure violated Article I:1. On 22 July 1975, the European Communities adopted a regulation setting up a minimum import price (MIP) scheme for tomato concentrates. According to this regulation, the MIP requirement would be enforced through a security deposit, which would be forfeited in proportion to any quantities imported at a price lower than the minimum price.

The United States claimed that the MIP system violated Article I because countries willing to guarantee observance of minimum price (Article 10, Council Regulation EEC No. 516/77) were excused from the security deposit. According to the United States, this measure amounted to conditional MFN treatment inconsistent with Article I:1 because it removed one of the requirements in relation to certain countries while maintaining a burden on others. The United States asserted that only countries with state trading or central marketing organizations could benefit from this provision, since it involved a guaranteed price, which was only possible in a controlled price economy. The EEC argued that the possibility of guaranteeing that the minimum price would be respected was open to all countries unconditionally, and that it could adduce evidence that many

supplying countries with liberal economies had provided guarantees that minimum prices would be respected.

The panel rejected the argument of the United States that the EEC regulations imposed a condition on those countries which were not able to offer a guarantee that the minimum price would be respected. According to the panel, 'regardless of whether a guarantee had to be provided by the importer or the government of the exporting country, so long as a guarantee was necessary for all imports from all potential third country suppliers there would be no discrimination within the meaning of Article I.1'.¹⁴³

The panel did not consider the hypothesis that an 'advantage' could have been granted to some countries as a result of the security deposit waiver. The panel interpreted both guarantees, the deposit and the countries' assurances, as having the same impact on supplier countries. This could have been a case of *de facto* discrimination, but the panel did not analyse whether the different types of guarantees resulted in discrimination.

In *EEC—Imports of Beef*,¹⁴⁴ the panel ruled on a complaint brought by Canada against the EEC. According to Canada, when implementing concessions in the form of a levy-free tariff quota for high-quality grain-fed beef, the EEC violated Article I:1 of the GATT. In order to implement the concession, the EEC issued detailed rules for the importation of this meat. Commission Regulation No. 2972/79 specified, in paragraph 1(d) of Article 1, the quality of the meat to be imported under this concession, and provided that certain US beef grades automatically qualified.¹⁴⁵ In addition, the Regulation required a certificate of authenticity to accompany the meat shipment. The Food Safety and Quality Service of the United States Department of Agriculture was the only authority listed as an approved certifying agency for the meat in question.

The panel found that exports of like products originating in countries other than the United States were in effect denied access to the EEC market, given that the only certifying agency authorized to certify the meat described in the Commission Regulation was a US agency mandated to certify meat only from the United States. The panel concluded that the Regulation had the effect of preventing access to the EEC market to like products from countries other than the United States. Hence, the panel concluded that the EEC Regulation was inconsistent with the MFN principle contained in Article I.

Although the panel did not use the words '*de facto* discrimination' to characterize the situation before it, it is clear that its analysis involved considerations of whether, despite the fact that the concession was not facially discriminatory (since it was extended to all countries),¹⁴⁶ the measures adopted by the EEC to implement the concession had discriminatory effects, in other words whether they *de facto* discriminated against the imports from countries other than the United States.

Spain—Unroasted Coffee can also be read as a case involving *de facto* discrimination. Although Spain's tariff classification system did not explicitly discriminate against Brazilian coffee, the panel found that the types of coffee exported mainly by Brazil were charged higher duties than the other types of coffee, which came largely from Spain's former colonies. Noting that Article I:1 requires that the same tariff treatment be applied to like products, and that the different types of coffee were like products, the panel concluded that Spain had acted inconsistently with Article I:1 of the GATT. Hence, even if the application of different tariff rates to different coffee varieties was formally origin-neutral, imports from Brazil were *de facto* discriminated against *vis-à-vis* imports from other countries which exported the coffee varieties subject to lower duty rates.

In *EC—Bananas III*,¹⁴⁷ the AB, for the first time, clearly asserted that Article I:1 of the GATT applies to measures involving *de facto* discrimination. The AB referred to *EEC—Imports of Beef and Spain—Unroasted Coffee* as examples of decisions where panels had taken *de facto* discrimination into account in order to find a violation of Article I:1.¹⁴⁸

In addition, the AB determined that the expression ‘treatment no less favourable’ in Article II (Most Favoured Nation) of the GATS should be interpreted as covering *de facto* as well as *de jure* discrimination. According to the AB:

The obligation imposed by Article II is unqualified. The ordinary meaning of this provision does not exclude *de facto* discrimination. Moreover, if Article II was not applicable to *de facto* discrimination, it would not be difficult—and, indeed, it would be a good deal easier in the case of trade in services, than in the case of trade in goods—to devise discriminatory measures aimed at circumventing the basic purpose of that Article.¹⁴⁹

Furthermore, the AB determined that the aims of a measure are not relevant to determining whether a measure provides less favourable treatment to some exporting countries than to others.¹⁵⁰ The AB rejected the applicability of the ‘aims and effects’ test. It pointed out that this test does not find support in the language of Article II of the GATS. In addition, the AB noted that the test had already been rejected with respect to Article III:2 of the GATT in *Japan—Alcoholic Beverages*.

The ‘aims and effects’ test was also rejected in the context of Article I:1 of the GATT. Ruling on the compatibility of the EC licensing regime with Article I:1 of the GATT, the AB analysed the EC argument that the activity function rules had been designed to address competition concerns, in other words that adoption of those rules was justified by EC competition policy. The AB’s response to this argument was that:

It may well be that there are considerations of EC competition policy at the basis of the activity function rules. This, however, does not legitimize the activity function rules to the extent that these rules discriminate among like products originating from different Members.¹⁵¹

These rulings indicate that the AB will probably not allow measures that discriminate on the basis of country of origin even if they have a legitimate public purpose. Such measures, where possible, would have to be justified under Article XX or XXI. This being said, the AB might well take into consideration the objective or neutral nature of the criteria of differentiation, and their relationship to non-discriminatory public purposes, in determining whether a differential impact on exporting producers of different countries amounts to Article I-illegal *de facto* discrimination.

In *Indonesia—Autos*, the complainants argued that the exemptions from customs duties for imports of National Cars and their parts and components, as well as the exemptions from sales tax on luxury goods for imported National Cars, were inconsistent with Article I:1 of the GATT because these exemptions provided an advantage which *de facto* benefited only and exclusively imports of motor vehicles, parts and components of the Kia brand originating in Korea. The complainants, invoking the decision of the AB in *EC—Bananas III*, argued that Article I:1 of the GATT prohibits not only measures which

discriminate formally and openly according to the country of origin of the imported goods, but also measures worded in generally applicable, origin-neutral terms which *de facto* benefit mainly imports from a certain Member.

The panel did not expressly rule on the question of whether Article 1.1 covered *de facto* as well as *de jure* discrimination. Nevertheless, the panel found that the Indonesian measures had discriminatory effects. According to the panel, the 1996 car programmes discriminated between imports in the allocation of tax and customs duty benefits, and hence were inconsistent with Article I:1 of the GATT.¹⁵²

In *Canada—Autos*, Japan and the European Communities argued that limiting the eligibility for the import duty exemption to certain motor vehicle manufacturers was inconsistent with Article I:1 of the GATT. In the complainant's view, such limitation resulted in *de facto* discrimination in favour of products originating in certain countries. Importantly, *Canada—Autos* differs from other *de facto* discrimination cases in that, in this instance discrimination was allegedly the result of conditions concerning the importers' eligibility for the import duty exemption, rather than the result of conditions concerning the products imported by such importers.¹⁵³ Such difference, however, did not prevent the panel from finding that the Canadian measures *de facto* discriminated against products originating in certain countries.

Evidence showing the predominantly, if not exclusively, intra-firm character of trade in automotive products played an important role in the panel's conclusion. According to the panel, 'in a context of intra-firm trade, the limitation of the availability of the import duty exemption to certain manufacturers, including fully-owned subsidiaries of firms based in a very limited number of third countries, discriminates as to the origin of products which will benefit from the import duty exemption'.¹⁵⁴

The panel also based its decision on considerations of the historical context of the import duty exemption. In the panel's view, the Canada-US Auto Pact was 'designed inter alia to achieve rationalization of production in the North-American market'; hence, 'from the outset the import duty exemption was expected to benefit mainly imports from particular sources'.¹⁵⁵ Although these considerations were not fundamental for the panel's decision, they seem to focus on the 'aims' of the Canadian measures. This could be interpreted as an effort to revive the 'aims and effects' test, which was rejected by the AB in *EC—Bananas III*. However, even if the panel was attempting to revive the 'aims and effects' test, this attempt was not supported by the AB.

As did the panel, the AB reaffirmed its interpretation in *EC—Bananas III* that, although neither the words '*de jure*' nor '*de facto*' appear in Article I, this Article covers both kinds of discrimination, namely *de jure* as well as *de facto* discrimination. The AB ruled that it could not accept 'Canada's argument that Article I.1 does not apply to measures which, on their face, are "origin-neutral"'.¹⁵⁶ This decision seems to have consolidated the view that *de facto* discrimination is not allowed in the context of Article I.1.

Applying a textual approach, the AB concluded that Canada was in breach of Article I:1 because '[t]he advantage of the import duty exemption is accorded to some motor vehicles originating in certain countries without being accorded to like motor vehicles from all other Members'.¹⁵⁷

THE MFN OBLIGATION IN ARTICLE XIII

In addition to Article I of the GATT, which embodies the main GATT MFN obligation, there are numerous other provisions in the GATT and other WTO Agreements which contain an MFN obligation. Article XIII contains an MFN obligation regarding administration of quotas.

The obligation contained in Article XIII:1 of the GATT is in the following terms:

No prohibition or restriction shall be applied by any contracting party on the importation of any product of the territory of any other contracting party or on the exportation of any product destined for the territory of any other contracting party, 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.

Interpretive issues that arise under Article XIII include the meaning of the phrase 'similarly prohibited or restricted' and Article XIII's application to safeguard administration.

General interpretation

In *EC—Bananas III*, among several other MFN complaints, the complainants claimed that the EC regime for the allocation of tariff rate quotas with respect to bananas violated Article XIII. The EC banana import regime was created by Regulation 404/93. This Regulation established three categories of banana imports: (1) traditional ACP bananas; (2) third-country bananas; and (3) non-traditional ACP bananas.

Quotas were allocated to each of these categories. The traditional ACP bananas had an 857,700-ton duty-free quota, which was divided into country-specific quantitative limits. The initial tariff rate quota (known as the basic tariff quota) for third-country bananas was set at 2 million tons (this was raised to 2.1 million tons and 2.2 million tons in 1994 and 1995 respectively). The tariff for in-quota shipments was ECU 75 per ton. As for out-of-quota shipments, the EC applied an MFN tariff of ECU 822 per ton (later reduced to ECU 792 and ECU 680). The EC carved out from the basic tariff quota 90,000 tons of bananas with a view to allocating them between the countries included in the third category of banana imports, the non-traditional ACP bananas. All the 90,000 tons were admitted duty-free, and out-of-quota shipments were subject to a per ton duty that amounted to ECU 100 less than the duties charged to third countries' out-of-quota shipments. Pursuant to the Framework Agreement on Bananas (BFA), signed in 1994 between the EC and Colombia, Costa Rica, Nicaragua and Venezuela,¹⁵⁸ the EC allocated to each of the four exporting countries specific shares of the basic tariff quota. In other words, these countries were guaranteed a slice of the quota for third-country bananas. The remaining countries in the third-countries category were put in an 'others' subcategory. These countries had to share among them the leftovers of the basic tariff quota.

The complainants (Ecuador, Guatemala, Honduras, Mexico and the United States) argued that Article XIII had been breached because the EC had provided country-specific

allocations to some countries (ACP and BFA signatories) while denying such allocations to other countries with similar or greater levels of past trade. Accordingly, the EC banana regime did not 'similarly prohibit or restrict' imports of bananas from all countries.

In addition, the complainants argued that the EC banana regime was inconsistent with Article XIII of the GATT because BFA countries were entitled, upon request, to have unused quota shares for BFA countries reallocated among them, to the exclusion of non-BFA countries.

Analysing these arguments, the panel first deemed it necessary to adopt an interpretation of Article XIII. According to the panel, the basic principle contained in Article XIII provides that Members 'may not limit the quantity of imports from some Members but not from others'.¹⁵⁹ The non-discrimination obligation extends further to require Members not to restrict imports from some Members using one means while restricting like imports from other Members using another means.¹⁶⁰ However, as the panel noted, Article XIII's general requirement of non-discrimination is modified in one respect by Article XIII: 2(d), which provides for the possibility of allocating tariff quota shares to Members with a substantial interest in supplying the product concerned. Despite the fact that Article XIII:2(d) provides for two methods to allocate tariff quota shares among Members with a substantial interest, the panel determined that Members cannot use one method to allocate shares to some countries with a substantial interest while using another method to allocate shares to other countries with a substantial interest.¹⁶¹

In the panel's view, the fact that Article XIII does not expressly provide for allocation of tariff quota shares to suppliers without a substantial interest does not necessarily mean that shares cannot be allocated to such countries. However, 'if a Member wishes to allocate shares of a tariff quota to some suppliers without a substantial interest, then such shares must be allocated to all such suppliers'.¹⁶² In addition, the Member would be 'required to use the same method as was used to allocate the country-specific shares to the Members having a substantial interest in supplying the product, because otherwise the requirements of Article XIII:1 would also not be met'.¹⁶³ The panel noted that if a Member should choose not to allocate specific shares to suppliers without a substantial interest, while allocating shares to Members having a substantial interest, there would be no conflict with Article XIII:1.¹⁶⁴

Accordingly, the panel concluded that the EC's allocation of tariff quota shares by agreement and by assignment to some Members not having a substantial interest in supplying bananas to the EC (including Nicaragua and Venezuela and certain ACP countries in respect of traditional and non-traditional exports) but not to other Members (such as Guatemala) was inconsistent with the requirements of Article XIII:1. Moreover, the panel found that 'under the BFA, the BFA countries were given special rights in respect of reallocation of tariff quota shares that were not given to other Members (e.g., Guatemala)'.¹⁶⁵ According to the panel, such differential treatment of like products from Members was inconsistent with Article XIII:1.

On appeal, the AB agreed with the panel, ruling that:

[A] Member cannot, whether by agreement or by assignment, allocate tariff quota shares to some Members not having a substantial interest while not allocating shares to other Members who likewise do not have a substantial interest. To do so is clearly inconsistent with the requirement

in Article XIII:1 that a Member cannot restrict the importation of any product from another Member unless the importation of the like product from all third countries is ‘similarly’ restricted.¹⁶⁶

The AB also found that the BFA’s tariff quota reallocation rules were inconsistent with Article XIII:1. According to the AB, ‘the reallocation rules allow the exclusion of bananas supplying countries, other than BFA countries, from sharing in the unused portions of a tariff quota share. Thus, imports from BFA countries and imports from other Members are not “similarly” restricted.’¹⁶⁷

The AB did not reverse any of the panel’s findings and interpretations in relation to the issues discussed above. The main difference between the two rulings is that the AB gave more emphasis to the requirement that imports must be ‘similarly’ restricted.

The AB, however, disagreed with the panel’s approach to the EC’s argument that the Lomé Waiver¹⁶⁸ justified possible inconsistencies with Article XIII deriving from the EC’s allocation of tariff quota shares to ACP countries. In the panel’s view, the Lomé Waiver waived inconsistencies with the requirements of Article XIII:1 ‘to the extent necessary to permit the EC to allocate shares of its banana tariff quota to specific traditional ACP banana supplying countries in an amount not exceeding their pre-1991 best-ever exports to the EC’.¹⁶⁹ According to the AB, the wording of the Waiver was clear and unambiguous, and no reference to Article XIII of the GATT could be found in it. In addition, the AB noted that ‘although Article I and XIII of the GATT 1994 are both non-discrimination provisions, their relationship is not such that a waiver from the obligations under Article I implies a waiver from the obligations under Article XIII’.¹⁷⁰ Accordingly, the panel’s decision with respect to the Waiver was reversed.

‘Similarly’

In *EEC—Apples I (Chile)*,¹⁷¹ Chile brought a complaint against the EEC regarding the application of quantitative restrictions to its exports of apples to the EEC. In an effort to liquidate excess stocks of apples due to overproduction caused by a price support system, the EEC imposed quantitative restrictions on imports of apples from Chile.¹⁷² While restrictions on imports from other supplying countries were negotiated in voluntary export restraint (VER) agreements, Chile rejected a 1979 VER offer because it had already made contracts for larger amounts. On 5 April 1979, the EC Commission issued Regulation 687/79 which suspended the free entrance into the Community of apples from Chile for a period of approximately four months. In light of these facts, Chile brought a complaint arguing that the EEC’s measure imposing quantitative restrictions violated Article XIII:1 because the voluntary agreements which the EEC had reached with other suppliers were not ‘similar’ either in form or in substance to the prohibition imposed on Chile. Chile submitted that under the terms of Article XIII:1 and XIII:2(d), a Contracting Party could not conclude agreements with some countries and unilaterally impose a restriction on those with whom it was not possible to arrive at an understanding.¹⁷³

The panel attached great importance to the interpretation of ‘similarly prohibited or restricted’. The phrase was interpreted as meaning that a Contracting Party could not employ certain means to restrict imports from some Contracting Parties while employing other means to restrict imports from other Contracting Parties. Hence, the panel found

that an inconsistency with the requirements of Article XIII:1 existed where a GATT Contracting Party (EEC) negotiated export restrictions on imports of products from some countries but imposed unilateral import restrictions on the like products from another country (Chile). The ruling determined that the VERs with other suppliers were not 'similar' to the quantitative restrictions applied to Chilean apples because there were differences in transparency and administration between the two measures. In addition, the panel observed that the import suspension was unilateral and mandatory, while the VER was voluntary and negotiated.

De facto discrimination

EC—Bananas III also provides an example of a case of *de facto* discrimination in the context of Article XIII. Although the parties and the panel did not use the term '*de facto* discrimination', the analysis of the panel focused on determining whether the interpretation suggested by the EC would result in discrimination.

The EC argued that it had two separate regimes for imported bananas: one for bananas from traditional ACP countries, and another for bananas from non-traditional ACP, BFA and other third-country sources. According to the EC, the regime for bananas from traditional ACP countries was a preferential regime and different tariff rates applied to the importation of these bananas as compared to other bananas. Accordingly, the panel should examine separately the consistency of each of these regimes with the requirements of Article XIII.

The panel rejected this argument, asserting that the terms of Article XIII 'do not provide a basis for analyzing quota allocation regimes separately because they have different legal bases or because different tariff rates are applicable'.¹⁷⁴ According to the panel:

Article XIII applies to allocations of shares in an import market for a particular product which is restricted by a quota or tariff quota. In our view, its non-discrimination requirements apply to that market for that product, irrespective of whether or how a Member subdivides it for administrative or other reasons. Indeed, to accept that a Member could establish quota regimes by different legal instruments and argue that they are not as a consequence subject to Article XIII would be, as argued by the Complainants, to eviscerate the non-discrimination provisions of Article XIII.¹⁷⁵

Similarly, the AB found that:

The essence of the non-discrimination obligations is that like products should be treated equally, irrespective of their origin. As no participant disputes that all bananas are like products, the non-discrimination provisions apply to all imports of bananas, irrespective of whether and how a Member categorizes or subdivides these imports for administrative or other reasons. If, by choosing a different legal basis for imposing import restrictions, or by applying different tariff rates, a Member could

avoid the application of the non-discrimination provisions to the imports of like products from different Members, the object and purpose of the non-discrimination provisions would be defeated. It would be very easy for a Member to circumvent the non-discrimination provisions of the GATT 1994 and the other Annex 1A agreements, if these provisions apply only within regulatory regimes established by that Member.¹⁷⁶

The panel and AB's conclusion was that allowing the EC to establish two separate regimes and have their compatibility with Article XIII analysed separately would result in *de facto* discrimination.¹⁷⁷

SAFEGUARDS AND THE MFN PRINCIPLE

Application of Article XIII to safeguard administration (Article XIX)

The application of Article XIII to the administration of safeguards was the main issue in *Norway—Textiles*.¹⁷⁸ The case involved a complaint brought by Hong Kong against the imposition of quantitative restrictions pursuant to Article XIX. Norway had negotiated VERs on textiles with six textile-supplying developing countries, but negotiations with Hong Kong were not successful because the parties were unable to determine a level of textile exports acceptable to both sides. Norway then decided to invoke Article XIX, introducing global import quotas on nine textile items. Imports from Hong Kong were included in the global import quotas, whereas the imports from the six countries with whom Norway had signed VER agreements were excluded. Hong Kong submitted that when applying quantitative restrictions pursuant to Article XIX, Norway acted inconsistently with its obligations under Article XIII because it excluded the six developing countries from the global quotas.

The panel ruled that the use of quantitative restrictions as a form of emergency action under Article XIX 'was subject to the provisions of Article XIII which provides for non-discriminatory administration of quantitative restrictions'.¹⁷⁹ According to the panel, to the extent that Norway had acted with effect to allocate import quotas for the textile products in question 'to six countries but had failed to allocate a share to Hong Kong, its Article XIX action was not consistent with Article XIII'.¹⁸⁰ As Hong Kong had a substantial interest in supplying the products in question, Hong Kong should be allocated shares according to the rules established in Article XIII:2(d). As in *EEC—Apples I (Chile)*, the panel in *Norway—Textiles* ruled that Article XIII of the GATT does not allow the use of different methods for the application of quantitative restrictions to countries having a substantial supplying interest.

The panel in this case did not directly address the issue of whether the safeguard restrictions must be imposed on all countries, including those whose exports have not, individually, caused a serious injury to the importing country's domestic industry. This, however, is the general understanding. For example, the Report on the Accession of Japan of the Ad Hoc Committee on Agenda and Intersessional Business in 1953 mentioned the views of Contracting Parties that 'emergency action under Article XIX would have to be non-discriminatory and would thus have to be applied to the trade of all

contracting parties, including those which were in no way responsible for the circumstances requiring redress'.¹⁸¹

The application of the MFN principle to the safeguard mechanism of the Agreement on Textiles and Clothing

An MFN question with respect to Article 6 (Transitional Safeguard) of the Agreement on Textiles and Clothing (ATC) arose in *US—Cotton Yarn*. This case involved a complaint by Pakistan with respect to a transitional safeguard measure imposed by the United States under Article 6.2 of the ATC on Category 301 imports of combed cotton yarn ('yarn') from Pakistan. The United States imposed the safeguard measure against Pakistan based on its Report of Investigation and Statement of Serious Damage or Actual Threat Thereof: Combed Cotton Yarn for Sale: Category 301 (December 1998) (the 'Market Statement'). This Market Statement defined the domestic industry to be investigated and concluded that increased imports had caused serious damage, and actual threat thereof, to the domestic industry, and that this damage and threat were attributable to Pakistan (Article 6.4 of the ATC).

Pakistan contended that the United States incorrectly attributed the damage solely to Pakistan. In Pakistan's view, the United States could not do a proper attribution analysis without at the same time individually examining Mexico's exports, which had increased rapidly and from a higher base.

Analysing Pakistan's claim, the panel stated that:

[I]t is clear from Article 6 of the ATC that safeguard measures need not be applied on an MFN basis. They are to be applied only to those imports causing serious damage, not to all imports... However, we do not agree that this means that restraints can be imposed only on some of the imports which may be responsible for causing serious damage.¹⁸²

The panel noted that the context, object and purpose of Article 6 should be examined for guidance in interpreting its meaning. In the panel's view,

the method most consistent with the WTO Agreement's, including the Safeguards Agreement's,^[183] requirements of MFN treatment and with the ATC's object and purpose is to require attribution to all Members found to be causing serious damage, not just one or some of such Members. Such an ability to pick and choose Members as proposed by the United States would be the least consistent with an MFN.¹⁸⁴

Accordingly, the panel decided that the United States acted inconsistently with its obligations under Article 6.4.

On appeal, the AB decided that, contrary to the view of the United States, Article 6.4, second sentence, does not permit the attribution of the totality of serious damage to one Member, unless the imports from that Member alone have caused all the serious damage'.¹⁸⁵ According to the AB, '[w]here imports from more than one Member contribute to serious damage, it is only that part of the total damage which is actually

caused by imports from such a Member that can be attributed to that Member under Article 6.4, second sentence'.¹⁸⁶ Furthermore, the share of total serious damage allocated to a particular Member must be proportionate to the damage actually caused by imports from this Member. An assessment of the share of total serious damage requires 'a comparison according to the factors envisaged in Article 6.4 with all other Members (from whom imports have also increased sharply and substantially) taken individually'.¹⁸⁷

The AB noted that Pakistan was not the only Member from whom imports had increased sharply and substantially. Accordingly, the AB upheld the panel's finding 'that the United States acted inconsistently with Article 6.4 by not examining the effect of imports from Mexico (and possible other appropriate Members) individually when attributing serious damage to Pakistan'.¹⁸⁸

The AB, however, did not consider it necessary to examine the question, which had been addressed by the panel, of whether Article 6.4 requires attribution to all Members the imports from whom cause serious damage or actual threat thereof'.¹⁸⁹ The panel's interpretation with respect to this question was determined to have no legal effect.¹⁹⁰

The issue of whether Article 6.4 requires attribution to all Members of the imports causing serious damage or actual threat thereof is an important one. Although the ATC is an exception to the general WTO rules, it seems reasonable to argue that the MFN principle should apply to the attribution of damages. Otherwise, cases will proliferate where a Member chooses one country (not necessarily the one which is causing the largest amount of damage), from the many countries which are causing damage, on which to impose safeguards.

3

National Treatment

The concept of National Treatment is central to the law of international trade, and is reflected not only in all of the key treaties of the WTO (the GATT, GATS, TRIPs etc.), but also in every major regional trade agreement.

With respect to trade in goods, National Treatment means that a party to a trade treaty must not discriminate against imports once they have crossed the border, by treating them less favourably than domestic products with which they are in competition in the importing country's domestic market. Thus, National Treatment is a discipline on *internal* policies of the members of a trade liberalization regime.

To understand the central role of National Treatment in negotiated trade liberalization we need to begin with the original character of such liberalization as exemplified in the GATT. The GATT was envisaged as a framework for the progressive removal or reduction of tariffs or other border measures (some of which, 'quantitative restrictions', were prohibited outright, with, however, many loopholes and exceptions). Unlike the European Economic Community (now the EU), where the Treaty of Rome guaranteed *general* freedom of movement for goods, services, capital and people, subject to various exceptions or limitations, the GATT did not—and does not—contain any such general right to market access. Perhaps reflecting the failure to agree to an international organization to *regulate* world commerce, the ITO (see Chapter 1), the GATT preserved the liberty of individual Member states to control commerce, subject to specific constraints, mostly bargained concessions with respect to tariffs and like restrictions.

Such a structure presents an enormous moral hazard problem: since the parties' policies that affect trade are not subject to *any general* norm of free market access, it is relatively easy for a party to undermine, or reduce the value of, its concessions to others, by subsequently adopting a substitute policy that has trade-restricting effects comparable to the tariff rates that it had legally bound itself to reduce.

Let us say I bind myself to a 15% *ad valorem* tariff on steel. What happens now if by legislation I turn the steel industry into a domestic monopoly? Or if it sets a regulatory standard (environmental performance, say) that foreign competitors in the industry are unlikely to be able to meet, or which will cost them much more than the domestic industry to meet? Which of these is a legitimate and acceptable public policy, and which might be considered improper circumvention of my trade liberalization reflected in the tariff binding?

In theory, we could say that when you agree to bargained tariff reductions, you simply take the other public policies of your partners as they are, as well as accept the risk of those policies being changed, charging a premium as it were to bear such risks, such as additional or higher concessions from the others. However, it is just as likely that the moral hazard problem will result in *fewer* concessions all round—I may well give little if

the value of what others are offering can be undermined by their subsequent conduct in other policy areas, over which I have no legal control.

An alternative solution would be of course to bargain *for* such legal control. At the limit this would entail opening for negotiation all public policies that might undermine market access from bargained trade concessions. The result would be specific disciplines on policies that would be sufficient to control moral hazard. But this alternative solution, although it is visible in post-Uruguay Round multilateral rules in areas such as intellectual property, services and food safety regulation to some extent (see Chapters 13, 12 and 7 respectively), comes at a significant price, or at least risk, to regulatory diversity.¹

National Treatment can be thought of as an intermediate option between on the one hand doing little or nothing about the moral hazard problem described above, and on the other attempting to tie the hands of domestic regulators, and democratic governments, impeding them from making substantive policy choices and changes that reflect the popular will.

Intuitively, it seems plausible (1) that public policies that discriminate against imports in favour of competing domestic products are rarely needed to achieve legitimate public policy goals, and thus (2) that it is exactly such discriminatory internal policies—‘regulatory protectionism’, to use a phrase of Alan Sykes—that are *most* likely to present a moral hazard problem that may undermine the willingness to bargain trade concessions. National Treatment therefore seems to offer the potential for minimum interference with substantive domestic policy choices, along with significant potential for controlling moral hazard.

However, like non-discrimination norms in other contexts (such as employment and human rights law), the obligation of National Treatment raises significant issues of interpretation. Is only formally different treatment of imports and domestic products to be disciplined? What about neutral (i.e. non-origin-based) classifications that have a disparate negative impact on the competitive opportunities of imported products? Are some such classifications inherently innocent (based on physical differences between products, for instance), while others are inherently suspect (based on considerations such as the environmental or labour conditions related to production and processing methods (PPMs))? Does protectionist intent matter in determining the existence of discrimination? If so, how can such intent be properly discerned by the adjudicator?

The treaty language in the GATT does not in any formal and decisive manner provide answers to these questions; nor does constitutional or statutory language in most other nontrade contexts, where the meaning of equality is the issue. Therefore, National Treatment is a matter of ‘jurisprudence’ in the classic meaning of the expression—there is a considerable interpretive task, which cannot be separated from consideration of the competing values at stake—on the one hand controlling moral hazard by disciplining ‘regulatory protectionism’, on the other hand preserving the scope of democratic regulatory autonomy.

THE NATIONAL TREATMENT OBLIGATION AS INTERPRETED BY THE APPELLATE BODY OF THE WTO

It is with these considerations in mind that we consider the text of the National Treatment obligation in the GATT, as it has been interpreted by the Appellate Body (AB) of the WTO.

Article III of the GATT, which contains the National Treatment obligation, has three main operative provisions. Article III:1 establishes the principle of non-protectionism as the fundamental concept in light of which National Treatment is to be applied. Article III:2 applies the National Treatment concept to internal taxation measures. Article III:4 applies the concept to 'internal laws, regulations, and requirements', essentially all domestic public policies apart from taxation (covered by III:2) and subsidies and government procurement (exempted by III:8).

National Treatment in respect of fiscal (domestic taxation) measures

The relevant provision is Article III:2. The first sentence of this legal provision reads:

The products of the territory of any contracting party imported into the territory of any other contracting party shall not be subject, directly or indirectly, to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products.

Article III:2, second sentence, reads:

Moreover, no contracting party shall otherwise apply internal taxes or other internal charges to imported or domestic products in a manner contrary to the principles set forth in paragraph 1.

Article III:1, to which Article III:2, second sentence, explicitly refers, reads:

The Members recognize that internal taxes and other internal charges, and laws, regulations and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use of products, and internal quantitative regulations requiring the mixture, processing or use of products in specified amounts or proportions, should not be applied to imported or domestic products so as to afford protection to domestic production.

Finally, Article III:2, second sentence, has an Interpretive Note that reads:

A tax conforming to the requirements of the first sentence of paragraph 2 would be considered to be inconsistent with the provisions of the second

sentence only in cases where competition was involved between, on the one hand, the taxed product and, on the other hand, a directly competitive or substitutable product which was not similarly taxed.

A complaining Party alleging a violation of Article III:2 may thus claim, under *the first sentence of Article III:2*, that:

- 1 the domestic and imported products are *like*, and
- 2 the latter is taxed *in excess* of the former.

Or, alternatively, under the *second sentence of Article III:2*, in conjunction with III:1 and the Interpretive Note, that:

- 3 the two products are directly competitive or substitutable (DCS);
- 4 the two products are *not similarly taxed*;
- 5 the dissimilar taxation operates *so as to afford protection* (SATAP) to domestic production.

***The GATT acquis*²**

Before considering the jurisprudence of the WTO AB with respect to National Treatment in Article III:2 of the GATT, it is worthwhile considering some of the earlier GATT jurisprudence with which the AB was faced when it attempted to make sense of the obligations in the first and second sentences of Article III:2.

Among the most important GATT-era cases, and the first where a formally origin-neutral taxation measure was found to violate Article III:2, is *Japan—Alcoholic Beverages*. The issue in this case was an internal tax measure that classified alcoholic beverages into different categories, subcategories and grades, based on alcohol content and other qualities, and set different tax rates on each category of alcoholic beverages. The European Communities complained that the Japanese liquor tax system violated the first sentence of Article III:2, by taxing imports at higher rates than ‘like’ domestic products, and the second sentence of Article III:2 by affording protection to ‘directly competitive or substitutable’ domestic products. Japan responded by arguing that each Contracting Party to the GATT was free to classify products for tax purposes as it chose, and that the ‘likeness’ or ‘directly competitive or substitutable’ relationship of imported and domestic products were legally irrelevant to the interpretation of Article III if both of these products were taxed in a non-discriminatory manner, regardless of their origin.

The panel concluded that the ordinary meaning of Article III:2 in light of its object and purpose³ supported the practice of examining the conformity of internal taxes with Article III:2 by determining, first, whether the taxed imported and domestic products were ‘like’ or ‘directly competitive or substitutable’, and, second, whether the taxation was discriminatory (first sentence) or protective (second sentence). The panel began its examination of the ‘likeness’ of products by noting that GATT Contracting Parties had never developed a general definition of the term ‘like products’. However, it found that the prior GATT decisions on this question were made on a case-by-case basis after examining a number of relevant factors. It cited the Working Party Report on ‘Border Tax Adjustments’ adopted in 1970,⁴ which concluded that problems arising from the

interpretation of the terms 'like' or 'similar' products should be examined on a case-by-case basis using the following criteria: (1) the product's end-uses in a given market; (2) consumers' tastes and habits, which change from country to country; and (3) the product's properties, nature and quality. It applied the above criteria and other criteria recognized in previous GATT practice, such as Customs Cooperation Council nomenclature for the classification of goods in customs tariffs, to determine whether the alcoholic beverages classified by Japanese law into different categories, subcategories and grades were 'like' products. The panel concluded, in view of their similar properties, end-uses and usually uniform classification in tariff nomenclatures, that imported and Japan-made gin, vodka, whisky, grape brandy, other fruit brandies, certain classic liqueurs, unsweetened still wine and sparkling wines should be considered as 'like' products in terms of Article III:2, first sentence, because such 'likeness' of these alcoholic beverages was recognized not only by governments for the purposes of tariff and statistical nomenclature, but also by consumers to constitute 'each in its end-use a well defined and single product intended for drinking', and that minor differences in taste, colour and other properties did not prevent products from qualifying as 'like products'. The panel did not rule out the possibility of considering other alcoholic beverages as 'like products', and it was of the view that the 'likeness' of the products must be examined taking into account not only objective criteria, such as manufacturing and composition processes of products, but also the perspective of the consumer. However, the panel cautioned that consumer habits were variable in time and space, and differential taxes could be used to crystallize consumer preferences for traditional domestic products. It argued that 'like' products do not become 'unlike' merely because of differences in local consumer traditions within a country or differences in their prices, which were often influenced by government measures (e.g. customs duties) and market conditions (e.g. supply and demand, sales margins).

The panel further concluded that even if imported alcoholic beverages, e.g. vodka, were not considered to be 'like' Japanese alcoholic beverages, e.g. shochu, flexibility in the use of alcoholic drinks and their common characteristics often offered an alternative choice for consumers, leading to a competitive relationship. In the view of the panel, under Article III:2, second sentence, there was direct competition or substitutability⁵ between imported and Japan-made distilled liquors, including all grades of whiskies/brandies, vodka and shochu, among each other; between imported and Japan-made liqueurs among each other; between imported and Japan-made sweetened and unsweetened wines among each other; and between imported and Japan-made sparkling wines among each other.

After having compared the imported and domestic alcoholic beverages to determine their 'likeness' or 'directly competitive or substitutable relationship', the panel next proceeded to a comparison of the fiscal burdens on the products at issue in the dispute. The panel noted that Article III:2, first sentence, prohibited the direct or indirect imposition of 'internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products'.

As this meant that even very small tax differentials were prohibited, the panel rejected Japan's argument that the measures in question had only a *de minimis* impact on trade.

In assessing whether there was tax discrimination, account was to be taken not only of the rate of the applicable internal tax, but also of taxation methods (e.g. different kinds of

internal taxes, direct taxation of the finished product or indirect taxation by taxing the raw materials used in the product during the various stages of its production) and of the rules for tax collection (e.g. basis of assessment). After having noted that Japanese specific tax rates on imported and Japanese special grade whiskies/brandies were considerably higher than the tax rates on first- and second-grade whiskies/brandies, the panel found that these tax differentials did not correspond to objective differences between the various distilled liquors, such as differences in alcohol content.

The panel found that, as a result of this differential taxation of 'like products', almost all whiskies/brandies imported from the EEC were subject to the higher rates of taxes, whereas more than half of the whiskies/brandies produced in Japan benefited from considerably lower rates of taxes, and thus the whiskies/brandies imported from the EEC were subject to internal Japanese taxes in excess of those applied to like domestic products in the sense of Article III:2, first sentence.

Under the first sentence of Article III:2, the tax on the imported product and the tax on the like domestic product had to be equal in effect, but Article III:2, second sentence, prohibited only the application of internal taxes to imported or domestic products in a manner 'so as to afford protection to domestic production'. Small tax differentials could influence the competitive relationship between directly competing products, but the existence of protective taxation could be established 'only in light of the particular circumstances of each case', and 'there could be a *de minimis* level below which a tax difference ceases to have the protective effect' prohibited by Article III:2, second sentence.

The panel found that the Japanese tax system was applied 'so as to afford protection to domestic production' because of considerably lower specific tax rates on domestic products, and the imposition of high *ad valorem* taxes on most imported products but with the absence of *ad valorem* taxes on most domestic products. Similarly, the product taxed at lower rates was almost exclusively produced in Japan, and the mutual substitutability of domestic products with imported products was illustrated by increasing imports of like products and consumer use. According to the panel, Article III:2 protects expectations on the competitive relationship between imported and domestic products, rather than expectations on trade volumes. Therefore, it was not necessary to examine the quantitative trade effects of these tax differentials for its conclusion that the application of considerably lower internal taxes by Japan on exclusively domestic products than on directly competitive or substitutable imported products had trade-distorting effects affording protection to domestic production contrary to Article III:2, second sentence.

The *US Malt Beverages* case⁶ was another significant GATT case involving facially neutral measures. The test applied to determine the consistency or inconsistency of such measures with Article III was significantly different from that applied in the above case. In this case, Canada had complained, among other things, that a lower tax rate applied by the state of Mississippi to wines made from a certain variety of grape discriminated against 'like' Canadian products and, therefore, was inconsistent with Article III:1 and Article III:2, and that restrictions on points of sale, distribution and labelling based on the alcohol content of beer above 3.2% by weight maintained by some US states were inconsistent with Article III:4, since all beers, whether containing an alcohol content of above or below the said level, were 'like' products, and an alcohol level of 3.2% was entirely arbitrary. The panel in this case considered that Canada's claim depended upon

whether wine imported from Canada was 'like' the domestic wine in Mississippi made from the specified variety of grape that qualified for special tax treatment, and noted that past decisions on the question of 'likeness' had been made on a case-by-case basis after examining a number of relevant criteria, such as the product's end-uses in a given market, consumers' tastes and habits, and the product's properties, nature and quality. However, it considered that the 'like' product determination under Article III:2 should have regard to the purpose of the Article, which was not intended to prevent Contracting Parties from using their fiscal and regulatory powers for purposes other than to afford protection to domestic production. In determining whether two products subject to different treatment were like products, it was necessary to consider whether such product differentiation was being made 'so as to afford protection to domestic production'.

Unlike *Japan—Alcoholic Beverages*,⁵⁶ the panel *began* its examination by looking into the rationality of the product differentiation made by the Mississippi wine tax law. The panel found that the special treatment accorded to wine produced from a particular type of grape grown only in the south-eastern United States and Mediterranean region was a rather unusual basis for a tax distinction, and that this particular tax treatment implied a geographical distinction which afforded protection to local production of wine to the disadvantage of wine produced where the type of grape could not be grown. Since tariff nomenclatures and tax laws, including those at the US federal and state level, did not generally make such a distinction between still wines on the basis of the variety of grape used in their production, and since the US also did not claim any public policy purpose for the tax provision other than to subsidize small local producers, the panel concluded that unsweetened still wines were 'like' products and that the particular distinction in the Mississippi law in favour of still wine of a local variety must be presumed to afford protection to Mississippi vintners. Therefore, according to the panel, the lower rate of excise tax applied by Mississippi to wine produced from the specified variety of grape was inconsistent with Article III:2, first sentence.⁷

On the issue of whether the restrictions on points of sale, distribution and labelling based on the alcohol content of beer were inconsistent with Article III:4, the panel again examined, first, the rationality of the regulatory measure in making a distinction between low-alcohol beer and high-alcohol beer and, second, the competitive effects of such regulations. It stated that the purpose of Article III was not to harmonize the internal taxes and regulations of Contracting Parties. In the view of the panel, it was imperative that the 'like' product determination in the context of Article III be made in such a way that it does not unnecessarily infringe upon the regulatory authority and domestic policy options of Contracting Parties. Therefore, even if low-alcohol beer and high-alcohol beer were similar on the basis of their physical characteristics, they need not be considered as 'like' products in terms of Article III:4 if the differentiation in the treatment of low-alcohol beer and high-alcohol beer was not such 'as to afford protection to domestic production'.

In determining the validity of the regulatory distinction based on the alcohol content of beer, the panel examined the issue of whether the aims and effects of such regulatory measure showed that it was applied so as to favour domestic producers over foreign producers. From the legislative history of relevant laws, the panel found that the policy background of the laws distinguishing alcohol content of beer was the protection of human health and public morals or the promotion of a new source of government

revenue, and that the alcohol content of beer had not been singled out as a means of favouring domestic producers over foreign producers. With respect to the effects of the regulatory measure, the panel found that Canadian and US beer manufacturers produced both high-and low-alcohol beer, and that the regulatory measure did not differentiate between imported and domestic beer as such, so that where a state law limited the points of sale of high-alcohol beer or maintained different labelling requirements for such beer, that law applied to all high-alcohol beer, regardless of its origin. Similarly, the burdens resulting from the measures did not fall on Canadian producers more heavily than on US producers and, despite the physical similarities and overlapping in the market for the two types of beer, there was a certain degree of market differentiation or specialization.⁸ Therefore, according to the panel, the regulatory measures were consistent with Article III:4.

The 'aims and effects' approach to determining 'likeness' that was applied for the first time in *US Malt Beverages* was also applied and elaborated on in the unadopted GATT panel decision in *US—Taxes on Automobiles*.⁹ In this case, the EC had complained against US regulations that imposed a luxury excise tax and gas-guzzler tax on domestic and imported automobiles on the basis of their value and gasoline consumption per mile. The threshold value of automobiles for the luxury excise tax was \$30,000 and the threshold gasoline consumption for the gas-guzzler tax was 22.5 mpg. Automobiles that were above the stated thresholds were subject to higher levels of tax. Most of the automobiles imported to the US from the EC were more expensive and subject to a higher rate of taxes.¹⁰

The panel proceeded to determine the 'likeness' of the automobiles in question by examining the protective aims and effects of these tax measures. Although there was evidence that the protective effects of these measures had not been ignored during the formulation of regulations providing for one of the taxes, the panel found that these tax measures served a bona fide regulatory purpose and that the competitive effects of these measures were neither clear enough nor inherent enough to be considered as protective. Applying the inherence criterion, the panel attempted to evaluate whether the regulations inherently divided products into those of domestic or foreign origin. Using this criterion, the panel found that the threshold set for the gas-guzzler tax did not discriminate between automobiles of domestic and foreign origin because the technology to manufacture high fuel-economy automobiles—above the 22.5 mpg threshold—was not 'inherent' to the US, nor were low fuel-economy automobiles inherently of foreign origin. Such an advantage would not, therefore, alter the conditions of competition in favour of domestic automobiles, and thereby have the effect of affording protection to domestic production. The panel applied the same 'inherence' test to conclude that the threshold set for the luxury excise tax also did not discriminate between automobiles of domestic and foreign origin because no evidence had been advanced that foreign automobile manufacturers did not in general have the design, production and marketing capabilities to sell automobiles below the stipulated threshold, or that they did not in general produce such models for other markets.

The WTO Appellate Body jurisprudence

Although the GATT panels had taken two different approaches—i.e. a formalistic approach, as applied in the 1987 *Japan—Alcohol* case, and a contextual or ‘aims and effects’ approach, as applied in *US—Malt Beverages* and *US—Taxes on Automobiles*—in examining the validity of a facially neutral regulatory measure, the WTO AB has consistently rejected the ‘aims and effects’ approach as an overarching methodology for applying Article III:2, while, as we shall see, at the same time it has suggested that an objective conception of regulatory purpose is relevant for purposes of determining whether, under the second sentence of Article III:2, a taxation measure is applied so as to afford protection to domestic production.

The first WTO dispute under Article III:2 is the second *Japan—Taxes on Alcoholic Beverages* case.

According to the panel, the appropriate test to define whether two products are like or directly competitive or substitutable is the marketplace. In the panel’s view, although the decisive criterion in determining whether two products are directly competitive or substitutable is whether they have common end-uses, *inter alia*, as shown by the elasticity of substitution in a market where competition exists, commonality of end-uses is a necessary but not sufficient criterion to define ‘likeness’. According to the panel, the term ‘like products’ suggests that, for two products to fall under this category, they must share, apart from commonality of end-uses, essentially the same physical characteristics. By applying the above-mentioned criteria for an examination of the products at issue, the panel concluded that vodka and shochu were like products because they shared most physical characteristics, and except for the media used for filtration, there was virtual identity in the definition of the two products.¹¹ The panel, however, did not conclude that shochu and the other alcoholic beverages in dispute were ‘like products’ because substantial noticeable differences in physical characteristics existed between the remaining alcoholic beverages in dispute and shochu that would disqualify them from being regarded as like products.¹²

According to the AB’s decision in *Japan—Taxes on Alcoholic Beverages*,¹³ when a claim is made that an internal tax measure violates the National Treatment obligation set out in Article III:2, first sentence, the words of the first sentence require an examination of the conformity of an internal tax measure with Article III by determining, first, whether the taxed imported and domestic products are ‘like’ and, second, whether the taxes applied to the imported products are ‘in excess of those applied to the like domestic products. If the imported and domestic products are ‘like products’, and if the taxes applied to the imported products are ‘in excess of those applied to the like domestic products, then the measure is inconsistent with Article III:2, first sentence. The AB found that this approach to an examination of Article III:2, first sentence, was consistent with the object and purpose of Article III:2 and with past practice under the GATT 1947.

According to the AB, if the imported and domestic products are not ‘like’ products for the purposes of Article III:2, first sentence, then they are not subject to the strictures of Article III:2, first sentence, and there is no inconsistency with the requirements of that sentence.

However, depending on their nature, and depending on the competitive conditions in the relevant market, those products may well be among the broader category of 'directly competitive or substitutable products' that fall within the domain of Article III:2, second sentence. In such a case, a separate examination is required to determine the consistency of an internal tax measure with Article III:2, second sentence. In the view of the AB, three issues¹⁴ must be established separately in this examination in order to find that a tax measure imposed is inconsistent with Article III:2, second sentence. These three issues are: (1) whether the imported products and domestic products 'are directly competitive or substitutable products'; (2) whether the directly competitive or substitutable imported and domestic products are 'not similarly taxed'; and (3) whether the dissimilar taxation of the directly competitive or substitutable imported and domestic products is 'applied...so as to afford protection to domestic production'.

The AB held that Article III of the GATT obliges Members of the WTO to provide equality of competitive conditions for imported products in relation to domestic products. The AB said that it is irrelevant that 'the trade effects' of tax differentials between imported and domestic products, as reflected in the volumes of imports, are insignificant or even non-existent, as Article III protects expectations not of any particular trade volume but rather of the equal competitive relationship between imported and domestic products.

By establishing the above-mentioned standards for an examination of the conformity of an internal tax measure with Article III:2, the AB seems to have accepted the panel's rejection of an 'aims and effects' test to determine the validity of an internal tax measure. Although they reached opposite results by applying essentially the same test, both the complainant, the US, and the respondent, Japan, had argued at the panel level,¹⁵ as well as before the AB,¹⁶ that the contested internal tax measure including the product distinction made for tax purposes should be examined in light of its aims and effects in order to determine whether or not it is consistent with Article III:2, and where the aims and effects of the contested tax measure do not operate so as to afford protection to domestic production, no inconsistency with Article III:2 can be established. Such arguments by Japan and the US were based upon rulings and findings by the GATT panels in the *US Malt Beverages* and *US—Taxes on Automobiles* cases. The panel simply rejected the 'aims and effects' test applied in these GATT cases, stating that the panel was not in a position to detect how the 1992 *US Malt Beverages* panel weighed the different criteria that it took into account in order to determine whether the products in dispute were like, and that the panel report in *US—Taxes on Automobiles* remained unadopted and, even if a panel could find useful guidance in the reasoning of an unadopted panel report that it considered to be relevant, unadopted panel reports have no legal status in the GATT or WTO system since they have not been endorsed by the Contracting Parties to the GATT or by WTO Members.¹⁷

The panel gave the following reasons for rejecting the 'aims and effects' test:

- 1 such a test is not consistent with the wording of Article III:2, first sentence, as the basis of this test is the words 'so as to afford protection' contained in Article III:1, and Article III:2, first sentence, contains no reference to these words;
- 2 the adoption of such test would have important implications for the burden of proof imposed on the complainant because, according to this test, the complainants would

- have the burden of showing not only the effect of a particular measure, which is in principle discernible, but also its aim, which sometimes can be indiscernible;
- 3 very often there is a multiplicity of aims that are sought through the enactment of legislation and it would be a difficult exercise to determine which aim or aims should be determinative for the ‘aims and effects’ test;
 - 4 access to the complete legislative history, which is argued by proponents of this test to be relevant to detect the protective aims, could be difficult or even impossible for a complainant party to obtain, and even if the complete legislative history were available, it would be difficult to assess which kinds of legislative history (statements in legislation, in official legislative reports, by individual legislators, or in hearings involving interested parties) should be primarily determinative of the aims of the legislation; and
 - 5 the list of exceptions contained in Article XX of the GATT could become redundant or useless because the ‘aims and effects’ test does not contain a definitive list of grounds justifying departure from the National Treatment obligations incorporated in Article III.¹⁸

While affirming that ‘aims and effects’ is not an appropriate overall methodology for determining whether a measure is consistent with Article III:2, the AB also affirmed that likeness should be construed narrowly so as not to condemn measures that are not meant to be condemned under Article III. The implication here seemed to be that there is an irreducible element of prudential judgment in weighing the elements of likeness and unlikeness using, *inter alia*, the Border Tax Adjustment criteria. The AB used the now famous image of the accordion to explain its meaning:

No one approach to exercising judgement will be appropriate for all cases. The criteria in Border Tax Adjustments should be examined, but there can be no one precise and absolute definition of what is ‘like’. The concept of ‘likeness’ is a relative one that evokes the image of an accordion. The accordion of ‘likeness’ stretches and squeezes in different places as different provisions of the WTO Agreement are applied. The width of the accordion in any one of those places must be determined by the particular provision in which the term ‘like’ is encountered as well as by the context and the circumstances that prevail in any given case to which that provision may apply. We believe that, in Article III:2, first sentence of the GATT 1994, the accordion of ‘likeness’ is meant to be narrowly squeezed.

According to the AB, after the determination of the ‘likeness’ of the products at issue, the only remaining step to determine the conformity of an internal tax measure with Article III:2, first sentence, is the examination of whether the taxes on imported products are ‘in excess of’ those on like domestic products. If so, then the Member that has imposed the tax is not in compliance with Article III. In the view of the AB, even the smallest amount of ‘excess’ is too much because the prohibition of discriminatory taxes in Article III:2, first sentence, is not conditional on a ‘trade effects test’, nor is it qualified by a *de minimis* standard. Accordingly, the AB agreed with the panel’s legal reasoning and with

its conclusions¹⁹ on this aspect of the interpretation and application of Article III:2, first sentence.

As noted earlier, even if the imported and domestic products are not 'like products', they may still be 'directly competitive or substitutable products'. In such a case, a three-step test is required to determine the validity of an internal tax measure under the principle of National Treatment. The first step is the determination of 'directly competitive or substitutable products'. In the AB's view, as with 'like products', the determination of the appropriate range of 'directly competitive or substitutable products' under Article III:2, second sentence, must be made on a case-by-case basis, taking into account all the relevant facts. In the view of the AB, it was not inappropriate to look at competition in the relevant markets as one among a number of means of identifying the broader category of products that might be described as 'directly competitive or substitutable'. The AB also agreed with the panel's view that the decisive criterion in order to determine whether two products are directly competitive or substitutable is whether they have common end-uses, *inter alia*, as shown by the elasticity of substitution in the relevant markets.²⁰

According to the AB, after the determination of directly competitive or substitutable products, the next step in the test is whether these products are similarly taxed. In its view, the phrase 'not similarly taxed' does not mean the same thing as the phrase 'in excess of' in Article III:2, first sentence, because if 'in excess of' and 'not similarly taxed' were construed to mean one and the same thing, then 'like products' and 'directly competitive or substitutable products' would also mean one and the same thing.²¹ According to the AB, there may be an amount of excess taxation that may well be more of a burden on imported products than on domestic 'directly competitive or substitutable products' but which may not be enough to justify a conclusion that such products are 'not similarly taxed' for the purposes of Article III:2, second sentence. It agreed with the panel that the amount of differential taxation must be more than *de minimis* to be deemed 'not similarly taxed'; and whether any particular differential amount of taxation is *de minimis* or not must be determined on a case-by-case basis. Thus, to be 'not similarly taxed', the tax burden on imported products must be heavier than on 'directly competitive or substitutable' domestic products, and that burden must be more than *de minimis* in any given case. The AB also agreed with the legal reasoning applied by the panel in determining whether 'directly competitive or substitutable' imported and domestic products were 'not similarly taxed'. However, the AB also found that the panel erred in blurring the distinction between that issue and the issue of whether the tax measure in question was applied 'so as to afford protection', which, in the AB's view, were entirely different issues that must be addressed separately. The panel had concluded that the following indicators, *inter alia*, were relevant in determining whether the products in dispute were similarly taxed in Japan: tax per litre of product, tax per degree of alcohol, *ad valorem* taxation, and the tax/price ratio.²²

According to the AB, if 'directly competitive or substitutable products' are 'similarly taxed', then there is neither need nor justification under Article III:2, second sentence, for inquiring further as to whether the tax has been applied 'so as to afford protection'. The AB held that an examination of whether dissimilar taxation has been applied so as to afford protection requires a comprehensive and objective analysis of the structure and application of the measure in question as related to domestic as compared to imported

products. In its view, it is possible to examine objectively the underlying criteria used in a particular tax measure, its structure and its overall application to ascertain whether it has been applied in a way that affords protection to domestic products.

As would become clearer in the later case of *Chile—Alcohol*, such an examination amounts to asking whether, looking objectively at the scheme, its classifications can be understood in terms of non-protectionist aims; thus, while repudiating an inquiry into subjective legislative intent, the AB was endorsing a conception of protectionism that went to regulatory purpose, albeit as discernible from objective features of the regulatory scheme. Because of the AB's emphatic rejection of subjective intent as a standard for protectionism, most commentators saw only a further indication that 'aims and effects' had been repudiated, not noticing that in fact a concept of regulatory purpose had been reintroduced into the analysis of 'protection', albeit an objective one.

The tests outlined by the AB in *Japan—Taxes on Alcoholic Beverages* have been followed by the panels and refined and in some measure altered by the AB in other cases involving internal tax as well as other regulatory measures. The practical difficulties in applying these tests²³ were evident in the *Canada—Certain Measures Concerning Periodicals* case,²⁴ where the panel found that imported split-run periodicals and domestic non-split-run periodicals were 'like' products under Article III:2, first sentence, whereas the AB found that such periodicals were not 'like' products, but were 'directly competitive or substitutable' products under Article III:2, second sentence. In this case, one of the issues in dispute was Part V.1 of the Canadian Excise Tax Act, which imposed an 80% excise tax on advertising in each split-run edition of a periodical.²⁵ The United States claimed that these provisions of the Excise Tax Act were in violation of the National Treatment obligation enshrined in Article III:2 of the GATT because they discriminated between two 'like' products, domestic non-split-run periodicals and imported split-run periodicals. The panel concluded that Part V.1 of the Canadian Excise Tax Act was inconsistent with Article III:2, first sentence, of the GATT 1994. Canada and the US both appealed.²⁶ Although the AB agreed with the application by the panel of the two-step 'like' products test established by the AB in the *Japan—Taxes on Alcoholic Beverages* case in examining the consistency of a tax measure with Article III:2, first sentence, it did not agree with the panel's conclusion that imported split-run periodicals and domestic non-split-run periodicals were 'like' products.²⁷ According to the AB, the panel did not base its findings on the exhibits and evidence before it,²⁸ and the panel's conclusions lacked proper legal reasoning based on adequate factual analysis. However, the AB did not determine whether the imported split-run periodicals and domestic non-split-run periodicals were 'like' products.²⁹ Instead, it proceeded to examine the consistency of the tax measure with Article III:2, second sentence.³⁰ It said that if the answer to the question of whether imported and domestic products are 'like' products is negative, there is then a need to examine the consistency of the measure with the second sentence of Article III:2.

Applying the three-step test established by the AB in *Japan—Taxes on Alcoholic Beverages*, the AB found that the imported split-run periodicals and Canadian non-split-run periodicals were 'directly competitive or substitutable' products insofar as they were part of the same segment of the Canadian market for periodicals. This conclusion was based on a study carried out by a Canadian economist, a Task Force Report submitted by Canada, and statements made by the Minister of Canadian Heritage and Canadian

officials, all of which had acknowledged the substitutability of, and considerable competition between, imported split-run periodicals and domestic non-split-run periodicals in the Canadian market.³¹ Similarly, the AB concluded that ‘directly competitive or substitutable’ imported split-run periodicals and domestic non-split-run periodicals were ‘not similarly taxed’ by the Canadian Excise Tax Act because it taxed split-run editions of periodicals in an amount equivalent to 80% of the value of all advertisements, whereas domestic non-split-run periodicals were not subject to the tax, and the amount of the taxation was far above the *de minimis* threshold specified by the AB in *Japan—Taxes on Alcoholic Beverages*. Finally, it concluded that the intention behind the design and structure of Canadian excise tax was clearly ‘to afford protection to the production of Canadian periodicals’. This conclusion was based on the magnitude of dissimilar taxation,³² the evidence of protective purpose from several statements of the government on Canada’s explicit policy objectives in introducing the measure, and the demonstrated actual protective effect of the measure.³³ Thus, the AB concluded that Part V.1 of the Canadian Excise Tax Act was inconsistent with Canada’s obligations under Article III:2, second sentence, of the GATT 1994. The explicit reliance in this case on official government statements about regulatory purpose again indicates that, while having rejected ‘aims and effects’ as an inquiry into subjective intent—an attempt to read the legislators’ minds, as it were—the AB was perfectly prepared to take into account objective evidence of regulatory purpose.

In *Korea—Taxes on Alcoholic Beverages*,³⁴ the AB upheld the findings of the panel that soju (diluted and distilled), whiskies, brandies, cognac, rum, gin, tequila, liqueurs and admixtures were directly competitive or substitutable products. It also upheld the panel’s conclusion that Korea had taxed the imported products in a dissimilar manner and that the dissimilar taxation was applied so as to afford protection to domestic production. According to the panel, the focus should not be on quantifying substitutability but on the *quality* of competition.

Upholding the panel in these respects, the AB relegated econometric criteria (cross-price elasticity) to second-order relevance and added that *potential* competition and evidence from other markets are relevant. The AB also clarified that a ‘trade effects’ test is not warranted under Article III:2. The AB appears, *since Japan—Alcohol*, to have effected a subtle shift from an economic notion of substitutability to a juridical conception of competitive equality, which looks in some respects more like the ‘aims and effects’ approach that the AB had apparently repudiated, or at least views the issue of competition as a normative question about whether consumers *ought* to look at two products as substitutable given their preferences and needs, rather than as an empirical economic question about revealed consumer behaviour.

We quote from §§114, 125–7, 130–1, 133–4 and 135–8 of the AB report:

A. ‘Directly Competitive or Substitutable Products’

1. Potential Competition

...In our view, the word ‘substitutable’ indicates that the requisite relationship *may* exist between products that are not, at a given moment, considered by consumers to be substitutes but which are, nonetheless, *capable* of being substituted for one another...

2. Expectations

As we have said, the object and purpose of Article III is the maintenance of equality of competitive conditions for imported and domestic products...[footnote omitted]

3. 'Trade Effects' Test

...the Panel stated that if a particular degree of competition had to be shown in quantitative terms, that would be similar to requiring proof that a tax measure has a particular impact on trade. *It considered such an approach akin to a 'type of trade effects test'.*

We do not consider the Panel's reasoning on this point to be flawed.

4. Nature of Competition

The Panel considered that in analyzing whether products are 'directly competitive or substitutable', the focus should be on the *nature* of competition and not on its *quantity* ... For the reasons set above, *we share the Panel's reluctance to rely unduly on quantitative analyses of the competitive relationship* [footnote omitted]. *In our view, an approach that focused solely on the quantitative overlap of competition would, in essence, make cross-price elasticity the decisive criterion in determining whether products are 'directly competitive or substitutable'.* We do not, therefore, consider that the Panel's use of the term 'nature of competition' is questionable.

Thus, products are competitive or substitutable when they are interchangeable or if they offer alternative ways of satisfying a particular need or taste.

With regard to the issue of whether or not the Korean liquor taxes were applied so as to afford protection to domestic products, the panel found that the Korean tax law had very large differences in levels of taxation,³⁵ and that the very magnitude of dissimilar taxation itself was sufficient to conclude that the taxes at issue were applied so as to afford protection to Korean domestic liquors. In addition to the very large levels of tax differentials, the panel also found the structure of the Liquor Tax Law itself to be discriminatory.³⁶ The AB upheld the panel's conclusions and rejected the arguments of Korea that there were no such protective effects in the market because of the large pretax price difference between diluted soju and the imported alcoholic beverages. According to the AB, this argument did not change the pattern of application of the contested measures because Article III is not concerned with trade volumes and therefore it was not incumbent on the complainant party to prove that tax measures were capable of producing any particular trade effect.

The panel and AB in *Chile—Taxes on Alcoholic Beverages*³⁷ followed the same approach as followed in *Japan—Taxes on Alcoholic Beverages* and in *Korea—Taxes on Alcoholic Beverages* in determining the issues of whether or not pisco, whisky and other spirits are directly competitive or substitutable; whether or not the domestic alcoholic beverages and the directly competitive or substitutable imported alcoholic beverages were similarly taxed; and, if there were dissimilar taxes above the *de minimis* level,

whether or not dissimilar taxes were applied so as to afford protection to domestic products. With regard to the first issue, the panel looked at evidence of the relationship between the products, including comparisons of their end-uses, physical characteristics, channels of distribution and prices, and found that pisco and other spirits were directly competitive or substitutable products.³⁸ According to the panel, products do not have to be substitutable for all purposes at all times to be considered competitive, and it is sufficient that they may be substituted for some purposes at some times by some consumers.

In evaluating substitutability in end-uses, the panel also found it useful to consider consumer theory, which, according to the panel, holds that

goods are, in the eyes of consumers, never really perceived as commodities that are in themselves direct objects of utility; rather, it is the properties or characteristics of the goods from which utility is derived that are the relevant considerations. It is these characteristics or attributes that yield satisfaction and not the goods as such. Goods may share a common characteristic but may have other characteristics that are qualitatively different, or they may have the same characteristics but in quantitatively different combinations. Substitution possibilities arise because of these shared characteristics.

According to the panel, one hypothetical example in this regard is that of butter, milk and margarine:

Butter and milk are both dairy products and they share important characteristics that margarine does not have. However, butter and margarine each have combinations of characteristics that make them good substitutes as complements for bread, which is not the case with milk. The characteristics of butter and margarine can be expressed as physical properties such as spreadability taste, colour and consistency. These physical characteristics combine to render both products good substitutes as bread complements. The latter represents the end-use of the commodities as determined by their combination of characteristics derived from certain physical characteristics.

In the panel's view, the same type of reasoning can be applied to the substitutability of pisco and other spirits such as whisky, brandy, cognac, etc.³⁹

Similarly, the panel also found that its conclusion on competition or substitutability between pisco and other spirits was consistent with the production and marketing decisions of the pisco producers, who desired to convey an image of pisco as a drink that competes with the best imported distilled spirits. According to the panel, when a product is being marketed in ways that suggest that it is in competition with up-market imported distilled spirits, this is evidence of at least potential competition with those imports. Likewise, the panel also found that the Chilean Central Preventive Commission, in deciding on a merger between two major pisco producers, had stated that pisco faced major competition from other alcoholic beverages, such as wine, beer and whisky, and

that these were alternative products which consumers of alcoholic beverages could choose to drink in the market for alcoholic beverages. Thus, the panel concluded that the totality of the evidence presented supported a finding that the imported distilled spirits and pisco were directly competitive or substitutable.

With respect to the issue of whether or not the imported distilled spirits and directly competitive or substitutable pisco were similarly taxed, the panel found that both the Transitional and New Systems applied dissimilar taxes to these alcoholic beverages. According to the panel, the level of difference in taxation between whisky and pisco under the Old System was greater than *de minimis* because whisky was taxed at more than twice the rate of pisco and, even if the Transitional System would make the difference in taxation somewhat narrow in the following years, the tax difference would still remain more than *de minimis*, and even with respect to other spirits, the tax difference of five percentage points *ad valorem* was greater than *de minimis*. The New System, which assessed taxes on an *ad valorem* basis that varied according to alcohol content, also applied dissimilar taxes greater than *de minimis* to directly competitive or substitutable imported and domestic products because the difference in taxation between the top (47%) and bottom (27%) levels of *ad valorem* rates of taxation of distilled alcoholic beverages was clearly more than *de minimis* and was so by a very large margin. Similarly, the difference of four percentage points between the various levels of alcohol content also constituted a greater than *de minimis* level of dissimilar taxation. In the view of the panel, a tax system based on taxing value is generally considered not to be applying dissimilar taxation if done on a purely *ad valorem* basis (i.e. a single *ad valorem* rate applied uniformly to all products). However, the New Chilean System was not strictly an *ad valorem* system because it applied *ad valorem* rates that varied not just by value but also by alcohol content.

On the issue of whether or not the Chilean alcohol taxes were applied so as to afford protection to domestic products, the panel concluded that both the Transition and New Systems applied dissimilar taxes to domestic products and directly competitive or substitutable imported products so as to afford protection to Chilean domestic products. According to the panel, the central issue in this regard is the design, architecture and revealing structure of the tax measure, and an important question in the determination of protective application is who receives the benefit of the dissimilar taxation. Since the Transitional System assessed tax rates by type of spirits and the lowest tax rate was on pisco which, under Chilean law, was exclusively a domestic product, it was clear that the beneficiary of the tax structure was the domestic industry. Similarly, the largest category of imports was whisky, which was taxed at a rate of 53% (at its least discriminatory level) compared to pisco's 25%, and pisco accounted for almost 75% of the domestic production of distilled spirits. The panel rejected the argument of Chile that the Transitional System did not have any protective application as it actually reduced the tax rate on whisky. The panel held that the fact that the Transitional System lessened the protective effect did not vitiate the conclusion that, even at its least discriminatory, it was a system that did and would afford protection to domestic production.

The New System also afforded protection to domestic production because the structure of the New System applied its lowest rate at the level of alcohol content of the large majority of domestic production and its highest rate at the level of the overwhelming majority of imports;⁴⁰ the large magnitude of the differentials was applied over a short

range of physical difference (27% for 35° vs. 47% for 39° of alcohol content); the interaction of the New System with the Chilean regulation which required most of the imports to remain at the highest tax level without losing their generic name and changing their physical characteristics;⁴¹ and the lack of any connection between the stated objectives and the results of the measures.⁴² The panel rejected the arguments made by Chile to support the non-protective application of the tax measure that any producer, whether foreign or domestic, could produce spirits at lower levels and benefit from the tax structure; that there were many spirits produced in the EEC at 35° of alcohol or less which could easily be exported to Chile and enjoy a lower level of taxation; that there was more absolute production of domestic spirits in Chile at the higher levels of taxation than there were imports; that there was not even *de facto* discrimination because the imported product could easily be diluted to take advantage of the lower available tax rates; and that if protection was the goal, Chile could have raised tariffs which were currently at 11%, but bound at 25%. The panel found these factors either irrelevant or as demonstrating that there would not be equal competitive conditions unless the foreign producers made certain important changes in their products, changes not justified by any exception or rule of the WTO Agreements. The AB upheld the findings of the panel in *Chile—Taxes on Alcoholic Beverages*.⁴³

Upholding the panel's findings, the AB notably brought considerations of objective regulatory purpose within its analysis of protective application, though it did not move to a pure *intent-based* test, suggesting at least a partial rehabilitation of 'aims and effects'. §§62, 69 and 72 of the AB report are pertinent:

The subjective intentions inhabiting the minds of individual legislators or regulators do not bear upon the inquiry, if only because they are not accessible to treaty interpreters. It does not follow, however, that the statutory purposes or objectives—that is, the purpose or objectives of a Member's legislature and government as a whole—to the extent that they are given objective expression in the statute itself, are not pertinent. To the contrary, as we also stated in Japan—Alcoholic Beverages:

'Although it is true that the aim of a measure may not be easily ascertained, nevertheless its *protective application* can most often be discerned from the *design*, the *architecture*, and the revealing *structure* of a measure.'

...Before the Panel, Chile stated that the New Chilean System pursued four different objectives: '(1) maintaining revenue collection; (2) eliminating type distinctions [such] as [those which] were found in Japan and Korea; (3) discouraging alcohol consumption; and (4) minimizing the potentially regressive aspects of the reform of the tax system.' Chile's explanations concerning the structure of the New Chilean System—including, in particular, the truncated nature of the line of progression of tax rates, which effectively consists of two levels (27 per cent *ad valorem* and 47 per cent *ad valorem*) separated by only 4 degrees of alcohol content—might have been helpful in understanding what *prima facie* appear to be anomalies in the progression of tax rates. The conclusion of protective application reached by the Panel becomes very difficult to

resist, in the absence of countervailing explanations by Chile [emphasis in original].

In *Indonesia—Certain Measures Affecting the Automobile Industry*,⁴⁴ Japan, the USA and the European Communities complained that the sales tax benefits provided under the February 1996, 1993 and June 1996 Indonesian car programmes violated Article III:2 of the GATT. Indonesia argued that the sales tax and luxury tax benefits provided to its National Car companies were subsidies and were consistent with the Agreement on Subsidies and Countervailing Measures (SCM Agreement) even if such tax benefits were inconsistent with Article III:2. It argued that there was a conflict between Article III:2 and the SCM Agreement in that the obligations contained in Article III:2 and the SCM Agreement were mutually exclusive because the SCM Agreement ‘explicitly authorized’ Members to provide subsidies that were prohibited by Article III:2. However, the panel rejected the arguments made by Indonesia and concluded that whether or not the SCM Agreement was considered generally to authorize Members to provide actionable subsidies so long as they did not cause adverse effects to the interests of another Member, the SCM Agreement clearly did not authorize Members to impose discriminatory product taxes. The SCM Agreement and Article III:2 were not mutually exclusive because it was possible for Indonesia to respect its obligations under the SCM Agreement without violating Article III:2 since Article III:2 was concerned with discriminatory product taxation, rather than the provision of subsidies as such.

Once the panel concluded that Article III:2 applied in regard to the Indonesian tax benefit scheme for National Car producers, it followed the approach adopted by the AB in *Japan—Taxes on Alcoholic Beverages* to test the validity of the Indonesian tax benefit scheme under Article III:2 of the GATT. The panel concluded:

Under the Indonesian car programmes the distinction between the products for tax purposes is based on such factors as the nationality of the producer or the origin of the parts and components contained in the product. An imported vehicle alike in all aspects relevant to a likeness determination would be taxed at a higher rate simply because of its origin or lack of sufficient local content. Such an origin-based distinction in respect of internal taxes suffices in itself to violate Article III:2 without the need to demonstrate the existence of actually traded like products.

The National Treatment obligation with respect to non-fiscal measures⁴⁵

Article III:4 of the GATT reads:

The products of the territory of any Member imported into the territory of any other Member shall be accorded treatment no less favourable than that accorded to like products of national origin in respect of all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use.

Thus, to make a successful claim of violation, a complainant must show that:

- 1 the complained-of measure is a 'law, regulation or requirement';
- 2 it affects the internal sale, offer for sale, purchase, transportation, distribution or use of domestic and imported products;
- 3 the imported product is 'like' a domestic product sold in the domestic marketplace; and
- 4 less favourable treatment has been afforded the imported product than to the like domestic product.

Scope of the National Treatment obligation

Elements 1 and 2 above may be said to go to the *scope of application* of Article III:4. The panel in its report on *US—Tax Treatment for Foreign Sales Corporations 'FSC'*⁴⁶ reaffirmed the GATT case law, which gives a very broad meaning to the expression 'laws, regulations or requirements' (§10.376):

A literal reading of the words *all laws, regulations and requirements* in Article III:4 could suggest that they may have a narrower scope than the word *measure* in Article XXIII:1(b). However, whether or not these words should be given as broad a construction as the word *measure*, in view of the broad interpretation assigned to them in the [GATT jurisprudence], we shall assume for the purposes of our present analysis that they should be interpreted as encompassing a similarly broad range of government action and action by private parties that may be assimilated to government action. In this connection, we consider that our previous discussion of GATT cases on administrative guidance in relation to what may constitute a 'measure' under Article XXIII:1(b), specifically the panel reports on *Japan—Semi-conductors* and *Japan—Agricultural Products*, is equally applicable to the definitional scope of 'all laws, regulations and requirements' in Article III:4.

In those earlier cases, the panels had held that a governmental action need not take the form of a mandatory regulation in order to fall within the scope of Article III:4 as long as the action has an effect on the behaviour of the regulated private entity (which could occur through informal pressures or incentives).

The AB in its report on *US—Tax Treatment for Foreign Sales Corporations 'FSC'*⁴⁷ had, *inter alia*, the opportunity to reaffirm the wide interpretation of the term 'affecting' in the earlier

GATT case law:

the word 'affecting' assists in defining the types of measure that must conform to the obligation not to accord 'less favourable treatment' to like imported products, which is set out in Article III:4. The word 'affecting' serves a similar function in Article I:1 of the *General Agreement on Trade in Services* (the 'GATS'), where it also defines the types of measure that are subject to the disciplines set forth elsewhere in the GATS but does

not, in itself, impose any obligation... In view of the similar function of the identical word, 'affecting', in Article III:4 of the GATT 1994, we also interpret this word, in this provision, as having a 'broad scope of application'.

(§§208–10; emphasis in original)

'Likeness' and 'no less favourable' treatment under Article III:4: the Appellate Body jurisprudence

When the AB was first faced with a major dispute concerning Article III:4, the *Asbestos* case, it had already developed its approach to 'likeness' in the first sentence of Article III:2 in *Japan—Alcohol*. Also, in *Bananas*, in reasoning admittedly not dealing with the central issues in the dispute, the AB had intimated that the rejection in *Japan—Alcohol* of 'aims and effects' as an overall methodology for determining whether National Treatment had been violated also applied *mutatis mutandis* to the interpretation of Article III:4.

In *Asbestos*, Canada challenged the French ban on asbestos in construction materials. Asbestos has long been known to be a deadly carcinogen, and France's ban of the substance applied without discrimination to both domestically produced and imported asbestos. Yet Canada argued that the asbestos it exports is a 'like product' to substitute products used in construction, therefore deserving no less favourable treatment under the National Treatment standard in the GATT (Article III:4). Canada also claimed that France had violated the obligation under the Technical Barriers to Trade (TBT) Agreement to ensure that its regulations are the least restrictive of trade necessary to attain the legitimate regulatory objective in question, here the protection of human life and health (Article 2.2 of the TBT Agreement). Canada argued that used in a 'safe' manner, the kind of asbestos (chrysotile) that it exports does not present health risks.

The panel accepted Canada's claim that asbestos and non-asbestos substitutes were 'like' products, despite the fact that the former was a proven, deadly carcinogen and the latter were not.⁴⁸ This resulted in a finding that France had violated Article III:4 of the GATT, in providing less favourable treatment to asbestos imported from Canada than to like substitute products. However, the panel went on to find that this violation of Article III:4 was justified under Article XX(b) of the GATT as 'necessary' for the protection of human health. With regard to Canada's TBT claim, the panel accepted a rather bizarre argument from France that because the French measure constituted an outright ban of asbestos, it did not fall within the definition of a technical regulation in the TBT Agreement. Therefore, the panel held, the TBT Agreement did not even apply to the measure.

For those concerned with the effects of the WTO on human health and related interests, the panel ruling was hardly a victory, despite the result of upholding the French ban. The notion that health considerations should be irrelevant in determining whether products are 'like' for purposes of assessing domestic regulations appeared to speak volumes about the obtuseness of the WTO in regard to basic human interests. However, such a ruling could be understood as the logical outcome, or perhaps *reductio ad absurdum*, of the approach adopted by the AB to National Treatment in the case of internal tax measures, in cases such as *Japan—Alcohol*, to view likeness purely from a

market-based perspective, without regard to differences between products that relate to externalities that would normally be addressed through government regulation. The panel, following apparently the spirit of the AB's rejection of 'aims and effects', considered that such matters were to be dealt with only in determining whether France's measure was justified by any of the regulatory purposes stated in the exceptions provision of the GATT, Article XX.

The disposition by the AB of the EC cross-appeal on the panel's finding of an Article III:4 violation is, to say the least, complex. This disposition has three separate parts to it: (1) an elaboration of the general approach to the interpretation of the treaty language in Article III:4; (2) findings of error of law by the panel; and (3) 'completing the analysis', where the AB goes on to apply Article III:4 correctly to the facts of the case, picking up at the point where the panel began to err in law.

In outlining the general approach to the interpretation of Article III:4, the AB places fundamental emphasis on Article III:1 as stating the general purpose that animates Article III as a whole. That principle, according to the AB, quoting its own words in *Japan—Alcohol*, 'is to avoid protectionism in the application of internal tax and regulatory measures'.⁴⁹ Thus, the meaning of 'like product' must be informed by the antiprotectionism principle of Article III:1. In order for protectionism to exist, the regulations being challenged under Article III:4 must, in the first instance, address imported and domestic products that are in a competitive relationship. Thus, the inquiry into 'likeness' in Article III:4 is about whether there is the kind of competitive relationship between the imported product and domestic products that *could* lead to a conclusion of protectionism, *if* the result of the regulatory treatment were that the imported product was treated less favourably. It is, then, not enough that there be *some* competitive relationship between the imported product and domestic products; rather, the issue of likeness is one that includes the 'kind' of competitive relationship. Already here, the AB is distinguishing its approach from that of the panel in *Japan—Alcohol*, making it clear that what is at stake is a contextual and qualitative judgment about competitive relationships, not merely the economic analysis of cross-elasticity of demand between two groups of products. Such an assessment must be made on a case-by-case basis, informed by the general principle of anti-protectionism, which informs all of Article III.

Once a competitive relationship has been established of the degree and kind relevant to Article III:4, then the second step of the analysis comes into play. Only where the differential treatment of the 'like' products amounts to 'less favourable treatment' of the group of imported products in relation to the group of like domestic products will there be a violation of Article III:4. In fact, the AB goes out of its way to emphasize that 'a Member may draw distinctions between products which have been found to be "like", without, for this reason alone, according to the group of "like" *imported products* "less favourable treatment" than that accorded to the group of "like" *domestic products*'.⁵⁰ The AB also emphasizes that less favourable treatment does not mean just *any* kind of worse treatment—'less favourable treatment' is a concept informed by the anti-protectionist principle in Article III:1. Thus, a judgment of 'less favourable treatment' implies, 'conversely', a conclusion of 'protection'.

As the AB noted, it did not need to apply the concept of 'less favourable treatment' to the facts in *Asbestos*, since it reversed the panel's ruling that the products were 'like', therefore obviating the second step of the analysis. However, this statement of the

approach to less favourable treatment is a very important one. First of all, the AB has made it clear that even where *products* are in a close enough competitive relationship to be considered ‘like’, members of that class or group of ‘like’ products may still be distinguished in regulation, provided that the result is not less favourable treatment, understood as protection of domestic production. This in effect blunts, without explicitly repudiating, the product/process distinction—the much-criticized idea, found in the unadopted *Tuna/Dolphin* panels, that process-based trade restrictions can never be considered as internal regulations consistent with the National Treatment standard of Article III.⁵¹ Even if products that have different process and production methods are considered to be ‘like’ under Article III:4 (which, as will be discussed below, they need not always be), regulatory distinctions may be made between them, on *any* grounds, provided the result is *non-protectionist*. Thus, for example, were all ‘shrimp’ considered to be ‘like’ regardless of whether they are turtle-friendly or not, i.e. whether or not caught in a manner that does not result in undue levels of turtle mortality, this would not *necessarily* mean that a regulation that requires that all shrimp sold in the US be turtle-friendly is inconsistent with Article III:4. One would have to consider whether the design and structure of the scheme results in less favourable treatment of imported shrimp as a group than domestic shrimp as a group, i.e. does the requirement result in protection of domestic production? The differential impact of such a requirement on imported shrimp *might* alter the competitive relationship between domestic and imported shrimp so as to protect domestic production, if, for instance, foreign producers of shrimp faced costs of adapting their fishing practices that domestic shrimp producers did not. However, as the AB emphasizes, the comparison is between the group of imports as a whole and the group of domestic products as a whole. Just because one particular foreign producer of shrimp faces a differential burden from the regulation in comparison to one particular domestic producer, a finding of ‘less favourable treatment’ would not be justified.

The AB’s emphatic statement about the crucial second step in Article III:4 National Treatment analysis must be borne in mind in considering its approach to the first step of ascertaining whether products are ‘like’; the AB admits that there is no one approach to likeness that will be appropriate in all cases, and that ‘likeness’ is a matter of judgment—qualitative as well as quantitative. This case-by-case approach may not seem to provide much assurance against a panel casting the net so wide, as it were, that legitimate non-protectionist regulatory distinctions are put into question. But the *second step* of Article III:4 analysis provides a safeguard against that possibility, by requiring the complaining Member to establish that the regulatory distinction in question results in protection of domestic production. Thus, while the AB had taken great pains in *Japan—Alcohol* to distance itself from ‘aims and effects’ analysis with respect to likeness, it has in effect brought ‘aims and effects’ back in at the second stage of considering whether there is ‘less favourable treatment’.⁵²

This brings us to the general remarks of the AB concerning likeness of products in Article III:4. The AB first of all recalls the *Border Tax Adjustment* criteria, with the addition of customs classification as the fourth criterion, as one approach that has been developed to likeness under Article III.⁵³ However, the AB also states that the criteria in question ‘are neither a treaty-mandated nor a closed list of criteria that will determine the legal characterization of products’.⁵⁴ Indeed, a panel *must* examine all the ‘pertinent evidence’ of likeness or unlikeness, regardless of whether that evidence goes to the kinds

of ‘potentially shared characteristics’ identified in the *Border Tax Adjustment* criteria. This last statement is significantly stronger than the caveat in *Japan—Alcohol* that other criteria may be relevant in certain cases—it actually limits the discretion of the panel, which must weigh all the evidence in every case, including evidence that does not go to the potential shared characteristics identified in the *Border Tax Adjustment* criteria. At the same time, the AB notes that because the likeness inquiry is about competitive relationships between products, it is necessary for a panel always to take into account evidence that goes to the competitive relationship in its analysis of likeness.

It is apparent that, here, the AB is engaged in a very subtle balancing act in articulating its approach to ‘likeness’. The AB makes it very clear that a panel cannot simply revert to an ‘aims and effects’-type analysis as conclusive of ‘likeness’ or ‘unlikeness’; the panel must *always* examine competitive relationships in the marketplace. At the same time, the AB goes out of its way to emphasize that there may be cases where it will be inappropriate to leave matters at that, and raises the possibility that in those cases, the evidence that tips the balance may well be evidence that does *not* go the market-based criteria articulated in *Border Tax Adjustment*. Otherwise, why make it obligatory in all cases to consider such evidence, if it exists?

Now the AB goes on to the second part of its consideration of National Treatment, the correction of the panel’s errors of law. The panel erred in not considering and weighing all the evidence, and this error relates to the error of not considering *all* four of the *Border Tax Adjustment* criteria explicitly and separately. First of all, the panel focused exclusively on assumptions about end-uses of the products in coming to the conclusion that differences in physical characteristics between asbestos and the substitute products were not of a kind and degree as to make these products ‘unlike’. According to the AB, the analysis of physical characteristics should be made separately from an inquiry into end-uses. According to the AB, physical differences between asbestos fibres and substitute products ‘are “important” because the microscopic particles and filaments of chrysotile asbestos fibres are carcinogenic to humans, following inhalation’.⁵⁵ The failure of the panel to find that such differences were ‘important’ stemmed partly from its error of law in conflating an analysis of physical characteristics with an analysis of end-uses. But it also stemmed from the panel’s error in concluding that health effects are irrelevant in analysing likeness under Article III:4. The panel took the view that were health considerations to enter into the application of the National Treatment standard in Article III, then the health exception in Article XX would be redundant. The AB, however, considered that consideration of health effects under Article III:4 is a very different kind of inquiry than that under Article XX. Under Article III:4, the issue is how health effects impact on the competitive relationship of products in the marketplace, whereas under Article XX the issue is whether a Member has a sufficient basis for adopting or enforcing a WTO-inconsistent measure on grounds of human health.⁵⁶

In addition, the panel committed a further error when it went on to examine end-uses as a separate criterion. In concluding that the evidence of end-uses sustained a conclusion of ‘likeness’ between asbestos and the substitutes, the panel left matters at pointing out a small number of similar end-uses of the two products, while failing to examine evidence of a wide range of dissimilar non-overlapping functions.

More importantly still, the panel erred in failing to consider at all the evidence of consumer tastes and habits, the third criterion that it was required to consider separately.

Here the AB comes closest to taking judicial notice of human health as a fundamental value: 'In this case especially, we are also persuaded that evidence relating to consumers' tastes and habits would establish that the health risks associated with chrysotile asbestos fibres influence consumers' behavior with respect to the different fibres at issue.'⁵⁷ While acknowledging that the initial consumers of the products are industrial users, the AB notes:

A manufacturer cannot, for instance, ignore the preferences of the ultimate consumer of its products. If the risks posed by a particular product are sufficiently great, the ultimate consumer may simply cease to buy that product. This would, undoubtedly, affect a manufacturer's decisions in the marketplace. Moreover, in the case of products posing risks to human health, it is likely that the manufacturer's decisions will be influenced by other factors, such as potential civil liability that might flow from marketing products posing a health risk to the ultimate consumer, or the additional costs associated with safety procedures required to use such products in the manufacturing process.⁵⁸

For the AB, then, the test from the perspective of consumer tastes and habits is whether the products would be substitutable and in a competitive relationship in an *idealized* marketplace, one where consumers have full information, and where, at least through tort liability, negative externalities have already to some extent been internalized. As the AB emphasizes, the fact of an imperfect marketplace does not mean that evidence cannot be found that is probative of how consumers *would* behave with respect to the two products in an *idealized* marketplace.⁵⁹ Indeed, to support the intuitions of the AB here, in the case of asbestos, the evidence of the social costs from the health risks of this substance is such that one would almost certainly expect that, in an idealized marketplace where those costs were internalized, asbestos and asbestos products would be very unlikely to be cost competitive. This sort of analysis of consumer tastes and behaviour brings into the picture the kinds of regulatory interests which under the GATT had been taken into account through the 'aims and effects' test. It is just that those interests are taken into account here by adopting not the perspective of the regulator as such, but the perspective of consumer behaviour in an idealized marketplace. But note that part of the picture of this idealized marketplace is a liability rule that makes manufacturers responsible for the health risks posed by their products; such a rule may well be premised not only on assumptions about the efficient allocation of risk, but also on judgments about the fair, or just, distribution of risk in a society. It is thus quite possible that this particular conception of the idealized marketplace embodies not only a conception of regulation as the 'efficient' correction of market failure, but also a conception of a just allocation of liability rules and/or property rights. Thus, just as with its notion of *quality* of competition in *Korea—Alcohol*, in analysing 'likeness' in *Asbestos*, the AB has—through the back door, as it were—brought into the picture regulatory interests, through the device of considering them as the preferences and tastes of consumers in an idealized marketplace.

The final part of the AB's discussion of National Treatment in *Asbestos* consists in completing the analysis—i.e. applying the legal interpretation of Article III:4 as corrected

to the facts. Having found that the panel did not err in law in choosing to adopt the *Border Tax Adjustment* approach to likeness, the AB does not undo that choice. The AB first turns to the consideration of physical characteristics. It comes to the conclusion that asbestos and the substitutes are 'very different' physically because of the health significance of the differences. Yet the AB does not explain *why* health effects should in this instance be decisive in evaluating whether physical differences are significant enough to lead to a conclusion of unlikeness. The AB might have pointed to its speculations about consumer tastes and habits. But if the panel was wrong to conflate an inquiry into physical characteristics with an investigation of end-uses, would not the AB have made a similar error, in evaluating the significance of physical differences through the lenses of the third criterion of consumer tastes and habits? As the AB stated earlier in its examination of Article III:4, one of the questions not answered by any dictionary definition of likeness is 'from whose perspective' the significance of differences and similarities is to be evaluated. Of course, one answer is the regulator's perspective, an answer that in some form or other leads back to 'aims and effects', an outcome unacceptable to the AB. Another answer is the consumer's perspective. But that leaves it as mysterious as to why an analysis of physical characteristics would be *logically prior* to a consideration of consumer tastes and habits, much less distinct from it.

In any case, the physical properties of the products having been determined to be 'very different' on the basis of health considerations, the AB suggests that this amounts to a preliminary or tentative finding of 'unlikeness', which Canada has a high burden to bear in reversing, through demonstrating, that despite significant physical differences, the products are in a sufficiently close competitive relationship, when the other factors are analysed. Here, with respect to end-uses, since there was no evidence on the record of the *extent* of non-overlapping, separate end-uses for the products relative to similar end-uses, the AB concluded that 'we cannot determine the significance of the fact that chrysotile asbestos and PCG fibres share a small number of similar end-uses'.⁶⁰

Two readings are possible concerning what the AB was saying here. The first reading is that it is saying that it is impossible to apply at all the second criterion of end-uses due to a defect in the factual record of the panel. If this is so, then the AB should not be completing the analysis,⁶¹ because on the AB's own theory of 'likeness', a panel must make a separate and thorough analysis of all four criteria if it adopts the *Border Tax Adjustment* approach. If the factual record as it stood did not permit such an analysis of the second criterion, then the AB could not, on its own terms, go on to apply adequately the *Border Tax Adjustment* approach to 'likeness'.

An alternative reading is that the AB understands the inquiry into end-uses as one that focuses on the *comparative* importance of similar as opposed to different or non-overlapping end-uses. On this reading, the AB would be holding that a Member, in order to make a *prima facie* case of likeness, has to provide evidence of likeness (similar end-uses) but also evidence of unlikeness (different or non-overlapping end-uses) and show at least the preliminary plausibility that the former evidence outweighs or is more probative than the latter. On the one hand, this view of the burden of proof is consistent with the AB's view that the inquiry into likeness is *inherently* a relative or comparative inquiry, entailing an appreciation of kind and degree of similarity; thus even a *prima facie* case of likeness would need to probe degree or extent, which obviously involves comparing the evidence of likeness against all evidence, including that of unlikeness. On the other hand,

it seems more intuitively plausible that in an adversarial process, where the complainant provides *some* credible evidence of likeness, it establishes a *prima facie* case, such that one would normally expect that the defending party would now have to muster equal or greater credible evidence of unlikeness. In any case, while this second reading raises difficult issues about the burden of proof, it does exonerate the AB from a straightforward error of completing the analysis on the basis of an inadequate panel factual record.

In the case of consumer tastes and habits, the third criterion, the panel held that since Canada had presented no evidence at all on consumer tastes and habits, Canada could not overcome the tentative or preliminary characterization of the products as ‘unlike’ based on physical characteristics.⁶² However, the reason that Canada presented no evidence, the AB noted, was its legal position that the criterion was irrelevant. Here an *error in law*, corrected only upon appeal by the AB, resulted in an inadequate factual record. Was this a reasonable basis on which to conclude that Canada had not met its burden of proof? Or should the AB instead have simply concluded that the factual record was inadequate and refused to complete the analysis? On balance, we are of the view that the AB acted appropriately. In failing to provide evidence on consumer tastes and habits, Canada was taking an ordinary litigation risk—the risk that if the adjudication were to disagree with its view that this criterion was irrelevant in the circumstances, it would lose the opportunity to argue in the alternative that consumer tastes and habits did point to a finding of likeness or at least did not detract from such a finding based on physical similarities and end-uses.

There is, arguably, a more general inconsistency between the way in which the AB completed the analysis and the overall approach to Article III:4 it elaborated in the first part of its discussion of Article III:4. In that part, it suggested that what a panel should do is to consider all the evidence of likeness on the basis of the *Border Tax Adjustments* criteria, and indeed also consider any evidence that does not go into the characteristics addressed by those criteria, and then make an overall judgment as to whether the products are ‘like’ or not. But, when completing the analysis, the AB appears to privilege the investigation of physical differences as of special and prior importance, such that where that analysis points to a finding of unlikeness, the evidence on the other criteria must be virtually overwhelming to justify an overall, definitive judgment that the products are ‘like’. Given that, in this case, the physical differences are significant in terms of a very fundamental human value, health, the approach does not seem unjustified. But the AB seems to adopt it as a rule of thumb for all cases, regardless of context. Nevertheless, it is important to note that the AB does not affirm the converse; that is the AB does *not* say that, where the analysis of physical characteristics points towards *likeness*, the burden of establishing *unlikeness* on the basis of *other* criteria and evidence is especially heavy.

What, then, is one to make of the overall ruling of the AB with respect to Article III:4? One way of understanding this ruling is that it navigates between two ‘constituencies’, both of which are important to the legitimacy of the AB on the WTO rules and institutions more generally.⁶³ The first constituency is that of the officials (delegates, Secretariat employees, etc.) who are the day-to-day guardians of the trading system—these people may be inclined to look for clear, economic guidelines in the application of trade law, and may tend to view ‘market access’ as the main objective of the entire system, subject to certain defined and limited ‘exceptions’. The second constituency is

that which comprises groups and individuals whose interests and values are habitually given short shrift when translated into trade rules and legal interpretation by the middle-level officials. Some of these groups see the only answer to this problem as structural—a roll-back of globalization. Yet there are other groups within the second constituency, such as those who filed applications for leave to submit *amicus* briefs in *Asbestos*, who see change within the system as at least part of the solution, including more sensitive interpretations of WTO law.

The *Asbestos* ruling navigates with agility between these two constituencies. It gives to the first constituency an ‘economic’ framework for the application of Article III:4, which is continuous with the recent jurisprudence on National Treatment in taxation. At the same time, it corrects for the narrowness of perspective of the panel, signalling that within the ‘economic’ framework for the analysis of likeness, broader human interests and values such as health must be taken into account. In addition, the AB has maintained two additional safety valves against interpretations of likeness under Article III:4 that threaten the legitimacy of the system by giving inadequate attention to human values and interests of a non-economic nature, in the narrow sense. The first is in the notion that the ‘economic’ framework is not necessarily decisive with regard to likeness in all cases, and evidence that cannot be assimilated to the characteristics important in that framework must be taken into account (even if the AB did not speculate on what such cases might be about). The second safety valve resides in the importance of establishing ‘less favourable treatment’, i.e. protection of domestic production, in order to prove a violation of Article III:4. To the extent that ‘less favourable treatment’ means treatment that is protectionist in terms of aims and effects, this second step in Article III:4 analysis creates the kind of safe harbour for non-protectionist domestic regulations that had been the central intent behind the now repudiated ‘aims and effects’ test. The member of the AB division who, in his concurring opinion, expressed the view that the AB should have stated outright that carcinogenic asbestos is not ‘like’ non-carcinogenic substitutes clearly, at some point, balked at this balancing act. He could not accept that the concern to preserve the ‘economic’ approach to ‘likeness’ in Article III:4 justifies the failure to make a strong and unambiguous statement that, in a case like this, health effects simply *trump* other considerations or factors that might be in play in assessing ‘likeness’.

Some may argue that in playing this kind of role, the AB has gone to the opposite extreme of its initial approach of sticking to the Treaty text. However, the AB is careful to note in its ruling that the Treaty text cannot resolve in any kind of straightforward, positivistic way the issue of ‘likeness’ in Article III:4. Thus, the AB has been compelled to find a legitimate solution in the absence of an agreed approach in the Treaty text itself. Under such circumstances, it has understandably resorted to techniques of adjudication described by Cass Sunstein in the US domestic context, somewhat misleadingly perhaps, as ‘judicial minimalism’.⁶⁴ These are techniques that Sunstein argues are appropriate in cases where a court must decide a complex matter on which people feel deeply, but also on which the relevant constituencies are deeply divided on the level of principle. The court must find an outcome in the individual case before it that does not represent a choice between the ultimate values that are contested in any simple or straightforward way. It will thus craft a decision that leaves many things undecided or under-decided; that resolves issues not through reference to high general principles but to narrow factors such as burdens of proof and issues specific to the facts of the case; that will be disinclined to

evolve the law in bold steps, by overtly replacing one kind of doctrinal framework with another. This kind of decision people may be able to live with, despite deep divisions among them about the general principles or norms at stake.

AN ASSESSMENT AND CRITIQUE OF THE JURISPRUDENCE

While the manner in which the AB has finessed the choice between an ‘aims and effects’ and an ‘economic’ approach to the analysis of discrimination in Article III of the GATT is understandable from the considerations discussed above, what has been sacrificed (to an important extent) is transparency, predictability and principled coherence.

Some critics, such as Trebilcock and Giri, argue for a more straightforward and rigorous version of the economic approach to which the AB seemed inclined in *Japan—Alcohol*. This approach, informed by anti-trust economics, would use formal economic tools (such as the WTO panel in *Japan—Alcohol* had placed weight on) to ascertain whether products are in a sufficiently close competitive relationship to be considered either ‘like’ or, if not ‘like’, directly competitive and substitutable. With respect to the inquiry about protective application under the second sentence of Article III:2, and to the inquiry into less favourable treatment under Article III:4, instead of the incomplete reversion to ‘aims and effects’ visible in *Korea—Alcohol* and *Asbestos*, Trebilcock and Giri recommend economic analysis of how the measure at issue affects the actual competitive relationship between imported and domestic products, either ‘like’ or ‘directly competitive or substitutable’, as the case may be. While Trebilcock and Giri are sensitive to the concern that this rigorous economic approach may result in some legitimate non-protectionist public policies being found in violation of Article III, they point out that the issue of whether such policies may nevertheless be justified as serving non-protectionist policy objectives should be addressed transparently under Article XX, the general exceptions provision of the GATT with justificatory burden on the respondent (given its superior knowledge of its own regulatory purpose).

Another set of critics of the AB jurisprudence on National Treatment seeks to achieve greater transparency and principled coherence through the AB adopting an interpretation of Article III:2 and III:4 that stresses regulatory purpose, but without necessarily reverting to an inquiry into subjective legislative intent, as the old ‘aims and effects’ test would seem to imply. These critics, who include Robert Howse and Donald Regan,⁶⁵ and, to some extent, Horn and Weiler⁶⁶ and Gaetan Verhoessel,⁶⁷ do share significant common ground with the first set, as exemplified by Trebilcock and Giri. First, the ‘regulatory purpose’ critics do not disagree that the analysis of likeness under III:2, first sentence, and III:4, and of ‘directly competitive and substitutable’ under III:2, second sentence, must entail, as one initial step, a determination of whether the domestic and imported products are in competition in the same marketplace. Nor do the ‘regulatory purpose’ critics object to the use of economic methodologies to answer that question. Second, the ‘regulatory purpose’ critics and the ‘economic’ critics such as Trebilcock and Giri agree that regulatory purpose should be addressed in a transparent, not a cryptic or indirect, way.

The disagreement, then, amounts to whether considerations of non-protectionist regulatory purpose ought to enter as a subsequent step in the determination of whether there is a violation of III:2 or III:4, or, alternately, through justification under Article XX.

From a purely textual perspective, neither solution is obviously superior to the other. While the individual heads of Article XX do explicitly mention various regulatory purposes, thus giving a textual basis for the consideration of regulatory purpose, so does Article III:1, which establishes the basic principle of National Treatment as that of avoiding protectionism, an idea that cannot be easily separated from some conception of the purpose of a measure, whether objectively or subjectively considered—at least not as a matter of ordinary language.

One textual argument against the ‘economic’ approach is that not all non-protectionist or indeed legitimate public policy purposes are covered by the individual heads of Article XX. For example, consumer protection is not included. However, this argument is not decisive—the meaning of ‘public morals’ in Article XX(a) has never been the subject of GATT or WTO jurisprudence, and if a WTO adjudicator were to adopt the Trebilcock and Giri approach to National Treatment, she might consider that the public morals rubric creates a kind of general or residual exception applicable to those legitimate nonprotectionist public policies that are not covered by the specific heads that follow XX(a). Analogizing public morals in this way to the idea of public order in European and public international law, or to the police power in American constitutional law, is not contrary to the plain meaning of the text of XX(a). Nor is there any jurisprudence or practice that would foreclose such a reading.

From the perspective of the ‘regulatory purpose’ critics, one disadvantage of the economic approach might be that it would impose an undue burden on a government acting purely innocently to be required in effect to justify any public policy that happens to have trade effects. Article XX has traditionally been read narrowly, and a high burden of justification has been placed on a defending Member to show that its measure is the least trade restrictive means of achieving its regulatory objective. However, as is discussed in the chapter on trade and environment in this book (Chapter 16), recently the AB has increased the margin of appreciation for domestic regulation in its approach to Article XX. Measures that are not ‘indispensable’ to the achievement of an objective may still be found to meet the necessity test under Article XX, if the trade-restrictive impact is not out of proportion to the regulatory benefit. (See the discussion of the *Korea—Beef* case in Chapter 7, on domestic health, safety and technical standards.)

If an ‘economic’ approach to Article III were adopted by the WTO adjudicator, then further differentiation of levels of scrutiny under Article XX might occur in tandem: for instance, facially neutral measures that do not in any way distinguish between foreign and domestic products on the basis of origin might be accorded a particularly deferential level of scrutiny under Article XX; in such cases, once the defendant had shown a rational connection to a legitimate purpose under one of the heads of Article XX, the burden of proof might be placed back on the complainant to show that, despite this rational connection, the measures in question lack an adequately close fit with their purported purposes.

In sum, from the perspective of taking regulatory purpose seriously, and ensuring that non-protectionist legitimate public policies are not inappropriately constrained by the GATT, what the ‘economic approach’ imagines as entailed in Article XX analysis could

well come to be functionally equivalent to what the ‘regulatory purpose’ critics propose with respect to Article III itself. This possibility is most visible in the approach of Gaetan Verhoessel, who advocates, essentially, collapsing the Article III and Article XX inquiries into a single examination of whether distinctions applied to competing products can be justified as necessary or rational in light of a legitimate non-protectionist public purpose.

How much, then, is really at stake in the differences between the ‘economic’ and the ‘regulatory purpose’ critics, once we assume the possibility of functional equivalence between the consideration of regulatory purpose under Article III:4 and under Article XX?

The best articulation of what is at stake comes from Henrik Horn and Joseph Weiler, who are at least partly⁶⁸ in the ‘regulatory purpose’ camp:

The strongest argument [for avoiding the ‘economic’ approach] is not, in our view, of a crude pragmatic nature—i.e. leading to tangibly different results but in the realms of concept and symbol... First there is something that comes under the concept of ‘naming and shaming.’ It is wrong, it can be argued, to deal with the case of a State which adopts an origin neutral measure for a totally legitimate purpose but which has the coincidental effect of giving an advantage to domestic production, as a violation of a non-discrimination provision requiring justification. Even if the result is the same, there is value in having cases dealt with in a correct normative context and not diluting the notion of discrimination with activities which should not be so branded.

There is, it is also argued, a ‘truth’ based argument, which goes beyond the lexical hermeneutics of the text of Article III, namely there can be no discussion of discrimination which does not imply in some way and at some level examination of purpose and an agreed comparator...

At an even deeper level, the difference...can go to the very symbolism of political identity. [The economic approach]...even if very solicitous to diverse socio-economic choices in the construction of Article XX, establishes a normative hierarchy whereby the default norm is liberalized trade, and for competing norms to prevail, they would have to be justified. This is not a question of technical burden of proof. It is a question of constitutional identity, the way a society wants to understand its internal hierarchy of values. [The non-economic approaches] reverse that default. The default value is the autonomy of political and moral identity which requires justification only if purposefully abused.⁶⁹

Reasonable people can disagree on whether the choice between the ‘economic’ and ‘regulatory purpose’ approaches to Article III has the kind of ‘expressive’ consequences that Horn and Weiler suggest. Supporters of the ‘economic’ approach might well question whether it is that hard for the public constituencies of the WTO to appreciate that a judgment that Article III has been violated is merely a conclusion that the competitive relationship between domestic and imported products at issue is sufficiently close, and the trade effects of the regulation sufficiently apparent, as to warrant a further

inquiry under Article XX about the regulation's bona fides. With respect to Horn and Weiler's concerns about normative hierarchy, it might be countered that by making recourse to Article XX routine, the 'economic' approach in fact would have the opposite result from the one they fear—Article XX would no longer be regarded as a very narrow exceptions provision, which should be invoked rarely and accepted even more rarely as a justification for trade-restricting policies. Instead, Article XX would become central to almost all cases where the issue is the interface between free trade and the regulatory state. Since Article XX *explicitly* puts other values before trade liberalization, routine findings that measures with trade-restricting effects are nevertheless justified on the basis of these superior values could strengthen the version of normative hierarchy that Horn and Weiler are concerned to preserve.

At the same time, public response to the panel ruling in *Asbestos* suggests that, empirically, i.e. in terms of understanding the nature of human discourse surrounding discrimination and equality, Horn and Weiler may have a point. Even though the panel, as discussed above, found the French ban to be justified under Article XX, many were offended at the very notion that a product that kills people could be found to be 'like' one that is innocuous, such that treating the two differently amounts to 'discrimination'. Judgments about like and unlike—about equality and discrimination—seem to have an inexorable moral logic to them in ordinary human discourse. It might indeed be difficult to communicate the message that a finding of 'unlikeness', and 'discrimination', is merely an empirical finding about effects on competitive conditions in the marketplace, with the underlying normative issues requiring a subsequent investigation (under XX).

The fact that the authors of this book come out on different sides of this debate reflects the subtlety and complexity of the issues. It may not augur well, either, for building a durable consensus on the AB bench concerning the appropriate interpretive approach. In these circumstances, as WTO Members seek greater clarity and predictability than case-by-case application of National Treatment is likely to provide, the more specialized WTO rules that discipline domestic regulation, such as those in the TBT and Sanitary and Phytosanitary (SPS) Agreements, as well as non-WTO initiatives for regulatory harmonization, mutual recognition and regulatory cooperation, may well play an increasing role in managing the interface between competitive global markets and competitive politics.

4

Dispute settlement

INTRODUCTION

The legacy of the GATT

As explained in Chapter 1, the General Agreement on Tariffs and Trade was originally intended as only one element of what was supposed to be a much more ambitious institutional structure. By 1950 it was clear that the US Congress would not accept the International Trade Organization, with the result that the only international organization left for the regulation of world trade was a provisional agreement never intended as a framework for such an organization.¹

From the beginning, then, the GATT was characterized by temporary measures and *ad hoc* solutions to emerging problems. Administrative services for the GATT were provided by the Interim Commission of the ITO and responsibility for oversight and direction was taken on by regular meetings of the Contracting Parties, with Geneva as the *de facto* site.²

In contradistinction to the ITO draft charter, the 1947 GATT made no provision for formal, juridical dispute settlement, nor was there any explicit provision for recourse to the International Court of Justice in resolving disputes.³ The emphasis was on diplomatic methods of consultation and consensus. Article XXII provided for consultations where representations were made by one Contracting Party to another ‘with respect to any matter affecting the operation of this Agreement’. Article XXIII provided for the possibility of an investigation, recommendations, and rulings by the CONTRACTING PARTIES (in effect, the GATT Council consisting of all Member states) in the case where a Contracting Party considered that a benefit under the GATT was nullified and impaired. This applied not only in the case where the nullification and impairment flowed from a violation of a provision of the GATT, but in other circumstances as well (which gave rise to what are referred to as non-violation nullification and impairment complaints, discussed later in this chapter). Article XXIII also permitted the CONTRACTING PARTIES to authorize a Contracting Party to suspend concessions under the GATT with respect to another Contracting Party, where it considered that ‘the circumstances are serious enough to justify such action’. It is on the legal foundation of these provisions that dispute settlement practice in the GATT was built throughout its history, and they remain in the 1994 GATT as a basis for the WTO Dispute Settlement Understanding (hereinafter DSU), which, however (along with various agreement-specific provisions, discussed below), govern dispute settlement practice with respect to not only the 1994 GATT but all the ‘covered agreements’ under the WTO umbrella.

The first complaints to come before the GATT were referred to the Chairman of the Contracting Parties at the Second Session in 1948 (without any warrant for such a

procedure in the GATT itself), who gave a ruling on the legality or otherwise of the measures complained of.⁴ At that same session, a 'working party' was set up for the first time to report on a dispute between the USA and Cuba regarding the latter's textile regulations. The working party, which consisted of GATT representatives from Canada, India, The Netherlands, Cuba and the USA, was to investigate the matter 'in the light of the factual evidence' and to recommend a 'practical solution' to the Contracting Parties. Three days of meetings led to a compromise satisfactory to both of the disputing parties.⁵ In contrast to the 'rulings' given by the Chairman, the working parties were really a forum for encouraging negotiation. This was not a third-party investigation for the purpose of coming to objective conclusions on the merits: such a function was precluded by the participation of the disputants, and the fact that the other representatives were acting on the instructions of their respective countries.

The Third Session, in 1949, saw the advent of something like third-party panel dispute resolution. Chile complained to the Contracting Parties about the practices of Australia with respect to fertilizer subsidies. A working party was established, and the report drafted by the neutral countries of the working party was accepted by the Contracting Parties notwithstanding the dissent of the Australian representative.⁶ But it was not until the Seventh Session, in 1952, that the Contracting Parties resorted to the panel procedures which have now become the standard means of dispute resolution within the GATT.⁷ The use of panels marked an important shift for the GATT. They no longer included representatives from the disputing parties; major trading nations like the UK and the USA were not automatically panel members; and the panel and the GATT Secretariat worked together to develop more formal procedures for the functioning of panels.⁸ The GATT Secretariat, in a report to the Contracting Parties, identified this move to panel procedures as an attempt to instil greater objectivity in dispute resolution.⁹ One GATT insider has called the institution of panels a Secretariat 'conspiracy' to enhance its influence, and lessen that of the larger countries which tended to dominate working parties.¹⁰ Whatever the real reasons for their creation, panels marked a move away from the GATT as an institution for facilitating negotiation towards a greater emphasis on third-party adjudication.

But the move towards third-party adjudication was not written in stone. No sooner had the panel process been instituted than it fell into a degree of disfavour with GATT nations. During the 1960s, very few disputes were brought before panels—there were only six panel complaints in this period—and from 1963 to 1970 no panels were set up at all. Countries resorted to consultation to resolve disputes, and the more contentious issues were dealt with by working groups, which issued reports with recommendations rather than rendered court-like judgments.¹¹ Several reasons have been suggested for this move away from legalism in procedure.¹²

The 1960s witnessed a growing perception among GATT countries that the rules of the Agreement were becoming outdated. This period also saw the emergence of the EU, Japan and several less-developed countries as important trading powers within the GATT. No one in this group found legalism particularly salutary to their interests: strict interpretations of the Agreement would have interfered with domestic programmes designed to manage international trade in various key sectors.¹³ Seen in this light, the legalism of the 1950s was probably more a result of the GATT's domination by the USA than some deeply felt commitment on the part of GATT Members in general. Moreover,

the 1960s was a period which saw declining compliance with the spirit of the GATT through the use of non-tariff barriers (even as tariffs fell dramatically after the Kennedy Round), and sectoral agreements which effectively managed trade.¹⁴ Faced with trade restrictions that challenged the very assumptions of the GATT, its dispute resolution mechanisms appeared increasingly inadequate to the task of ensuring compliance with the Agreement. The 1970s would see a revival of the use of panel procedures, but this was largely the result of a new aggressiveness on the part of the USA.¹⁵ The real challenges facing the GATT implied the need for new rules.

The Tokyo Round was initiated in part to deal with contentious forms of non-tariff barriers. The USA also hoped to use the round to strengthen the panels by elaborating their procedures and increasing the predictability of their outcomes. The USA did achieve an important codification of existing practice, and a renewed commitment from GATT countries to use the Agreement's dispute resolution mechanisms.¹⁶ In addition, some of the subsidiary codes negotiated during the Tokyo Round included their own dispute settlement provisions, which set deadlines for dispute settlement and allowed resort to dispute settlement as of right.¹⁷ But US efforts towards an even greater emphasis on legalism, for example through the imposition of stricter deadlines, were blocked.¹⁸ In the Tokyo Round, an Understanding on Dispute Settlement (DSU) was negotiated, which in many respects codified and clarified GATT practice as it had evolved to that point, with some relatively minor reforms that addressed some of the concerns that had been raised about the effectiveness of the process. These are summarized by Hudec:

The Understanding on Dispute Settlement rejects the practice of defendants linking the complaint to resolution of other related issues. It also authorizes the Secretariat to maintain a standing roster of potential panel members, exhorts parties to respond to Secretariat nominations of panel members within seven working days, exhorts parties to 'not oppose nominations except for compelling reasons', and sets a 'normal' time period for the establishment of panels of not more than thirty days after authorization by Council decision.¹⁹

Finally, in the Uruguay Round a comprehensive agreement on dispute settlement procedures was achieved, including an Appellate Body.

Perspectives on dispute settlement

In order to understand the achievements of the DSU agreed to in the Uruguay Round, it is necessary to examine briefly the various achievements and limitations of dispute settlement practices as they evolved in the GATT on the basis of Articles XXII and XXIII. As noted, often the debate over these practices was cast in terms of 'rules' vs. 'diplomacy', with some Contracting Parties, particularly the United States, arguing for greater legalism, and some other countries, as well as important voices in the global trade policy élite, arguing the advantages of diplomatic flexibility. The demand for legalism usually signalled a concern that panel processes be governed by time limits, that adequate reasons be offered for rulings and that the adoption of a ruling should not depend on a consensus of all the Contracting Parties (including the Parties complained against), as

was considered to be the case under Article XXIII. Those who preferred elements of diplomatic flexibility tended to emphasize the inherently political nature of trade arrangements, and the need for safety valves if the commitment to the system by individual Member States was not to be undermined by dispute outcomes they considered (or their domestic constituencies considered) to be illegitimate. Dispute resolution reform was an important item on the agenda during the Uruguay Round and has resulted in a new Understanding on Rules and Procedures Governing the Settlement of Disputes²⁰ that largely ratifies, on a permanent basis, the Mid-term Review Agreement, adopted on an interim basis in 1988 during the Uruguay Round negotiations.

Our own perspective on dispute settlement, on which we will elaborate throughout our discussion of the DSU, reflects a modification of the neo-liberal view of the multilateral trading order as a regime whose basis is a mutually self-interested bargain among states. Sustaining such a bargain requires institutions that are capable of identifying and sanctioning (or at least authorizing sanctions against) cheating²¹ on the cooperative equilibrium which this bargain represents. Diplomatic, power-based solutions to disputes are unlikely to generate the normative benchmarks necessary to distinguish conduct consistent with the bargain from cheating, and are therefore unlikely to sustain a cooperative equilibrium over time. It is impartial, rules-based dispute settlement that can best perform this function. This is what G.R.Shell in a seminal article on dispute resolution and international relations theory refers to as the 'Regime Management' model of dispute settlement.²² However, as we note in several of the chapters of this book, elements of the multilateral trading system as it is evolving are superimposing on a domestic and global welfare-maximizing optimal bargain to constrain protectionism—one that is welfare-maximizing *whatever* the policy choices individual states adopt on non-trade matters²³—a supranational regulatory regime that embodies certain substantive trade-offs between free trade and other values. Here we have in mind the TRIPs Agreement, which prescribes minimum standards for national intellectual property laws and regulations, as well as elements of the GATS and the Sanitary and Phytosanitary Measures and Technical Barriers Agreements that go beyond National Treatment to place constraints or conditions on *non-discriminatory national regulatory outcomes*. Also, when dispute panels have had to weigh environmental and related justifications for largely non-discriminatory measures that have been found GATT-illegal (such as the Process and Production Method-based requirements in the *Tuna/Dolphin* and *Shrimp/Turtle* disputes), they have ended up making implicit or explicit trade-offs between the trade liberalization values of the GATT regime and the values that underpin other international and national regimes (in the case of *Tuna/Dolphin* and *Shrimp/Turtle*, biodiversity values). Increasingly, in these kinds of situations, dispute settlement may entail more than the evolution and application of a set of norms to identify and distinguish 'cheating' from legitimate state behaviour, and may require a direct regulation of national and international public policy outcomes that implicate diverse values and constituencies. In these circumstances, the Regime Management goal of sustaining a cooperative equilibrium through the sanctioning of cheating becomes intertwined with the need to produce rulings that have legitimacy with a range of stakeholders whose interests are affected by the way that policy trade-offs are made in interpreting the GATT and the other WTO Agreements. This need is reflected in what Shell calls the 'Trade Stakeholders' model, which 'views trade dispute resolution as part of a wide-ranging

deliberative process by which an emerging global social system can set its priorities'.²⁴ Shell has very broad global democratic aspirations for this model, which he sees as a means of achieving republican democracy on a world scale. Whether one shares his utopianism or not, the basic idea is a logical consequence of a world where the enforcement of trade norms no longer leaves national (and sub-national) polities, as well as supranational non-trade regimes, unconstrained in their policy autonomy, provided they do not engage in trade discrimination. Since dispute rulings directly²⁵ impinge on the constituencies that affect the legitimacy of states themselves, the commitment to a cooperative equilibrium by those states will depend not only on the appropriate sanctioning of 'cheating', but also on how dispute settlement is perceived by constituencies to affect their own bargain with the state, or the domestic welfare calculus. Thus, we see the Stakeholder model as a logical implication of the application of the Regime Management model to the 'beyond the border' trade regime of the present and future. The implication of the model is that the WTO dispute resolution process should be open 'to all groups with a stake in the outcomes of trade decisions'.²⁶ This need not mean, and indeed we would not endorse, standing for all affected actors to bring complaints to the WTO. What it does imply is transparency and publicity in the process, the possibility of intervention through written or oral submissions by affected non-governmental and transnational organization actors, and decisions with clear reasons for factual and legal findings, which can then be subject to meaningful debate by experts and affected groups, both national and supranational.

The DSU negotiated in the Uruguay Round reflects a response to many criticisms of the GATT dispute settlement process,²⁷ some of which have obvious salience from either a Regime Management or a Trade Stakeholder perspective, or both. These criticisms included the following:

- 1 delay and uncertainty in the process, given the absence of a right to a panel (this remaining at the discretion of the CONTRACTING PARTIES) and the absence of hard time limits on consultations, responses to requests for panels, and panel proceedings and rulings;
- 2 an absence of legal rigour and clarity in the panels' rulings;
- 3 the uncertainty of a panel ruling being adopted, given the consensus rule for adoption (which demanded the consent of the losing party),²⁸
- 4 delay in and partial or non-complete compliance with panel rulings.

Interestingly, from a Regime Management perspective, despite these various shortcomings, the GATT dispute settlement process proved relatively successful through most of the GATT's history in actually achieving compliance, and thereby sustaining a cooperative equilibrium through disciplining, or being seen to discipline, cheating.

From 1947–85, it took about two years to resolve a dispute from the time a complaint was lodged to the implementation of remedial measures.²⁹ Only ten cases have taken longer than two years, and only one was very protracted indeed.³⁰ More importantly, a detailed review of all GATT disputes between 1948 and 1989 by Hudec *et al.*³¹ finds a compliance rate for success complaints of 88%. While the success rate declined somewhat in the 1980s, the compliance record still stood at 81%. Other trends of note that emerge from the Hudec study are: (1) the explosion of complaints in the 1980s—more than half of all GATT complaints were brought in the last of the four decades of

GATT history; (2) for the entire 42-year period, 73% of all complaints were filed by the USA, the EU and its Members, Canada, and Australia. The USA, the EU and its Members, Canada, and Japan accounted for 83% of all appearances as defendants. Of all complaints, 92% involved either the USA or the EU (or its Members) as a party; (3) for the entire period, 52% of all complaints related to non-technical barriers (NTBs), 21% to tariffs, 16% to subsidies and 10% to antidumping/countervailing duty measures (AD/CVDs). Over time, NTBs and AD/CVDs have increased as a percentage of complaints while tariffs have sharply declined; (4) in the 1950s, only 23% of all complaints involved agriculture, while for the period 1960–84, one-half of the complaints involved agricultural trade measures, many relating to the EU's Common Agricultural Policy. However, compliance rates with rulings in agricultural and non-agricultural complaints are roughly the same; (5) according to the authors, the most important finding of their study is the disproportionate level of non-compliant behaviour by the USA, especially in the 1980s.

There is clearly a link between the increasing ineffectiveness of GATT dispute settlement in the 1980s, defined in terms of perceived or actual compliance (which gives Parties to the bargain the confidence needed to sustain their commitment to it), and the rise in the proportion of disputes related to normative baselines for trade-impacting national (e.g. subsidies) policies. Because some complaints stood on the margins of the text of the GATT itself, the inability of the dispute settlement process to resolve them arguably in those cases reflected the need to evolve the terms of the bargain itself in light of changed circumstances that affected, or arguably affected, the original balance of concessions. Of course, the idea of non-violation nullification and impairment contained in Article XXIII provided a means of adjusting this balance through dispute settlement itself where, despite the absence of a clear violation of the text of the GATT, the behaviour of a Contracting Party undermined the original expectation of benefits. But there were obvious limits to dispute panels playing such a role, given that arguments about expectations often related to controversies over what normative baselines for domestic policy Contracting Parties may have assumed in formulating their expectations of benefits.

But the increasing ineffectiveness of the panel process in the 1980s (despite the appearance of increased legalism defined in terms of referring to previous panel decisions as precedents and lengthy reasons for rulings) relates also to the practices in dispute settlement that impeded a transition from a conventional Regime Management model to a Trade Stakeholder model. These included secrecy in panel proceedings and the way in which panel rulings were developed and drafted, as well as long delays in the derestriction of the rulings and related documents.

In general, panellists under the GATT system were not experts in international trade law, or distinguished jurists of any kind, but rather junior to middle-level trade diplomats, or retired trade diplomats, mostly without formal legal training. These individuals were expected to take advice from the GATT Legal Affairs Division. The Division, in almost all cases, provided the panel with not only a statement of the Parties' pleadings, but also analysis of the merits of each Party's case, and also drafted the panel's decision itself.³² While commentators close to the process, such as Plank,³³ insist that the rulings nevertheless reflected the panels' own analysis of the issues, one can imagine that non-lawyer junior or middle-level diplomats would not often explicitly challenge the

‘professional’ advice of the Secretariat as to how a matter should be decided. Also, the Division played a crucial role in the selection of names for appointment to panels, another means of influencing outcomes—for junior and middle-level diplomats, and even perhaps for some academics, service on a panel is an honour or perk, and one can easily imagine that some individuals would not wish to jeopardize their chances of serving more than once in this capacity through a run-in with the Secretariat. Thus, while in appearance a practice of impartial, disinterested juridical decision-making by a panel of experts, the dispute settlement process was, largely, in reality, dominated by a small, closely knit technocratic élite with a professional interest in the maintenance of the GATT as a regime dominated by liberal trade values. As Keohane and other neo-liberal theorists have pointed out, such élites can play an important positive role in regime maintenance, and as long as the task was that of identifying ‘cheating’ (explicit or hidden protectionism), the Secretariat’s domination of the panel process worked reasonably well from a Regime Management perspective. Academics and independent jurists were unwilling to engage in very much open and critical scrutiny of panel rulings, in part because they believed that to do so would undermine the legitimacy of a process that was effective for Regime Management, and give various protectionist interests with a stake in disrupting the cooperative equilibrium an opportunity to do so. Also, and less idealistically, a further means of control over the system by the Secretariat was epistemic. Because panel reports were only derestricted once adopted, and usually not derestricted if not adopted, by the Contracting Parties, and even if derestricted often only published in the official reporting service (BISD) much later, many academics and other independent jurists were dependent on good relations with members of the Secretariat to obtain documents critical to timely analysis. In the 1980s, and especially after the *Tuna/Dolphin I* panel ruling, a great deal of pressure was placed on the GATT by the United States to remedy the unavailability of documentation. Various groups began publishing bootleg versions of still-restricted panel rulings on the internet—such versions now regularly show up in *Inside US Trade* and have apparently also sometimes been posted on the website of the United States Trade Representative.

These developments reflect the fact that, once the panels were put in the position of not simply sanctioning ‘cheating’ but explicitly making trade-offs between different values, the Secretariat-dominated panel process experienced a legitimacy crisis. Faced with such a challenge in the *Tuna/Dolphin* case, which concerned trade sanctions to enforce a regime to protect dolphins for biodiversity purposes (and which applied domestically as well), the response of the system was to approach the problem purely from the professional interest in the maintenance of the liberal trade regime, and view the measures as either covert protectionism (‘cheating’ disguised as action for non-trade purposes), or unwarranted ‘noise’ or interference in a self-contained, single value-based regime. In ways that are described in detail in Chapter 16 on trade and the environment, the law and jurisprudence of the GATT were manipulated in order to make the value of liberalized trade trump the value of biodiversity. Ironically, the system had thought that what it was doing was protecting the integrity and coherence of the liberal trading regime, while what it actually provoked was a legitimacy crisis in a crucial element of the system from a Regime Management perspective—dispute settlement. This crisis was, however, diffused (at least temporarily) by the ability of the United States to prevent the adoption of the reports of the panels in *Tuna/Dolphin I* and *II*.

THE WTO DISPUTE SETTLEMENT UNDERSTANDING (DSU)

(The following draws extensively from Mavroidis, Howse and Bermann, *The Law of the WTO*, forthcoming, West, 2005.)

In light of this critical and analytical history of GATT dispute settlement, we now examine the reforms initiated in the Uruguay Round and consider the potential of these reforms to allow the transition from a Regime Management model of dispute settlement to a Trade Stakeholder model, a transition which, as we have suggested, is implied by the very objective of Regime Management, since the multilateral trade regime is increasingly implicated in prescribing and constraining national and international regulatory choices and, consequently, in trade-offs between liberal trade and other policy values. Already, numerous panel and Appellate Body (AB) decisions have interpreted provisions of the DSU, and the following commentary incorporates these interpretations.

Scope of the DSU: relationship to Articles XXII and XXIII of the GATT 1994 and other WTO Agreements (Articles 1 and 3 and Appendix 2)

The ‘rules and procedures’ of the DSU apply to all the ‘covered agreements’ of the WTO (Article 1) that are listed in Appendix 1 to the DSU. This list is reproduced below:

a Agreement establishing the World Trade Organization

b Multilateral Trade Agreements

Annex 1a: Multilateral Agreements on Trade in Goods

Annex 1b: General Agreement on Trade in Services

Annex 1c: Agreement on Trade-related Aspects of Intellectual Property Rights

Annex 2: Understanding on Rules and Procedures Governing the Settlement of Disputes

c Plurilateral Trade Agreements

Annex 4: Agreement on Trade in Civil Aircraft

Agreement on Government Procurement

International Dairy Agreement

International Bovine Meat Agreement.

The DSU applies subject to specialized provisions in dispute settlement in particular covered agreements—in the event of a conflict between a provision of the DSU and a dispute settlement provision of a covered agreement, the latter is to prevail (Article 1.2). A list of the relevant provisions of the covered agreements is provided in Appendix 2 to the DSU. This list is reproduced below:

Agreement Rules and Procedures

Agreement on the Application of Sanitary and Phytosanitary Measures 11.2

Agreement on Textiles and Clothing 2.14, 2.21, 4.4, 5.2, 5.4, 5.6, 6.9, 6.10, 6.11, 8.1 through 8.12

Agreement on Technical Barriers to Trade 14.2 through 14.4, Annex 2

Agreement on Implementation of Article VI of GATT 1994 17.4 through 17.7

Agreement on Implementation of Article VII of GATT 1994 19.3 through 19.5,

Annex II 2(f), 3, 9, 21

Agreement on Subsidies and Countervailing Measures 4.2 through 4.12, 6.6, 7.2 through 7.10, 8.5, footnote 35, 24.4, 27.7, Annex V

General Agreement on Trade in Services XXII: 3, XXIII:3

Annex on Financial Services 4

Annex on Air Transport Services 4

Decision on Certain Dispute Settlement

Procedures for the GATS 1 through 5.

The list of rules and procedures includes provisions where only a part of the provision may be relevant in this context. There are some agreement-specific provisions not on this list; these do *not* take precedence over the general provisions of the DSU.

In the event that a dispute concerns more than one covered agreement, and the agreement-specific dispute settlement provisions of the various agreements conflict, the Parties must themselves agree on which rules and procedures apply, failing which the Chairman of the Dispute Settlement Body will decide on the applicable rules, following the principle that the rules of the DSU itself should be used in order to obviate conflict.

Dispute Settlement Body (Article 2)

Article 2 of the DSU establishes the Dispute Settlement Body (DSB), which is the collectivity of WTO Members acting in their dispute settlement capacity and has a role parallel to that of the GATT Council in the pre-WTO multilateral dispute settlement arrangements. Thus, the DSB ‘shall have the authority to establish panels, adopt panel and Appellate Body reports, maintain surveillance of implementation of rulings and recommendations, and authorize suspension of concessions and other obligations under the covered agreements’ (Article 2.1).

Consultations and other alternatives to panel dispute settlement (Articles 4 and 5)

Reflecting criticisms that the GATT practice with respect to consultations often permitted a Party to delay inordinately the commencement of dispute settlement proceedings, Article 4 provides a set of strict time limits for consultations. A Member must reply to a request for consultations within ten days of receiving it, and enter into ‘consultations in good faith’ within 30 days thereafter. If a Member of whom consultations have been

requested fails to comply with either deadline, then the Member so requesting may 'proceed directly to request the establishment of a panel'. If consultations fail to resolve the dispute within 60 days of the receipt of the request for consultations, the complaining Member may request the establishment of a panel. A panel may be requested before this 60-day period has expired where both the complainant and the responding Member consider that consultations have failed to solve the dispute. The role of consultations was noted by the AB in *Underwear*,³⁴ where it held that a Member could not backdate the application of Transitional Safeguards under the Agreement on Textiles and Clothing (ATC) to the date of request of consultations. One reason the AB gave for this finding was the need to protect the effectiveness of consultations as a means of resolving disputes. However, the consultations here were undertaken under specific provisions of the ATC and not Article 4 of the DSU. Paragraph 4.8 provides for an accelerated timetable for consultations in 'cases of urgency'. In such cases, consultations are to be entered into within ten days of the receipt of the request, and if these fail a panel may be requested after 20 days of receipt of the request. In one of the first disputes under the WTO, concerning imposition of tariff surcharges on Japanese automobiles by the US, Japan requested that the matter be treated as a case of urgency within the meaning of 4.8. Japan's argument was that the measures would have an almost immediate impact upon Japanese trading interests.³⁵ Normally, consultations are requested *after* a measure has been implemented and trade effects are *already* being felt—if Members had intended cases of urgency to extend even to instances where measures have not yet been adopted, but are imminent, then they would have been better advised to make the timetable for urgency the normal timetable. Indeed a non-urgent matter, on the basis of Japan's reasoning, would be a case where the imposition of the measures would be in the non-immediate future—where if anything the action might not be ripe. The reference to 'perishable products' in 4.8 suggests that, in fact, cases of urgency are those where irreparable harm would be caused by delay, something akin to the criterion for granting an interlocutory injunction in many domestic legal systems. With respect to ripeness, the DSU does not state what circumstances may give rise to a right to request consultations.

The *Fructose Corn Syrup* ruling of the AB³⁶ held that a panel could be properly established even if consultations had not occurred, where the behaviour of the defending party was such as to waive its right for consultations; in this case, the defendant (Mexico) had not objected to the establishment of a panel when the matter came before the DSB (DSU).

Establishment and terms of reference of panels (Articles 6 and 7)

Article 6 provides that a panel shall be established at the latest at the DSB meeting following the meeting at which the request first appears as an item on the agenda; a Member may request the convocation of a DSB meeting for these purposes, and one shall be held within 15 days of the request for the meeting, subject to a 10-day advance notice requirement. The DSB may only refuse to establish a panel on the basis of unanimity—since this would mean the very Member requesting the panel would have to object to its establishment, the effect is to create a right to a panel, once the applicable time periods for consultations have elapsed. Since, however, the *agenda* of the DSB meeting is established by positive not negative consensus, the defendant can block the establishment

of the panel at the *first* meeting of the DSB at which the request could be considered; the failure to establish the panel at that first meeting, though, makes its establishment automatic at the second. So this blocking power (widely used) is very temporary.

Standing

In the *Bananas* case, the AB considered a challenge by the EC to the United States participating in the panel as a complaining party, on the grounds that public international law requires that a state have a 'legal interest' in order to have standing before an arbitral tribunal. The EC claimed that in this instance, no such legal interest existed, because the United States had never exported a single banana to the EC. The AB found that the various sources of public international law invoked by the EC did not contradict the recourse to a treaty itself to determine the issue of standing to commence an action under the dispute settlement provisions of that treaty.³⁷ The AB then referred to the *chapeau* of Article XXIII of the GATT, which expresses the right to bring a matter before the CONTRACTING PARTIES when a Member 'considers' that there has been, *inter alia*, a violation, and also to Article 3.7 of the DSU, which states that 'Before bringing a case, a Member shall exercise its judgement as to whether action under these procedures would be fruitful.' From this language, the AB drew the inference that 'a Member has broad discretion in deciding to bring a case against another Member under the DSU...a Member is expected to be largely self-regulating in deciding whether any such action is "fruitful"' (para. 135). Despite this emphasis on self-regulation, the AB went on to find that the United States was 'justified' in bringing its claims because it was a producer of bananas and thus the US could have a 'potential export interest' (para. 136). It is unclear whether the AB was here merely endorsing, in *obiter dicta*, the manner in which the US was regulating itself pursuant to Article 3.7, or was implying that despite the large element of self-regulation, there is nevertheless a *de minimis* standing requirement of some kind of recognizable interest.

Ripeness/mandatory vs. discretionary legislation

A complaint must normally be based on a violation of WTO provisions that has already occurred.

An issue arises with respect to challenges to legislation, as opposed to a specific action of the authorities that impairs the trading rights of a WTO Member in a specific situation. Legislation may be challenged prior to such specific action where the legislation itself *mandates* the authorities to act in a manner contrary to WTO provisions; where the legislation merely authorizes or provides *discretion* to authorities to act in a manner contrary to WTO obligations, a challenge under the DSU must await specific action based on the legislation which violates WTO obligation.³⁸ However, the mandatory/discretionary distinction is not to be applied 'in a mechanistic fashion'.³⁹ For example, even if, formally, a statute may leave some margin of discretion to the implementing authority to avoid a WTO violation, the discretionary element may be so marginal or peripheral that the statute on its face, considered in light of all the circumstances, presents such a serious threat of WTO violation to be independently actionable.⁴⁰

Institutional balance

There are a number of provisions in the covered agreements that engage not only the dispute settlement organs but also the political or diplomatic bodies of the WTO in the assessment of compliance. Most notably, the Committee on Regional Trade Arrangements (CRTA) plays a role in the determination of whether customs unions and free trade areas conform to the criteria set out in GATT Article XXIV, and the Balance of Payments (BOP) Committee is charged with reviewing BOP restrictions, pursuant to Articles XII–XVII of the GATT and the Uruguay Round Balance of Payments Understanding. The AB has held that, where there is an otherwise valid complaint under the DSU, the mandate of these non-judicial WTO organs does not preclude parallel dispute panel jurisdiction.⁴¹ In the *Turkey—Textiles* case, the CRTA had not yet pronounced on the customs union at issue; in *India—Balance of Payments*, the matter had been considered by the BOP Committee, but there was a failure to reach consensus. In the former dispute, the question arises as to whether, even if it had jurisdiction, the panel should have suspended proceedings until the CRTA had an opportunity to give its views. The question also arises, in the latter dispute: it is interesting to speculate on the legal situation had the BOP Committee actually made a determination (with which the complainant was dissatisfied)—would the AB be obliged to defer to that determination, and thus to reject the claim? Arguably, such decisions would be subsequent practice or a subsequent agreement between the parties within the meaning of the Vienna Convention Article 31, and would thus merit considerable attention from any dispute panel seized of the same matter.

In any case, the *Turkey—Textiles* and *India—Balance of Payments* rulings clearly stand for the proposition that panels and the AB have the authority to determine the limits of their own jurisdiction in relation to other organs of the WTO. This is close to judicial supremacy as it is understood in many domestic legal systems; it contrasts with the International Court of Justice's hesitation, in the *UN Expenses* case, to assert itself as a final arbiter of the competences of each organ of the United Nations. This judicial supremacy in the WTO is subject to the possibility of an authoritative ruling by the Membership on the correct interpretation of a WTO provision, as established in Article IX of the WTO Agreement (Marrakesh Protocol). However, such an interpretation would in practice require, most likely, consensus, and is therefore no easier to achieve than an actual treaty amendment. Thus, *de facto*, at least, judicial supremacy is a cornerstone of the WTO system.

Request for a panel

The request for a panel must 'identify the specific measures at issue and provide a brief summary of the legal basis of the complaint sufficient to present the problem clearly' (Article 6.2). In *Bananas*, the AB upheld the panel's view, ruling that, to meet the specificity requirement in Article 6.2, it is sufficient

for the Complaining Parties to list the provisions of the Agreements alleged to have been violated without setting out detailed arguments as to which specific aspects of the measures at issue related to which specific provisions of those agreements. In our view, there is a significant

difference between the *claims* identified in the request for establishment of a panel, which establish the panel's terms of reference under Article 7 of the DSU, and the *arguments* supporting those claims, which are set out and progressively clarified in the first written submissions, the rebuttal submissions and the first and second panel meetings with the parties.

(para. 141)

The specificity with which claims must be stated in the complainant's request for a panel in order to be within the panel's jurisdiction was further addressed by the AB in the *Korea—Dairy* case.⁴² The AB held that, at a minimum, the treaty provisions that the complainant is claiming to have been violated by the defendant must be identified, at least by treaty Article. However, the AB also held that the complainant could be required to be even more specific (for example as to paragraph or sub-paragraph), where failure to be more specific might prejudice the defendant's ability to defend the action effectively (para. 127). The measures complained of must also be identified with adequate specificity; however, in considering whether the request for a panel is adequately specific in this regard, the AB may find that even a quite general identification of the measure is sufficient, if the context, or communications or discussions between the Parties, are such that the defendant is able to understand the exact character of the complainant's claim, despite the vagueness in the panel request itself.⁴³

A complaining Member may either request special terms of reference for the panel, in which case the proposed terms are to be included in its request for a panel, or accept a standard set of terms, which essentially authorize the panel to consider any relevant provisions of covered agreements in relation to the matter referred to in the request for the panel. More typically, specific terms of reference are agreed on the basis of consultation between the parties, as foreseen by Article 7.2. In the *Desiccated Coconut* case, the AB attributed a very important status to the terms of reference of a panel, holding that

A panel's terms of reference are important for two reasons. First, terms of reference fulfil an important due process objective—they give the parties and third parties sufficient information concerning the claims at issue in the dispute in order to allow them an opportunity to respond to the complainant's case. Second, they establish the jurisdiction of the panel by defining the precise claims at issue in the dispute.⁴⁴

In *Desiccated Coconut*, the AB also held that, in order for a claim to come within a panel's terms of reference, it must have been referred to in the request for a panel (p. 22). A logical implication of the view that the terms of reference establish the panel's jurisdiction is that it may not consider claims of violations that are not mentioned in the terms of reference.⁴⁵ However, a panel is not required to restrict itself to the *arguments* raised by parties in the proceedings, and may develop its own legal reasoning.⁴⁶ In order for a panel to be capable of adjudicating a claim that a particular provision of a covered agreement has been violated, the specific provision, and not merely the agreement itself or other provisions of that agreement, must be mentioned in the terms of reference (*Indian Patents*, para. 92). Article 7.2 of the DSU states that 'Panels shall address the

relevant provisions in any covered agreements or agreements cited by the parties to the dispute.’ In *Shirts and Blouses*,⁴⁷ the AB held that ‘[a] panel need only address those claims which must be addressed in order to resolve the matter in issue in the dispute’ (p. 19). The AB also emphasized that the DSU does not prohibit a panel from interpreting provisions in addition to those strictly necessary to resolve the dispute. Such remarks would, however, be considered as *obiter dicta*, and might not be subject to appellate review—thus, in *Shirts and Blouses*, a statement by the panel relating to the powers of the Textile Monitoring Body was regarded by the AB as ‘purely a descriptive and gratuitous comment’ and not subject to appellate review.

Composition of panels (Article 8)

Panels are to be composed of three panellists, based on nominations from the Secretariat from its rosters. WTO Members may from time to time propose additional names of qualified persons to add to the rosters. However, a party to a dispute may not challenge the Secretariat’s choice of panellists, except for ‘compelling reasons’ (8.6). Panellists are to be ‘well-qualified governmental and/or non governmental individuals’. These may include persons who have served as diplomatic officials at the GATT, in the Secretariat, or as senior trade officials in national governments. The only non-governmental category explicitly mentioned is that of persons who have ‘taught or published on international trade law or policy’. Ironically, given that these criteria are heavily weighted to the traditional trade policy élites, the DSU also states that, in addition to independence, panel members should be selected with a view to ensuring ‘a sufficiently diverse background and a wide spectrum of experience’ (8.2). From the perspective of achieving a transition from a Regime Management to a Trade Stakeholder model of dispute settlement, these provisions are largely disappointing. The Secretariat retains considerable control over the composition of panels, and as already mentioned, despite the language on diversity and wide experience, is given an explicit basis to continue choosing persons who come from the traditional governmental trade policy élites. Activists, business persons and individuals with expertise in substantive public policy areas that now interface with international trade rules are not even mentioned as possible candidates for the rosters. One qualification is that in some of the covered agreements, expertise in a substantive public policy area may be an additional criterion relevant to the establishment of the rosters—for instance, the Decision on Certain Dispute Settlement Procedures for the General Agreement on Trade in Services provides that a special roster of panellists be established for dispute settlement under the GATS, comprising persons who have expertise related to trade in services, ‘including associated regulatory matters’ (Article 3). There is supposed to be at least one developing-country panellist on every panel in a dispute where a developing country is a party.

Procedures for multiple complaints (Article 9)

Article 9 deals with a situation where more than one Member wishes to complain about ‘the same matter’. In this situation a single panel may be struck to examine the multiple complaints ‘taking into account the rights of all Members concerned’. The proceedings are to be organized so that all Members enjoy the same rights they would have had in the

case of separate panels being struck (9.2). A particular difficulty arises where a Member or Members seek(s) to join a complaint as an additional party or parties, once the panel has been struck on the basis of an individual complaint. In such a case, as discussed above, the terms of reference will have been determined through the original individual complaint. Thus, in order to join a complaint and still enjoy the right to raise claims not initially raised by the original individual complainant, the other Members would appear to have to do so before the panel's terms of reference (its 'jurisdiction') have been determined. However, while a panel cannot amend its own terms of reference (*Bananas*), the DSB can. Thus, in *Reformulated Gasoline*, when Brazil requested a panel on US measures which were already the subject of a complaint by Venezuela, the DSB established new terms of reference for the joint panel. In this case, it was a particularly straightforward matter, since the original panel had standard terms of reference, i.e. not limiting the panel's consideration of any provision in a covered agreement relevant to disposing of the complaint.⁴⁸ In cases of a joint complaint, the panel may issue multiple reports, each of which addresses the particulars of the complaint of a single Member (as for example occurred in *Bananas*) (Article 9.2). It is to be emphasized that there is no requirement that complaints by two or more Members concerning the same or similar measures of another Member be consolidated in the same panel proceeding. It is an interesting question as to whether the DSB can insist on joinder, even if one or more complainants object—arguably, if joinder were only at the consent of all parties, then there would not have been the need to protect the rights of each party in the event of joinder, since a party who thought their rights would be compromised could simply insist on a separate proceeding. In *Hormones*, there were parallel proceedings by Canada and the United States against the EC. In the case of parallel proceedings, the DSU provides that 'If more than one panel is established to examine the complaints related to the same matter, to the greatest extent possible the same persons shall serve as panelists on each of the separate panels and the timetable for the panel process in such disputes shall be harmonized.' In *Hormones*, Canada and the US participated in *each other's* panels as *third parties* (a status discussed below). An interesting issue arose from decisions taken by the members of the panels with a view to rationalizing the parallel proceedings: a joint meeting was held with scientific experts, all the information provided in the Canadian proceeding was provided to the United States, and *vice versa*, and the United States was invited to attend and even speak at the second meeting of the Canadian panel. On appeal, the EC objected to all these decisions, claiming that they exceeded the normal rights of third parties in WTO panel proceedings. The AB treated all but the last of these decisions not in terms of third-party rights, but rather as related to 'economy of effort' in a situation of parallel proceedings concerning the same matter. Referring to the language in 9.3 of the DSU concerning 'harmonization of timetables', the AB noted 'we can see a relation between timetable harmonization...and economy of effort' (*Hormones*, para. 153). The AB further observed: 'Having access to a common pool of information enables the panel and the parties to save time by avoiding duplication of the compilation and analysis of information already presented in the other proceeding [footnote omitted]'. Article 3.3 of the DSU recognizes the importance of avoiding unnecessary delays in the dispute settlement process and states that the prompt settlement of a dispute is essential to the effective functioning of the WTO (para. 153). With respect to the granting to the USA of a right to be present at the second substantive panel meeting, the AB deferred to the

judgment of the panel that the relationship of this meeting to the joint scientific experts' session was such as to provide a due process case for the US presence there; 'this decision falls within the sound discretion and authority of the panel, particularly if the panel considers it necessary for ensuring to all parties due process of law' (para. 154). Enhanced third-party rights have been granted in subsequent cases, most recently the *EC—India GSP* dispute.

Amicus

In the *Shrimp/Turtle* case, the AB reversed a finding of the panel below that it did not have the authority to accept *amicus* submissions from non-governmental entities. The panel had considered that since it had a right to 'seek' information from any person pursuant to Article 13 of the WTO DSU, it was thereby *prohibited* from considering non-requested information. The AB held that the reading of the word 'seek' as a prohibition of this kind ignored the context, which was a very broad grant of fact-finding authority to the panel in order that the panel may discharge its Article 11 obligation to make an 'objective assessment of the facts' (paras 107, 108).

The AB went on to find that the combined scope of Article 12 (which allows a panel to create its own procedures, deviating from the default procedures in Appendix 3 of the DSU) and Article 13 gives panels broad procedural discretion in how they discharge their duty under DSU Article XI 'to make an objective assessment of the matter...including an *objective assessment of the facts of the case and conformity with the relevant covered agreements*' (para. 106; emphasis in original). Thus, *amicus* briefs to panels may address either issues of fact or issues of law or both.

Amicus submissions by non-governmental organizations have been considered by panels in a number of disputes since; recently, one of the panels in the *US—Softwood Lumber* case took the step of inviting the parties to respond to the substance of one particular *amicus* brief. In the *EC—Sardines* case, the AB held that not only NGOs and private individuals but also WTO Member governments could submit *amicus* briefs.

Amicus participation is clearly desirable on a Stakeholder model of WTO dispute settlement—it allows stakeholders whose values and interests are implicated in WTO litigation an opportunity to state directly their point of view, without it having to be filtered through a national government. (See R.Howse)

Intervenors (third parties) (Article 10)

Article 10 affords intervenor status to any Member 'having a substantial interest in a matter' (102). Such intervenors ('third parties') have the right to make both oral and written submissions to the panel, and to obtain the submissions of the parties to the dispute to the first meeting of the panel. 'Third party submissions are to be provided to the parties to the dispute and shall be reflected in the final report' (10). In a number of cases (besides *Hormones*, discussed above, where the third-party rights were those of other *parties* in a multiple complaint), panels have granted enhanced third-party rights, including the right to observe the entire proceedings, and to receive all of the parties' submissions. The most recent example is the *EC—Tariff Preferences (GSP)* case, discussed in the trade and development chapter of this book (Chapter 15). The AB has

held that panels have discretion to grant enhanced third-party rights, subject to general due process norms.⁴⁹

The jurisdiction and mandate of panels (Articles 3, 11, 13 and 19)

Article 11, which we have just discussed with respect to intervenors, is a fundamental reference point for the jurisdiction and mandate of the panel. It states in part:

The function of panels is to assist the DSB in discharging its responsibilities under this Understanding and the covered agreements. Accordingly a panel should make an objective assessment of the matter before it, including an objective assessment of the facts of the case and the applicability of and conformity with the relevant covered agreements, and 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 broadness of this mandate is of course qualified by the constraints imposed on the panel by its terms of reference, as discussed above. Also relevant to the panel's mandate with respect to legal interpretation is Article 3.2, which states in part: 'Recommendations and rulings of the DSB cannot add to or diminish the rights and obligations provided in the covered agreements.' Article 19.2 states in turn that: 'In accordance with paragraph 2 of Article 3, in their findings and recommendations, the panel and the Appellate Body cannot add to or diminish the rights and obligations provided in the covered agreements.' The significance of these provisions for interpretation will be discussed below in the section on principles of interpretation. The reference to 'covered agreements' throughout raises the issue of how the panel may deal with a situation where a party or third party invokes an agreement other than a covered agreement as relevant to the dispute. In the *Bananas* case, for instance, among the issues in dispute was the consistency with the GATT waiver for Lomé preferences of certain measures by the EC. The legal question was whether the measures fell within the waiver because, in the language of the waiver, they were 'required' by the EC's obligations under the Lomé Convention. The EC argued that, the Lomé Convention not being a covered agreement, the panel should have deferred to the views of the signatories to the Lomé Convention as to what it 'required'. The AB upheld the view of the panel that the Lomé Waiver, inasmuch as it incorporated a reference to the Lomé Convention itself, required the panel to examine the provisions of the Lomé Convention to determine whether in fact the EC measures were 'required' by it (paras 167–8). While the AB was probably correct to reject a stance of total deference towards the interpretation of the Lomé Convention by parties, it went on to interpret the Convention largely without reference to the practice surrounding this treaty, which suggests a rather narrow view of the interaction of other international legal regimes with the WTO. As Petersmann notes, in the WTO Agreements there are

numerous references to other international agreements and general international law rules such as the UN Charter, the International Monetary Fund Agreement, international environmental agreements like the

International Plant Protection Convention, international ‘standards’ promulgated by other ‘relevant international organizations open for members to all (WTO) Members’, international services agreements, e.g., on international air transport and international telecommunication, worldwide agreement on intellectual property rights.⁵⁰

The coherence of the international legal system would be put at risk if WTO panels and the AB were to apply or interpret provisions of other agreements referenced in WTO Agreements in abstraction from the practice surrounding those agreements, including dispute rulings, views of the institutional organs associated with the treaty and the opinions of jurists. From the perspective of the evolution of WTO dispute settlement towards a Trade Stakeholder model, since the references to other agreements often relate to benchmarks that are relevant where the panels are dealing with trade-offs between values of liberalized trade and other substantive policy values, the way in which the benchmarks in these other regimes have been evolved by and in response to regime-specific constituencies must be taken into account to ensure an outcome that does not unduly privilege liberal trade over other relevant policy values.

It is to be noted that the AB in the *Shrimp/Turtle* case utilized the relevant instruments of the Rio Biodiversity regime to interpret the concepts of ‘sustainable development’ and ‘exhaustible natural resources’ (see Chapter 16 on trade and the environment); also, in cases on trade and intellectual property rights, which deal with WTO TRIPs obligations incorporated from WIPO treaties, the panels and the AB have considered extensively and relied on practice with respect to those WIPO treaties, and the views of WIPO itself on interpretation (*US and Havana Club* case, see Chapter 13 on TRIPs).

Burden of proof and standard of review

The AB has observed that

various international tribunals, including the International Court of Justice, have generally and consistently accepted and applied the rule that a party who asserts a fact, whether the claimant or the respondent, is responsible for providing proof thereof [footnote omitted]. Also, it is a generally-accepted canon of evidence in civil law, common law and in fact, most jurisdictions, that the burden of proof rests with the party, whether complaining or defending, who asserts the affirmative of a particular claim or defence. If that party adduces evidence sufficient to raise a presumption that what is claimed is true, the burden then shifts to the other party, who will fail unless it adduces sufficient evidence to rebut the presumption [footnote omitted].

(*Shirts and Blouses*, p. 14).

There are some provisions of the WTO Agreements which are in the nature of affirmative defences. These provisions are invoked by the party complained against. The panel will consider such defences once it has determined that there is a violation of some other provision of a covered agreement (*Reformulated Gasoline*, p. 16), the burden of proof for

establishing which is on the complaining party. After the violation of the other provision is thus established, the burden of proof shifts to the party complained against to prove the affirmative defence. While in *Shirts and Blouses* the AB gave the obvious example of GATT Article XX as an instance of an affirmative defence, what constitutes an affirmative defence may not always be so obvious. In *Hormones*, the AB noted: ‘The general rule in a dispute settlement proceeding requiring a complaining party to establish a *prima facie* case of inconsistency with a provision...before the burden of showing consistency with that provision is taken on by the defending party, is *not* avoided by simply describing that same provision as an “exception”’ (*Hormones*, para. 104). In *Hormones*, the panel had adopted an interpretation of the Sanitary and Phytosanitary (SPS) Agreement which suggested that the party complained against generally bore the burden of proof that its measures complied with the Agreement, unless they were based on international standards. This would have had the result of making the resort to SPS measures as such a *prima facie* violation of WTO law, unless these measures conformed to international standards. The AB rightly found that such a reading was inconsistent with the text and structure of the SPS Agreement, which indicate that the Agreement establishes alternative sets of disciplines on Members’ SPS measures, depending on whether or not they are based on international standards. The AB noted that, according to the SPS Agreement, Members have an ‘autonomous right’ to introduce measures that establish a higher level of protection than that provided for by international standards, subject to the disciplines contained in the Agreement; logically, then, the burden of proof rests on the complainant to establish a violation, by showing that these disciplines have not been complied with. The AB reasoned in a similar fashion in the *Sardines* case (see Chapter 7 on domestic health, safety and technical regulations), in a provision of the Technical Barriers to Trade (TBT) Agreement that required the use of international standards except where ineffective or inappropriate. The AB held that the complainant bore the initial burden of proof to establish that international standards, in the situation at hand, were *not* ineffective or inappropriate for the regulating Member (the defendant); the language in question defined the scope of a positive obligation itself (i.e. the requirement to use international standards), rather than stating an affirmative defence to some *other* positive obligation.⁵¹

Once a provision has, however, been characterized overall as an affirmative defence, it appears that the burden of proof is shifted to the defending party with respect to *all* the legal and factual tests in that defence (barring explicit textual language to the contrary). Thus, in *Reformulated Gasoline*, the AB found that with respect to Article XX, the burden of proof of showing that a measure is not an *abuse* of an exception falls on the defending party, even after that party has established that the measure qualifies under one of the specific heads of Article XX (p. 22). The AB, however, gave no explicit justification for this finding—one could as easily have argued that once a measure is shown to fall within an exculpatory category, the burden of demonstrating that it is being used abusively shifts back to the complaining party, based upon the notion that Members of the WTO should not generally be subject to a rebuttable presumption that they are abusing rights acquired under WTO law.

In the recent *Japan—Apples* case (on the substance of the dispute, see Chapter 7 on domestic health, safety and technical regulations), the AB noted: ‘It is important to distinguish, on the one hand, the principle that the complainant must establish a *prima*

facie case of inconsistency with a provision of a covered agreement from, on the other hand, the principle that the party that asserts a fact is responsible for providing proof thereof. In fact, the two principles are distinct' (para. 157; footnotes omitted).

The issue of standard of review arises where a panel is examining the domestic law of a Member as interpreted by domestic authorities and tribunals to determine whether the law, or the actions of those authorities and tribunals (including fact-finding), or both, are in compliance with provisions of the covered agreements. Only the Antidumping Agreement explicitly addresses the issue of standard of review. A certain degree of deference to *findings of fact* by domestic authorities in antidumping matters is provided in Article 17.6 of the Agreement, which states in part that 'If the establishment of the facts was proper and the evaluation was unbiased and objective, even though the panel might have reached a different conclusion, the evaluation shall not be overturned.' In *Hormones*, the AB suggested that the appropriate standard of review for a panel lay somewhere between *de novo* review of the facts at issue before the domestic authorities and 'total deference to national authorities', and referred to the Article 11 responsibility of the panel to make an objective assessment of the facts. It is difficult to see how the AB was able to understand Article 11 as illuminating with respect to where on the spectrum between *de novo* review and total deference the appropriate benchmark is to be found. In the *Indian Patents* case, the AB considered an argument by India that domestic law had to be proven as a fact by the complainant in a WTO panel proceeding, and furthermore that India should be given the benefit of the doubt with respect to whether, under its domestic legal system, certain administrative instructions would provide the legal security required by the provision of the TRIPs Agreement in issue, and that, at least, India's guidance in interpreting these administrative instructions should have been sought (para. 64). The AB appeared to take the view that, when examining a Member's domestic law solely for the purpose of determining whether it complies with a covered agreement, no particular deference to domestic interpretations of that law is warranted (para. 66). This is, however, rather too simplistic, for in this particular case the very determination of whether India was in compliance with the TRIPs Agreement entailed an assessment of whether the administrative instructions would survive a *domestic* legal challenge under the Indian Patent Act. This entails a predictive judgment about how a particular country's domestic tribunals would understand the interaction between particular administrative decrees and a domestic statute, and it is difficult to see how the AB was able to uphold a panel finding on this matter that was not based on evidence by Indian legal experts on Indian administrative and intellectual property law and how it is applied in the Indian courts. Instead, the AB reviewed the panel's finding as if it were reviewing an ordinary panel interpretation of a WTO provision itself. This being said, later case law, for example the adopted panel ruling in the *US—Section 301* case and the AB ruling in the *Shrimp/Turtle* 21.5 dispute, suggests a more subtle and cautious approach to the treatment of domestic law by WTO tribunals. These later cases suggest that WTO tribunals should refrain from speculative judgments about the effects of the operation of domestic law on WTO rights and obligations, and should base their interpretations on the evidence of the actual legal and administrative practice in the WTO Member in question.

Findings of fact

The DSU does not explicitly provide for evidentiary discovery between the parties prior to the commencement of panel proceedings. However, in *Indian Patents*, the AB suggested that consultations concerning the terms of reference should be viewed as, in part, fulfilling this function. The AB noted:

Parties engaged in dispute settlement under the DSU must be fully forthcoming from the beginning both as to the claims involved in a dispute and as to the facts relating to those claims. Claims must be stated clearly. Facts must be disclosed freely. This must be so in consultations as in the more formal setting of panel proceedings. In fact, the demands of due process that are implicit in the DSU make this especially necessary during consultations. For the claims that are made and the facts that are established during consultations do much to shape the substance and the scope of subsequent panel proceedings. If, in the aftermath of consultations, any party believes that all the pertinent facts relating to a claim are, for any reason, not before the panel, then that party should ask the panel in that case to engage in additional fact-finding.

(para. 94)

Here the AB was responding to a US argument that the panel should be able to adjudicate a claim not contained in the terms of reference, since only on the basis of facts disclosed later did it make sense for the United States to advance that claim—the AB held that it could not go beyond its terms of reference, even to remedy such a situation. It added: ‘It is worth noting that, with respect to fact-finding, the dictates of due process could better be served if panels had standard working procedures that provided for appropriate factual discovery at an early stage in panel proceedings’ (para. 95). In addition to the submissions of the parties and third parties, a panel may, as already noted, ‘seek information and technical advice from any individual or body which it deems appropriate’, subject to certain notification and confidentiality conditions (Article 13.1), and also may ‘seek information from any source and may consult with experts to obtain their opinion on certain aspects of the matter’. This may entail the establishment of an expert review group (Article 13.4). The procedures governing such groups are contained in Annex 4 of the DSU.

Moreover, a panel may draw an adverse inference from a Member’s refusal to provide certain information, i.e. it may assume that the information, if provided, would support the factual assertions of the opposing party on the issue in question.⁵²

A panel’s fact-finding is to be guided by the requirement in Article 11 to ‘make an objective assessment of the matter before it, including an objective assessment of the facts of the case’. Various of these provisions were considered by the AB in *Hormones*. According to the AB,

The duty to make an objective assessment of the facts is, among other things, an obligation to consider the evidence presented to a panel and to

make factual findings on the basis of that evidence. The deliberate disregard of, or failure to consider, the evidence submitted to a panel is incompatible with a panel's duty to make an objective assessment of the facts. 'Disregard' and 'distortion' and 'misrepresentation' of the evidence, in their ordinary signification in judicial and quasi-judicial processes, imply not simply an error of judgment in the appreciation of evidence but rather an egregious error that calls into question the good faith of the panel [footnote omitted].

(para. 133)

However, with respect to statements of experts, the panel has 'a substantial margin of discretion as to which statements are useful to refer to explicitly' (para. 138). Moreover, not every inaccuracy in the panel's representation of statements by experts will 'amount to the egregious disregarding or distorting of evidence before the Panel' (para. 144). From the perspective of a Trade Stakeholder model of dispute settlement, Article 11 as interpreted in *Hormones* offers some real protection against manipulation of panel proceedings by the Secretariat. The panel cannot simply read out of the record or misrepresent information from diverse constituencies—environmental, health or otherwise—once these have been brought before the panel. This is arguably what happened in the GATT *Thai Cigarette* case—the panel chose to ignore a report of the World Health Organization, which dealt with the challenges developing countries face in dealing with increased levels of cigarette smoking in their populations; inasmuch as what the panel was doing in *Thai Cigarette* was deciding that the report was irrelevant, this would now be viewed as a legal finding subject to appellate review; inasmuch as the panel was not making such a legal finding but wilfully disregarding relevant evidence, it would have been prohibited from so doing under Article 11. In *Canada Periodicals*, the AB held that a panel's legal conclusions must be based upon adequate factual analysis, based on the evidence on the record before it, and that it must be logically possible to reach the conclusions of law based upon the evidence. Here, the AB did not rely on Article 11 of the DSU. Rather, it suggested that in cases where the legal test itself is highly contextual, such as the application of the 'like product' concept in Article III, inadequate factual analysis could mar a panel's legal reasoning. In some jurisdictions, domestic administrative law may similarly extend review for errors of law to these situations where there is a 'mixed' question of law and fact.⁵³

This being said, the AB continues to be very reluctant to impugn findings of fact by the panels under Article 11 (for a recent example of rather extreme deference in the presence of many important methodological issues raised by the appellant concerning the panel's handling of the record, see the *Japan—Apples* AB ruling). Deference extends to situations, such as with SPS and TBT, where there may be significant value judgments entangled in, for example, the determination of whether 'sufficient' scientific evidence exists to justify the existence of an SPS measure: since panels are not professional triers of fact and tend to come from the trade insider community, a Stakeholder perspective on dispute settlement would suggest a somewhat closer scrutiny of their approaches to facts to counter the risk of bias, myopia and the tendency to look at the evidence solely from a 'pro-free trade' perspective. On the other hand, given the resources of the AB and the short time frame for appellate review (see below), it is understandable that the AB has not

been very inclined to scrutinize closely under Article 11 the manner in which panels have handled the facts. Nevertheless, it should be noted that in one case, the AB did find that the panel had violated Article 11 because its findings contradicted the evidence on the record.⁵⁴ In the same case, the AB found a further violation of Article 11, because the panel had based its findings concerning certain actions of the United States not on the evidentiary record, but on statements of US counsel in the panel proceedings concerning the nature of those actions, which were not supported by the record (para. 162).

Findings of law

Sources of law

It is obviously the role of panels to apply and interpret the legal provisions of the 'covered agreements'. There are, however, many WTO legal instruments that are not covered agreements, but which bear on their interpretation, including at least one Understanding (on commitments in financial services) and numerous Ministerial Decisions and Declarations, as well as Waivers, i.e. agreed derogations from the obligations in covered agreements. Decisions on Waivers in force prior to the entry into force of the WTO are, however, deemed to be part of the GATT 1994, which is a covered agreement (GATT 1994, 1(b)(iii)), as are 'other decisions of the CONTRACTING PARTIES to GATT 1947' effective prior to the entry into force of the WTO Agreement. Whether the Ministerial Decisions taken at the end of the Uruguay Round constitute Decisions in this sense is uncertain: they would arguably have had to have entered into force prior to the entry into force of the WTO Agreement, by virtue of the fact that they were viewed as preparatory to the establishment of the WTO. Under the WTO Agreement, a Decision of the Ministerial Conference and General Council will only constitute an authoritative interpretation of a covered agreement where such a decision is taken upon recommendation of the Council responsible for overseeing the agreement in question, and is adopted by three-quarters of the Members (WTO Agreement, IX(2)). By virtue of being authoritative, such an interpretation is obviously binding on panels (and the AB) and is therefore to be regarded as a superior source of law. Another source of law is other international agreements mentioned or referenced in the covered agreements—as noted above, in *Bananas* the AB seemed to be suggesting that these should be applied by panels in the same manner as if they were covered agreements themselves. Finally, Article 3.2 of the DSU states that the purpose of dispute settlement is to clarify the provisions of the WTO Agreements 'in accordance with customary rules of international law'.

Palmer and Mavroidis suggest that 3.2, along with Article 7, which refers to relevant provisions of the covered agreements, has the effect of bringing into the WTO the sources of law stated in Article 38(1) of the Statute of the International Court of Justice.⁵⁵ These are: international conventions, where 'expressly recognized by the consenting states'; custom; general principles of law; judicial decisions and teachings of publicists as 'subsidiary means' of interpretation. In *Reformulated Gasoline and Alcoholic Beverages*,⁵⁶ the AB held that Articles 31 and 32 of the Vienna Convention on the Interpretation of Treaties⁵⁷ constituted 'customary rules of interpretation of public international law' for purposes of DSU 3.2. Article 31 of the Vienna Convention, which

requires the use of certain interpretive canons and sources, begins with the general prescription that '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' (31.1). 'Context' here includes an agreement concluded between the parties in connection with the treaty and any instrument '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' (31.2(a), (b)). 'Taken together with the context', the following shall also be taken into account: subsequent agreements 'between the parties' on treaty interpretation or application; subsequent practice in application of the treaty; 'any relevant rules of international law applicable in the relations between the parties' (31.3(a)–(c)). Article 32 of the Vienna Convention permits (but does not require) recourse to the preparatory work for a treaty (*travaux préparatoires*), either to confirm an interpretation based on the sources prescribed in Article 31, or to determine meaning where there is ambiguity or obscurity, or where the meaning derived from interpretation based on Article 31 sources 'leads to a result which is manifestly absurd and unreasonable'. Clearly, many WTO or GATT Decisions, Declarations and Understandings—if not part of covered agreements—would constitute 'context' for the interpretation of covered agreements within the meaning of 31.2. Other instruments, however, might be viewed as 'subsequent' agreements or 'subsequent practice' within the meaning of 31.3. Thus, depending on the circumstances, one might view a particular WTO legal instrument that is not a covered agreement either as law that panels must apply by virtue of the legal structure of the WTO itself (see above) or as interpretive sources, to be applied by virtue of the Vienna Convention rules, applicable to dispute settlement both by virtue of Article 3.2 of the DSU and independently, simply by virtue of their status as customary international law.⁵⁸ The AB has applied elements of Articles 31 and 32 in a number of its decisions. One very important interpretive principle that it has crafted out of Article 31.1 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' (*Reformulated Gasoline*, p. 22; applied in *Alcoholic Beverages* and *Hormones*). Here the AB has responded to the tendency of panels to overlook exact textual wording in order to give effect to what they see as the 'object and purpose' of the treaty as a whole. Such a tendency could be seen in the past as quite consistent with the Regime Management model of dispute settlement—the text being understood as a means of constraining cheating on a bargain to reciprocally reduce trade barriers, a too literal interpretation might fail to catch forms of cheating that could undermine the bargain (since it is extremely difficult to specify in advance all behaviours that may constitute 'cheating' on a cooperative equilibrium). Loose interpretation by a professional élite sure of its understanding of the overall purpose of the regime, using what one trade economist colleague described as a 'sniff test for protectionism', may well serve Regime Management goals, by closing 'loopholes' or gaps that could undermine confidence in the bargain by a means less cumbersome than amendment or decision-making by the Parties. If, however, the text of an agreement constitutes or reflects a painstakingly negotiated set of trade-offs between liberal trade values and interests and other policy values and interests—hence between diverse, legitimate constituencies or stakeholders—attention to the exact text is essential to preserve the balance of the bargain. Thus, under

the Trade Stakeholder model of dispute settlement, the AB's insistence on careful attention to the exact text appears highly desirable. Indeed, the need for such an approach seems reflected in Article 19.2, which states (as already noted) that 'the panel and Appellate Body cannot add to or diminish the rights and obligations provided in the covered agreements'. Nevertheless, having insisted correctly that a purposive interpretation should not lead to neglect of the text, the AB has on occasion perhaps been too inclined to identify textual fidelity with literal or positivistic textual analysis. If a purposive reading does not mean disposing with textualism, textualism should not mean a neglect of inquiry into purpose and object, when *considering the exact words of the text*.

In the *Hormones* case, the AB considered the application of rules of international law in the interpretation of a covered agreement (the SPS Agreement; see Chapter 7 on domestic health, safety and technical standards). The EU claimed that the panel should have taken into account the precautionary principle in determining whether its measures with respect to hormone-fed meat were based on a scientific risk assessment; this refers to the notion that in cases where uncertainty surrounds the probability or seriousness of a risk, regulators should take precautions in order to avoid possible harm. The AB held that while the precautionary principle might have crystallized into a rule of international environmental law, there was considerable uncertainty about whether it had yet attained the status of general or customary international law (para. 123). Nevertheless, the AB held that the notion of precaution was relevant to the *interpretation* of the SPS treaty, for example in ascertaining the meaning of the requirement that SPS measures be based on sufficient scientific evidence. From the perspective of a Trade Stakeholder model on dispute settlement, the openness of the panels and AB to the use of non-trade international law will be of considerable importance, in bringing the relevant diverse values and constituencies into dispute settlement, where the dispute relates to the interface between the liberal trade regime and other policy regimes, both national and international. From this perspective, we fully endorse the concerns of Palmetier and Mavroidis about the rationale for rejecting as irrelevant international environmental treaties given by the *Tuna/Dolphin II* panel. The panel suggested that these agreements were irrelevant, because they were not concluded among the Contracting Parties to the General Agreement, and that they did not apply to the interpretation of the General Agreement or the application of its provisions,⁵⁹ suggesting that the GATT was a self-contained regime, sealed off from the norms and rules of other international regimes and the values and constituencies that these reflect. As Palmetier and Mavroidis note, this reasoning is clearly inconsistent with 31.3(c) of the Vienna Convention, which as noted refers to the relevance of 'any' relevant rules applicable between the parties.⁶⁰ As already noted, in *Shrimp/Turtle*, the AB applied international environmental law (including soft law) in order to interpret the scope of the expression 'exhaustible natural resources' in Article XX(g) of the GATT. The AB rightly adopted a dynamic approach to treaty interpretation, recognizing that developments in international environmental law were relevant to giving meaning to words drafted more than fifty years ago. This dynamic approach is clearly consistent with the structure of the Vienna Convention: Article 31, which deals with *obligatory* sources of treaty interpretation, includes law developed subsequent to the drafting of a treaty, while Article 32, which deals with *optional* and *secondary* sources of interpretation, refers to evidence of original intent. In *Alcoholic Beverages*, the AB considered the status of adopted panel reports as a source of WTO

law. With Article IX of the WTO Agreement in mind, which as noted above gives the Ministerial Conference and General Council the exclusive authority to adopt interpretations of covered agreements, the AB held that adopted panel reports could not have the status of binding precedents with respect to interpretation of the agreements, even if as Decisions they are binding on the parties to the dispute. Nevertheless, past adopted panels ‘create legitimate expectations among WTO Members, and, therefore, should be taken into account where they are relevant to any dispute’ (p. 14). The AB endorsed the panel’s conclusion that unadopted panel reports ‘have no legal status in the GATT or WTO system’ although on occasion they might provide ‘useful guidance’ to a panel (p. 15). In *Argentina—Measures Affecting Imports of Footwear, Textiles, Apparel and Other Items*, the AB, however, criticized the panel for relying on unadopted panel rulings as legal authority.⁶¹ In the *Shrimp/Turtle* implementation ruling, the AB held (not surprisingly) that future panels were to be guided by prior rulings of the AB itself. In a number of contexts, panels may be required to refer to or interpret municipal law, and indeed review the manner in which that law has been interpreted and applied by internal tribunals and authorities—this is most obviously the case with respect to the TRIPs Agreement and the Subsidies and Antidumping Agreements, which specify certain standards which a Member’s domestic law and legal proceedings must meet. The issues surrounding interpretation of domestic law, or its invocation in interpretation of covered agreements, have been canvassed in the section above on standard of review.

With respect to customary international law, the panel ruling in *Korea—Measures Affecting Government Procurement*⁶² held that ‘customary international law applies generally to the economic relations between WTO Members. Such international law applies to the extent that WTO treaty agreements do not “contract out” from it’ (para. 7.96).

Bilateral agreements between the disputing parties have also been found to be relevant to the *interpretation* of WTO treaty obligations, where there is a close connection between the two.⁶³

While under the Vienna Convention, Article 32, treaty preparatory work is only a secondary and optional source of interpretation, to be resorted to where the sources in Article 31 do not yield an unambiguous or reasonable reading of a treaty clause, or to confirm a reading under Article 3, panels continue to resort to preparatory work extensively. The *Canada Generic Medicines* panel (see Chapter 13 on TRIPs), for example, used preparatory work before carefully considering the treaty words in their context, including other provisions of the TRIPs Agreement itself, thus proceeding contrary to the approach indicated by Article 31 of the Vienna Convention in relation to Article 32, which is to attempt an interpretation based on the wording of the treaty in context, only resorting to Article 32 where the result of such an attempt is ambiguity or an absurd result (or to confirm an interpretation based on the Article 31 technique). In some instances, however, recourse to the negotiations may be warranted where these provide evidence of some side agreement or understanding between the particular parties to the dispute on how a particular provision of the main agreement is to be read: here, in effect, the WTO adjudicator is less invoking Article 32 of the Vienna Convention than searching for evidence of a collateral agreement, within the meaning of Article 31.

Panel procedures (Articles 12–15, 18 and 20)

There are few rules of evidence or formal due process that govern panel procedures. Each panel creates its own working procedures, based on a ‘boilerplate’ found in Appendix 3 of the DSU. Article 12.2 of the DSU emphasizes the importance of ‘flexibility’ to obtain high-quality panel reports. Some detailed working procedures are set out in Appendix 3 of the DSU, but these are mostly of a logistical nature. There are normally two meetings between the panel and the parties and at least two opportunities for parties to make written submissions. Normally, the complaining party makes its first submission before that of the responding party, so that the latter party’s submission can contain a response to that of the former. Reversing the panel, the AB held in *Bananas* that ‘There is no requirement in the DSU or in GATT practice for arguments on all claims...to be set out in a complaining party’s written submission to the panel’; omissions can be corrected in subsequent submissions (paras 145–6). Perhaps most disappointing from the perspective of a Trade Stakeholder model of dispute settlement is that the DSU continues GATT practice that panel deliberations are confidential (Article 14). The Rules of Conduct⁶⁴ with respect to settlement of disputes go beyond even this language, and refer to the confidentiality not only of dispute settlement deliberations, but also of proceedings. Worse still, Article 18.2 provides that ‘written submissions to the panel or the Appellate Body shall be treated as confidential’. While Members may disclose publicly their own position and demand of the other party a summary of its position for public consumption, stakeholders have no direct access whatever to submissions on disputes that affect them. This, of course, falls far short of the transparency and publicity norms of many municipal legal systems. Concern about these shortcomings, particularly on the part of the United States, has produced some modest progress towards greater publicity and transparency, as reflected in the *Decision on Procedures for the Circulation and Derestriction of WTO Documents*.⁶⁵ At least, now, panel reports are to be derestricted rapidly; in addition, through the WTO website (<http://www.wto.org/>), stakeholders have immediate and free access to documents such as requests for consultations and panels, and the terms of reference of the panels. This at least allows for publicity concerning what measures are or may be challenged in dispute settlement and the nature of the complaining party’s legal claims (if not the detailed arguments of the parties). Also, through the website there is free access to all adopted panel and AB decisions, and many other now derestricted documents related to dispute settlement—in the past, even unrestricted material was often difficult to obtain without contacts in the Secretariat, and was frequently not published in accessible form until long after being in theory publicly available.

Often, confidential material is leaked in one way or another to interested individuals and NGOs. In addition, a party to a WTO dispute settlement proceeding may normally share with whoever the party designates as its ‘adviser’ or ‘counsel’ confidential material in the dispute, provided that person or persons is also under a duty of confidentiality.

Representation of Parties

Traditionally, in GATT practice, only governmental officials represented the Parties before panel proceedings, although some Parties had resort to outside counsel for

opinions and advice. This placed developing countries, who were unlikely to have large armies of inhouse expert trade counsel, at a considerable disadvantage in pursuing complaints. However, there was no textual basis for this practice. In *Bananas*, the AB held that it could find no legal basis, either in WTO treaty law or in customary international law, for interfering with the choice of a Member as to who represents it before the AB (para. 10). Nevertheless, the AB stressed that it was not deciding the issue of representation in panel proceedings, which had not been appealed. It is difficult to believe that the same principles would not, however, apply to panel proceedings, and in the *Indonesian Autos* case the panel so found.⁶⁶ Opening up the process to non-governmental counsel is a positive development from the perspective of the Trade Stakeholder model; it reduces somewhat the control by governmental and diplomatic élites over the process, and also may erode somewhat the logic of confidentiality, since it is not easy to bind private lawyers to a type of confidentiality to which they are not accustomed, unlike diplomats and bureaucrats.

Relief

A panel, when it concludes that a measure violates a covered agreement, 'shall recommend that the Member concerned [footnote omitted] bring the measure into conformity with that agreement' (Article 19.1). As well, a panel may suggest ways in which the Member concerned could implement the recommendations. It is an important issue whether a recommendation that a measure be brought into conformity can encompass a recommendation for specific relief, for example the refunding of antidumping or countervailing duties collected in contravention of the provisions of a covered agreement. As Petersmann notes, five GATT panel reports have recommended this kind of relief, which he refers to as 'restitution in kind'.⁶⁷ Given that Article 3.4 of the DSU states that 'Recommendations or rulings made by the DSB shall be aimed at achieving a satisfactory settlement of the matter', and that the principles of GATT Article XXIII dispute settlement are affirmed in Article 3.1, it would be surprising if the language in Article 19 had been intended to narrow the scope of alternatives already available to a panel to achieve a 'satisfactory settlement' under pre-existing GATT practice. In the *Australia—Leather* dispute, the 21.5 panel required that Australia compel the recipient of an illegal subsidy to pay it back in full to the government. This remedy has been widely criticised as not based on any provision of either the Subsidies and Countervailing Measures Agreement or the DSU. The remedy does not take into account that the competitive advantage received from the subsidy may well be less than its total amount, depending on how the subsidy is used, and the nature of the marketplace.

Adoption of panel reports (Article 16)

Panel reports are to be adopted by the DSB within 60 days of circulation to Members, *unless a consensus exists against adoption*. Since such a consensus would normally include the winning party, this amounts to adoption as of right. This is a radical reversal of the GATT practice prior to the WTO, which required a consensus *in favour* of adoption of panel reports. Curiously, Article 16 does not specify how soon after circulation to the parties of a final report it must be circulated to Members. Article 12.7

merely states that the panel shall submit its findings to the DSB ‘in the form of a written report’ when the parties have failed to develop a mutually satisfactory solution. This, however, is arguably subject to Article 20, which stipulates that ‘Unless otherwise agreed to by the parties to the dispute, the period from the date of establishment of the panel by the DSB until the date the DSB considers the panel or appellate report for adoption shall as a general rule not exceed nine months where the panel report is not appealed or 12 months where the report is appealed.’

Appellate review (Article 17)

Article 17 provides for the establishment of a standing Appellate Body, composed of seven ‘persons of recognized authority, with demonstrated expertise in law, international trade, and the covered agreements generally’, a major innovation in dispute settlement. These individuals are appointed for a four-year, once-renewable term, and hear appeals in panels of three. If notice of appeal is not filed prior to adoption by the DSB, the panel report will become the binding settlement of the dispute—thus, notice must be filed within 60 days following the circulation of the final report to Members. The AB is to complete its review within 60 days from the filing of the notice of appeal, with the possibility of extension to 90 days. Detailed procedures relating to submissions, hearings and such are contained in the AB’s Working Procedures for Appeal.⁶⁸ This also contains rules of conduct for AB members concerning, *inter alia*, conflict of interest. Proceedings of the AB are confidential (DSU 17.10). The ‘appeal shall be limited to issues of law covered in the panel report and legal interpretations developed by the panel’ (17.6). As already discussed, issues of law may include whether the panel conducted its own operations in accordance with the requirements of the DSU and of the relevant WTO law, and not only panel findings related to claims that the responding party was in violation of provisions of covered agreements. Thus, in *Hormones*, the AB reviewed the treatment by the panel of the factual record, and certain of its findings of fact, for consistency with the obligation of ‘objective assessment of the facts’ in Article 11 of the DSU. In *Hormones* as well, the AB determined that a decision to exclude evidence on the basis of non-relevancy is reviewable for error of law (para. 143). A panel’s interpretation of a Member’s municipal law for purposes of determining whether that law conforms with the provisions of a required agreement is also reviewable (*Indian Patents*, para. 68). The AB ‘may uphold, modify or reverse the legal findings and conclusions of the panel’. As Petersmann notes, this does not include ‘(explicit) power for remanding the case back to the panel’.⁶⁹ Such remands would not normally be consistent with the concern that pervades the DSU for timeliness in the settlement of disputes; however, where the AB has found that the panel’s treatment of the factual record did not conform to the requirements of the DSU, a remand might be an appropriate alternative to merely quashing the panel’s findings and any resultant recommendations; in recent cases, such as *Periodicals* and *Shrimp/Turtle*, the AB has instead resorted to what it calls ‘completing the analysis’, applying its own interpretation of the law to the factual record. Appellate Body reports are to be adopted on the basis of the same negative consensus rule applicable to panel reports, within 30 days of circulation to Members. From a Trade Stakeholder perspective, the AB may be the most important innovation in the dispute settlement system. Appeals make panel decisions contestable and they subject those

decisions to scrutiny against juridical norms, making the panel process much less susceptible to manipulation by an inside professional élite. In this connection, it is important that the DSU stipulates that AB members may not be affiliated with any government, and that they are appointed directly by the DSB, without nomination by the Secretariat. Furthermore, the AB has its own legal support services, at least formally separate from those in the Secretariat who advise the panels.

Among the most controversial aspects of AB procedure is the discretion of the AB to accept *amicus* briefs from non-governmental organizations and private individuals. In *Turtles*, in preliminary rulings not reproduced in full in the AB final report, the AB accepted at least one *amicus* submission that was made directly to the AB, and not attached to a Member's submissions. Three other submissions were accepted as attachments to the US brief—the appellants had challenged the right of the USA to attach material that was not an integral part of its brief. The AB admitted these submissions with the caveat that 'considering that the United States has itself accepted the briefs in a tentative and qualified manner only, we focus in the succeeding sections below on the legal arguments in the main US appellant's submission' (para. 91).

Later, in the *Carbon Steel* case, the AB affirmed explicitly its authority to consider unsolicited *amicus* briefs. The AB held:

[i]n considering this matter, we first note that nothing in the DSU or the *Working Procedures* specifically provides that the Appellate Body may accept and consider submissions or briefs from sources other than the participants and third participants in the appeal. On the other hand, neither the DSU nor the *Working Procedures* explicitly prohibit acceptance or consideration of such briefs. However, Article 17.9 of the DSU provides [that working procedures are to be drawn up by the Appellate Body]. This provision makes clear that the Appellate Body has broad authority to adopt procedural rules which do not conflict with any rules and procedures in the DSU or the covered agreements [footnote omitted].

(para. 39)

In the footnote, the AB referred to 16(1) of the *Working Procedures*, which allows a division to develop an appropriate procedure where a procedural question is not covered by existing rules of procedure.

In the *Asbestos* case, the AB set out a Special Procedure⁷⁰ according to which entities would apply for leave to submit a brief to the AB. This Procedure established a strict time frame both for submission of the application, as well as for submission of a brief itself, in the circumstance where the AB decided to grant leave.

According to the Special Procedure an application must, *inter alia*, disclose the nature of the entity applying for leave, its interest in the case, and whether it is being financed or supported by the parties. Also, the applicant would have to explain, briefly, how its submission would help the AB decide the case, going beyond the arguments the parties themselves could be expected to make.

All of this was very sensible as a way of addressing the due process and transparency issues surrounding the acceptance of *amicus* briefs. In addition, by pre-screening, as it were, the AB was acting to address a related fear—that if there was discretion to accept

amicus briefs, the system would be overwhelmed by submissions, thereby taxing the already limited resources for dispute settlement. This fear was largely a product of ignorance of *amicus* practice before other courts and how it evolved—in practice, courts, whether municipal or international, end up accepting only a few briefs, with most submissions rejected on grounds of lack of relevance. Far from assuaging due process and related concerns, however, the Special Procedure in *Asbestos* provoked a virulent backlash by delegates at the WTO. Delegations from many countries lashed out against the AB, in public and private, for pre-empting the rights of the Membership itself to establish procedures for dispute settlement, for compromising the nature of the WTO as a ‘Member-driven’ organization and for pandering to developed-country NGOs. It is in this context that the AB decided to reject all of the applications for leave submitted to it. The applicants were sent a form letter stating that they had not complied sufficiently with the formal requirements for an application for leave.

Although it has never again attempted to create a formal procedure for submission of *amicus* briefs, since *Asbestos* the AB has reaffirmed that it has the discretion to accept such briefs. In the *Sardines* case, the AB was faced with the novel issue of an *amicus* submission by a WTO Member, Morocco, which had failed to intervene as a third party. The AB held that not only could non-governmental persons and groups participate in WTO proceedings through *amicus* submissions, but so too could WTO Members. In *Sardines*, the AB found both Morocco’s brief and one by a private individual (one of the authors of this book) to be ‘admissible’, although it did not in the end rely on either in its disposition of the appeal. The brief of the private individual was sent by email to the Director of the Appellate Body Secretariat, with copies to the parties to the dispute; it appears from the admissibility of this brief that this is an adequate procedure for submission.

Implementation (Article 21)

Within 30 days of the adoption of a panel or AB report, the losing party must inform the DSB of the steps it intends to take to implement the recommendations and rulings adopted. Where immediate compliance is ‘impracticable’, a Member may have a ‘reasonable period of time’ to bring itself into conformity. A reasonable period of time may be determined by the DSB on the basis of proposals from the losing party, or by agreement between the parties, or through binding arbitration. Such a period of time may be fifteen months (the normal maximum mentioned in the DSU), or more or less depending on the circumstances, i.e. the difficulties that the losing Member faces in implementation, such as a requirement for new legislation for example.⁷¹ Disagreements over whether implementation measures are adequate are to be referred back to the original panel wherever possible, which is to circulate its report within 90 days of the referral (DSU 21.3).

A panel charged with examining a dispute about implementation is limited in its mandate to the *new* measures that have been taken to implement the original panel ruling, and cannot reconsider the measures that were before the original panel; however, the consistency of the *new* measures with WTO provisions *other* than those raised in the original panel *may* be considered by the 21.5 implementation panel.⁷² The *Hormones* case

raised some difficult interpretive issues related to how this procedure interacts with procedures for suspension of concessions in Article 22 (see below).

Compensation and suspension of concessions (Article 22)

Compensation and suspension of concessions are available to the complaining party if the adopted panel or AB report is not implemented within a reasonable period of time. Compensation is a voluntary alternative to implementing a ruling; suspension of concessions requires authorization by the DSB, subject to a number of conditions and criteria listed in 22.3 and related provisions of this Article.

The suspension of concessions is to be equivalent to the nullification and impairment arising from the continued violation of the WTO provisions in question. The level of suspension of concessions may be contested before an arbitral panel, the decision of which is not subject to appeal to the AB. The arbitrator will normally examine the estimate in monetary terms of the export trade that the retaliating Member claims that it would have *but for* the continued failure to implement WTO obligations by the losing party, and will determine whether that estimate is reasonable. The burden of proof is on the Member being retaliated against to make a *prima facie* case that the level of suspension of concessions exceeds the amount of nullification and impairment.⁷³

Normally, retaliating Members are expected to suspend concessions in the same sector or under the same Agreement as the violation. However, where this is not practical or effective, a Member may retaliate in a different sector or under a different Agreement. Thus, in the *Bananas* case, Ecuador was permitted to withdraw concessions from the EC not only under the GATT but also under the GATS and the TRIPs Agreement. Ecuador had successfully argued before the arbitrator that retaliation in the goods sector alone would not be practical or effective, since it would involve suspending half of all EC exports to Ecuador, most of which were capital goods or inputs essential for the Ecuadorian economy.⁷⁴

Provided that the overall level of concessions withdrawn does not exceed the nullification and impairment from a continuing violation of WTO law, an arbitrator will not examine the manner in which the retaliation is administered, for example the choice of products (subject to reviewing a choice to retaliate in a different sector or under a different agreement, as described above). Thus, in *Hormones*, the EC was unsuccessful in challenging the USA 'carousel' strategy of retaliation, whereby the USA changes the mix of products retaliated against on an ongoing basis, so as to maximize disruption to orderly trade. The arbitral panel ruled that it had no mandate to consider such practices or their effects, as long as the USA did not exceed the aggregate maximum monetary amount that it was permitted to withdraw in a given year.⁷⁵

In the *Bananas* dispute, the United States argued that it had the right, once the reasonable period of time for the EC to implement had expired, to proceed forthwith to retaliation under Article 22.6, *without* the prior step of a 21.5 panel on the issue of the adequacy of the EC actions to implement the original panel ruling. Article 22.6 is silent as to whether a party seeking DSB authorization for retaliation must first obtain a ruling by a 21.5 panel that the violating party has failed to implement. The standoff in the DSB between the USA and other WTO Members on this issue produced the first crisis in the WTO dispute settlement system. Through the intervention of the Chair of the DSB, and

de facto consolidation of 22.6 and 21.5 proceedings in this particular case, a compromise solution was found, with the understanding that the relationship between 22.6 and 21.5 should be clarified when the DSU is reviewed. It is widely believed that only an amendment to the DSU can clarify the relationship between the mechanisms in these two provisions. One dissenting view is that of Petros Mavroidis, a leading WTO scholar. Mavroidis argues that one can clearly distinguish situations where the Member found in violation has done something to implement a ruling from those where the Member has done nothing at all: in the former situation, argues Mavroidis, there must be prior recourse to a 21.5 panel to determine whether what has been done is adequate; only in the instance where *nothing* at all has been done should it be possible immediately to demand of the DSB the withdrawal of concessions. According to Mavroidis, this interpretation makes sense of the text of the DSU as it is written, making neither the 21.5 process nor that under 22.6 redundant.⁷⁶ A major advantage of Mavroidis's approach is that it obviates the need for a DSU amendment. On the other hand, his solution leaves open the risk that a Member found in violation could endlessly postpone retaliation by taking cosmetic and unsatisfactory further steps to implement after a 21.5 ruling, thereby inviting yet another 21.5 ruling, which could be followed by further unsatisfactory steps, yet one more 21.5 panel, etc.

It should be added that a panel eventually went some distance to endorsing the US view of the relationship between 21.5 and 22.6, opining that a 22.6 panel had the competence to determine not only the reasonableness of the quantum of retaliation requested, but also whether the Member found in violation by the original panel had implemented the original ruling, or, alternatively, was still in violation.⁷⁷ The AB, however, reversed this particular finding, on the procedural grounds that the issue was not one properly before the panel, given the facts of the case.⁷⁸

Exclusivity of WTO procedures (Article 23)

Article 23 requires Members to resort exclusively to WTO dispute settlement procedures to seek 'redress' for a violation of a covered agreement, and in particular not to make determinations that WTO rules have been violated outside the framework of the DSU. In the *US—Section 301* case, a panel considered whether elements of the US Section 301 procedure violated Article 23 of the DSU, because they appeared to give rise to the possibility that US authorities would make a determination that another Member was in violation of WTO commitments prior to the completion of dispute settlement procedures in accordance with the DSU timetable. The panel ultimately found no violation of DSU Article 23 because it was persuaded that the manner of application of the provisions in question, as mandated by the executive branch and evidenced by declarations of the USA before the panel, would avoid the result of a unilateral determination outside the DSU timetable. By contrast, the panel in *United States—Import Measures on Certain Products from the EC* found a violation of Article 23, because the United States imposed retaliation before the arbitration proceeding under 22.6 had run its course.

In some instances, a complaint may be brought under both WTO procedures and the procedures of some other trading regime, such as NAFTA, in respect of the same measures. Since NAFTA incorporates many provisions of the GATT and (prospectively) some in the WTO,⁷⁹ an issue arises as to whether a Member is prohibited from raising

issues related to these provisions in a complaint under NAFTA dispute settlement procedures. This issue is further complicated by the NAFTA's own choice of forum rules, which will be discussed later in this chapter.

In the *Argentina—Poultry* case, the panel considered a claim by Argentina, the defendant, that Brazil was estopped from bringing the action because it had chosen to have recourse to proceedings under the MERCOSUR regional agreement in respect of the same antidumping matter. The panel was open to the possibility that the conduct of a party in a regional forum such as MERCOSUR could give rise to an estoppel of WTO proceedings; however, it found on the facts that Brazil, in bringing proceedings at MERCOSUR, had never, explicitly or implicitly, waived its right to bring a subsequent action in the WTO forum.⁸⁰

***Ad hoc* arbitration (Article 25)**

Article 25 of the DSU provides that, if they so choose, the parties may decide to submit a dispute to an *ad hoc* arbitration process. In one case where this has so far occurred, the *US Music or Juke Box* case, the arbitration came *after* an adopted panel report (for a detailed discussion, see Chapter 13 on TRIPs), and concerned an alternative remedy to withdrawal of the measure, in this case monetary damages.

Non-violation nullification and impairment (GATT Articles XXIII(1)(b), DSU Article 26)

Under Article XXIII(1)(b) of the GATT, as interpreted in GATT practice, a Contracting Party could have recourse to dispute settlement even where no violation of a specific provision of the GATT was complained of, if a benefit was considered to be nullified or impaired by the conduct of another Member. This served the Regime Management goal of maintaining a cooperative equilibrium over time, through vindicating the reasonable expectations of Contracting Parties concerning the benefits obtained from reciprocal concessions even where the conduct threatening to undermine them was not specified explicitly and prohibited in the GATT. This logic is articulated in a general statement concerning non-violation nullification and impairment in the *Oilseeds* panel:

The idea underlying [non-violation nullification and impairment] is that the improved competitive opportunities that can legitimately be expected from a tariff concession can be frustrated not only by measures proscribed by the General Agreement but also by measures consistent with that Agreement. In order to encourage contracting parties to make tariff concessions they must therefore be given a right of redress when a reciprocal concession is impaired by another contracting party as a result of the application of any measure, whether or not it conflicts with the General Agreement.⁸¹

It follows from this that to invoke non-violation nullification and impairment, the complaining party must be able to identify a specific tariff concession or concessions and a benefit flowing from these concessions, or reasonably expected to flow, that has been

undermined as a *consequence* of the measures complained of. Article 26 of the DSU stipulates that in the case of non-violation nullification and impairment complaints, ‘the complaining party shall present a detailed justification in support of any complaint’, and that where non-violation nullification and impairment has occurred, there is no requirement to withdraw the measure; instead, the panel or AB is to recommend a ‘mutually satisfactory adjustment’. The approach in *Oilseeds* was followed by the WTO panel in the *Kodak/Fuji* ruling, where it rejected a claim of the US that certain allegedly anti-competitive policies and practices of Japanese authorities and industry constituted non-violation nullification and impairment (see Chapter 18 on trade and competition). In *Asbestos*, the AB rejected an argument by the EC that bona fide non-economic regulatory measures, such as health measures, are *a priori* excluded from challenge under a non-violation nullification and impairment complaint.

REVIEW OF THE DSU—OPTIONS FOR REFORM⁸²

Since its inception, the WTO DSU has been heavily used by Members. According to Leitner and Lester, as of 1 January 2003 there had been 276 complaints filed under the DSU.⁸³ Seventy-two panel reports were issued between 1995 and 2002, and 72% of panel reports have been appealed.

The results of dispute settlement have led to criticism and controversy even after less than a decade of the system’s operation. There are concerns about access of developing countries to dispute settlement and their ability to use the system effectively. Also, the AB—the appellate court—of the WTO has had to rule on a variety of complex issues related to some of the most heated debates about globalization (such as trade and environment). Applying general legal norms, or provisions of the Uruguay Round Agreements never before subject to judicial interpretation, it is not surprising that the AB has been criticized by discontents of its decisions in controversial matters with ‘inventing the law’.⁸⁴ The AB has proven more open to and subtle in dealing with human values and interests other than ‘free trade’ than had earlier GATT dispute panels, consistent with the Stakeholder model advocated in this chapter; thus, the attacks on its jurisprudence have come as much from dogmatic free traders, nostalgic for the old GATT approach of ‘send the tree huggers packing’,⁸⁵ as from the anti-globalization movement. A different kind of criticism has been that dispute settlement rulings in cases involving the application of domestic trade remedy laws, antidumping, countervailing duties and safeguards have shown insufficient deference to the legal and factual determinations of domestic agencies and tribunals. The problem here is a real one—the technique of review of administrative determinations is one that needs to be developed and refined by WTO adjudicators; in fairness to them, part of the problem is a set of ambiguous (perhaps sometimes intentionally so) treaty provisions, and the lack of a comprehensive negotiating history that would throw light on the ambiguities. These criticisms occur in a context where it is effectively impossible to adjust through a political or diplomatic process the results of adjudication, except with the consensus of the entire WTO Membership. Thus, there is limited opportunity for a structured dialogue between the judicial and legislative branches of the WTO.⁸⁶

The requirement for review of the DSU is built into the DSU itself, but the deadline set in the DSU has been extended several times. The negotiations are taking place in a special forum of the DSB. Around the expiration of the previous deadline (end of May 2003), a Chairman's text was produced, summarizing and synthesizing a number of the proposals for changes to the DSU that were gaining some measure of support among delegations. However, this Chairman's report never itself became an agreed document among delegations.

What follows is a brief overview of some of the major systemic issues entailed in dispute settlement reform negotiations. Space does not permit an examination of the many technical or 'housekeeping' proposals.⁸⁷

Addressing substantive critiques of the WTO jurisprudence

Substantially weakening or reducing the jurisdiction, mandate or authority of the dispute settlement system is simply not on the negotiating table; this reflects the fact that, despite criticisms and concerns for improvement, the system has a large amount of legitimacy and is generally viewed as playing a constructive role in achieving the purposes of the WTO as an organization.

Justified concerns about the quality of rulings at the panel (as opposed to the Appellate) level have led to a meritorious proposal by the European Community to replace the current panel selection process (that leads to the choice of many panellists without the appropriate expertise) with a roster of permanent professional panellists. Others including apparently the United States oppose this, for reasons that are not clear. It seems to be thought that the diplomatic control over panellist selection offered by the present system creates an advantage for the USA. This seems implausible, in a system where the ultimate decision-maker is the AB.

One of the more unusual proposals for reform is that put forward by the USA and Chile, which would allow, by consent of the parties to the dispute, some kind of cut-and-paste of the AB ruling, including the removal of aspects of the ruling that the parties do not want to see there. This seems to strike at the heart of the values of legal certainty, judicial independence and the notion of a series of coherent precedents that can be followed in future cases. However, it apparently does not have much support among delegations.

Improving access of developing countries to dispute settlement and its effectiveness for developing countries

This concern has brought forth a wealth of interesting proposals. Some focus on empowering developing countries to be full and effective participants in the system, while others aim at special and differential treatment as the goal. One of the former that is of particular interest is the proposal that, in disputes between developed and developing countries, where the developed country is the loser in dispute settlement, it should pay the developing country's costs. This goes some way to addressing an obvious advantage that developed countries have in the current system (with some exceptions): they are deep-pocket litigants, relative to most developing countries. Other issues related to the

participation of developing countries in the dispute settlement system are canvassed in the chapter of this book on trade and development (Chapter 15).

Transparency and NGO participation

As noted above, perhaps the most heated controversy over WTO dispute settlement procedures concerns *amicus* briefs. The AB has ruled on several occasions that the rules on disputes permit panels and the AB itself to exercise their discretion to accept *amicus* briefs, unsolicited, including from NGOs. Many diplomatic representatives of the Members in Geneva became quite incensed by these rulings. However, the AB has not reversed its course but has in fact expanded the earlier rulings by now also allowing *amicus* participation by other WTO Members who are not parties or third parties in the dispute (the case of Morocco in the *Sardines* dispute). Some of the concern about *amicus* briefs is misinformed; for example, it is not true that such briefs are alien to non-common law legal culture, nor that they are prohibited by most other international tribunals. Nor is it true that such briefs create 'rights' for non-governmental persons; at issue is the discretion to consider them, not any purported 'right' of the author to have their brief considered.

Other concerns about *amicus* briefs, such as adequate notice for parties and third parties to respond to them, and transparency about the financial or other interests of those submitting briefs or funding them, are legitimate and important, and need to be addressed by the creation of a procedure to govern such submissions. In the recent DSU reform negotiations, the European Community has put forward an interesting proposal in this regard.

A related issue concerns the secrecy of dispute settlement proceedings, including both written and oral pleadings. Such secrecy is at odds with the Stakeholder model of dispute settlement, and generally in conflict with liberal democratic values concerning justice 'being seen to be done' (see the recent controversy about the use of military tribunals to try US prisoners at Guantanamo). It also limits the access of NGOs to the system, by curtailing their information about what is at stake in particular disputes; citizens may not even know what arguments their own government is putting forward. The United States is proposing to eliminate this secrecy. That would of course require special rules to deal with exceptional cases where some element of confidentiality is justified, such as the handling of commercially confidential information in subsidies and dumping cases for instance. Opponents of the US proposals claim that secrecy in the proceedings facilitates negotiated early settlement of disputes; however, according to former legal director of the WTO Professor William Davey, based on his experience, 'I doubt that the actual publication of submissions or the opening of panel proceedings to the public...would discourage or complicate attempts at settlement. Any settlement discussions, as always, would remain confidential.'

Remedies and compliance

As noted above, the standard remedy where a panel or the AB has found a breach of WTO rules is for the Member in breach to change its measures to bring them into conformity. Several issues have been raised concerning this standard remedy. First, there

are situations where it may be genuinely difficult politically for a Member to change its laws, at least in the near term: in these situations, should there be more scope for compensation or even monetary damages in lieu of specific performance? Second, the standard remedy is only prospective, and does not provide any compensation for damage to trading interests from the point of breach up until the breaching Member brings its measures into conformity with a dispute settlement ruling; this appears to give the breaching Member a 'free ride', which could last up to two years or more, depending on how long it takes to resolve the matter fully through dispute settlement. Third, where the breaching Member fails to bring itself into conformity after a reasonable period of time, the mechanism currently available to induce compliance is the withdrawal of concessions, i.e. retaliation: this may be effective when used by big countries against small ones, but has been largely ineffective in most other situations in inducing compliance (e.g. *Hormones*); should retaliation be strengthened, through allowing collective countermeasures in excess of the commercial effect of the breach (which would allow a small country victim of a breach to make common cause with other WTO Members against the violator); going even further, should a country be able to assign a right of retaliation to another WTO Member, who may have trading relations with the breaching country of a scale or nature that make it more likely that the retaliation will 'hurt'?

None of these issues or proposed reforms is easy or unproblematic. Susan Esserman and Robert Howse (Esserman and Howse, 'The WTO on Trial', *Foreign Affairs*, January/February 2003) have argued that dispute settlement rules and procedures should facilitate remedial settlements that are flexible and take into account in particular cases the difficulty of resolving the matter through specific performance. While we think it is important to maintain the notion that only bringing itself into compliance can fully discharge the legal obligation of the breaching party, we also believe that the winning party should be able to negotiate voluntarily with the breaching party an alternative settlement such as monetary damages, and that the rules should facilitate panel arbitration concerning the quantum and design of such alternative settlements, again with the consent of both parties (the arbitration in the *US Music* or *Juke Box* case establishes a precedent in this regard).

On the other hand, we are sceptical about proposals to make retaliation more severe or painful for the losing party. While sanctions should not be abolished (they send an important normative message about the importance of law-abiding behaviour), they should be seen as a last, not a first, resort for resolving compliance issues; after all, sanctions have an important cost, which is that they operate through making trade more restrictive. At the end of the day, in any international legal regime, the legitimacy of the rules and the rulings in question, combined with reputation effects, and moral pressure are the primary means for inducing compliance. What the WTO needs is more creative thinking not about sanctions but rather about how to increase the legitimacy and understanding of the rules and the rulings among the public and relevant constituencies, as well as about new opportunities for exercising moral suasion and making reputation effects work—for example public reports on the overall compliance records of individual WTO Members, perhaps a scorecard of sorts, and a process for holding to account the worst offenders.

Moving the dispute settlement reform process forward

As mentioned above, the DSU sets out a process and timetable for review of dispute settlement procedures that is, formally, independent of the Doha Round. It is tempting to try to tie progress on DSU reform to the overall momentum of the Doha Round, seizing the opportunities for linkage to other issues. However, such linkages may backfire, making DSU reforms that are important for the legitimacy of the judicial branch of the WTO hostage to the trading of concessions in areas, such as agriculture, that entail striking a delicate balance on matters really not directly relevant to dispute settlement procedures. It may be more promising to endorse an incremental, and autonomous, approach even to more controversial reforms of the DSU, taking matters a step at a time, and permitting a dialogue between the political organs of the WTO and the judicial organs—in other words, a kind of ongoing council on dispute settlement issues, that operates relatively independently of other WTO negotiations.

DISPUTE SETTLEMENT IN THE NAFTA

Background: the Canada-US Free Trade Agreement

The Canada-US Free Trade Agreement (FTA or ‘the Agreement’) provided two main avenues for the resolution of disputes between its signatories. Chapter 18 of the Agreement set up a Commission to resolve disputes; Chapter 19 detailed procedures for resolving problems in antidumping and countervailing duty cases. The Chapter 18 and 19 mechanisms involved the use of consultation, negotiation and panels—all of which resembled dispute resolution mechanisms in the GATT under Article XXIII(2). The Agreement also appears to have benefited from experience under the GATT, and to have adopted some of the improvements which were introduced into its procedures post-Tokyo Round.⁸⁸

Chapter 18

Article 1801 of the FTA stated that Chapter 18 is for the ‘avoidance or settlement of all disputes regarding the interpretation or application of this Agreement’ except insofar as any dispute relates to the provisions of Chapter 17 (Financial Services) or Chapter 19 (Antidumping and Countervailing Duty Cases).⁸⁹ It established the Canada-US Trade Commission (‘the Commission’) to supervise the implementation of the Agreement, to resolve disputes under it, ‘to oversee its further elaboration, and to consider any other matter that may affect its operation’.⁹⁰

Articles 1803–4 laid down the procedures for notification and consultation regarding actual or proposed measures that might materially affect the operation of the FTA. The FTA required the Parties to notify each other of such measures in advance of implementation or as soon thereafter as possible. It also gave each Party the right to ask the other for information regarding these measures.⁹¹ Article 1804 allowed each Party the right to consultations regarding any measures or any other matter material to the FTA, and it exhorts the Parties to make every effort to reach mutually agreed-upon solutions to problems that arise in these consultations.⁹² If consultations did not allow the Parties to

resolve their differences within 30 days, then Article 1805 permitted either Party to request a meeting of the Commission, which was to convene within ten days (unless otherwise agreed) to attempt 'to resolve the dispute promptly'.⁹³

If a dispute was not resolved within 30 days of being referred to the Commission, that Commission *must* in the case of a dispute over safeguard actions or⁹⁴ (in the case of other actions) *may* refer the dispute to binding arbitration,⁹⁵ failing which either Party had the right to request the establishment of a panel of experts 'to consider the matter'.⁹⁶ The panel was to be drawn 'wherever possible' from nominated lists of unaffiliated individuals who have been chosen by each country on the basis of their expertise, objectivity, reliability and sound judgment.⁹⁷ A panel would have five members, two from each country and a Chair chosen by agreement between Parties, failing which the Commission could intervene. If the Commission could not agree, the Chair would be chosen by lot from the roster.

A panel would determine its own procedures, subject to the requirement of at least one oral hearing, as well as the right to present written submissions and rebuttal arguments. Proceedings were confidential and the panel was required to base its decision solely on submissions (unless otherwise agreed by the Parties).⁹⁸

Once the Commission received the final report, it was to agree on a resolution of the dispute in question 'normally' in conformity with the recommendations of the panel.⁹⁹ 'Whenever possible', this resolution was to be the non-implementation or withdrawal of measures not conforming with or causing nullification or impairment of benefits accruing under the FTA.¹⁰⁰ If the Commission could not reach agreement within 30 days of the receipt of the final report, or if a Party refused to comply with the findings of a panel under the binding arbitration provisions of Article 1806, then the other Party could suspend the application of equivalent benefits to that Party.¹⁰¹

During the lifetime of the FTA, only five disputes were remitted to panels under Chapter 18: one relating to Canadian salmon and herring landing requirements; another relating to the treatment of non-mortgage interest on land or plant and machinery for purposes of rules of origin; another relating to whether exports of durum wheat to the USA by the Canadian Wheat Board were occurring below acquisition cost; another relating to the adoption of regulations in Puerto Rico that precluded continuing sales of ultra-high temperature (UHT) milk by a Quebec producer to Puerto Rican consumers; and another which concerned a US ban on 'undersized' lobsters.

Chapter 20 of the NAFTA

Chapter 20 of the NAFTA incorporates the essential structure of dispute settlement provided in Chapter 18 of the FTA. Under the FTA, disputes that fell under Article 18 arising under that Agreement and the GATT could be settled in either forum at the discretion of the complaining Party, although once an election had been made, this excluded the alternative dispute settlement process (Article 1801). Under NAFTA, however, where disputes relate to environmental and conservation matters or sanitary and phytosanitary measures, the responding Party may insist that a complaint be heard by a NAFTA rather than GATT panel (Article 2005). In such cases, a disputing Party may request, or a panel on its own initiative may solicit, a written report of a scientific review board on any factual issue concerning such matters (Article 2015). There is an interesting

issue of how these rules interact with the provisions of exclusivity of WTO dispute settlement procedures in Article 23 of the DSU, discussed above. Under Vienna Convention principles, the DSU might be argued to modify or prevail over the NAFTA provisions, as an agreement later in time. If this is so, then a NAFTA Party would be prohibited from pursuing its WTO claim in the NAFTA process by virtue of the DSU; this would mean that, by virtue of the election rules, it would be deemed to have chosen the WTO forum, and thereby would not be able to pursue its NAFTA claim at all, since the WTO dispute settlement procedures do not provide panels with the jurisdiction to consider violations of NAFTA provisions (however, since many GATT provisions are incorporated into NAFTA, but for the DSU, a Party might have been able to pursue both sets of claims in NAFTA Chapter 20 dispute settlement).

Other changes from the FTA in NAFTA Chapter 20 include: (1) instead of separate national rosters of respective panellists, as provided under Chapter 18 of the FTA, the NAFTA contemplates a consensus roster of up to 30 persons acceptable to all member countries; (2) instead of disputing Parties selecting nominees from the roster who are their own nationals, NAFTA calls for a process of reverse selection, by which Parties must select from the other country's nationals on the roster; (3) unlike the FTA, NAFTA permits third-country and non-member-country nationals to serve as a Chair of a panel; (4) unlike the FTA, disputes regarding financial services are fully subject to dispute settlement, through specialized procedures designed to ensure appropriate panel expertise (Chapter 14); and (5) under the investment provisions of NAFTA (Chapter 11), any NAFTA investor who alleges that a host government has breached an obligation of the investment chapter may invoke an arbitral tribunal to hear the matter. Investment obligations include requirements for National Treatment and Most Favoured Nation treatment, as well as certain disciplines on specified performance requirements, rules against restricting transfers, and against expropriation without compensation. Procedures may be based on IC SID or its Additional Facility, or on the UNCITRAL Rules for such arbitrations. Procedures are provided to enable consolidation of cases, to avoid procedural harassment and for the intervention of governments responsible for the Agreement both individually before the arbitral tribunal or collectively through the issuance of Commission interpretations of the Agreement on questions that may be before the arbitral tribunal. Awards for monetary damages are directly enforceable in the domestic courts of the NAFTA Members as if they were domestic court judgments. Thus, in the investment context, private parties are given direct access to international dispute resolution mechanisms for the first time in an international trade treaty. The jurisprudence of Chapter 11 panels is discussed extensively in the trade and investment chapter of this book (Chapter 14).

So far, Article 20 procedures in NAFTA have only been invoked in three cases: the *Agricultural Tariffication* panel (discussed in the chapter of this book on trade in agriculture, Chapter 11); the *Broomsticks* case (discussed in the chapter on safeguards, Chapter 10); and the *Mexican Trucking* case (discussed in the chapter on trade in services, Chapter 12).

Chapter 19 of the FTA and NAFTA

As a middle power whose main trading partner is the United States, Canada long relied on the rules and processes of international trade law—including the process of GATT dispute settlement—to constrain American protectionism. With the rise of administered protection in the 1970s and 1980s—particularly in the form of harassment of Canadian exporters by countervailing duty and antidumping actions—the multilateral legal framework appeared increasingly incapable of maintaining open borders between Canada and the United States, despite conventional tariffs having been reduced to low levels in the GATT negotiations. Curbing these forms of administered protection was stated to be a central concern of Canada's FTA negotiators.¹⁰²

In the event, the United States did not accept any substantive limitation whatever on the application of trade remedy laws within North America. The Americans did agree to a process of review of domestic countervail and antidumping determinations by *ad hoc* binational panels, which, in the context of American trade authorities, would replace appellate review by the US Court of International Trade (CIT). Canadian trade analysts generally viewed the CIT as extremely deferential to the determinations of the US agencies, the International Trade Administration (ITA) of the Department of Commerce and the International Trade Commission (ITC).¹⁰³ Binational review would at least subject these agency decisions to scrutiny against basic US administrative law standards of reasonableness and the requirement to base one's decision on substantial evidence from the record. This binational procedure is set out in Chapter 19 of the FTA and NAFTA.

Article 1904 of the FTA provides that binational panels shall replace judicial review of the 'final determinations' of domestic trade authorities of the two countries in countervail and antidumping cases.¹⁰⁴ At the request of either Party, a panel may consider and issue a binding decision as to whether such a final determination is in conformity with the domestic trade remedy law of the importing country. The standard of review is that laid down by the relevant statutes (as amended from time to time) of each Party, and by 'the general legal principles that a court of the importing Party would otherwise apply'. Requests for panels must be made within 30 days of the issuance of a final determination. While only a Party may request a panel, Article 1904:5 allows interests that would normally be entitled to judicial review under domestic law to petition as of right their government to establish a panel. This means that, in practice, the panel process is largely driven not by governments but by private litigants, with producer interests in both countries heavily represented by counsel throughout the process.

In the case of US countervail and antidumping decisions, the panel's standard of review is largely derived from the general principles of US administrative law. The standards require that agency determinations represent reasonable interpretations of US law, i.e. not necessarily correct but at least defensible as one of several possible reasonable interpretations of the law, and that findings of fact be supported by substantial evidence on the record, i.e. enough evidence that would allow a reasonable person to draw the inference in question.¹⁰⁵

Where a binational panel deems that a finding is not in accordance with a reasonable interpretation of the law, or is not supported by substantial evidence on the record, its

powers are limited to remanding the matter to the domestic agency that made the original determination, to reconsider its findings in light of the panel's recommendations. *Thus, the binational panel itself is powerless to remove duties; it can only order the domestic authorities in question to redetermine the matter.* Where dissatisfied with a redetermination, the only recourse of an exporter is to have its government request yet another panel. In a number of cases, two or three panels have been necessary before the domestic agency in question brought its decision in line with the law (or gave up on finding adequate evidence to support it) and removed or reduced duties.

Panel decisions are made by majority vote, and reasons (majority, concurring, dissenting) are provided in writing. Panellists are chosen from rosters of trade experts provided by the two countries, with two of the five members chosen by each country and the fifth by agreement between them, and in the case of an inability to agree, the fifth panellist may be selected by the two others, or if that fails, by lot from the entire roster. (As will be discussed below, the criteria for panellists have changed with NAFTA.)

Article 1904 of the FTA (13) provides for an 'Extraordinary Challenge' mechanism, whereby a panel ruling may be appealed to an Extraordinary Challenge Committee (ECC), composed of three persons who must be judges or former judges of a US federal court or a court of superior jurisdiction in Canada. The grounds for an extraordinary challenge are: (a) a panel member was guilty of gross misconduct; (b) the panel seriously departed from a fundamental rule of procedure; or (c) the panel manifestly exceeded its powers, authority or jurisdiction as set forth in Chapter 19. Only, however, where the ECC determines that the panel's decision has been materially affected by one or more of these defects and the integrity of the binational review process is threatened will an Extraordinary Challenge succeed. (As will be discussed below, the grounds of an Extraordinary Challenge have been substantially broadened in NAFTA.)

Changes to the binational panel review process in NAFTA

During the NAFTA negotiations and especially in their final phases, a concerted assault was launched on the binational panel process in the US Congress, focusing on the absence of deference to US agencies and the supposed incorrect application of US law by several panels.¹⁰⁶ While much of this criticism clearly represents 'sour grapes' due to the number of cases which US domestic producer interests had lost, several genuine concerns about the legitimacy and coherence of the process were also in play. First of all, it is generally acknowledged by those with a knowledge of both systems that the Canadian and American administrative law standards for judicial review of agency determinations are different. This asymmetry is built into the panel process itself, of course, such that where US interests are challenging a Canadian agency determination, the panel must apply the Canadian administrative law standard, as embodied in the Federal Court Act, which is one of significantly greater deference to agency decision-making than the US standard. While error of law is a basis for overturning a Canadian agency decision, with respect to errors of fact the threshold is very high indeed: the finding must have been made in a perverse or capricious manner without regard to the evidence before the agency or tribunal. This standard has been interpreted in recent Supreme Court decisions as requiring a very high level of deference to agency decisions.¹⁰⁷ By contrast, it will be recalled, American law requires that any finding not based on substantial evidence on the

record be overturned. Thus, American interests do not have equal opportunity to have adverse Canadian agency findings reversed by panels as do Canadian interests with respect to US agency findings. A second area of legitimate concern has been that since each panel is an *ad hoc* decision-maker in a particular dispute, approaches of different panels to legal issues need not be consistent. This leads to lack of legal certainty; ironically, arbitrariness in agency legal interpretation may now be replaced by inconsistent panel rulings. The most obvious case of inconsistency has been panel interpretation of the specificity test in US countervailing duty law, and particularly whether all of a number of factors that go to *de facto* specificity must be considered by the agency: the *Magnesium* panel considered that this was not necessary, while one of the *Softwood Lumber* panels, which was ruling almost at the same time, answered that all factors must be weighed. And the Extraordinary Challenge procedure does not provide a means of clarifying inconsistent panel rulings so as to produce legal coherence for the future.

A third, related concern that has some legitimacy is that even if the panels are applying the US standard of review in an acceptable manner, they are nevertheless evolving the law in a somewhat different fashion than are the US courts with respect to countervail and antidumping actions that apply to all other countries. At one level, this may be the result of a misunderstanding of the process because, at least in theory, any future binational panel would be bound by the rulings of the US courts in cases dealing with NAFTA non-parties as one aspect of the 'law' that it must apply. Nevertheless, in practice, the fact that two very different kinds of institutions are evolving the US law as it applies to different countries suggests the potential for some lack of legal coherence.

The changes that US negotiators insisted on in NAFTA reflect the weight attached by the US Congress and the Administration to these various concerns. The grounds for Extraordinary Challenge review have now been extended to include failure 'to apply the appropriate standard of review'.¹⁰⁸ This is, in fact, a very broad rubric, going far beyond the notion in the *Swine* and *Pork* cases that Extraordinary Challenge review may be available where the standard of review has clearly been incorrectly articulated or not applied conscientiously, i.e. not in good faith. 'Appropriate' is a vague legal category, and leaves ample room for voicing objections to just about any panel ruling. In this respect, it is significant that unlike the FTA, the NAFTA provisions on Extraordinary Challenges explicitly invite the ECC, in effect, to reopen the whole case through 'examination of the legal and factual analysis underlying the findings and conclusions of the panel's decision' (Annex 1904.13(3)). To permit the ECC the opportunity to re-examine the whole case, the period for Extraordinary Challenge review has been tripled from 30 to 90 days. The Ways and Means Committee of the US House of Representatives all but suggests that these changes will turn the Extraordinary Challenge procedure into another kick at the can:

By expanding the period of review and requiring ECCs to look at the panel's underlying legal and factual analysis, the changes to Annex 1904 clarify that the ECC's responsibilities do not end with simply ensuring that the panel articulated the correct standard of review. Rather, ECCs are also to examine whether the panel correctly analyzed the substantive law and underlying facts.¹⁰⁹

Finally, with respect to the primary panels themselves, the roster of panellists is to 'include sitting or retired judges to the fullest extent practicable' (Annex 1901.2(1)). This represents a major change from the FTA, which allowed for rosters to be dominated by experts in international trade law and economics. The full import of this change can only be understood when one recognizes that the kind of errors in US agency determinations identified by binational panels, especially as they relate to the 'substantial evidence' standard of review, involve the examination of complex methodologies, empirical economic studies, including econometric modelling, and, sometimes, dozens of specific calculations. Counsel for these cases are usually highly experienced experts from the trade bar, supported by teams of consulting economists and econometricians.¹¹⁰

CONCLUSION

The WTO dispute settlement system represents an enormous advance towards the rule of law in international trade and indeed perhaps in the evolution of international law more generally. The entitlement of a complainant to dispute settlement, with or without the consent of the other party, and the effectively automatic adoption of rulings as legally binding between the parties, represent important gains over the previous practice of the GATT. Perhaps no advance is more significant, however, than the establishment of a standing Appellate Body, which reviews the legal reasoning of dispute panels. Throughout the GATT's history—admittedly more in earlier than later years—panels, under the wing of the Secretariat, treated the law of the GATT rather freely, in order to obtain outcomes that were thought to be diplomatically viable and helpful in sustaining the overall trade liberalization bargain. As the GATT increasingly found itself in a position of deciding matters that entailed a balance of competing or diverse policy values, for example in the trade and environment area, such an approach threatened a legitimacy crisis. Disciplining the activity of panels by requiring a rigorous approach to the legal texts themselves, and the appropriate use of interpretive techniques and sources in public international law (which apply across diverse normative fields touched by international law, whether environment, health and safety, or human rights), is part of the answer to this legitimacy challenge. Unfortunately, another part of the answer—non-governmental stakeholder access to the dispute settlement system—has yet to be put fully in place. However, the AB has now repeatedly ruled that there is nothing in the text of the DSU that excludes the possibility of a panel using its rather broad powers of inquiry and investigation to allow and consider appropriate submissions by non-governmental organizations and other stakeholders, for instance international organizations in other regimes such as international environmental law.

Dispute settlement under the FTA and NAFTA, by contrast, has become increasingly problematic. Very few cases have been brought under the general dispute settlement provisions, partly because, due to overlap between many FTA/NAFTA and GATT/WTO provisions, it made more sense to pursue dispute settlement at the WTO. As discussed in the trade and investment chapter of this book (Chapter 14), serious legitimacy issues have been raised concerning the impact of Chapter 11 investor-state dispute settlement on domestic regulatory democracy. With respect to binational panel review of domestic agency determinations on countervailing duty and antidumping matters, the *Softwood*

Lumber dispute has displayed the fragility of the Chapter 19 review process in cases where genuine normative conflict underlies the dispute and represents a legitimacy crisis for that process of considerable proportions; despite repeated rulings finding defects in the reasoning of the US Commerce Department and the ITC over a considerable number of years, FTA and NAFTA panels in this dispute have failed to produce a resolution of the dispute (although they have arguably resulted in some reductions and refunds in duties). Particularly since the WTO Subsidies and Countervailing Measures Agreement incorporates legal disciplines on the imposition of countervailing duties as a matter of international law that are similar to the constraints imposed in domestic law (which must be based on WTO obligations), review of these matters is likely to occur increasingly under the WTO dispute settlement procedures as well (there have indeed already been several WTO rulings in the *Softwood Lumber* dispute, discussed in the chapter of this book on subsidies and countervailing duties, Chapter 9). In our view, this is as it should be—it obviates the danger of competing interpretations of similar or overlapping legal rules and norms by different dispute settlement bodies, and would reflect the basic thrust of Article 23 of the WTO DSU, which provides for the exclusivity of WTO procedures where WTO rules are at issue.

5

Trade, exchange rates and the balance of payments

INTRODUCTION

The theory of comparative advantage that we outlined in Chapter 1 suggests that it will benefit a country to produce domestically those products in which it has a comparative advantage and import those in which other countries have a comparative advantage. While the theory shows how a country that does not have an absolute advantage in anything will still be able to export and benefit from trade, it by no means demonstrates that the value of a country's exports of products in which it has a comparative advantage will equal the value of imports in which it has a comparative disadvantage.

To return to the Ricardian example of the exchange of wine and cloth between England and Portugal, what if England's wine imports yield Portugal £100 a year, yet the English cloth it requires costs £200? In this example, to maximize the gains from trade, Portugal must draw down its national reserves of wealth (e.g. gold) in order to obtain the additional £100 it needs to purchase English cloth. It thus seems that the mercantilist objection that liberal trade could reduce accumulated national wealth has not really been met by the theory of comparative advantage.

The philosopher David Hume is 'thought to be the first to have developed a theory of the balance of payments that could meet this objection.'¹ In essence, the theory suggests that since the demand for a country's currency depends on demand for its exports, where the latter rises, so will the former. Where a country has a trade surplus, the extra demand for its exports will increase the value of its currency and therefore make its exports more expensive and its imports cheaper. This, in turn, will reduce the surplus, as demand for exports goes down in response to their relatively higher cost, whereas demand for imports goes up due to their relatively lower cost. In theory, an equilibrium will eventually be reached where trade and payments are balanced at a given exchange rate.

This 'market equilibrium'² view of exchange rates and the balance of payments is fundamental to understanding the interface between the legal order of international trade and the international monetary system. The post-war Bretton Woods arrangements contemplated a system of fixed exchange rates tied to the gold standard. Under this system, a country would in theory be required to hold sufficient reserves of gold to back the quantity of its currency in circulation. Where a temporary imbalance of payments occurred (i.e. where a country could not meet payments for imports with its receipts of foreign currency from export sales without selling gold for foreign currency), this would be financed by a country borrowing from the International Monetary Fund.³ In the case of a structural or persistent imbalance, a country would devalue its currency under the supervision of the IMF, which might recommend domestic policy adjustments to ensure

that further devaluations were not required in order to maintain the balance of payments.⁴ In the case of a country running a persistent trade surplus, foreign demand for its currency, i.e. by purchasers of its exports, would eventually exceed the amount of its currency that could be backed by gold reserves, therefore calling for a revaluation of the exchange rate and/or domestic policy changes to dampen exports and/or boost imports.

Paul Volcker has said of the Bretton Woods system of IMF-managed fixed exchange rates: 'The irony is that no sooner did it become mechanically operative than worries about its sustainability began. Nor was it purely a coincidence that the first sign of stress appeared about the same time the system began to blossom.'⁵ When the European currencies became convertible in the 1950s, the United States was running an enormous trade surplus with its trading partners. However, this was balanced by large outflows of dollars in the form of development assistance to Europe and Japan. As the European and Japanese economies began to recover, the US trade surplus started to decline, while outflows of US currency due to foreign aid and investment continued to increase. By 1960, the United States no longer had sufficient gold reserves to cover all of the dollar holdings abroad, and for the first time there was a crisis of confidence in the US dollar. During the 1960s, and particularly in the early 1970s, the Johnson and Nixon Administrations, respectively, largely refused—contrary to what was contemplated by the founders of Bretton Woods—either to devalue the dollar or to alter US domestic policies so as to reduce the payments deficit. Devaluation would have increased the costs of foreign borrowing to finance the Vietnam War, and the appropriate domestic policy changes (tighter macroeconomic policies to dampen US consumer demand for imports) were considered politically unfeasible. At the same time, Germany and Japan did not wish to revalue *their* currencies, since this would dampen trade expansion by making exports from these countries to the United States more expensive. Finally, in 1971 the United States unilaterally refused to back the dollar with gold any longer, and proposed that a new system of floating exchange rates be negotiated to replace the Bretton Woods system. The dominant position of the United States in the world economy, as well as the extent of foreign dollar holdings, permitted this unilateralism. In effect, if other countries did not agree to the new system, the crisis in confidence in the dollar would be disastrous for them as well as the United States, since their dollar holdings were enormous and their exports to the United States were a very important source of economic growth. Although between 1971 and 1973 an attempt was made to manage floating rates within a fixed margin or band, by the mid-1970s any attempt at multilateral management of exchange rates was abandoned, although since then there have been occasional negotiated realignments of exchange rates through central bank intervention on the currency markets and through some coordinated adjustment of domestic policies among the major monetary powers, the so-called G-7 (e.g. the Plaza Agreement of 1985 and the Louvre Accord of 1987).⁶

What are the implications for the international trading order of the key relationships between trade, exchange rates and the balance of payments as they have played themselves out in the post-war period under both fixed and floating rate systems?

First of all, while a decline in the exchange rate seems a logical way to correct a trade deficit (i.e. by making imports more costly and exports less costly), this may be not without significant cost to other pressing domestic policy objectives. In many instances, higher costs for imports may have socially unacceptable effects—for instance, in the case

of developing countries, a falling exchange rate could make imported medicines, foodstuffs and other essential requirements prohibitively expensive. More generally, as Fisher notes, 'a depreciation directly affects domestic inflation by raising the prices of imports. Further by increasing the profitability of exports and increasing aggregate demand, depreciation affects wage claims and thereby indirectly increases the inflation rate.'⁷ On the other hand, in the case of a country that is running a trade surplus, an appreciation in the value of its currency will lead to unemployment at least in the short run, as sales of exports decline and imports increase—a consequence that may be politically unacceptable.

These are just two illustrations of why countries may be unprepared to accept adjustments to exchange rates in order to move towards a balance of payments equilibrium. A further concern, however, is *liquidity*. Even if countries were prepared to accept the domestic consequences of the indicated adjustments, there is, of course, an assumption that until the adjustment takes place, the country running the deficit in trade will have sufficient reserves of wealth, such as gold or the currency of its trading partners, to meet demands for currency to purchase imports that exceed its foreign currency receipts from exports.

Where liquidity is thin, an imbalance of payments inevitably leads either to import restrictions or to limits on the convertibility of currency (exchange controls). Both such measures represent a fundamental threat to liberal trade, and yet may be seen as an unavoidable outcome of free trade between countries that lack reserves of foreign currency or gold.

An equally fundamental challenge to liberal trade is the presence of a variety of factors quite apart from the trade balance that affect exchange rates, such as the movement of capital across national boundaries for investment reasons, remittances of expatriate workers and speculation on the future value of currencies by currency traders. Taken together, the implication of these figures is clear; today the bulk of foreign exchange transactions is not accounted for by payment for traded goods.⁸

Indeed, it has been suggested that comparative advantage in trade can easily be wiped out, at least in the short run, by changes in exchange rates due to these non-trade factors.⁹ There are several dimensions to the problem. The first is that the *volatility* of floating exchange rates threatens to upset the cost and price calculations of exporters and importers, making trade more risky than purely domestic economic activity that does not involve exchange of currencies. The second, mentioned above, is that non-trade domestic macroeconomic objectives, such as the control of inflation, may deter a country from adjusting its currency so as to permit the achievement of an equilibrium in trade. Lack of macroeconomic policy coordination between major currency countries can thus place considerable strain on the commitment to liberal trade (this is often referred to as the problem of misalignment).

Third, the actual experience of the United States in the mid-1980s, when it allowed the dollar to fall in order to redress its trade deficit, puts in question whether Hume's equilibrium theory still applies in contemporary circumstances. Briefly, an apparently substantial decline in the value of the dollar did not result, even after the required time period for adjustment in consumers' expectations, in a significant reduction in the US trade deficit.¹⁰ Among the reasons often given is that upward pressure on the dollar from high US interest rates (a reflection of the financing requirements of the US budget deficit)

made it virtually impossible for the dollar to fall to the point where adjustment in the prices of US imports and exports respectively would lead to an elimination, or significant reduction, of the trade deficit.¹¹

It is sometimes argued that a return to fixed exchange rates (where governments determine exchange rates in accordance with economic fundamentals) would help to resolve the instability and imbalance in trade attributable to floating rates. However, in the past, fixed exchange rates co-existed with a financial system where private actors did not trade currency except, largely, to pay for imports and exports. A return to fixed or managed rates would probably entail a reimposition of exchange controls, at least on the capital account (thereby entailing a retreat from the globalization of capital markets). As was demonstrated in the crisis in the European Monetary System in 1992–93 (discussed later in this chapter), even an open-ended commitment by governments to intervene in the markets to sustain fixed rates in the presence of market forces that threaten to destabilize them may not be enough under conditions of free capital flows, where speculators are free to make their own assessment of the credibility and sustainability of these interventions.

A final challenge to liberal trade is much more straightforward—the *substitutability* of currency restrictions for protectionism. Imposing a quota or tax on the sale of foreign currency to purchase an import is likely to have a similar protectionist impact to imposing a quota or tariff on the import of the product itself. Effectively maintaining bargains about the elimination or reduction of tariffs and quotas, therefore, also implies some rules to constrain parallel currency measures. A different but related issue is that of *transaction costs* on trade that occur due to government policies that are not motivated by protectionism (for instance, requirements that foreign exchange transactions be reported to the authorities).

Having sketched in brief some of the key relationships between trade and money, and the challenges they present to maintenance of liberal trade, we turn to the legal rules that have been devised to deal with these various challenges.

LIQUIDITY, ADJUSTMENT AND SUBSTITUTABILITY

Liquidity was viewed from the outset of the Bretton Woods system as a fundamental challenge. Few countries had the reserves necessary to be able to wait until a devaluation brought imports and exports back into balance. Therefore, the system had to be designed to permit temporary imposition of both trade restrictions and currency controls in order to manage a balance of payments crisis. At the same time, it was important to ensure that these measures were temporary and did not lead to permanent protectionism. This would involve supervision of a process of domestic policy adjustment with a view to the balancing of exports and imports, encompassing domestic policy reforms and/or including exchange rate adjustment.

The legal rules of both the GATT and the IMF, and the institutions of the latter, were designed to reflect this approach to liquidity.

The GATT

Articles XII to XIV of the GATT elaborate a complex code designed to govern and discipline the use of trade restrictions for balance of payments purposes. Article XII:1 states the basic right of any Contracting Party to impose quantitative restrictions in derogation from Article XI 'in order to safeguard its external financial position and its balance of payments'. Article XII:2 establishes that such restrictions shall be limited to what is 'necessary: (i) to forestall the imminent threat of, or to stop, a serious decline in monetary reserves, or (ii) in the case of a Contracting Party with very low monetary reserves to achieve a reasonable rate of increase in its reserves'. As well, such restrictions must be progressively relaxed as the balance of payments improves.

Furthermore, Contracting Parties 'undertake, in carrying out their domestic policies, to pay due regard to the need for maintaining or restoring equilibrium in their balance of payments on a sound and lasting basis' (XII:3). At the same time, no Contracting Party is obligated to take domestic balance of payments measures that would threaten the objective of full employment (i.e. contracting the domestic money supply to dampen demand for imports, XII:3(d)). A process of consultations is envisaged with the GATT Council concerning any new restrictions or increase in restrictions, with periodic review of the necessity of the trade measures and their consistency with Articles XII–XIV. In addition, Article XII contains provisions on dispute settlement, including the authorization of retaliation where a Party persists in trade restrictions that have been found by the Contracting Parties to violate the GATT. Articles XIII and XIV contain respectively the requirement that measures taken pursuant to Article XII:1 be implemented on a non-discriminatory basis and certain narrow exceptions to this non-discrimination requirement, e.g. where discriminatory exchange controls have been authorized by the IMF (see the discussion of substitutability below).

In the case of developing countries, there is a much broader exemption for balance of payments-based trade restrictions. Hence, Article XVII:2(b) states the principle that developing countries should have additional flexibility 'to apply quantitative restrictions for balance of payments purposes in a manner which takes full account of the continued high level of demand for imports likely to be generated by their programmes of economic development'. What this suggests is that even though a developing country could address its balance of payments difficulties through exchange rate adjustments or tighter macroeconomic policies, it should not be expected to do so given the harm to development that may come from the resultant decline in needed imports. It is recognized that quantitative restrictions will allow a developing country to conserve its limited foreign currency resources for purchases of imports necessary for development—whereas an exchange rate devaluation would result in *all* imports becoming more expensive. In this connection, it bears emphasis that balance of payments restrictions in general may be discriminatory with respect to products although not with respect to countries. Indeed, it is explicitly stated that 'the contracting party may determine (the) incidence (of restrictions) on imports of different products or classes of products in such a way as to give priority to the importation of those products which are more essential in the light of its policy of economic development' (XVIII:B(10)). Finally, Article XV:2 provides for deference to the IMF in the determination of what constitutes a balance of payments

crisis as well as other financial issues involved in the application of Articles XII and XVIII.

There have been few invocations of Article XII by developed countries since the 1960s.¹² One of the most anomalous features of Article XII is its application to quantitative restrictions exclusively, rather than to reimposition of tariffs (as contemplated by Article XIX safeguards against import surges, for example). Perhaps this exclusive emphasis on quantitative restrictions may be in part explained by the assumption that reimposition of tariffs would not operate rapidly enough to stem a drain on foreign exchange reserves. In the event, Contracting Parties turned out to be *more* inclined to use import surcharges (i.e. tariff-like measures) than to invoke Article XII explicitly in response to balance of payments difficulties. In some cases, the surcharges were made consistent with the GATT through an explicit waiver. In others, they were simply tolerated as a kind of *de facto* expansion of Article XII.¹³

Finally, in 1979 the Contracting Parties, without formally amending the General Agreement, made the 'Declaration on Trade Measures taken for Balance-of-Payments Purposes',¹⁴ which expanded the ambit of Articles XII–XIV and XVIII beyond quantitative restrictions to include 'all import measures taken for balance of payments purposes'. The Declaration also imposes an obligation on Contracting Parties taking such measures to 'give preference to the measure least restrictive of trade', which, as Petersmann suggests, would usually involve a preference for tariffs and surcharges over the quantitative restrictions explicitly mentioned in Article XII.¹⁵

Through much of the history of the GATT, balance of payments-based trade restrictions were not subject to much direct scrutiny. Developing countries, in particular, made liberal use of such restrictions. However, by the mid-1980s, the increasing invocation of these restrictions in the wake of the less-developed country (LDC) debt crisis, combined with a new emphasis on the importance of trade liberalization to development in more recent thinking on the subject, had led to increasing concern, particularly on the part of the United States and some other developed countries.¹⁶ Another, in some sense almost opposite, source of concern was the continued maintenance of restrictions by countries that were growing rapidly, e.g. the Asian NICs. Thus, in a 1989 case, the United States complained that South Korea continued to impose Article XVIII B restrictions on imports of beef despite improvements in its balance of payments position.¹⁷ The approach of the GATT panel was quite straightforward—it deferred to the conclusion of the GATT Balance of Payments Committee, in its 1987 consultation with Korea, that the country's current and prospective balance of payments was such that continued restrictions could not be justified. The Committee in turn had acted on the advice of the IMF, in accordance with Article XV:2.

The Understanding on the Balance of Payments Provisions of the General Agreement on Tariffs and Trade 1994, incorporated in the Uruguay Round Final Act, is aimed at improving GATT/WTO discipline of trade measures taken for balance of payments purposes. Members commit themselves to publish, as soon as possible, time-schedules for the removal of such trade measures. Such schedules may, however, be modified 'to take into account changes in the balance-of-payments situation' (Article 1). Furthermore (and perhaps the most important modification of the existing GATT regime), Members commit themselves to give preference to trade measures of a price-based nature, such as tariff surcharges, and to only resort to new quantitative restrictions where 'because of a

critical balance-of-payments situation, price-based measures cannot arrest a sharp deterioration in the external payments position' (Articles 2, 3). The Understanding further sets out an elaborate set of procedures for review by the Committee for Balance-of-Payments Restrictions of both the time-schedules for elimination of existing restrictions and notifications of any new restrictions. The overall intent appears to be that of placing balance of payments trade restrictions under ongoing scrutiny, with a view to their elimination as soon as possible. This is consistent with the original GATT regime, where such restrictions are envisaged as temporary, and not an appropriate longer-term solution to payments imbalances. It is also, however, something of a retreat from the more permissive approach to such restrictions reflected in the Tokyo Round declaration.

Pursuant to the Understanding, on 31 January 1995, the WTO General Council established the WTO Committee on Balance-of-Payments Restrictions.¹⁸ From its inception through 2004, the Committee has conducted consultations with numerous Members¹⁹ concerning the existence and possible reduction and phase-out of their balance of payments restrictions, including Brazil, South Africa, Slovakia, Poland, Sri Lanka, India, Egypt, Turkey, Tunisia, Hungary, Nigeria, Bangladesh, the Philippines, the Czech Republic, Bulgaria and Pakistan. In most cases, Members made commitments to eliminate or reduce the restrictions in question, which satisfied the Committee. In some instances, with respect for example to India and Tunisia, there was some controversy within the Committee itself as to how rapidly the balance of payments situation of the country would reasonably permit the removal of measures. In other instances, such as Bangladesh and Romania, the precariousness of the balance of payments situation was easily agreed in the Committee. In several cases, including those of Hungary, the Czech Republic and Brazil, the Committee considered new measures introduced by Members. The Czech measure, a requirement that importers post a deposit that does not bear interest, was regarded by a majority of the Committee as inappropriate, and was eliminated a month after the Committee made this observation.

The Asian and Latin American financial crises of the 1990s, remarkably, did not lead to widespread imposition of trade restrictions as a response to financial instability and its consequences, such as excess capacity and high unemployment. A report of the WTO Secretariat notes: 'Fears that the financial crisis would provoke a *trade protectionist backlash*, either in the crisis-hit countries and/or in their major trading partners, proved to be largely unfounded. Aside from a few tariff increases in Thailand and Malaysia, the crisis-hit countries themselves did not view trade restriction as a useful contribution to their immediate problems.'²⁰

In general, the Balance of Payments (BOP) Committee appears to be an effective vehicle for scrutinizing balance of payments restrictions, although equally clearly there are differences of view on how to interpret situations where the Member's economy has been subject to rapid change.

The failure, however, of the Committee to agree as to its approach with regard to India led to a path-breaking dispute settlement case, where the United States challenged India's continued use of balance of payments-based trade restrictions, claiming violations of the GATT and the BOP Understanding. A key threshold issue was the relationship between the mandate of the BOP Committee and the jurisdiction of the WTO dispute settlement organs; India argued that, given the explicit role of the Committee in the surveillance of the challenged measures, the dispute panel should defer to that process. The panel below

found that the competence of the BOP Committee and that of the panel were not mutually exclusive in these matters. India appealed this finding.

The Appellate Body (AB) first observed, in disposing of this appeal that, according to Article 1.1 of the Dispute Settlement Understanding (DSU), the dispute settlement procedures in the DSU apply generally to disputes brought under the dispute settlement provisions of the covered agreements (in this case Article XXIII of the 1994 GATT), and that furthermore the DSU rules and procedures are subject only to special or additional rules identified in agreements as listed in Appendix 2 of the DSU. The AB noted that Appendix 2 does not identify any special or additional rules or procedures relating to balance of payments restrictions' (para. 86). In particular, it did not mention Article XVIII:B of the GATT, which calls for review by the CONTRACTING PARTIES of balance of payments restrictions maintained on the basis of developmental considerations set out in XVIII:B. Thus, one could not infer any limitation on the rights of access to dispute settlement under the DSU, or on the competence of panels to interpret and apply the balance of payments provisions of the GATT, from the grant of competence to review XVIII:B justifications for such restrictions to the CONTRACTING PARTIES.

India, however, also argued that GATT practice with respect to Article XXIII precluded access to dispute settlement for balance of payments purposes. Since Article XXIII is the very basis on which DSU procedures may be invoked in the case of the GATT, practice with respect to Article XXIII of the GATT is relevant to the ultimate scope and limits of authority of panels and the AB when they are applying the GATT. Here, however, whatever pre-existing GATT practice existed in this matter was codified and perhaps also modified by the BOP Understanding negotiated in the Uruguay Round. The second sentence of footnote 1 to the BOP Understanding reads: '[t]he provisions of Articles XXII and XXIII of GATT 1994 as elaborated and applied by the Dispute Settlement Understanding may be invoked with respect to any matters arising from the application of restrictive import measures taken for balance-of-payments purposes'. Here, India argued that the expression 'application' somehow limited the competence of the dispute settlement organs in balance of payments disputes, in favour of that of the Membership, sitting as the BOP Committee. The distinction that India drew was between disputes about the 'application' of balance of payments measures and those that concerned the substantive justification of the measures. The AB, however, held that the use of the word 'application' merely reflected 'traditional GATT doctrine that, with the exception of mandatory rules, only measures that are effectively applied can be the subject of dispute settlement proceedings' (para. 93).

But, at first glance, this very interpretation would seem to risk reducing the word to complete inutility—as *that* much, the AB is saying, has already been established by GATT practice. However, the BOP Understanding is intended to 'clarify' Articles XII and XVIII:B of the GATT. Such clarifications provide greater legal certainty and security, but will amount in large measure to restatements of what a sound treaty interpreter would already find to exist in the *status quo*. The assumption in treaty interpretation developed in *Reformulated Gasoline* and subsequent cases that each treaty provision should be assumed to have a discrete, non-redundant legal meaning may have to be modified in cases where the text being interpreted is an understanding that clarifies and largely affirms other, existing legal provisions.

The problem with the AB's reading is, however, with the semantic structure of the footnote. The footnote first asserts that '[n]othing in this Understanding is intended to modify the rights and obligations of Members under Articles XII or XVIII:B of GATT 1994'. The footnote then goes on to express the situation with respect to Articles XX and XXIII of the GATT in terms of the right to invoke these procedures in matters arising from the application of balance of payments measures. Now if, as the AB suggests, the effect is simply to confirm existing rights under Article XXIII, then why was Article XXIII not added to the list of GATT provisions containing rights and obligations that the BOP Understanding is not intended to modify?

The AB's interpretation of the word 'application' is also undermined by the structure of Article XVIII:B of the GATT itself. XVIII:B (9) contains the criteria for justification of balance of payments measures under XVIII:B, while XVIII:B (10) states certain conditions that a Member must adhere to in the application of its balance of payments measures, even if they are justified under XVIII:B (9). Thus, the relationship between XVIII:B (9) and XVIII:B (10) is not dissimilar to the relationship between the various lettered paragraphs of Article XX and the *chapeau*. Thus, the most obvious interpretation of 'application' in the footnote is that the BOP Understanding modifies rights and obligations under Article XXIII of the GATT to the extent that it limits dispute settlement action under XXIII to claims that the *application* of balance of payments measures is inconsistent with the criteria for such application contained in XVIII:B (10), which would be consistent with exclusive competence for the BOP Committee with respect to review of justification of such measures under XVIII:B (9).

Despite all this, there may be good legal reasons why the AB came to the conclusion that footnote 1, second sentence, of the BOP Understanding does not oust the jurisdiction of the dispute settlement organs to consider complaints related to the justification of balance of payments measures under XVIII:B (9). As the AB noted, the DSU itself purports to provide transparency with respect to any special procedures that might apply so as to modify or supplement DSU procedures in the case of particular covered agreements, and the BOP Agreement is not on the list. Article 3.2 of the DSU provides, in part, that '[t]he dispute settlement system of the WTO is a central element in providing security and predictability to the multilateral trading system'. Article 23.1 of the DSU provides that redress of a violation of obligations or other nullification and impairment of benefits *must* be had through DSU procedures. Whatever the best ordinary-language interpretation of the word 'application' in the context of Article XVIII, there is a certain overall implausibility to the notion that, in the absence of any explicitly *restrictive* language, a footnote in an Understanding interpreting Article XVIII of the GATT could alter another, more fundamental and general provision of the GATT so as to qualify such basic provisions of the DSU as Article 23.1. Thus, the *broader* interpretive context supports the reading of the AB.

India, however, made a further argument that the 'institutional balance' in the WTO would be undermined if the dispute settlement organs were not to defer to the competence of the BOP Committee with respect to the justification of balance of payments measures. The AB's rejection of this argument has been criticized *in extenso* by Dr Frieder Roessler.²¹ Dr Roessler concedes that the AB may be right that access to dispute settlement to adjudicate the justification of balance of payments measures does

not, formally, undermine the competence of the BOP Committee to examine the justification of such measures. Nevertheless,

the legal alternatives formally available in one forum can be curtailed, or even reduced to inutility, by the creation of new legal opportunities in another. It is obvious that the process of reaching a consensus in the BOP Committee, as in any other WTO body, takes place in the shadow of the procedural alternatives available in the absence of a consensus and that these alternatives can effectively dictate the outcome of the process.

This tends to raise the question of the correct balance. Under consensus decisionmaking in the BOP Committee, a single WTO Member can block a decision concerning the interpretation and application of Article XVIII of the GATT. In the presence of such blockage, it would indeed seem to undermine institutional balance in the WTO to prevent the dispute settlement organs from acting to apply and interpret the law. The implication of Roessler's suggestion that the dispute settlement organs desist in the presence of inaction by the BOP Committee is that a single Member of the WTO could, in effect, impede the application of the law altogether. The automaticity of adoption of panel reports, as well as the clear statement of rights to dispute settlement, in the WTO DSU testify to the increasing unacceptability of such a situation under the older GATT system, and to the resolve to create a very different kind of institutional balance in the new WTO system.

Where the BOP Committee has *acted* by consensus, that is another matter—here Dr Roessler is surely right that there would be a strong case for the panels and the AB to be deferential to its views. But these views would likely amount to 'subsequent practice' among the parties, within the meaning of Vienna Convention 31, and so the requisite institutional balance can be achieved through the dispute settlement organs simply applying the treaties in accordance with the customary rules of interpretation of international law. No special doctrine of restraint or deference is necessary. Moreover, Dr Roessler's view of institutional balance is influenced by his assumption that 'the rulings of the [Dispute Settlement Body] emerge from a proceeding in which only the facts and claims submitted by the parties to the dispute are considered and the results of which are binding only on the parties to the dispute'. As we have seen, in our discussion of the *amicus* issue, the first part of this statement is not strictly true. There is no difficulty, through the *amicus* procedure, with the panels or AB considering information from or views of the IMF, nor—as might in some situations be even more appropriate—of various UN entities or organizations such as the United Nations Conference on Trade and Development (UNCTAD).

While Articles XII–XIV and XVIII of the General Agreement deal with trade restrictions taken to address a balance of payments crisis, Article XV concerns the trade effects of currency and other monetary restrictions. Here a fundamental concern is the substitutability of exchange measures for trade restrictions. Thus, Article XV:4 states that Contracting Parties shall not 'by exchange action frustrate the intent of the provisions of this Agreement, nor, by trade action, the intent of the provisions of the International Monetary Fund'. Contracting Parties are required to obtain membership in the IMF, or, alternatively, to negotiate a 'special exchange arrangement' with the GATT. Article

XV:4 is subject to the proviso that any exchange measures explicitly authorized by the IMF are to be considered consistent with the General Agreement (XV: 9). In the *Cigarettes* case (*Dominican Republic-Measures Affecting the Importation and Internal Sale of Cigarettes*, WT/DS302/R, Report of the Panel, November 26, 2004), the Dominican Republic argued that a foreign exchange fee it charged on imported cigarettes, among other products, was an exchange restriction within the meaning of XV:9(a) and therefore justified even if the measure would otherwise be a violation of Article II of the GATT. The panel rejected this defense on two grounds: first of all, as it was currently operated (as opposed to the original design), the exchange fee measure applied only to importation, and not other kinds of foreign exchange transactions, and was no longer a limitation on the availability or use of currency as such; thus, the measure was no longer a genuine exchange control, but rather in essence a charge on imports; secondly, the IMF had confirmed to a panel (through a letter from the general counsel) that in its view the measure was no longer an exchange control subject to approval by the Fund.

Following close upon its accession to the WTO, the exchange rate practices of China have been subject to intense scrutiny and criticism, with some economists, and industry and worker interests in the United States, claiming that China has been manipulating the exchange rate of its currency with the US dollar in order to maintain or enhance the competitiveness of its exports, in alleged contravention of GATT Article XV and related IMF rules (see below). While China was required to move towards convertibility in current account transactions upon joining the IMF in 1995, it has nevertheless attempted to maintain a rough 'peg' with the US dollar through large-scale intervention in the currency markets. This is the practice that is viewed by critiques as 'manipulation'. The claim is that, but for this intervention, the widening trade imbalance between the USA and China, along with other factors, would have naturally led to a significant strengthening of the Chinese currency as against the dollar. According to congressional testimony of a representative of the Manufacturers' Alliance/MAPI, purchases of foreign exchange by the Chinese central bank between 2001 and 2003 showed a sharp upward increase, from US\$3.8 billion in 2001 to US\$10 billion by July 2003, a scale of purchases claimed to be without precedent in the IMF's 60-year history (although closely matched by similar behaviour by Japan over that same time frame).²²

The Bush Administration, while putting pressure on the Chinese regime to revalue the yuan, has so far steered clear of claiming that China is in technical violation of its WTO obligations. A recent report of the US Treasury Department noted:

The Administration has engaged in direct talks calling on the Chinese to move towards a flexible exchange regime. The Administration has utilized bilateral and multilateral forums to urge China to move toward greater flexibility. At the September 2003 G7 meeting in Dubai, the ministers and central bank governors endorsed flexibility in exchange rates for large economies. Secretary Snow traveled to China for discussions with senior Chinese officials on financial issues including exchange rate policy. President Bush, in his bilateral meeting with President Hu, discussed China's exchange rate policy. China has maintained its fixed exchange rate despite significant changes—up and down—in the exchange rate of

the dollar vis-à-vis other currencies. Recently there has been strong pressure on the yuan, as evidenced by foreign exchange reserves rising to \$346 billion in June 2003, up 43 percent from June 2002. The Chinese government has indicated that it will move to a flexible exchange rate regime. It is taking steps to get there and the U.S. is providing technical cooperation. However, it also has stated that doing so immediately would harm the banking system and the overall Chinese economy.²³

It has been suggested by some in Congress that Chinese exchange rate policies may constitute a countervailable subsidy.²⁴ However, the definition of 'subsidy' in the WTO Subsidies and Countervailing Measures (SCM) Agreement (see Chapter 9 on subsidies and countervailing duties) includes a requirement that there be a 'financial contribution' by government to an industry or firm, not only the conferral of a competitive 'benefit'; exchange rate policies do not appear to conform to any of the meanings of financial contribution stipulated in the SCM Agreement. Moreover, China's exchange rate policy applies to the entire Chinese economy and therefore would be unlikely to be considered 'specific' and, under both US and WTO law only 'specific' subsidies may be countervailed.

Reflecting developing, country concerns about the effects of financial crises, external debt, and IMF policies on trade-driven growth and development, a WTO Working Group on Trade, Debt and Finance was established at the 4th Ministerial Conference in Doha in November 2001, with the following mandate:

We agree to an examination, in a Working Group under the auspices of the General Council, of the relationship between trade, debt and finance, and of any possible recommendations on steps that might be taken within the mandate and competence of the WTO to enhance the capacity of the multilateral trading system to contribute to a durable solution to the problem of external indebtedness of developing and least-developed countries, and to strengthen the coherence of international trade and financial policies, with a view to safeguarding the multilateral trading system from the effects of financial and monetary instability. The General Council shall report to the Fifth Session of the Ministerial Conference on progress in the examination.

This report, formally tabled at the Cancun Ministerial in September 2003, had as its basis the Working Group's own report to the General Council of 11 July 2003, which merely identified a number of 'themes' for ongoing study and examination, namely the effect of the deterioration of the terms of trade on the ability of debtor countries to service their debt, and the need for greater access to facilities for export financing, as well as the issue of coordination and coherence between the WTO and other relevant international institutions including the international financial institutions.²⁵

The matter of adequate export financing raised in the report has direct implications for WTO rules. Here the concern, discussed at length in a later discussion paper of the Secretariat is that, as a consequence of financial crises and indebtedness, many countries have been left with a shortage of private funding for export financing, which is necessary

for most export transactions, since there is usually a time gap between the buyer ordering the goods and paying for them; this in turn limits the ability of those countries to use exports as a means of restarting or increasing growth and a source of revenue for debt financing.²⁶

The public provision of export financing, even short-term instruments, may, however, easily run afoul of WTO prohibitions on export subsidies (see Chapter 9 on subsidies and countervailing duties, and particularly the discussion there of the dispute between Canada and Brazil on financing of civil aircraft transactions). One solution, discussed in the Secretariat paper, is that export financing be provided by multilateral development banks and institutions, since these entities (as opposed to WTO Members) are not, apparently, bound by the WTO subsidies rules (p. 12). However, the paper acknowledges that this view of the SCM Agreement is one held only by 'some Members' of the WTO. It also seems rather perverse to use multilateral institutions as a means of, effectively, circumventing WTO rules, rather than making changes to the rules themselves, which would permit governments to provide short-term export financing on a non-discriminatory basis, even in situations where profit-maximizing private actors would not do so, given the risks associated with financial crisis conditions.

The IMF

The IMF Articles of Agreement provide that an IMF Member shall not 'manipulate exchange rates or the international monetary system in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members' (IMF Agreement Article IV, Section 1(iii)). Currency manipulation as such is defined in the surveillance provisions of the IMF Articles as 'protracted large-scale intervention in one direction in the exchange market'. This does correspond to the pattern of accelerating Chinese purchases of foreign currency noted by critics of China's exchange rate policy. However, it remains to be determined if this 'manipulation' is 'to gain an *unfair* competitive advantage' (emphasis added). IMF law and practice are not illuminating on the meaning of unfairness. Denters suggests that Chinese exchange rate policies may be aimed at creating or sustaining a favourable climate for foreign investment, by limiting the currency risk that investors face.²⁷

The provisions of Article XV of the GATT, taken together, suggest considerable reliance on the IMF to ensure an open payments system that sustains liberal trade. At the time the General Agreement was negotiated and came into effect, however, currency controls were pervasive not only in developing but also in most developed countries. As mentioned earlier in this chapter, the Bretton Woods system was designed in such a way as to permit countries eventually to stabilize their balance of payments without resort to such measures, through lending from the IMF's own resources to sustain liquidity, and through Fund-approved adjustments of exchange rates in connection with appropriate domestic policy reforms. However, it was considered that this state of affairs would not occur, for most countries, until after a considerable transition period.

Countries were therefore provided with an option of accepting the full convertibility obligations of Article VIII of the Fund Articles of Agreement, or joining the Fund through the transitional provisions of Article XIV of the Articles of Agreement. Even the

convertibility obligations of Article VIII still permitted a member of the Fund to impose exchange controls with Fund approval.

Thus, Article VIII:2(a) prohibits 'restrictions on the making of payments and transfers for current international transactions' without Fund approval. The expression 'current international transactions' certainly encompasses all import or export sales, but does not include, for example, many forms of foreign investment, securities transactions, etc. In this respect, it is important to note that most developed countries maintained, consistent with Article VIII, restrictions and controls on the *capital* account until the 1980s.²⁸ Article VIII does not provide any explicit criteria for the authorization of current account restrictions by the Fund, nor does any other provision of the IMF Articles.²⁹ Article XIV allows a Member of the Fund to impose exchange restrictions in 'the post-war transitional period' provided the Member declares to the Fund its intent to do so. The Fund may decide that any such measure is no longer necessary, i.e. that the transition period has elapsed, but must in the first instance give the Member country 'the benefit of the doubt' (Article XIV:5).

Particularly during the LDC debt crisis, the Fund played an important role in sustaining liquidity in LDC debtor countries and preventing the economic collapse of the debtor states. However, the Fund insisted on macroeconomic and trade policy reforms as a condition for liquidity assistance, thereby forcing painful domestic adjustment as the appropriate response to the crisis in the balance of payments. Similarly, today the Fund encourages the newly liberalizing countries (NLCs) of Central and Eastern Europe to move rapidly towards liberalization of trade and payments. Much of Western assistance is premised on the need for liquidity support to underpin these rapid policy shifts. However, liquidity is only part of the problem—the domestic adjustment costs are the other part and these can be enormous.

Interaction between the GATT and IMF rules

A number of legal issues have arisen concerning interaction between GATT rules on trade restrictions for balance of payments purposes and IMF rules concerning exchange controls and monetary restrictions. One such issue is the characterization of measures that can be plausibly viewed as one or the other. This issue was raised but not resolved by a GATT panel in a 1952 case that involved a Greek tax on foreign exchange for imports, which varied depending on 'the usefulness and necessity of the products imported'.³⁰ Eventually, largely through a decision of the IMF Directors, it was clarified that a measure will be considered an exchange restriction if the *technique* used involves restricting access to foreign exchange, even though the principal intent and effect is to restrict imports.³¹ Under this approach, the Greek tax would have been deemed an exchange restriction and therefore subject to IMF as opposed to GATT discipline, despite the fact that it was quite directly targeted at imports.

There is some evidence that Contracting Parties have sought to minimize IMF scrutiny of *trade* measures, by advocating a narrow interpretation of Article XV: 4, which would limit the IMF's role to that of providing statistical findings concerning a balance of payments crisis.³² However, in the *Korean Beef Import* case discussed above, a GATT panel took a more expansive view of the IMF's role, deferring to a finding based not just on facts provided by the IMF, but also on the Fund's 'advice'. In addition, as noted

above, the IMF itself, as a condition of assistance, may well impose a requirement that trade restrictions, not just exchange restrictions, be lifted. The overall effect of these developments is that today, whether a Contracting Party chooses to enact trade restrictions or currency measures to address a balance of payments crisis, it will find its actions subject to a similar level and kind of scrutiny by the IMF.

In the *India—Balance of Payments* dispute, discussed above, the panel relied extensively upon advice from the IMF in determining that India's measures could no longer be justified under the balance of payments provisions of the GATT. India had argued that it could maintain its measures because GATT Article XVIII:11 stipulates that no Member shall be required to withdraw its balance of payments-based trade restrictions if the case for doing so is premised on the notion that if the Member changes its 'development policy', it can manage its balance of payments problems without recourse to trade measures. The panel gave short shrift to India's argument on the basis that the IMF had determined that India's balance of payments difficulties could be managed through macroeconomic reforms and did not entail any change to its development policy.

The AB upheld the manner in which the panel deferred to the IMF on the issue of what India could do to manage its balance of payments difficulties without continuing recourse to trade measures. This deference to the Fund is not entirely unproblematic. First of all, as already noted, GATT Article XV:4 stipulates deference to the IMF only in factual or statistical matters. Here, the panel appears to have simply assumed that the normative policy judgments of the IMF—which have been subject to enormous criticism and controversy in recent years—were an adequate and legitimate benchmark for evaluating India's behaviour. Second, the distinction between macroeconomic measures and 'development policy' is one that is dubious to say the least. In fact, macroeconomic policy is the fundamental context for development, and the ability of a developing country to advance development through research, education, investment in technology and so forth will be directly affected by macroeconomic measures that affect levels of income, employment and government revenue. Finally, it is arguable that in understanding 'development policy', the panel should have solicited the views of international organizations such as UNCTAD that are deeply engaged in understanding the relationship between trade, finance and development policies.

The OECD Invisibles Code

The OECD Code on Liberalization of Current Invisible Transactions is intended to go beyond the obligations of Article VIII of the IMF Articles in seeking to eliminate all restrictions on 'current invisible transactions and transfers' between OECD Member Countries. Indeed, Members are encouraged to extend the benefit of the Code to all IMF members (Article I(d)). Whereas Article VIII of the Fund Articles applies only to restrictions on payments and transfers themselves, such as rationing of access to foreign currency, the Code applies also to taxes and charges, as well as administrative requirements imposed on the actual *transactions* required to make payments and transfers abroad. These measures fall between the cracks of the GATT and IMF rules, in that they neither apply to imports and exports of products nor directly restrict payments on the current account. Obligations under the OECD Code on Invisibles are subject to various

reservations filed by individual Member States. However, in recent years, reservations have been reduced and the Code strengthened.³³

VOLATILITY

As mentioned earlier in this chapter, the original Bretton Woods arrangements were intended to function with fixed exchange rates. A country would be permitted to adjust these fixed rates in order to correct 'a fundamental disequilibrium'.³⁴ The intent of these arrangements was that exchange rate changes would occur only occasionally and would be supervised by the IMF to ensure that they did not cause undue harm to the trading or other economic interests of other countries, i.e. that they reflected changes in the terms of trade rather than constituting an attempt unilaterally to alter those terms in favour of the devaluing country. Thus, a country would be permitted to devalue where its exports had been declining relative to imports, but not in order to create a trade surplus where its existing trade was not in disequilibrium (i.e. competitive, beggar-thy-neighbour exchange rate devaluations that characterized the inter-war period).

Under the system of floating rates that emerged in the 1970s after the collapse of the Bretton Woods fixed rate system, what determines exchange rates is supply and demand with respect to the various currencies. Central banks can and do intervene in the market to alter the value of their countries' currency, in accordance with domestic policy objectives. However, because currencies are no longer fixed in value as against a common, objective standard (such as the price of gold), or subject to adjustment only in accordance with internationally agreed criteria ('fundamental equilibrium'), volatility is much greater.

Blame is often placed on the US for undermining the fixed rate system and thereby introducing fundamental volatility into exchange rates.³⁵ However, greater volatility was arguably inevitable. With the terms of trade changing rapidly, and moreover with globalization of capital markets, enormous and rapid shifts in capital flows would have probably required very frequent adjustments to exchange rates even under a fixed rate system—or, alternately, curbs on globalization itself. As Spero notes, during the 1980s, 'most developed countries...abolished or relaxed exchange controls, opened domestic markets to foreign financial institutions, and removed domestic regulatory barriers. A revolution in telecommunications, information processing, and computer technologies made possible a vastly increased volume, speed, and global reach of financial transactions.'³⁶

Those who advocate a return to fixed rates with a view to addressing volatility and sustaining the gains from trade thus also tend to argue for deglobalization, and reimposition of controls on the import and export of capital.³⁷ However, this perspective fails to consider the extent to which liberalized capital flows themselves contribute to the expansion of trade through globalization of production (foreign direct investment), and the exploitation of comparative advantage in the financial services sector.

There is a serious empirical issue as to the extent to which exchange rate volatility has negatively affected trade.³⁸ Sophisticated actors on world markets can hedge the foreign exchange risk from their trade transactions by buying and selling in a variety of currencies, or by actively trading in currencies themselves. Nevertheless, these

possibilities are significantly less open to smaller traders, and there are always transaction costs entailed in the hedging of currency risks. In order to reduce volatility, it has been proposed that a tax be placed on foreign exchange transactions. The tax would be set low enough that it would not affect trade in goods and services but would impose a high cost on 'short term in-and-out transactions' of a speculative nature.³⁹ However, this kind of proposal presumes that speculation is the driving force behind exchange rate volatility—if, however, such volatility is endemic to globalized capital markets, then short-term transactions may be critical to hedging endemic foreign exchange risk, and therefore the tax may be fundamentally self-defeating.⁴⁰ In the *India-Balance of Payments* case, as noted above, the United States challenged India's decision to maintain imports restrictions on balance of payments grounds. The relevant exceptions provision in the GATT allowed such restrictions but required that they be removed as soon as the crisis conditions to which they were addressed had passed, unless the removal were likely to provoke the return of those conditions. But a further proviso was that, in any case, a developing country should not be required to remove balance-of-payments import restrictions, if doing so could require a change in that country's development policies.

India's reliance on this provision required the Appellate Body to determine what is a development policy and whether if India were to remove its balance-of-payments restrictions it would be required to change those policies. The Appellate Body did rely entirely on a judgment of the IMF that India did not need to change its development policies because it could address the consequences of removing its balance-of-payments-based import restrictions through 'macroeconomic' policing. We do not believe that the Appellate Body's deference to the IMF on the meaning of 'development policy' is justified by the text of the GATT; defining development is quite a different matter than the role of the Fund in statistical and exchange control matters as contemplated in Article XV. The notion that macroeconomic policy can be separated from development policy is itself an example of a contestable normative judgment about proper public policies—to say nothing of other considerations, macroeconomic policies may well determine the availability of revenues to fund pro-active development measures. In any case, it would have been more appropriate to consider the views of UNCTAD or the United Nations Development Programme (UNDP) on the appropriate meaning of 'development policy' in Article XVIII of the GATT.

MACROECONOMIC POLICY COORDINATION AND PROPOSALS FOR MANAGED EXCHANGE RATES

Under the system of fixed exchange rates that prevailed until 1971, changes in macroeconomic policies did not automatically result in changes to exchange rates and thereby did not directly affect the trade interests of other countries or the demand for protection in the country making the policy change. Under the system of flexible rates, however, no rules or institutions have been created for the international management and supervision of macroeconomic policies.

These policies continue to put considerable pressure on the liberal trading order. Occasionally, the G-7 countries, i.e. those nations with the major international currencies including the United States, Germany and Japan, have agreed on certain targets and

goals. More recently, Europe and Japan have expressed concern about the weakening of the US dollar against the euro and the yen, which has made European and Japanese exports to the United States more expensive.

Some economists—most notably John Williamson⁴¹—have developed proposals for targeting zones for exchange rates. This does not represent a return to fixed rates and strict domestic controls on the movement of capital. Rates are still set by supply and demand in the currency markets. Should, however, rates move outside the target zone, countries commit themselves,⁴² through central bank intervention and/or policy adjustments, to a return within the zone. This kind of solution seems to offer a number of advantages. First of all, unlike a return to fixed rates, it appears to avoid the kind of limits on financial market liberalization that would be entailed by the (re-)imposition of controls on capital movements or restrictions on the markets. In theory, at least, governments sustain the target zones not by constraining the markets but by playing them. Second, since the zones are established by some kind of objective standard, such as a current account target, i.e. what a country's account should look like given a number of external (e.g. trade) and internal (e.g. inflation) factors, the indeterminacy that characterizes open-ended discussions on policy coordination would appear to be avoided.

The problem is, as Cooper notes, that 'the setting of current account targets would be an intrinsically arbitrary exercise in a world of high capital mobility and open markets in goods and services'.⁴³ Given the multiplicity of reasons why money flows in and out of countries—investment, repatriation of earnings, capital market transactions such as the purchase and sale of bonds and other securities—how does one begin to determine the balance between inflows and outflows that a given country should maintain at a given point in time? A further difficulty, in the absence of exchange controls, is that governmental commitments to maintain the zones must be credible to speculators—otherwise governments will find themselves in the almost impossible position of fighting the expectations of the market. When speculators believe that governments' commitments to their domestic interests are sufficiently pressing that they will not be able to sustain in future their internationally agreed exchange rate targets, the collapse of the targets can easily become a self-fulfilling prophecy. In sum, without either a return to controls or a move forward to macroeconomic policy harmonization and the kind of supranational control of domestic policies envisaged in the Maastricht blueprint for European monetary union, 'coordination' is likely to remain at the level of a very occasional adjustment in rates which reflects a saw-off between conflicting interests of the major financial powers, or perhaps even more likely, the unilateral threat of protection from the USA if exchange rates are not adjusted appropriately.

THE MEXICAN AND ASIAN CRISES: THE CASE FOR CAPITAL CONTROLS REVISITED

With respect to developing or transitional economies, the collapse of the Mexican peso in 1994–95 and the concomitant outflow of foreign short-term capital,⁴⁴ and the 1997–98 crisis in Asian capital markets, have led some economists to question whether liberalizing capital controls is a sound policy except at a very mature stage of economic development. Jagdish Bhagwati, for example, draws a sharp distinction between the robust case for

liberalization of trade and the much more questionable case for free movement of capital.⁴⁵ According to Bhagwati,

economists properly say that there is a correspondence between free trade in goods and services and free capital mobility: interfering with either will produce efficiency losses. But only an untutored economist will argue that, therefore, free trade in widgets and life insurance policies is the same as free capital mobility. Capital flows are characterized...by panics and manias.⁴⁶

Former US Treasury Secretary Robert Rubin, who played a central role in the global policy response to the Mexican and Asian currency crises, is sceptical of the view that reimposition of capital controls is an appropriate answer. He suggests that the better response may be fewer restrictions on foreign banks and long-term investment, not new controls on short-term flows:

In practice, most of the countries that suffered from overborrowing had gone out and sought that capital. They had also, in many cases, resisted the entry of foreign banks—which could have provided immediate aggregations of trained personnel and management, technology, and capital to their banking sectors... And some countries restricted the longer-term investment that could have been a stabilizing force... I have some sympathy for those who argue that controls on the inflow, as opposed to the outflow, of short-term investments might sometimes make sense as a transitional device. Chile had some apparent success in reducing reliance on volatile funds through restrictions on the inflow of short-term capital, but it did not use controls to avoid reform. The central reasons for Chile's success were sound policies and a floating exchange rate.⁴⁷

Another former senior Clinton Administration official who dealt with the financial crises of the 1990s, Dan Tarullo, has, however, suggested (along with Bhagwati) that capital controls were a relatively effective means by which Malaysia was able to stem a panic exodus of short-term capital.⁴⁸ In testimony before the same US House of Representatives Subcommittee as that faced by Tarullo, Bhagwati observed of the Malaysian case that capital controls allowed Malaysia to avoid the need for sharp interest rate increases (which would have otherwise been required to try to stem capital flight), thereby preventing the kind of deflation that had such serious social and economic consequences elsewhere in Asia. In their testimony, both Tarullo and Bhagwati were highly critical of the Bush Administration for insisting that bilateral trade agreements with Chile and Singapore contain an outright prohibition on capital controls.

While Bhagwati recognizes the importance of foreign capital to economic development, he believes that foreign direct investment (FDI) is the appropriate vehicle for this, and thinks that there is little evidence that FDI depends on liberalizing capital flows. The IMF points to factors such as 'inadequate financial sector supervision, poor assessment and management of financial risk, and the maintenance of relatively fixed

exchange rates' as causes of the Asian crisis.⁴⁹ The common ground between Bhagwati's diagnosis and the lessons from Asia proposed by those, like the Fund, who have promoted capital mobility for developing and transitional economies may be this: it appears that liberalization of capital flows should be sequenced after various governance-oriented reforms that assure the kind of regulatory protections against financial instability typical of those mature economies that have learned from managing their own crises. An additional lesson may be that crisis behaviour can result where governments attempt to maintain relatively fixed exchange rates while simultaneously liberalizing capital controls. Without capital controls, if investors no longer have confidence in the government's ability to sustain its currency at a given exchange rate or within a given zone, they can take flight within hours. Indeed, as will be discussed in the next section of this chapter, the crisis in the European Monetary System in 1992 can in part be explained in terms of the risks of maintaining managed exchange rates once capital controls have been removed.

An interesting compromise solution to the debate over free movement of capital is advocated by Haas and Litan. They suggest that, instead of either *laissez-faire* or heavy-handed re-regulation, a penalty should be imposed on all foreign lenders in an IMF bailout after a financial crisis in developing-country markets—these lenders would face some loss of principal when they refuse to roll over or extend their loans. This, Haas and Litan argue, would better internalize the risk of crisis into the price of credit, and provide investors with greater incentives to monitor borrowing countries for soundness of governance practices and adequacy of financial data.⁵⁰

THE EUROPEAN MONETARY SYSTEM

The European Monetary System (EMS) provides an interesting case study of the difficulties of maintaining a system of managed or fixed exchange rates under conditions of increased liberalization and globalization of financial markets and in the absence of an agreed common macroeconomic policy approach.⁵¹ Established in 1978, the EMS applied to many but not all of the Members of the European Union (for instance, the UK chose to stay out until quite recently). The core of the EMS was an agreement to maintain currencies within a $\pm 2.25\%$ band of a fixed rate against the ecu, the common EU currency. This agreement was made possible, it is generally thought, by the presence of Germany in the system as a hegemonic financial power. If other members of the system engaged in substantially looser monetary and fiscal policies than the traditionally conservative Bundesbank, confidence in their currencies would weaken, with investors switching their holdings into Deutschmarks. Eventually, to sustain the exchange rate within the $\pm 2.25\%$ band, these other countries would have to alter their monetary policies so as to conform with those dictated by the Bundesbank.

In fact, however, this happened only to a limited degree. Until the full liberalization of financial markets in the EU in 1992, a number of the countries with weaker currencies continued to maintain exchange controls. Through these controls, the countries concerned (e.g. Italy) were able to maintain looser macroeconomic policies than those of Germany, since they could limit outflow of capital in response to higher interest rates and a stronger currency in Germany. Also, the system had permitted the fluctuation of some currencies

outside the $\pm 2.25\%$ band. In addition, some devaluations and revaluations of currencies actually did occur, despite the commitment in principle to fixed rates. These (albeit infrequent) realignments would eventually create further pressure on the system, by inducing in currency traders and speculators the expectation that at a certain point, where particularly currencies in the system were under sustained pressure, the EMS members would act to realign the fixed rates. The expectation of a devaluation would intensify sale of the currencies already under pressure, and therefore increase that pressure enormously (especially after the lifting of capital controls).

The breakdown of the EMS in September 1992 can be attributed to the interaction of the above factors.⁵² In the 1990s, Germany's macroeconomic policies could no longer be considered an adequate benchmark for economically sound price stability goals. Instead, they reflected Germany's special needs to finance German reunification. Because of the politically motivated refusal of the Chancellor to raise taxes to finance unification, the Bundesbank was required to raise German interest rates beyond a level required by macroeconomic fundamentals, in order to finance unification by borrowing. Under these circumstances, with capital controls removed, other EMS members faced extreme pressure on their currencies. They did not want to raise interest rates to match those set by Germany's extraordinary borrowing requirements for reunification, because this would worsen the recession in their countries. At the same time, the French did not want to devalue the franc, because a strong franc was viewed as necessary to maintain investor confidence in the French economy.

One logical solution would have been revaluation of the Deutschmark. Revaluation would, of course, have reduced Germany's exports and increased its imports, therefore countering at least to some extent the effects on other currencies of *capital* inflows to Germany.⁵³ And, indeed, such a solution was favoured by the Bundesbank—thereby creating speculation on the markets that currency realignments were imminent. However, the German Chancellor rejected revaluation, probably for political reasons (it will be recalled that, in the short term, revaluation costs domestic jobs, as exports decline and imports rise). Finally, one important factor that continued to hold the system together, and dampen somewhat investor speculation that it was under fundamental threat, was the expectation that the Maastricht plan for a single European currency, once it shifted into full gear, would result in greater coordination of macroeconomic policies in the transitional phase of moving to a single currency, thereby restabilizing the system, or perhaps more accurately putting it on a new, surer footing.

In September 1992, with expectations that Maastricht might be rejected in the French referendum running high, with capital controls now completely removed, and with no resolution in sight to the problem of German interest rates, there was a speculative run on a number of the other currencies in the EMS. Perhaps even more ominous than the speculative run itself was the discovery by governments and central banks that—with the end of exchange controls—the possibilities of restabilizing their currencies through intervention were dramatically reduced. Even overnight increases in interest rates in the hundreds of percentage points did not succeed, and several countries, including Britain, had to withdraw from the Exchange Rate Mechanism of the EMS.

The European Monetary Union and the euro

The breakdown of the EMS initially created considerable doubt as to whether plans to proceed with a single currency, as envisaged in Maastricht, were at all feasible. Also, numerous proposals existed for putting the EMS back together again, at least in the short run. However, with the French referendum result narrowly supporting the Maastricht Treaty, and with Denmark's eventual acceptance of the Treaty, the project for monetary union received renewed momentum. As for the EMS, it was rehabilitated in a much weakened form by an August 1993 decision to allow currencies to float within a 15% band (Germany and the Netherlands nevertheless undertook to keep their currencies within a 2.25% band).⁵⁴

Finally, it is arguable that the crisis of the EMS reinforced rather than undermined the Maastricht approach of monetary *union*, which required as a prerequisite to the movement to a single European currency a substantial degree of harmonization of macroeconomic policies. For example, in order for a country to enter the monetary union it must, *inter alia*, have a relatively low rate of inflation, it must not be running an 'excessive' budget deficit, and its interest rates must not exceed a norm based upon the interest rate performance of the three EU countries with the lowest inflation rates.⁵⁵

In part due to the possibility that an insufficient number of Member States would satisfy these various criteria on time, in December 1995 the European Council moved back the starting date for the final stage of transition to a single currency from 1997 to 1999. By 1997, it was evident that all the countries intending to join the European Monetary Union (EMU) (the UK, Sweden and Denmark decided to opt out) had largely met the convergence criteria related to inflation, public finances, interest rates and exchange rates, with the partial exception of Greece.⁵⁶ Thus, on 2 May 1998 the Council made a final decision to proceed with the final phase of transition in 1999, including the creation of a European Central Bank (ECB) to supervise a common monetary policy.⁵⁷ However, the project for the EMU remained fraught with tensions—in fact, the 2 May decision was only able to proceed due to a compromise on who would be the first head of the ECB. The Maastricht Treaty stipulates an eight-year term, but France's insistence on its own candidate resulted in a bizarre compromise whereby the choice of other Member States, Wim Duisenberg, made a statement that he would voluntarily end his term early (thus paving the way for a French candidate to serve the remainder of the eight years). This permitted a successful outcome to the 2 May discussions.

Even as the transition phase ended and the euro became the common currency for those countries that had joined the EMU, Europeans have continued to debate whether the loss of macroeconomic policy autonomy is too high a price to pay for currency union. Many believe that Member States have already been constrained in their ability to address the social and economic challenges of unemployment and redesign of the welfare state by the need to meet the convergence criteria for inflation and deficits. While the ECB controls only monetary, and not fiscal, policy, at German insistence the Council has pressed ahead with the 'Stability and Growth Pact', which would limit budget deficits to 3% of GDP on pain of fines. *The Economist* has suggested that this 'foolishly constrains fiscal policy at a moment when the loss of an independent monetary policy argues for more, not less fiscal flexibility'.

These words were prophetic. The Stability and Growth Pact has met with major difficulties. A number of structural problems have been exposed with the cyclical downturn of 2001, from which the area is recovering only hesitantly. Regarding fiscal policy, the Stability Programmes presented by the Member States on the eve of the 2001 downturn envisaged balanced budgets to be achieved by 2002, but this goal has been put off by at least four years. Overruns were particularly large in three major countries—Germany, France and Italy—as well as Portugal. Portugal breached the deficit limit of 3% GDP in 2001. Germany and France followed in 2002, with Italy approaching the danger zone.⁵⁸ Finally, in late November 2003, the Stability and Growth Pact suffered a fundamental setback when, under enormous pressure from France and Germany, EU Member States voted to suspend proceedings against those countries in respect of their exceeding the 3% limit, which, if they had gone ahead, would have resulted in stiff fines; instead, it was understood that both would have another year to bring their deficits under control. Many observers, including those inside the EU, see this as the death of the Pact; others, including some within the Commission, were furious at this political override of legal requirements of monetary union, and there was successful litigation in the European Court of Justice, challenging the legality of the Member States' decision to suspend enforcement of the Pact. In light of this court ruling, efforts are now underway to reform the Pact, to make it more flexible and responsive to the economic situation in individual Member States. In September 2003, a clear majority of Swedes rejected joining the eurozone in a national referendum. Monetary union remains intensely controversial in Great Britain, where the Prime Minister, Tony Blair, supports joining the eurozone when the 'conditions are right', as he likes to put it. However, this support is far from universal, even in Blair's own party.

CONCLUSION

An examination of the rules and institutions that govern the interrelationship between trade and finance suggests that despite the 'casino' of currency speculators and globalized capital markets, the Bretton Woods rules and institutions did in many respects prove well adapted, or at least adaptable, to sustaining a relationship between trade and money conducive to liberal trade. The liquidity and balance of payments adjustment problems are increasingly being addressed through IMF assistance, conditioned upon acceptance of an open trade and payments system. While the LDC debt crisis represented a serious setback, its end result is more rather than less liberalization of trade by the LDCs affected. Moreover, the GATT and IMF rules and the institutional arrangements of the IMF have proven effective in addressing the substitutability problem, whereby countries attempt to undercut trade concessions by resorting to currency measures. With respect to volatility under floating rates, and the corresponding increase in the riskiness of trade transactions, the system has proven less effective in explicitly addressing the challenge. However, in the end it may turn out that hedging techniques are a relatively effective means of private actors themselves reducing foreign exchange risk in trade, although smaller and less sophisticated actors have less access to these strategies.

Where the system has been least effective is in addressing the trade pressures that result from and/or intensify conflicts over domestic macroeconomic policies. The latest

example of this is the controversy over whether China's pegging of its currency to the dollar is an unfair trade policy.

As noted above, the financial crises of the 1990s, which caused enormous human hardship and misery, did not, however, provoke a protectionist backlash, which would certainly have made matters much worse. This displays, among other things, the value and effectiveness of multilateral rules on trade in restraining and managing domestic policy responses to crisis, such as to avoid beggar-thy-neighbour protectionist reactions. At the same time, internal reforms such as improved corporate governance and sounder regulation of financial institutions may not be enough to ensure financial stability in developing-country economies; in some cases, without debt reduction and increases in facilities for export financing, it is unlikely that crisis-hit and debt-burdened countries will be able to take advantage of an open world economy to restart and increase growth through trade.

6

Tariffs, rules of origin and regional trading arrangements

THE ECONOMIC EFFECTS OF A TARIFF

The economic effects of a tariff on both importing and exporting countries are best understood by first examining the case of a prohibitive tariff—that is a tariff that is so high that it prevents all imports. Here we draw on an example provided by Ruffin and Gregory.¹

With a prohibitive tariff, the prices paid for shirts in each country are determined by the supply and demand curves in each country. To compare prices, we assume that US\$2=£1. If there were no tariff, prices would be the same in the two countries. The prohibitive tariff in America raises the price in America from US\$6 to US\$9. Consumers lose area A+B, but producers gain area A. The net loss to America is area B. In Europe, prices fall from £3 to £2, and producers lose area C+D, while consumers gain C. The gain to consumers is less than the loss of producers. The net loss to Europe is area D. (See Figure 6.1.)

One can next consider a non-prohibitive tariff, which does not preclude all imports of the product. Ruffin and Gregory graph this example as in Figure 6.2. Before the non-prohibitive tariff, the price of the product is P_w . The tariff raises the price to P_w+t ; that is the world price plus the amount of the duty. Consumers lose area N+R+T+V. Producers gain N. The government gains the tariff revenue T, which equals the tariff per unit times the quantity of imports. The net loss is R+V. The tariff lowers imports from (q_4-q_1) to (q_3-q_2)

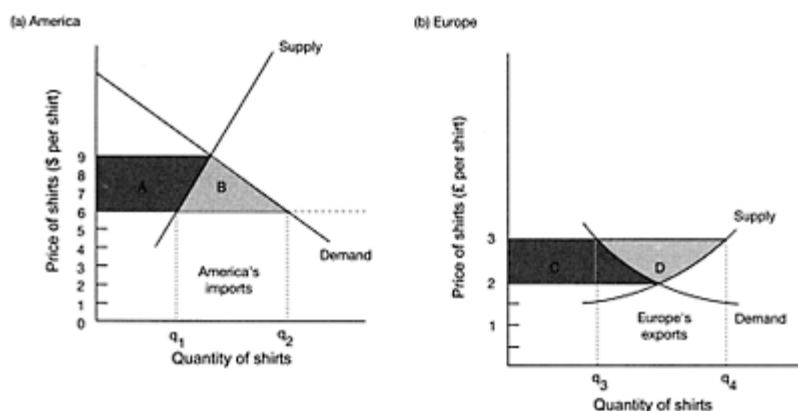


Figure 6.1 The costs of a prohibitive tariff.

Source: *Principles of Economics*.

It is also important to note certain economic characteristics of tariffs that contrast with other policy instruments that governments might invoke to protect domestic industries. For example, governments in importing countries may seek to protect domestic industries by quantitative restrictions (or quotas). As protectionist devices, these have the virtues of definitively limiting the volume of imports that will be permitted, and thus provide stronger assurances to domestic producers of protected market shares. On the other hand, they exhibit the corresponding vice, depending on their design, of insulating domestic producers from most forms of foreign competition and thus encouraging inefficient production. In contrast, with a non-prohibitive tariff, highly efficient foreign producers may be able to surmount the tariff and still compete effectively with domestic producers, thus creating some incentives for the latter to enhance their productive efficiency. Another difference between tariffs and quotas relates to who collects the scarcity rents that they engender. With tariffs, governments in importing countries collect revenues from non-prohibitive tariffs. With quotas, depending on how they are allocated, domestic holders of import quotas or licences may collect scarcity rents (rather than the government collect tariff revenues). If the quotas are allocated to foreign exporters, these firms will collect scarcity rents by charging more for their goods in the protected market, without being under any obligation to pay customs duties on the imports.

Tariffs should also be distinguished from production subsidies designed to make domestic industries artificially competitive with imports. Such subsidies will distort domestic production decisions by attracting resources into the subsidized activity, but will not necessarily (depending on how they are financed) distort domestic consumption decisions, in that the goods in question will still trade at world prices. Tariffs, in contrast, distort both domestic production and consumption decisions, first by attracting resources into the protected sector, and second by raising prices to consumers above world prices, which in general reflect least cost means of production, thus inducing consumers to allocate their resources to less preferred forms of consumption.

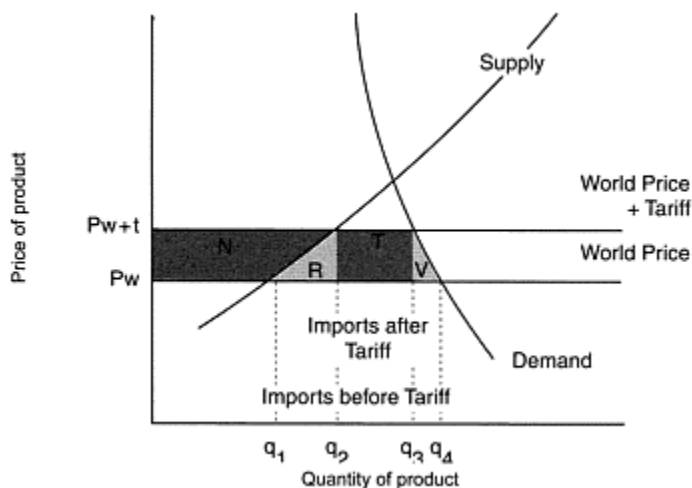


Figure 6.2 The effects of a non-prohibitive tariff.

Source: *Principles of Economics*.

As noted in Chapter 1, these characteristics of alternative instruments of protection find rough analogues in the provisions of the GATT. The GATT in Article XI purports to take a strong prohibitory approach towards quantitative restrictions. On subsidies, Article XVI reflects a much more ambivalent position and, while the Tokyo Round Subsidies Code and Uruguay Round Subsidies and Countervailing Measures Agreement (especially the latter) take a somewhat less equivocal stance, only a narrow range of subsidies are subject to outright prohibition. Tariffs are not presumptively good or bad and there is no obligation under the GATT to reduce them, although Article XXVIIIbis contemplates periodic negotiations on a reciprocal and mutually advantageous basis directed to the substantial reduction over time of the general level of tariffs.

ALTERNATIVE BARGAINING STRUCTURES

Product-by-product negotiations

In the five negotiating rounds under the GATT prior to the Kennedy Round (1964–67), tariff concessions were negotiated on a product-by-product basis. Under the Principal Supplier rule that was adopted by participants, countries who were principal suppliers of goods into international markets would prepare ‘request’ lists of goods where they were seeking tariff concessions from importing countries. Countries preparing request lists would at the same time prepare offer lists indicating products on which they were prepared to make concessions. Because of the Most Favoured Nation (MFN) principle, requests and offers were typically directed by principal suppliers to principal importers, thus essentially bilateralizing tariff negotiations. A principal supplier would have no

interest in directing a request to a minor importer because trade concessions negotiated with such a country, while entailing MFN obligations on the latter's part, would entail no such obligations on the part of major importers. Similarly, the principal supplier of product X would have no interest in making concessions on imports of product Y from a minor exporter, where this concession would have to be generalized to major exporters without being able to extract from these exporters major concessions on products of which the importing country was the principal supplier. According to Finger,² product-by-product negotiations achieved very high internalization rates, in the sense that the benefits of trade concessions were confined, to a very large extent, to Parties offering countervailing trade concessions, with very little free-riding (pursuant to the MFN principle) on the part of exporters who offered no reciprocal concessions. To the extent that there were likely to be significant spillovers benefiting non-reciprocating Parties from tariff concessions, typically product-by-product negotiating rounds concluded with a settling-up session where concessions previously tentatively negotiated were subject to threats of withdrawal or revision unless non-reciprocating countries agreed to offer concessions as well.

While this process may have led to deeper tariff cuts on items that were subject to negotiations, it arguably substantially restricted the range of products with respect to which active negotiations occurred, thus restricting the coverage of the resulting tariff reductions. Product-by-product negotiations had other limitations: first, small exporting and importing countries were largely frozen out of the negotiating process; second, by focusing negotiations on particular products, domestic producer constituencies were encouraged to become active in resisting tariff concessions on products in which they were interested; third, the negotiating process was highly transaction cost-intensive because of its focus on line-item negotiations.

Linear-cuts with exceptions

In the Kennedy and Tokyo Rounds, the Contracting Parties chose to substitute for product-by-product negotiations a linear-cutting formula, with a provision for exceptions lists where countries could take products out from the linear-cuts and negotiate, as before, on a product-by-product basis. Obviously, with this approach, the coverage of products embraced by tariff reductions was likely to be much larger, although the degree of internalization of concessions exchanged was likely to have been lower and, according to Finger, would have created incentives for shallower cuts. Finger refers to this as the internalization—coverage trade-off. In fact, both the Kennedy and Tokyo Rounds produced average tariff cuts of about 35%—well in excess of tariff reductions negotiated in the four rounds that had intervened between the initial GATT negotiations and the Kennedy Round. However, linear-cutting formulae present problems of their own. Now, negotiations must focus on the appropriate formula, and in both rounds these negotiations proved problematic in various respects. For example, countries that already had low tariffs on average argued that it was unreasonable to expect them to cut these tariffs by the same percentage as high-tariff countries, the reasoning being that, for example, a 50% cut of a 60% tariff would still leave a 30% tariff in place, which, if one assumes that the initial tariff contained a lot of 'water', might still be largely prohibitive of imports, while

a country cutting a 10% tariff to 5% might well find that this would have a significant impact on the volume of imports.

In both rounds, formulae were finally agreed to which required, in one respect or another, larger cuts of higher tariffs than of lower tariffs. Another problem with the linear-cutting approach was the risk that countries would abuse the right to take items out from the linear-cutting formula and place them on an extravagant exceptions list where they would be subject only to product-by-product negotiations. Indeed, a number of countries with import-sensitive sectors like textiles, clothing and footwear adopted this expedient. Also, countries primarily engaged in the exportation of agricultural products or natural resources (like Canada), in which tariffs were in many cases quite low but whose manufacturing sectors were highly protected, viewed product-by-product negotiations as more advantageous than linear-cuts, and in the Kennedy Round were entirely exempted from the linear-cutting process, but not in the Tokyo Round, although subject to extensive exceptions lists. Notwithstanding these problems, as noted above, between linear-cuts and product-by-product negotiated tariff reductions, the average level of tariffs was substantially reduced in the course of both rounds.

Sector-by-sector negotiations

In both the Kennedy and Tokyo Rounds, efforts were made to negotiate reductions in trade barriers in selected sectors, such as steel, chemicals and forest products. Canada was a prominent proponent of this approach. It was largely a failure. The reasons are not hard to identify. To focus negotiations on a particular sector (e.g. steel) is likely to engage the interest principally of producer interests in this sector and, rather than reducing or eliminating trade restrictions, instead runs the risk of a managed trade arrangement effectively entailing cartelization of the global industry. Alternatively, because negotiations among producer interests in the same sector in different countries tend to have a zero-sum quality to them, no agreement at all will be possible. While a code on trade in civil aircraft and components was successfully negotiated during the Tokyo Round and did reduce some trade barriers, and while the Agreement on Agriculture negotiated during the Uruguay Round modestly liberalized trade in agriculture, the Multi-Fibre Arrangement that emerged in the 1970s is a stark example of the protectionist scenario. More generally, by attempting to negotiate trade liberalization within sectors, the political room for manoeuvre in cross-product or cross-sectoral exchanges of concessions, as entailed in product-by-product or linear-cutting negotiations, is dramatically reduced.

Non-reciprocal concessions

As recognized in Part IV of the GATT, developing countries are not expected to offer reciprocal commitments in trade negotiations, and developed countries are expected, to the fullest extent possible, to accord high priority to the reduction of barriers to products of particular export interest to developing countries. Pursuant to these provisions, in the early 1970s many industrialized countries adopted the Generalized System of Preferences (GSP), and unilaterally extended preferential tariff rates on certain items of export interest to developing countries. However, these preferential tariffs typically were not

bound, usually entail escape clause provisions that permit the termination or reduction of the preferences in the event of import surges, and contain graduation provisions whereby developing countries lose their preferences when, in the view of the country extending them, they have reached a state of development where they no longer require them. As well, GSP preferences have typically not been extended on items produced by politically sensitive domestic sectors such as textiles, clothing and footwear, even though these are of major export interest to many developing countries early in the process of industrialization. Moreover, as MFN rates have declined as a result of subsequent multilateral negotiations, the margin of preference between GSP and MFN rates has contracted.³

In the *EC-Tariff Preferences (GSP) case (European Communities—Conditions for the Granting of Preferences to Developing Countries)*. Report of the Panel (WT/DS246/R), the European Community argued that Article I:1 of the GATT allowed it to condition treatment of like products on objective, origin-neutral criteria, and that the additional tariff preferences it provided to developing countries deemed to have drug enforcement challenges were conditions of this nature (the EC *also* defended its measures as authorized by the Enabling Clause that provides an exemption from MFN with respect to GSP schemes; see the chapter on Trade and Developing Countries). With respect to Article I:1 of GATT, the EC claimed that the requirement to provide MFN treatment ‘unconditionally’ in Article I:1 of the GATT meant only that MFN treatment must not be conditioned on compensation or benefits provided reciprocally by the WTO Member in question. India argued that ‘unconditionally’ meant without any conditions whatsoever. The majority of the panel (there was one dissenting panelist, a highly unusual occurrence) agreed with India on the doctrinal point, even though the adopted panel ruling in *Canada-Autos* had come to the opposite conclusion, stressing that the MFN obligation was not intended to prevent distinctions between products that were origin-neutral. In failing to consider the *Canada-Autos* panel report here, the majority neglected its duty to take into account previous adopted panel reports. The majority saw ‘no reason not to give [the term “unconditionally”] its ordinary meaning’ in the *New Shorter Oxford English Dictionary*. However, the panel in *Canada-Autos* had understood that the notions of ‘conditional’ and ‘unconditional’ MFN were to be given their specialised meanings in trade law and practice (see Vienna Convention on the Law of Treaties, 31:4). The interpretation of the EC-Tariff Preferences panel of ‘unconditionally’ in Article I:1 of the GATT was not judicially considered in the appeal of the panel ruling; strictly speaking, the approach of the Appellate Body, focusing on the Enabling Clause as the legal framework for GSP preferences, rendered the panel’s interpretation of Article I:1 moot. Given the failure of the panel to perform its duty to consider prior adopted panel rulings (in this case, *Canada-Autos*), it is argued that little precedential authority should attach to the EC-Tariff Preferences panel’s interpretation of ‘unconditionally’ in GATT I:1. (See Robert Howse, ‘The Death of GSP? The panel ruling in the India-EC dispute over preferences for drug enforcement,’ BRIDGES, January 2004, whence the above is derived).

OUTSTANDING TARIFF ISSUES

While the first seven rounds of tariff negotiations under the GATT since the Second World War dramatically reduced world tariffs on average (from about 40% on manufactured goods in 1947 to about 5%), Laird and Yeats⁴ identified a number of tariff issues that remained outstanding at the outset of the Uruguay Round multilateral negotiations. First, despite low average tariffs, most countries still maintained very substantial tariffs on particular products. Moreover, there was still a good deal of unevenness in tariff levels from one industrialized country to another with respect to particular items, suggesting that the low tariff-high tariff debate in negotiating modalities for reducing these disparities had not yet been fully resolved.

Second, many national tariffs were still not legally bound; this applied particularly to GSP tariffs and also to tariffs in many developing countries. Third, there were different and adverse effects of specific tariffs on developing countries' exports (i.e. a fixed charge per unit), as opposed to *ad valorem* tariffs (a percentage of value). Specific tariffs were still quite common. Fourth, the cost-insurance-freight (CIF) as opposed to free-on-board (FOB) procedures for customs valuation continued to discriminate against geographically disadvantaged developing countries, particularly those that are least developed and landlocked. Fifth, a serious problem still existed as to how to liberalize tariffs for products that are also simultaneously covered by non-tariff barriers (such as quotas). Sixth, developed countries still commonly applied escalating tariffs to imports depending on their stage of processing, in order to protect domestic processing industries, often at the expense of developing countries who would derive substantial advantages from being able to engage in value-added processing of what otherwise are purely commodity or raw materials exports.

The Uruguay Round tariff negotiations

In the Uruguay Round tariff negotiations,⁵ Contracting Parties were free to apply any method of reducing tariffs, provided the reduction would be at least equivalent to the overall reduction achieved in the Tokyo Round (about one-third of prevailing duties). Substantial reductions were in fact achieved. The trade-weighted *ad valorem* reductions in tariffs on industrial products were close to 40%. In addition, duty-free trade was assured for 44% of developed economies' exports of industrial products. Significant progress was also made on reducing escalating tariffs on processed goods. After implementation, developed countries' tariffs on industrial products fell from 6.3 to 3.8% on average (one-tenth of the average tariff level before the entry into force of the GATT in 1947). Moreover, 99% of developed economies' tariff lines of industrial products are now bound compared with 78% before the round, while 73% of developing countries' tariff lines are now bound compared to 21 % before the round. These numbers are, of course, aggregates or averages, and tariffs continue to be higher in several categories, including textiles and clothing; leather, rubber, footwear and travel goods; fish and fish products; and transport equipment. For example, with respect to textiles and clothing, many tariffs remain in the 15–35% range. In the case of agricultural products, as part of

the broader Uruguay Round Agreement on Agriculture (discussed in Chapter 11), quantitative restrictions must be converted into tariff equivalents (sometimes running to several hundred per cent) and lowered by an equivalent of 36% in six years in the case of developed countries, with a minimum reduction of 15% for each tariff line (24% overall for developing countries over ten years).

Subsequent to the close of the Uruguay Round, the WTO Ministerial Declaration on Trade in Information Technology Products (ITA) was agreed to at the close of the first WTO Ministerial Conference in December 1996 in Singapore. The ITA provides for participants to eliminate customs duties and other duties and charges on information technology products by the year 2000, on an MFN basis. Six main categories of products are covered: computers, telecommunications equipment, semiconductors, semiconductor manufacturing equipment, software and scientific instruments. However, implementation was contingent on expanding ITA participation to cover approximately 90% of world trade in IT products by 1 April 1997. On 26 March 1997, participants agreed that this criterion had been met. They also established a Committee as the Expansion of Trade in Information Technology Products, which will monitor the implementation of the ITA.

There are currently 60 parties to the ITA, accounting for over 95% of world trade in IT products. The ITA provides for the 'staging' of tariff cuts in four equal rate reductions of 25% each year from 1997 to the year 2000. In addition to regular customs duties, the ITA also provides for the elimination of other duties and charges. Some countries have requested and been granted additional time to complete their reductions, but there are no extensions past 2005.

The ITA does not currently cover consumer electronic goods. Consultations are underway to extend the coverage of the Agreement.

The Doha Round tariff negotiations

Brown, Deardorff and Stern⁶ point out that post-Uruguay Round tariffs in industrialized countries are low, and non-tariff border barriers are almost gone, except in the agriculture sector. However, among the highest remaining tariffs are those in areas where developing countries export, including textiles and apparel. The authors estimate that world welfare would increase by \$686.4 billion if post-Uruguay Round tariffs and other barriers on agricultural and industrial products were reduced by 33% in the Doha Round. This includes welfare gains of \$164 billion to the United States, \$227 billion to the EU/EFTA and \$132.6 billion to Japan.

The Doha Declaration⁷ directly addresses tariff reductions in two of its sections. The Doha Declaration agrees to trade and environment negotiations on, among other matters, the reduction or elimination of tariff and non-tariff barriers to environmental goods and services (para. 31(iii)). With respect to market access for non-agricultural products, Members commit to negotiations aimed at reducing or eliminating tariff and non-tariff barriers, with emphasis placed on products important to developing countries. There will be no *a priori* exclusions from product coverage, and negotiations will seek to address tariff peaks, tariff escalation and high tariffs. Flexibility for developing countries will take the form of exceptions to full reciprocity in reduction commitments. In order to promote the effective participation of developing countries in the negotiations, modalities for negotiation must include studies and capacity-building measures (para. 16).

In May 2003, the Chair of the Non-Agricultural Market Access Negotiating Group circulated the first draft of modalities⁸ to WTO Members. In addition to special and differential treatment and less than full reciprocity in reduction commitments, the draft modalities allow developing countries longer implementation periods for tariff reductions and the possibility of leaving up to 5% of tariffs unbound. Also, the modalities exempt less-developed countries (LDCs) from certain reductions required of other Members, but note that LDCs should still increase their binding commitments (para. 8). Although the draft modalities proposed that developed Members ‘who so decide’ remove tariff and quota barriers to LDCs’ exports entering their markets, they impose no obligation that they do so (para. 9).

Although it does not explicitly address agricultural tariffs, the Doha Declaration also commits to negotiations aimed at substantial improvements in market access for agriculture (para. 13). Members missed their deadline and have not yet agreed on modalities for further commitments on agriculture.

Annex B of the failed Cancun draft text addressed modalities for reduction in non-agricultural tariff barriers (Non-Agricultural Market Access). The July 2004 Framework for the Doha Negotiations (Decision Adopted by the General Council on 1 August 2004 WT/L/579, 2 August 2004) contains few concrete advances towards agreement on an actual formula for negotiations on non-agricultural tariffs. The International Centre for Trade and Sustainable Development notes: ‘Th[e] initial paragraph [of the part of the Framework dealing with Non-Agricultural Market Access] stipulates that “[a] dditional negotiations are required to reach agreement on the specifics of some of these [initial] elements”—which relate to the tariff reduction formula, the starting point for binding unbound tariff lines, flexibilities for developing countries, and participation in the sectoral initiatives.’ (‘WTO: July Framework Agreed at Eleventh Hour’, *BRIDGES Weekly Newsletter*, Vol. 8, No. 27, 3 August 2004). Paragraphs 4ff. of Annex B of the July Framework contain some general principles for tariff reductions on non-agricultural products: ‘4. 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. 5. We further agree on the following elements regarding the formula: product coverage shall be comprehensive without *a priori* exclusions; tariff reductions or elimination shall commence from the bound rates after full implementation of current concessions; however, for unbound tariff lines, the basis for commencing the tariff reductions shall be [two] times the MFN applied rate in the base year; the base year for MFN applied tariff rates shall be 2001 (applicable rates on 14 November); credit shall be given for autonomous liberalization by developing countries provided that the tariff lines were bound on an MFN basis in the WTO since the conclusion of the Uruguay Round; all *non-ad valorem* duties shall be converted to *ad valorem* equivalents on the basis of a methodology to be determined and bound in *ad valorem* terms; negotiations shall commence on the basis of the HS96 or HS2002 nomenclature, with the results of the negotiations to be finalized in HS2002 nomenclature; the reference period for import data shall be 1999–2001. 6. We furthermore agree that, as an exception, participants with a binding coverage of non-agricultural tariff lines of less than [35] per cent would be

exempt from making tariff reductions through the formula. Instead, we expect them to bind [100] 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.⁷

DOMESTIC ADMINISTRATION OF TARIFFS

Each country's customs authorities are responsible for administering the country's customs laws. Primarily, their task involves calculating the duties owed by the importer, completing the required paperwork, and collecting the payments. However, calculating import duties involves a number of tasks: valuing the imported goods; locating the goods in the appropriate product classification; and identifying the goods' country of origin. Each stage of the process, from the valuation system to the paperwork and administrative fees, is a potential barrier to trade; domestic administration can increase the level of protection afforded by tariffs or even make the importing process prohibitively complicated. As a government official is once reputed to have remarked: 'Let me write the Administrative Act and I care not who writes the rates of duty.'⁹ In the areas of customs valuation and classification there has been general acceptance of harmonized rules, but little progress has been made on rules of origin, and administrative fees still remain at each country's discretion. Under Article X of the GATT, every Contracting Party is obligated to publish in accessible form all laws, regulations, rulings, etc. pertaining to classification, valuation and customs administration, and to institute a system of judicial or quasi-judicial review to enable prompt review and correction of administrative actions relating to customs matters. In Canada, tariff schedules are set out in great detail in the *Customs Tariff*, running into several thousand items. Five major tariff rates often exist for a given item: (1) the MFN tariff rate; (2) the NAFTA rate; (3) the General rate (for non-GATT members); (4) the British Preferential rate (for some Commonwealth countries); and (5) the GSP rate (for some developing countries). In turn, the Customs Act creates the domestic administrative machinery for the collection of duties through the Canada Customs and Revenue Agency. Internal appeal mechanisms within the Agency on classification, valuation and related issues are provided for. Appeals from final Agency determinations may be made to the Canadian International Trade Tribunal and thence, on matters of law, to the Federal Court of Appeal. Where a tariff is imposed or increased to provide temporary protection from foreign competition, Article 5.1 of the Safeguards Agreement requires the measure to be applied only to the extent necessary to prevent or remedy serious injury and to facilitate adjustment.

Valuation and tariff structure¹⁰

Most tariffs today are *ad valorem*, requiring the importer to pay a certain percentage of the good's value in duty.¹¹ Hence, the value of the imported goods is an important determinant of the ultimate import duty: 'any advance in value is accompanied by a commensurate increase in both duties collected and in the level of protection'.¹² It is in the interest of all countries that valuation techniques be uniform and predictable. A system that is unpredictable or unfair to exporters serves as a non-tariff barrier to trade

and undermines the effects of tariff reductions. Furthermore, differences in valuation methods make tariff negotiations more complex.¹³ In negotiations, a country must take into account the different effects of tariffs due to the different valuation techniques employed to ensure that it is receiving reciprocal trade concessions.

In the case of *Argentina—Certain Measures Affecting Imports of Footwear, Textiles, Apparel and Other Items* (WTO Doc. WT/DS50/AB/R of 27 March 1998), the Appellate Body considered the legal obligations that flow from binding a tariff as *ad valorem* in a WTO Member's schedule. Argentina had scheduled an MFN *ad valorem* tariff on certain footwear and textiles products. However the actual duties that Argentina applied to these products were based upon a complicated formula that calculated an average value for these categories of products over a certain period of time. The result was that a higher rate of duty than the MFN *ad valorem* rate could be imposed on a particular shipment of imports in certain circumstances. Argentina claimed that this practice did not violate Article II of the GATT because in other cases the tariff imposed was less than the bound *ad valorem* rate, resulting in an average for these categories of products that did not exceed overall the *ad valorem* rate. The AB did not accept this reasoning, holding that the obligation in Article II not to impose duties in excess of bound rates applied to each individual imported product in the relevant classification, and could not be discharged by averaging whereby in some cases lesser and in others greater duties were applied to imports in the categories in question. At the same time, the Appellate Body also appeared to accept that even if a WTO Member had bound a tariff *ad valorem*, it could later on apply a different sort of tariff, as long as *in no instance* the resulting amount of duties were to exceed the *ad valorem* rate to which the Member had bound itself.

In a later case, *Chile—Price Band System and Safeguard Measures Relating to Certain Agricultural Products* (WTO Doc. WT/DS207/AB/R of 23 September 2002), the AB was required to rule on a Chilean practice of determining the actual tariff applied on certain agricultural products by using a price band based on the fluctuating world prices of the commodities in question, and in particular whether (for purposes of application of the *Agreement on Agriculture*, which required certain measures to be converted into 'ordinary customs duties') the Chilean practice could be considered an 'ordinary customs duty.' During the panel proceedings, Chile changed its regulations such that the application of the price band could never result in duties being applied in excess of its *ad valorem* bound rates. The panel held that a method of calculating duties that took into account what it called 'exogenous' factors such as fluctuating world prices could not be considered an 'ordinary customs duty' within the meaning of Article II of the GATT, on which the relevant provisions of the *Agreement on Agriculture* were premised. The AB rejected the panel's attribution of a 'normative' significance to the expression 'ordinary customs duty' in Article II; the AB noted the lack of textual foundation for such a reading. The AB also disagreed with the panel's use of the actual scheduling practices of WTO Members as a basis for concluding that Chile's duties were not within the meaning of 'ordinary customs duties'; such practices, unless they represented the common agreement of all WTO Members, could not be a basis for giving a restrictive legal meaning to the expression 'ordinary customs duty.' While ultimately in *Chile-Price Band* the AB agreed with the panel that the *Agreement on Agriculture* had been violated, as far as the AB's remarks on Article II of the GATT are concerned, both this case and *Argentina-Footwear* suggest that, under Article II, a WTO Member has a wide scope for

applying tariffs according to any formula it desires, provided that the actual applied tariff in every case does not *exceed* the *bound* rate in the Member's schedule.

The current international rules on the valuation of goods for customs purposes are found in the Uruguay Round Agreement on Implementation of Article VII of the GATT.¹⁴ A Customs Valuation Code was initially negotiated during the Tokyo Round in order to 'provide a uniform, neutral valuation system that conforms to commercial realities and prohibits arbitrary values for duty'.¹⁵ A slightly revised Agreement was negotiated during the Uruguay Round.¹⁶ Prior to this, the rules were found in Article VII of the GATT. Article VII was intended to ensure that signatories used fair systems of valuation that conformed with certain principles. It requires that Parties to the Agreement base 'value for customs purposes of imported merchandise...on the actual value of the imported merchandise...not...on the value of merchandise of national origin or on arbitrary or fictitious values'.¹⁷ Actual value is defined as the 'price at which...such or like merchandise is sold or offered for sale in the ordinary course of trade under fully competitive conditions'. The Article does not specify the valuation method to be used and it gives the importing country discretion over the time and place for determining price.

Prior to the Tokyo Round negotiations, over 100 countries (including Japan and the countries of the EU) had adopted the valuation system called the Brussels Definition of Value (BDV).¹⁸ However, two major GATT trading nations retained separate systems of valuation: Canada and the United States. Because of the Protocol of Provisional Application (the Grandfather Clause),¹⁹ many of the signatories to the GATT were only bound to apply its Articles to 'the fullest extent not inconsistent with existing legislation'. Along with the general nature of Article VII, this provision allowed the perpetuation of very different, sometimes unfair, systems of valuation. For example, the United States used, in part, the American Selling Price (ASP) method of valuation, which was viewed as 'a device to keep the American public from seeing in all its nakedness the exorbitant level of duties contemplated by rampant protectionism'.²⁰ The American system was made up of nine different methods of valuation and was 'stupefying in its complexity'.²¹ In addition, Canada's valuation system was long considered to be inconsistent with Article VII of the GATT.²² Countries which traded with the USA and Canada raised the issue of customs valuation in the Tokyo Round negotiations in an attempt to have them abandon their systems.²³ The original intention of countries using the BDV was that it would become the worldwide system, but a compromise was reached with the USA.²⁴ The Customs Valuation Code that was concluded in 1977 was based in part on the US system and was accepted by the major trading nations.²⁵ Signatories were obliged to render their legislation consistent with the Code by 1 January 1981, but many countries, including Canada, reserved the right to postpone implementation in order to ensure the maintenance of tariff protection at pre-Code levels.²⁶

A major objective of the Code was to constrain the exercise of administrative discretion. Both the Tokyo and Uruguay Round Codes establish 'transaction value' as the primary standard of valuation.²⁷ Transaction value is the price paid or payable for the goods when sold for export to the country of importation, plus certain additions such as the cost of packaging and the value of various items provided to the buyer free of charge in connection with the sale of the goods (assists). There are also some items that can be deducted from the price such as the cost of transportation, handling and insurance from the place of direct shipment. The transaction value can only be used for the purposes of

valuation in certain circumstances. It can be used if there are no restrictions on the disposition or use of the goods other than those that are imposed by law or that restrict the resale area or that do not substantially affect the value of the goods.²⁸ In addition, to use transaction value, the price of the goods cannot be subject to any conditions or consideration, such as an undertaking by the buyer to buy more goods at a later date. Sales between related persons (generally officers of each other's companies, partners, direct or indirect controlling interests) are eligible for use of transaction value provided it is demonstrated that the relationship did not affect the price.²⁹ There are a number of valuation methods outlined in the current Customs Valuation Agreement to be used in the event that the transaction value cannot be used. Authorities must resort to these methods in a particular order; for example, only if the first and second cannot be used can resort be made to the third. In the prescribed order, they are:

- transaction value of identical goods exported to the same country of importation at approximately the same time;
- transaction value of similar goods exported to the same country at approximately the same time;
- deductive value based on resale price in the country of importation; and
- computed value based on the cost of production of the imported goods.³⁰

In many cases, the use of one of the alternate methods of valuation will be inappropriate because of information limitations or difficulties in calculation. Generally, resort will be made to the third or fourth method when the price is affected by the relationship between the parties to the transaction or when there is no selling price at the time of importation.

Certain methods of valuation are expressly prohibited in the Agreement, such as the use of arbitrary or fictitious values, and the use of the selling price in the country of importation.³¹ In the Canadian and American legislation, customs officials are authorized to apply one of the above methods flexibly if goods cannot be valued under any of the above methods; this is the residual or alternative method. Part II of the Agreement also provides for the establishment of a Customs Valuation Committee comprising representatives of all Members that is responsible for furthering the objectives of the Agreement and facilitating consultation and dispute resolution with respect to the valuation system.

Classification

Because there is wide variation in the level of tariffs from product to product, goods must be located in the correct product category to receive proper tariff treatment. As with valuation, the problem with classification for customs purposes is that it can be used as a protectionist device. A country that has agreed to reduce its tariffs in exchange for reciprocal concessions can use the classification system to ensure that the benefit is only received by the reciprocating country. This selectivity can be achieved if the product's classification can be subdivided so that the goods from the reciprocating country are in a distinct category. Then the tariff on the distinct category of goods can be reduced and other countries that would normally receive the benefit of the reduction through MFN treatment receive no benefit.³² This same technique of product classification is also used

to reduce the tariffs on inputs for domestic manufacturers and processors while maintaining the overall level of protection.³³

The Customs Cooperation Council was established in 1950 and given a mandate to develop and harmonize customs systems of the world. The result of the Council's work is the Harmonized Commodity Description and Coding System. The Harmonized System (HS) was open for signing in 1984 and was implemented in some countries by 1987.³⁴ The basis of the HS is that goods should only be classified by their essential or intrinsic nature (i.e. by what they are and not how they are used) and should only fall into one category.³⁵ In Canada's previous classification system it was not uncommon to find the same good in several different categories carrying different rates of duty.³⁶ The nomenclature consists of a mandatory six-digit classification system that is used by all signatories. Countries who find the classification too imprecise for their needs may use up to four more digits, as Canada has done.³⁷ Along with the numbers and descriptions, the system includes legal notes that are binding on the signatories. The notes provide definitions of terms and phrases essential to the classifications and set boundaries on the goods to be included in each. In addition, the notes list specific goods to be included or excluded in each category and give directions for locating the appropriate classification for excluded goods. Finally, there are extensive explanatory and interpretive notes.

In 1997, the United States requested that a panel³⁸ be established to examine a US challenge that EU changes to the tariff classification of Local Area Network (LAN) equipment and personal computers with multimedia capabilities (PCs) violated GATT Article II:1 because they resulted in treatment 'less favourable' than that provided in the EC's schedule of concessions—Schedule LXXX (Panel, para. 3.1). Following the conclusion of the Uruguay Round, the EU changed the tariff classification of certain LAN equipment and PCs to tariff classes with generally higher duties.³⁹ The panel found that the United States had 'legitimate expectations' that LAN equipment would have the same tariff treatment before and following the Uruguay Round, that those expectations were frustrated and that therefore the EC had violated GATT Article II:1 by not according 'treatment no less favourable' to LAN equipment imports under Schedule LXXX (Panel, paras 8.60–8.62).

The Appellate Body⁴⁰ (AB) reversed this conclusion. It found that 'legitimate expectations' of an exporter are not relevant for interpreting Schedule LXXX nor for deciding whether the EU violated GATT Article II:1 (para. 97). Although the AB concurred with the panel that one object and purpose of the GATT and the WTO Agreement is 'the security and predictability of "the reciprocal and mutually advantageous arrangements directed to the substantial reduction of tariffs and other barriers to trade"', the AB did not agree that this allows individual exporting Members' subjective opinions about an agreement to be the basis on which concessions are interpreted. It also found that such an approach would be inconsistent with good faith interpretation under Article 31 of the Vienna Convention, which requires determining parties' common intentions. Furthermore, tariff concessions in a Member's schedules are mutually agreed upon. Since schedule concessions are part of the GATT due to Article II:7, they are treaty terms and must be interpreted according to the Vienna Convention rules (paras 82–4). The AB overturned the panel's finding, indicating that the panel had come to its decision based on 'erroneous legal reasoning' and 'selective evidence' (para. 98).

Rules of origin

The final task in calculating the appropriate duty on imported goods is establishing the country of origin of imports. Tariff treatment is often dependent on the country of origin of the imports. As noted earlier, in Canada there are five major tariff treatments. In order to qualify for a particular tariff treatment, an importer must establish the product's origin. Establishing origin is often difficult: goods may be processed, assembled, packaged or finished in a variety of different countries, or shipped to the importing country via another country where they may or may not enter the commerce of that country.

There are presently no comprehensive multilateral rules that govern determinations of rules of origin. Moreover, in many countries, rules of origin are not internally harmonized; that is there are different rules for establishing origin within the country depending on the context. For example, rules of origin are generally categorized as either preferential or non-preferential. The former enhance market access to particular entities, while the latter restrict access.⁴¹ Preferential rules of origin are those applicable under NAFTA or a GSP, for instance. Enforcement of antidumping and countervailing duty orders are two uses for non-preferential rules of origin.⁴² This can pose a difficulty for exporters: a good that originated in country A may pay the tariff rate for country B, where it was processed, but face antidumping duties levied against goods from country A.

There have been two notable previous attempts at harmonizing rules of origin.⁴³ In 1953, GATT Contracting Parties considered adopting uniform rules of origin, but could not agree on a draft text defining origin. In 1974, the Customs Cooperation Council adopted the International Convention on the Simplification and Harmonization of Customs Procedures (i.e. the Kyoto Convention), which provided guidelines for rules of origin, not applicable rules. Both proposals used the concept of attributing origin to the country in which the good in question had been produced entirely or had undergone its last 'substantial transformation'. However 'substantial transformation' can be interpreted in many ways,⁴⁴ and is consequently the source of most international disputes.

The Uruguay Round Agreement on Rules of Origin adopts the following approach with respect to rules of origin. First, the Agreement sets out plans for transition to a harmonized system of origin-determination, to be developed by a Committee on Rules of Origin and a Technical Committee assisting it within three years of the acceptance of the Agreement. The first step requires all countries to harmonize their own rules of origin.⁴⁵ During this period, the rules applied by each country must be based on a positive standard (i.e. what confers origin, not what does not confer origin). Once this harmonization is achieved, countries will be required to base determinations of origin on either the country where the good was wholly obtained or the country where the good underwent its last substantial transformation. The rule of last substantial transformation is not fully defined in the Agreement,⁴⁶ but it combines a change in tariff classification with supplementary criteria based on percentage of value added or specific manufacturing or processing operations. Although the planned deadline for these reforms was 1996, EU, US and developing-country opinions still differed on several issues prior to the Doha Ministerial Conference.⁴⁷ Even in the unlikely event that a consensus is reached on harmonization,⁴⁸ the Agreement on Rules of Origin only deals with rules of origin for non-preferential agreements. Hoekman and Kostecki note, however, that rules of origin for preferential arrangements are the most contentious, and their exclusion 'reflects the fact that many

countries did not want to see constraints imposed on their policy freedom with regard to regional integration or the mechanics of trade preferences for developing countries'.⁴⁹

Based on a political economy analysis, Hirsch argues that rules of origin are increasingly being used as a protectionist tool to increase trade barriers faced by non-contracting states with the aim of increasing local consumption and to lure investment into the contract market.⁵⁰ He attributes this increase to three factors, beginning with Bhagwati's 'law of constant protectionism',⁵¹ which implies that demand for protection is not completely removed with trade barriers, but is redirected to other protectionist methods. In this case, Hirsch argues that rules of origin are serving as 'substitutes for tariffs. Another contributing factor to the increase in use of rules of origin as trade barriers is their lack of transparency, which makes their use and the resultant losses more difficult to determine.⁵² Finally, trade disciplines addressing the use of rules of origin are absent with respect to preferential use and inadequate with respect to non-preferential use.⁵³ Hirsch's reform suggestion is to increase transparency by defining rules of origin according to local content percentage rates, a process he compares to tariffication, followed by gradual reduction of these rates to within the 35–45% range, depending on the country in question and its factor endowments and production costs. This percentage target aims to minimize strategic protectionism, without eliminating the ability of rules of origin to serve their differentiating purpose.⁵⁴

In a recent case, *United States—Rules of Origin for Textile and Apparel Products*,⁵⁵ India made several arguments regarding US rules of origin for textile and apparel products. For example, India alleged that the US intended and designed its rules to protect its domestic industry and to favour EU products over developing-country products. India challenged the rules as a violation of Article 2(b), (c) and (d) of the Rules of Origin Agreement, which read as follows:

Until the work programme for the harmonization of rules of origin set out in Part IV is completed, Members shall ensure that...

- (b) notwithstanding the measure or instrument of commercial policy to which they are linked, their rules of origin are not used as instruments to pursue trade objectives directly or indirectly;
- (c) rules of origin shall not themselves create restrictive, distorting, or disruptive effects on international trade. They shall not pose unduly strict requirements or require the fulfilment of a certain condition not related to manufacturing or processing, as a prerequisite for the determination of the country of origin. However, costs not related to manufacturing or processing may be included for the purposes of the application of an ad valorem percentage criterion...
- (d) the rules of origin that they apply to imports and exports are not more stringent than the rules of origin they apply to determine whether or not a good is domestic and shall not discriminate between other Members, irrespective of the affiliation of the manufacturers of the good concerned.

Although none of India's claims succeeded, the panel made several interpretive comments. Notably, the panel found that Articles 2(b)–(d) prescribe what a Member should not do, not what a Member must do. Thus, within the boundaries set out by these provisions, Members may decide for themselves 'the criteria which confer origin,

changing those criteria over time, or applying different criteria to different goods' (paras 6.23–6.24). With respect to Article 2(b), the complaining Member needs to demonstrate that another Member 'is using rules of origin for a specified purpose, viz., to pursue trade objectives' (para. 6.36). In order to determine whether rules of origin are being used for a 'specified purpose', the panel imported the AB reasoning from another case⁵⁶ addressing Article III:2 of GATT 1994. According to the AB in that case, subjective intentions of individuals are outside the inquiry, but statutory purposes or objectives, i.e. the collective intention of the government and legislature, are relevant 'to the extent that they are given *objective* expression in the statute itself (paras 6.37–6.38). The panel then went on to note that 'trade objectives' in Article 2(b) include 'the kind of policy objectives which trade policy measures or instruments typically pursue', such as 'protecting the domestic industry against import competition' and 'favouring imports from one Member over imports from another' (para. 6.42).

Addressing Article 2(c) of the Rules of Origin Agreement, the panel indicated that the fact that rules of origin must not 'create restrictive, distorting, or disruptive effects on international trade' means they should not create such an effect in addition to the restrictive, distorting and disruptive effects caused by the commercial policy measure they are implementing. Alternatively, where the commercial policy measure has no prohibited effects, the rules of origin must not create any new effects of that kind (paras 6.136–6.138). The panel then explained that the word 'create' in Article 2(c) requires a causal link between the rules of origin and the restrictive, distorting and disruptive effects, although this link need not be deliberate. It then went on to define 'restrictive' effects as those that limit the level of international trade, 'distorting' effects as those that interfere with the natural pattern of international trade, and 'disruptive' effects as those that interrupt the normal continuity of international trade. 'Effects on international trade' includes effects on imports to which the rules of origin are applied, but not effects on trade in closely similar finished goods (paras 6.140–6.147). Turning to the second clause of Article 2(c), the panel interpreted 'requirements' to encompass 'the substantive origin requirements that must be met for a good to obtain origin status', 'strict' requirements to be those that 'make the conferral of origin conditional on conformity with an exacting or rigorous (technical) standard', and 'unduly' to mean 'excessively' (paras 6.204–6.207). Finally, the panel rejected India's assumption that Article 2(d) of the Rules of Origin Agreement precludes discrimination across different but closely related goods. The panel emphasized that Article 2(d) is meant to ensure that for a given good, rules of origin are equally strict regardless of the good's source (para. 6.248).

The NAFTA also contains a number of complex rules of origin designed to clarify and harmonize determinations of content.⁵⁷ Goods are deemed to originate in the territory of a NAFTA Party if they are wholly produced or obtained in any of the three NAFTA countries. They may contain offshore materials or components if they are transformed within a NAFTA country so as to be subject to a change in tariff classification. Special regional content rules apply in the case of some products. For example, to qualify for preference, computers must have motherboards made in North America, most textiles and clothing must include North American yarn, cars and trucks must have 62.5% North American content, and computer monitors and most colour televisions must be made with North American picture tubes.⁵⁸

Opinions diverge as to whether NAFTA rules of origin successfully balance the need not to be excessively restrictive with the need to avoid trans-shipment of third-country goods through Mexico.⁵⁹ On either view, distortions caused by NAFTA rules of origin are costly—estimated at 2–3% of NAFTA GDP.⁶⁰ Goldfarb identifies several costs associated with rules of origin—‘greater administrative costs, more complicated border inspections, less predictability, lower levels of trade and investment, higher component prices for producers and higher prices for consumers’⁶¹—and argues that a US–Canada customs union, even a partial one, would be a significant improvement over the current NAFTA system. The Canadian Department of Foreign Affairs and International Trade is currently studying the possible impact of a customs union.⁶²

Customs fees

Aside from the calculation of duties on imported goods, customs authorities are also responsible for processing documentation and collecting duties and administrative fees from importers. Both fees and documents may be barriers to trade. Documentation requirements can make the importation process more costly or prohibitively burdensome. In 1952, a Code of Standard Practices for Documentary Requirements was accepted by the GATT. The Code’s main purpose is to restrict the kind and number of documents required. The result of the Code was the abolition in many countries of consular invoices which were previously a heavy burden on international trade.⁶³

With respect to fees, there is no international agreement beyond the basic provisions of the GATT. Article VIII provides that:

All fees and charges of whatever character imposed by contracting parties on or in connection with importation or exportation shall be limited in amount to the approximate cost of services rendered.

The terms of Article VIII are vague and do not significantly constrain domestic practices. For example, importing countries often charge fees equal to a set percentage of the value of imports, leading to total charges far in excess of the cost of services rendered; the protective effect of such fees can be significant.⁶⁴ At present, domestic authorities retain a great deal of discretion in this area of customs administration.

Article II:1(b) of the GATT prohibits the imposition of ‘other duties and charges’ (i.e. other than bound tariffs) in excess of those existing at the time of GATT 1994. In the *Cigarettes case (Dominican Republic-Measures Affecting the Importation and Internal Sale of Cigarettes, WT/DS302/R, Report of the Panel, November 26, 2004)* Honduras challenged a number of import charges on cigarettes by the Dominican Republic as ‘other duties and charges’ within the meaning of Article II:1(b). The Dominican Republic maintained, however, that it had entered in its schedule at the end of the Uruguay Round an amount of some 30% percent for ‘Other Duties and Charges.’ The various measures complained of fell within that 30% ceiling; the panel nevertheless found a violation of Article II:1(b) since it appeared that the scheduled 30% ODCs were in reference to internal taxes that existed at the time of the scheduling, which are (of course) not ODCs at all. The Dominican Republic had referenced its scheduling to a policy measure that fell outside the meaning of an ODC, and thus could not take advantage now of the 30%

ceiling for its measures on cigarettes, which were ODCs. The panel's refusal to allow the ODCs based upon what appears to be a technical error by the Dominican Republic in scheduling at the end of the Uruguay Round, without looking to what would have been the reasonable expectations of *both* parties as to the intent and effect of the Dominican Republic's scheduling, is to be regretted, and we hope and expect that this aspect of the panel's decision will be reversed on appeal. At a minimum, the panel ought to have considered the implications of error or mistake under the customary international law on treaties, as reflected in the Vienna Convention.

MULTILATERALISM VS. REGIONALISM⁶⁵

The emergence of regional trading blocs, most prominently the European Union and the Canada-US Free Trade Agreement, and now NAFTA, in the post-war period, collateral to the evolution of the GATT and sanctified by Article XXIV of the GATT, constitutes easily the most important exception to the MFN principle of non-discrimination embodied in the GATT, and on that account requires an extended discussion.⁶⁶

While the record of the GATT in reducing tariffs on manufactured products has been impressive, it is also true that it has proven less effective in disciplining tariffs on primary products and non-tariff barriers to trade. If the reference point against which the GATT is to be judged is the deep integration being realized in the EU, with integration being pursued with respect to not only goods but also services, capital and people, adoption of a single currency, and harmonization of a plethora of domestic fiscal and regulatory policies, it is impossible not to adopt a relatively gloomy prognosis for the future of the GATT/WTO.⁶⁷ However, it is important to be explicit about the premise on which this prognosis rests. Only with a hegemonic pro-free trade presence in the case of the multilateral system, or heavily centralized policy-making institutions in the case of the EU, is it likely that deeper economic integration can be achieved.

Thus, in the case of the GATT/WTO, now with an arguably declining US hegemonic economic influence and with more than 140 Members (compared to 23 at the outset) in very different stages of economic development and with widely differing political, economic and cultural orientations—a heterogeneity that is likely to be increased in the future with the admission of more countries in transition from command to market economies—it is difficult to imagine the emergence of centralized integrating institutions to whom Member states are prepared to surrender major aspects of their political sovereignty. Thus, if one insists on viewing the GATT, as traditional liberal institutionalists do, as a system of international legal rules designed to constrain domestic self-interest, a system which can only be reinvigorated by stressing the importance of a global vision, of farsighted statesmanship that places global welfare and common interest over immediate domestic self-interest, and of the global rule of law,⁶⁸ the GATT is now and will always be a disappointment. Andrew Rose argues that even if the WTO's success is measured in terms of trade liberalization, it is not achieving this measure of success. Rose provides empirical data indicating that countries acceding or belonging to the GATT/WTO do not have significantly different trade patterns from non-members.⁶⁹ Rose also asserts that almost no measures of national trade policy are significantly correlated with GATT/WTO Membership, indicating that the GATT/WTO is not

associated with more liberal trade policy.⁷⁰ Rose concludes that there is no evidence that the WTO has increased trade. However, a somewhat more optimistic (and realistic) view of the GATT is possible. Sometimes referred to as the new liberal institutionalist approach,⁷¹ this view stresses that multilateralism should rather be seen as a decentralized framework for the negotiation and maintenance of mutually advantageous bargains among states. Liberal internationalists seek ways for designing or re-designing processes that, by reducing information, transaction, surveillance and verification costs, will facilitate Pareto-superior deals between or among states that are largely self-enforcing contracts. Performance of these contracts is promoted by reputation effects and tit-for-tat retaliation strategies that tend to solve the Prisoner's Dilemma problem in multi-period games.⁷² This is precisely what describes the greatest achievement of the GATT—the dramatic reduction in tariffs, but, it bears recalling, over a 40-year period and over eight successive bargaining rounds. In response to Rose's analysis, Subramanian and Wei provide support for the well-entrenched belief that the WTO has affected trade liberalization by pointing out Rose's failure to consider empirically three liberalization asymmetries which obscure the unevenness in the patterns of trade liberalization across Members, across time and across products. Subramanian and Wei assert that the WTO 'has done a splendid job of promoting trade', taking into account three key liberalization asymmetries: 'between developed and developing countries; between developing countries that joined the WTO before and after the Uruguay Round; and between sectors where the WTO has been effective in bringing down trade barriers and those—notably agriculture, and textiles and clothing—where it has been less effective'.⁷³

While it has become fashionable to talk of a 'borderless' world economy, the growth of global federalism, the decline in the significance of the nation-state, and the rise of consumer sovereignty,⁷⁴ it is as plausible to view the rapidly integrating world economy as overlain with 'a splintering world polity'.⁷⁵ The rise of regional trading blocs arguably reflects this latter trend. A total of 208 regional arrangements have been notified to the GATT/WTO since 1947: 141 under GATT Article XXIV (FTA), 14 under GATT Article XXIV (CU), 19 under the Enabling Clause and 34 under GATS Article V (see Figure 6.3).⁷⁶ Apart from the EU and NAFTA, other prominent or emerging regional trading blocs include: Mercosur (Argentina, Brazil, Paraguay and Uruguay) in Latin America; APEC (Asia Pacific Economic Co-operation) in Asia and the Pacific Rim;⁷⁷ and CARICOM (the Caribbean Common Market). There is also a commitment in principle

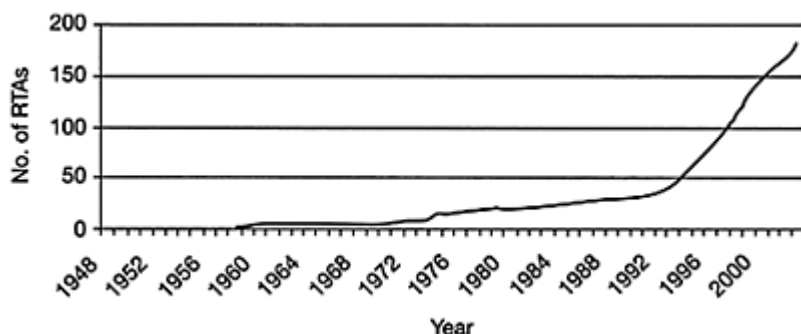


Figure 6.3 Regional trade agreements (RTAs) in force, by date of entry into force.

Source: Notifications to GATT/WTO.

to extending NAFTA throughout the western hemisphere by no later than 2005 (a Free Trade Area of the Americas—FTAA),⁷⁸ and preliminary discussion of a Transatlantic Free Trade Area between the US and the EU.⁷⁹

Regional trading blocs have generally enjoyed a bad press from trade economists.⁸⁰ The reasons are straightforward enough. At a political or foreign policy level, they necessarily entail playing favourites and risk reducing international relations to mutually destructive factionalism of the kind that was so dramatically evidenced in the 1930s. From an economic perspective, regional trading blocs, whatever their trade expansion properties with respect to intra-regional trade, almost necessarily also entail some measure of trade diversion (in the sense that lower-cost producers outside the regional trading blocs are discriminated against), thus distorting the efficient global allocation of resources and hence reducing global welfare.⁸¹ But this said, the question must be asked, ‘Compared to what?’ Compared to complete, undistorted global free trade, regional trading blocs are clearly second-best. But compared to the world trading system that actually prevails, or is likely to prevail in the foreseeable future, the case against regional trading blocs is not so clear.⁸²

In this second-best world, Lawrence and Litan⁸³ provide a balanced assessment of their strengths and weaknesses. In the end, their assessment is cautiously positive. Central to this assessment is, on the one hand, their view that regional trading blocs may be able to achieve a deeper degree of economic integration than the multilateral system—negotiations typically involve a much smaller number of ‘like-minded’ nations, and (less explicitly claimed) the necessary centralized or federalizing policy-making and enforcement institutions (as with the EU) are more likely to emerge. On the other hand, their view that the trade diversion potential of regional trading blocs is often overstated, given both the size of inherent intra-regional trade flows already involved, at least in the EU and NAFTA,⁸⁴ and the empirical evidence on the importance of extra-regional trade to all of the major regions that might conceivably become involved in regional trading blocs. That is, it is reasonable to assume (or hope) that regional trading blocs will remain ‘open’, rather than become ‘closed’.⁸⁵

We are less confident about both sides of this coin. With respect to the trade diversion argument, it is easy to be persuaded of the opposing view. One might argue, as Lawrence

and Litan implicitly do, that it would be economically irrational for the EU to constrain extra-regional trade when this has such self-destructive properties. But this can equally be said of most of the plethora of protectionist policies that have ever been adopted by any country anywhere. In the case of the EU, history suggests that economic rationality has not been the only force at play in the evolution of the Common Market. The Common Agricultural Policy (CAP) has transformed the EU at high cost over the post-war period from the world's largest importer of temperate zone agricultural products to the world's second largest exporter, with massive trade diversionary effects.⁸⁶

Jagdish Bhagwati, in a trenchant critique of regional trading blocs (which he prefers to call Preferential Trade Agreements—PTAs) entitled 'Fast Track to Nowhere',⁸⁷ points to evidence that Mexico's losses from trade diversion due to NAFTA (and its highly restrictive rules of origin) could be as high as US\$3 billion a year. The World Bank has estimated that approximately 36% of Caribbean exports to the USA will be subject to potential displacement.⁸⁸ Bhagwati argues that as PTAs spread, the world trading system comes to look like a 'spaghetti-bowl' of ever more complicated trade barriers, each depending on the supposed 'nationality' of products (determined by ever more complex and arbitrary rules of origin). Bhagwati warns that bilateral trade deals pose a 'deadly threat to the multilateral system', and that they 'have become a vehicle for the introduction of extraneous issues into the WTO for the benefit of narrow U.S. domestic interests'. Bhagwati views bilateral trade deals as undermining the MFN principle and distorting the role of the WTO. Griswold responds, noting that free trade agreements (FTAs) are WTO-legal under Article XXIV of the GATT.⁸⁹ Griswold argues that FTAs can serve as carrots to encourage the spread of political and economic freedom by breaking down barriers to trade between nations. Griswold notes that as membership of the WTO grows, reaching consensus multilaterally becomes more difficult and FTAs may provide a template for broader negotiations, particularly in politically sensitive sectors including labour and environmental standards.⁹⁰ Notably, the US-Jordan FTA and the US-Cambodia FTA may be evidence of Griswold's hypothesis. The US-Jordan FTA represents the first time a US trade agreement, rather than a side agreement, includes in the body of the agreement key provisions that reconfirm that free trade and the protection of the rights of workers can go hand in hand. Article 6 of the Agreement reaffirms the parties' support for the core labour standards adopted in the 1998 International Labour Organization's Declaration on Fundamental Principles and Rights at Work.⁹¹ Article 5 of the Agreement contains detailed provisions and obligations on environmental standards. The US-Cambodia Textile Agreement is the first bilateral textile trade agreement containing a labour provision. It permits an annual quota increase of 14% if the USA finds that Cambodia is in 'substantial compliance' with its labour laws and internationally recognized core labour standards.⁹²

Even if the existence of a hegemonic power is a necessary condition to the maintenance of a liberal trading regime, it clearly is not a sufficient condition—as exemplified by the historical role of the Soviet Union in Eastern Europe and the non-leadership role of the USA in the first third of the twentieth century.⁹³ Similarly, while it may also be the case that the existence of strong centralized institutions in a regional trading bloc is a necessary condition for deep economic integration, it would seem equally hazardous to assume that it is also a sufficient condition.

But this leads us to the first of the two reasons offered by Lawrence and Litan for their relatively positive view of regional trading blocs as conducive to deeper economic integration—negotiations occur among fewer and more like-minded countries than in the multilateral system. Under these circumstances, countries will be more willing to cede the kind of political sovereignty to federalizing central institutions that is required for deeper economic integration. Then presumably, once these regional trading blocs have achieved a high degree of economic integration, it is assumed that negotiations between a handful of major trading blocs, all oriented towards progressive trade liberalization, will be conducive to inter-regional economic integration. We are less sanguine than the authors about this scenario.

First, as they would acknowledge, many actual or potential regional trading blocs offer very small prospects for intra-regional trade expansion, even setting aside their effects on external trade. This is true for many actual or potential trading blocs in Africa, Latin America, the South Pacific and the Caribbean, where similarity of natural endowments often sharply limits the potential mutual gains from trade, although the rapid growth in intra-Asian trade suggests more potential for regional trade in manufactured goods.

Second, once one contemplates more ambitious regional trading blocs, it is difficult to imagine scenarios where a trading bloc is not dominated by one major economic power. It is superficially attractive to characterize the multilateral system as afflicted by the ‘convoy problem’ in which ‘the least willing participant determines the pace of negotiations—the speed of the convoy moving toward free trade is limited by the speed of the slowest ship’.⁹⁴ This can be contrasted with the regionalist alternative evoked by Lawrence and Litan through the more appealing metaphor of a geese migration, with the USA (or Japan) as head goose flying in a V-formation with a gaggle of other smaller countries in the same formation eagerly striving to keep up the pace towards at least regional economic integration. But as citizens of one of the smaller countries in such a formation, our judgment, after observing the ferocity of political debates in Canada over adoption of the Canada-US FTA in 1988, is that this entirely ignores political sensitivities to loss of sovereignty. If the virtue of regional trading blocs is their capacity for achieving a deeper degree of economic integration than the multilateral system, this view, as noted earlier, is premised either on a hegemonic theory of trade liberalization or on strong, federalizing central policy-making and enforcement institutions.

To take the Canada-US or Canada-US-Mexico case, we cannot imagine Canadians (or Mexicans) tolerating an arrangement whereby the USA is free to impose a common set of policies on all three countries across the spectrum of issues being addressed by the EU in its drive to integration (e.g. a common currency, centrally coordinated monetary policy, regulatory and directive powers over many domestic fiscal and regulatory policies). On the other hand, it is equally difficult to imagine the USA accepting a set of federalizing central institutions in which Member Countries are accorded relatively equal standing (recall the demise of the Havana Charter and the ITO). Thus, we conclude, as the Canada—US FTA and NAFTA largely corroborate, that most regional trading blocs will not be conducive to deep economic integration. We believe the EU is a *sui generis* case. Partly because of the much greater symmetry in size and resources of many of the participating countries, and partly because of special historical and political considerations largely related to the ravages of recurrent wars, Member Countries have been prepared to cede significant political sovereignty to federalizing central institutions.

Even in the case of the EU, intense internal debates and divisions over the implications for domestic political sovereignty of the Maastricht Treaty suggest growing reservations about this trend.

Third, even if we are wrong, we believe that it is highly speculative to assume that following deep regional integration, regional trading blocs will then readily move to interregional economic integration through negotiations with other trading blocs. It is easy to assume that if political forces within each of these blocs have been amenable to regional trade liberalization and perceive the economic gains associated therewith, they would as readily perceive the virtue of just keeping on going, so to speak, and integrating interregionally. But the problem here is that regional patterns of integration and specialization that develop may (depending on how much trade diversion is created) significantly exacerbate the adjustment costs of subsequent inter-regional integration, where different patterns of integration and specialization may be entailed.⁹⁵ Moreover, regional trading blocs unquestionably place a premium on foreign investment relative to foreign trade (partly because of its domestic employment-enhancement effects), and as foreign firms, principally multinational enterprises, establish substantial presences in each of the major trading blocs, a major political force for broader trade liberalization is attenuated (so-called 'cooperative protectionism').⁹⁶

Fourth, one should not underestimate the sequencing problems in maintaining an 'open' regional trading bloc,⁹⁷ in the sense of it remaining open to membership by subsequent parties. First-movers in such an arrangement face considerable uncertainty in determining the value of the preferences they are receiving in return for putatively deep concessions of their own, when these preferences may be eroded by subsequent admissions to the bloc. This will lead countries to be more reluctant to enter into a bloc in the first place, or to make deep concessions if they do, at least without a right of veto on new Memberships (creating hold-out problems). Alternatively, negotiations with all prospective Members will need to occur simultaneously, but in this event the large numbers problem said to afflict negotiations in the multilateral system will tend to re-emerge, as with current negotiations over accession of new Members to the EU or an FTAA involving more than thirty countries in the Western hemisphere.

Canada had to confront these issues in deciding on its role in the US-Mexico free trade negotiations. The strategy adopted in this case may set the mould for future free trade negotiations between the USA and other Latin American countries. The risk to Canada in staying out of such negotiations was that its preferences in the US market under the FTA would be eroded by similar preferences extended by the USA to Mexico while gaining nothing in return (in contrast to the USA) in terms of enhanced access to Mexico's market for exports and foreign investment. These effects would be exacerbated with each new bilateral agreement that the USA negotiated with another country—in the limiting case, a free trade area from Anchorage to Tierra del Fuego, in President Bush Senior's words. In turn, there would be strong incentives for export-oriented firms to invest in operations in the USA, relative to other parties to these bilateral (hub-and-spoke) agreements, because this would assure them of unrestricted access to all affected markets.⁹⁸ In recognition of these considerations, Canada joined the negotiations that led to the North American Free Trade Agreement (NAFTA).

The reservations noted above about the economic implications of regional trading blocs constitute strong reasons for being slow to abandon or attenuate the commitment to

the non-discriminatory multilateral world trading regime envisaged by the founders of the GATT.⁹⁹ Rather, we need a reconceived role (and a more patient set of expectations) for the WTO in promoting Pareto-superior and largely self-enforcing deals between countries on non-technical barriers and other trade distortions in successive bargaining rounds modelled as closely as possible on the tariff-reduction bargaining process that the GATT has so successfully facilitated in the past. Reducing most trade distortions to a common metric—a tariff equivalent or effective rate of protection—would be an important first step in pursuing this strategy.

GATT ARTICLE XXIV¹⁰⁰

GATT Article XXIV, supplemented by the Understanding on the Interpretation of Article XXIV, creates an exception to the MFN principle. It allows for the formation of a customs union (CU), free trade area, or an interim agreement leading to one of the two, subject to several conditions, including notification to the GATT Contracting Parties (Article XXIV: 7) and what we will refer to as the ‘internal trade requirement’ and the ‘external trade requirement’.¹⁰¹ For a free trade area, or an interim agreement leading to one, the external trade requirement is that duties and other regulations of commerce imposed on non-free trade area members may not be higher or more restrictive than they were before integration, or the interim agreement (Article XXIV:5(b)). The internal trade requirement is that duties and other restrictive regulations of commerce, with some exceptions, must be eliminated on substantially all the trade within the free trade area (Article XXIV:8(b)). For a CU, or an interim agreement leading to one, the external trade requirement is that duties and other regulations of commerce imposed on non-CU members may not be ‘on the whole’ higher or more restrictive than they were before integration, or the interim agreement (Article XXIV:5(a)). The internal trade requirement is that duties and other restrictive regulations of commerce, with some exceptions, must be eliminated on substantially all the trade within the CU. Also, CU members must generally apply substantially the same duties and other regulations of commerce to non-CU members (Article XXIV:8(a)).

In *Turkey—Restrictions on Imports of Textile and Clothing Products*¹⁰² (*Turkey Textiles*), India argued that Turkey’s quantitative restrictions on certain textile and clothing imports from India, which violated Articles XI and XIII of GATT, and Article 2.4 of the Agreement on Textiles and Clothing (ATC), were not justified by GATT Article XXIV. In 1973, Turkey began gradually aligning its customs duties with the EC Common Customs Tariff with the object of achieving a CU as a step towards possible EC accession (Panel, para. 2.13). As part of the final phase of the CU, Turkey was supposed to adopt, and did apply as of 1 January 1996, relevant EC regulations regarding textiles and clothing, including certain quantitative restrictions (paras 2.32, 2.38). The panel found that these quantitative restrictions *prima facie* violated GATT Article XI, which requires that WTO Members not generally use quantitative restrictions, and Article XIII, which provides that a Member must apply quantitative restrictions on a non-discriminatory basis if it uses them at all (para. 9.66). It also found a violation of ATC Article 2.4.

The panel found, and the AB agreed for different reasons, that Turkey's violation of GATT Articles XI and XII and Article 2.4 of the ATC were not justified by GATT Article XXIV. The AB indicated that the *chapeau* of GATT Article XXIV:5 allows for violation of other GATT provisions under certain conditions 'only if the measure is introduced upon the formation of a customs union, and only to the extent that the formation of the customs union would be prevented if the introduction of the measure were not allowed' (paras 45–6). More specifically, Article XXIV is a defence subject to two conditions: conformity with GATT Article XXIV:8(a) and XXIV:5(a), and demonstration that the CU would have been prevented if not for the measure at issue (para. 58).

For there to be a 'customs union', Article XXIV:8(a) indicates two requirements. First, two or more customs territories must eliminate duties and other restrictive regulations of commerce for substantially all trade within the CU. The AB noted that WTO Members have never agreed on the meaning of 'substantially all', but that it accords 'some flexibility' to CU members under GATT Article XXIV:8(a)(i). Second, with respect to trade barriers against non-CU members, the AB noted that the GATT does not require that they be the same, only that they be 'substantially the same', affording limited flexibility to CU members under Article XXIV:8(a)(ii) as well (paras 47–50).

Next, in order for Article XXIV to be a defence against GATT violations, the measure in violation must have been introduced 'upon the formation' of a CU that conforms with the Article XXIV:5(a) condition that 'duties and other regulations of commerce imposed [on non-CU members] shall not on the whole be higher or more restrictive than...in the constituent territories prior to the formation of such union'. The Understanding on the Interpretation of Article XXIV, paragraph 2, clarifies this obligation. The general incidence of duties before and after the CU will 'be based upon an overall assessment of weighted average tariff rates and of customs duties collected'. With respect to other regulations of commerce, the Understanding indicates that 'for the purpose of the overall assessment of the incidence of other regulations of commerce for which quantification and aggregation are difficult, the examination of individual measures, regulations, products covered and trade flows affected may be required' (paras 51–4).

Finally, the party claiming the defence must prove that absence of the measure in question would prevent the formation of the CU (para. 58). In this case, Turkey argued that but for the quantitative restrictions, the EC would have been forced to exclude textile and clothing products from free trade within the CU in order to avoid trade diversion. As a consequence, 40% of Turkey's exports to the EU would have been excluded, preventing the establishment of a CU because trade barriers would not be removed for 'substantially all trade' between the EC and Turkey, as required by Article XXIV:8(a)(i). The AB disagreed with this argument, pointing out that alternatives to quantitative restrictions, such as rules of origin, could be used to avoid trade diversion. Consequently, the AB concluded that Turkey had not made out its case and that quantitative restrictions were not justified under Article XXIV (paras 61–3). This AB position is questionable on two grounds. First, rules of origin can be seen as restrictive regulations of commerce that members must eliminate under Article XXIV:8(a)(i) to constitute a CU. Second, requiring CU members to employ rules of origin keeps them from adopting one shared commercial policy and thus creates a barrier to establishing an advanced CU.

Another controversial feature of this case is that the AB held that Article XXIV conditions are justiciable. This was contrary to conventional wisdom that whether or not a CU existed was a matter for political determination by the Committee on Regional Trade Arrangements. The panel proceeded on the assumption that the CU between Turkey and the EC was compatible with Article XXIV (para. 9.55). However, the AB indicated that panels are expected to require a party to establish that a CU exists (para. 59).¹⁰³

One further question related to Article XXIV is whether or not it can be used as a defence for violations of the WTO Agreements other than the GATT. Although this question has not been answered with respect to all non-GATT Agreements, *Turkey Textiles* partially addressed the question. The AB indicated that an Article XXIV defence may be raised for a violation of Article 2.4 of the ATC, because Article XXIV is incorporated in the ATC through the language of Article 2.4, which reads: '[n]o new restrictions...shall be introduced except under the provisions of the Agreement or relevant GATT 1994 provisions'.¹⁰⁴

The Doha mandate

The Doha Declaration commits to 'negotiations aimed at clarifying and improving disciplines and procedures under the existing WTO provisions applying to regional trade agreements' (para. 29). The WTO formed a negotiating group on WTO rules in February 2002.¹⁰⁵ The issue identification phase is not completed. However, matters on the agenda to date include: RTA transparency, 'RTAs and development, RTA coverage (in particular the definition of "substantially all trade" in GATT Article XXIV:8), other (restrictive) regulations of commerce (in particular matters related to preferential rules of origin and safeguards), and the primacy of the multilateral trading system and possible RTA negative effects on third parties',¹⁰⁶ and grandfathering RTAs. Special and differential treatment proposals are also under discussion. The negotiating group plans to continue work following the Cancun Ministerial.

Trade policy and domestic health and safety regulation and standards

INTRODUCTION

There has been a dramatic shift in the focus of trade policy concerns from the barriers that lie at the border to the barriers which exist ‘within the border’.¹ The WTO and many other trading arrangements have been largely successful in reducing both the levels of tariffs worldwide and the scale of other border measures such as quotas. This has revealed a new and more subtle category of measures which restrict trade—the numerous commonplace regulations which governments enact to protect the health and safety of their citizens and the environment in which they live. Such regulations vary tremendously: one nation’s bunch of grapes is another nation’s repository of carcinogenic pesticide residue. This effort to protect citizens from the hazards of everyday life has become a virtual minefield for trade policy-makers, as such differences can often be manipulated or exploited to protect domestic industry from international competition.² Even when there is no protectionist intent on the part of lawmakers, through a lack of coordination, mere differences in regulatory or standard-setting regimes can function to impede trade. It has thus become increasingly difficult to delineate the boundaries between a nation’s sovereign right to regulate and its obligation to the international trading community not to restrict trade gratuitously. The question of how to address this problem has received increasing attention from trade scholars. As Miles Kahler states, ‘the decades-long process of lowering trade barriers resembles the draining of a lake that reveals mountain peaks formerly concealed or (more pessimistically) the peeling of an onion that reveals innumerable layers of barriers’.³

There has been a steady growth in the regulations that pertain to health, safety, consumer protection and the environment over the past three decades. In many respects, these regulatory trends can be viewed as part of the elaboration of the modern welfare state in much of the industrialized world, reflecting in part the proposition that greater safety, a cleaner environment, etc. can be thought of as normal economic goods, the demand for which rises as income levels rise, so that greater prosperity (in significant part engendered by trade liberalization) has been accompanied by increased demands for these kinds of domestic policies. As trade liberalization, at least with respect to border measures, has continued to advance, these ‘within the border’ regulatory measures require new disciplines under international trade rules, particularly in a globalizing economy which, it is argued, has a low tolerance for ‘system frictions’.⁴

The allegation that regulations ostensibly designed to protect consumer health and safety are often trade barriers has substantially heightened both domestic and international political conflicts, as trade policy and domestic policy become increasingly

linked in domains previously thought to lie outside the arena of trade policy. Regulation in areas which seem purely domestic, such as food inspection, product labelling and environmental policy, can all affect how goods cross borders. This has resulted in a polarization of domestic political interests and has drawn new domestic political constituencies into debates over trade policies in the form of consumer and environmental groups or other NGOs seeking to resist the imposition of constraints on domestic political sovereignty by international trade agreements. As David Vogel notes,

free trade advocates want to limit the use of regulations as barriers to trade, while environmentalists and consumer advocates want to prevent trade agreements from serving as barriers to regulation. While the trade community worries about an upsurge of 'eco-protectionism'—the justification of trade barriers on environmental grounds—consumer and environmental organizations fear that trade liberalization will weaken both their own country's regulatory standards and those of their nation's trading partners.⁵

This has become a concern in both exporting and importing countries. Domestic producer interests in countries of destination often argue that lax health and safety regulation in countries of origin constitute an implicit and unfair subsidy to foreign producers which should be neutralized, e.g. by countervailing duties or by insistence on foreign countries adopting policies similar to those that obtain in countries of destination.⁶ This insistence of across-the-board equivalence raises a number of normative difficulties. How can trade in all goods worldwide really be expected to occur on a level playing field? This proposition seems to be at odds with the theory of comparative advantage, which is centrally predicated on nations exploiting their differences (not similarities) in international trade. Few international trade theorists believe any longer that comparative advantage is exclusively exogenously determined, but is significantly shaped by endogenous government policies, including health and safety regulation. Exploiting differences in government policies is no less legitimate than exploiting differences in natural endowments.⁷

This phenomenon has resulted in a number of potential conflicts. For example, the US Delaney Clause bars the approval of any food additive found to be carcinogenic. This 'zero-tolerance' approach extends to the pesticide DDT. However, DDT is currently approved for use under the Codex Alimentarius, the international body responsible for establishing standards benchmarks. Likewise, labelling has become a sensitive issue, whereby very specific product standards are often required before a specific label can be used, sometimes leading to perverse results. Such was the case when a British sausage-maker, wishing to export to Germany, was required to label its product 'pork-filled offal tubes' rather than use the more appetizing (and more marketable) title of 'sausages'.⁸ Labelling concerns are currently at issue between North America and the EU, particularly in the area of genetically modified agriculture (biotechnology). Canada and the United States, global leaders in the area, have invested massive resources in the development of this technology, which has allowed for large productivity gains. Yet EU markets remain for the most part closed to such products. The EU has further threatened to impose

discriminatory labelling schemes, despite the existence of the growing European biotechnology industry.⁹

Within North America, Mexico has recently succeeded in partially overturning an 82-year US ban on Mexican avocados because of the eradication of alleged pests which inhabit the avocado pits. Now imports of Mexican avocados are limited to 19 Midwestern and north-east states during the winter months only, at the same time that California avocado producers are in low season. Likewise, Mexican tomatoes have had ongoing difficulties with US market access. Florida's tomato industry has not fared well in the new competitive environment under NAFTA and consequently several actions have been taken to deny Mexican tomatoes access to the US market, including health and safety barriers stemming from concerns relating to irrigation and mulching practices.

From an economic perspective, there is much at stake. The US Department of Commerce recently estimated that in 1993 almost two-thirds of the \$465 billion in US merchandise exports worldwide were affected by foreign technical requirements and standards.¹⁰ Market access issues threaten to reduce the gains made in the Uruguay Round in the area of agriculture. The US Department of Agriculture maintains that over 12% of the total \$60 billion in US agriculture exports was subject to 'unjustified' trade restrictions involving sanitary and phytosanitary measures in 1996.¹¹ Smaller export-driven economies are particularly vulnerable as they lack the resources necessary to comply with multiple regulatory requirements in multiple export markets. The value of a trade agreement and its potential for economic integration is ultimately dependent on the legal and institutional structures that support it. It is now useful to consider how the international legal system has evolved to address these concerns.

This chapter first reviews the legal and jurisprudential foundations to these issues and then explores some of the future policy concerns. Although the focus of this chapter is domestic health and safety standards, environmental issues overlap to some degree with the issues presented. However, this chapter does not deal directly with environmental regulation. For a full discussion of trade and environmental issues, see Chapter 16.

LEGISLATIVE HISTORY

Successive international trade agreements have attempted to address the issue of standards as non-tariff barriers through increasingly sophisticated legal frameworks. The relevant provisions of three international agreements will be discussed here: GATT/WTO, the NAFTA and the EU. As a starting point, some early work of the OECD is instructive. Although not a trade agreement, the OECD represents the world's major trading economies, and helps to situate the issue in a historical context.

The OECD

The growth in legal instruments addressing the issue of standards in international trade has been relatively recent. Despite this, the Organization for Economic Cooperation and Development (OECD) recognized this as an issue as early as 1972, in the context of environmental regulations in its Guiding Principles Concerning the International Economic Aspects of Environmental Policies. These principles have more generally

informed trade policy approaches to technical standards. Although these principles do not represent binding legal commitments, they are an early example of attempts to balance the imposition of standards which relate to the valid environmental protection measures of a country on the one hand with the corresponding impacts on trade that measures may have on the other. The principles recognize that valid reasons for divergent standards exist, such as different social objectives or levels of industrialization. The principles also recognize that harmonization, while desirable, would be difficult to achieve in practice. The language in the principles seems to foreshadow the issues that are prominent on the trade agenda today:

Where valid reasons for differences do not exist, Governments should seek harmonization of environmental policies, for instance with respect to timing and the general scope of regulation for particular industries to avoid the unjustified disruption of international trade patterns and of the international allocation of resources which may arise from the diversity of national environmental standards.

...

Measures taken to protect the environment should be framed as far as possible in such a manner to avoid the creation of non-tariff barriers to trade.

...

Where products are traded internationally and where there could be significant obstacles to trade, governments should seek common standards for polluting products and agree on the timing and the general scope of regulations for particular products.

...

It is highly desirable to define in common, as rapidly as possible, procedures for checking conformity to product standards established for the purpose of environmental control. Procedures for checking conformity to standards should be mutually agreed so as to be applied by an exporting country to the satisfaction of the importing country.¹²

The GATT/WTO

The original GATT as adopted in 1947 does not contain provisions that directly restrict the Contracting Parties' freedom to adopt environmental, health and safety standards provided that these do not discriminate against imports in favour of domestic products (see Chapter 3 on National Treatment). Moreover, pursuant to Article XX, the General Exceptions provision of the GATT, even measures that are found to violate the non-discrimination requirements in Articles I (Most Favoured Nation) and III (National Treatment) may be justified as, *inter alia*,

(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 restrictions on domestic production or consumption [.]

These exceptions are dealt with in depth in Chapter 16 on trade and the environment.

The Tokyo Round

In response to the general perception that the GATT regime was inadequate in dealing with the growing problem of trade distortions arising from disparate national regulations,¹³ an Agreement on Technical Barriers to Trade, or the 'Standards Code', was adopted in 1979 at the Tokyo Round of multilateral trade negotiations¹⁴ but ratified by only 39 countries.¹⁵ The Standards Code established and elaborated on the principles first introduced in the OECD Guiding Principles above. The Standards Code applied to 'all products, including industrial and agricultural products'.¹⁶ It reiterated the National Treatment (non-discrimination) obligations of the Contracting Parties in this context and further sought to ensure that technical regulations and standards were not adopted 'with a view to creating obstacles to international trade'.¹⁷ Contracting Parties were urged to work towards the international harmonization of standards¹⁸ and were obligated to adopt such internationally accepted standards, unless inappropriate for reasons which included national security, the protection of human, animal and plant health, technological problems, and climatic and geographical factors.¹⁹ This provision thus shifted the onus of justifying any standard different from the internationally established benchmark to the Contracting Party. Also worthy of note was the obligation to specify standards in terms of their 'performance rather than design or descriptive characteristics'.²⁰ This provision sought to avoid the potential creation of artificial distinctions based on the intricacies of product design rather than their actual effect.²¹ In the event that a Contracting Party did choose to adopt a standard which differed from an international standard or where no such international standard existed, and that standard may have affected trade, notification was required through the GATT Secretariat.²² With respect to conformity assessment, the Standards Code provided that 'imported products should be accepted for testing under conditions no less favourable than those accorded to like domestic or imported products' and that such procedures should not be more complex or time-consuming than such treatment accorded to like domestic products.²³ The Standards Code also strongly encouraged Parties to adopt a 'mutual recognition' policy, wherever possible, for test results, certificates and marks of conformity of other Parties.²⁴

The Standards Code offered a clear articulation that standards which 'create an unnecessary obstacle to international trade' are not permitted. Such wording implies that there may exist necessary obstacles to trade, but no set of criteria was offered in order to determine the dividing line between necessary and unnecessary obstacles to trade. Thus, although the Standards Code may be viewed as a helpful first step to reducing the trade-restricting effect of divergent domestic standards, regulations and conformity assessment procedures, its effectiveness was weakened by the fact that it did not address the issue of

what exactly constitutes an unacceptable standard. This meant that the complaining party had the formidable onus of having either to prove 'deliberate protectionist intent, or to demonstrate that the measure went beyond what was "necessary"'.²⁵ From this legacy came the momentum to make as an objective of the Uruguay Round the development and extension of this legal framework.

The Uruguay Round

The Uruguay Round elaborated the Tokyo Round Standards Code into two new agreements governing standards. The Agreement on Sanitary and Phytosanitary Measures²⁶ (SPS Agreement) addresses measures designed to protect human, animal and plant life, and health. The Technical Barriers to Trade Agreement²⁷ (TBT Agreement) covers other technical standards and measures not covered by the SPS Agreement. Under the 'umbrella' provisions of the WTO, all parties to the GATT are obligated to adhere to both of these Agreements.²⁸ This expanded the number of global imports subject to trade disciplines by approximately \$182 billion, according to one estimate.²⁹

The issues created by technical barriers to trade have been discussed by the US National Research Council. Concerned that standards-related issues were undermining potential gains from trade in the United States, a group of experts were convened to undertake a comprehensive study of the issue. The group, led by prominent trade economist Gary Hufbauer, concluded that 'there is evidence to indicate that significant barriers to global trade are embedded in existing standards and will continue to grow in complexity'.³⁰ These conclusions were based on the following observations of the group:

- (1) standards that differ from international norms are employed as a means to protect domestic producers;
- (2) restrictive standards are written to match the design features of domestic products, rather than essential performance criteria;
- (3) there remain unequal access to testing and certification systems between domestic producers and exporters in most nations;
- (4) there continues to be a failure to accept test results and certifications performed between domestic producers and exporters in most nations;
- (4) there continues to be a failure to accept test results and certifications performed by competent foreign organizations in multiple markets;
- and (5) there is a significant lack of transparency in the systems for developing technical regulations and assessing conformity in most countries.³¹

Agreement on Sanitary and Phytosanitary Standards (The following draws on Mauroidis, House and Bermann, The Law of the WTO, Forthcoming West Publishing)

The SPS Agreement was intended to address measures designed to protect human, animal and plant life and health, and is used primarily as a tool to regulate SPS measures as nontariff barriers.³² SPS measures are a highly controversial area of regulation as they concern for the most part the safety of a nation's food supply and have consequently been the focus of intense NGO lobbying efforts. Central SPS issues such as scientific

justification and allowable risk are difficult to arbitrate and lie at the heart of a country's sovereignty.

The SPS Agreement applies to a defined set of measures, to the exclusion of TBT, namely a wide range of measures that protect human, animal or plant life or health from pests, contaminants, toxins, disease-carrying organisms, etc.³³ GATT rights and obligations concerning such measures (including National Treatment Article III:4) run parallel to the rules in SPS. Thus, the same food safety measure could give rise to a claim that it violates both certain provisions of SPS as well as certain GATT rules. In such a case, a panel would follow the principle of examining the measure first against the more specific norms (here those of SPS) and only then considering the more general provisions of GATT (*Bananas, Sardines*).

The SPS Agreement gives rise to several types of rights obligations: first of all, the Agreement contains provisions that encourage, without requiring, the use of international standards, including those of the Codex Alimentarius (see below); second, there are provisions that require that SPS measures (unless they conform to international standards) be based on scientific evidence, and an assessment of risk in accord with scientific principles. This is subject to the right of a Member to adopt provisional measures where scientific evidence is insufficient to conduct a risk assessment (5.7); third, the SPS Agreement contains disciplines to ensure that Members' SPS measures are not unnecessarily trade-restrictive in relation to the level of risk the Member is prepared to tolerate (5.6), and also to ensure that Members do not address different risks differently so as to engage in arbitrary and protectionist selectivity of which hazards are addressed through stringent regulation and which are not, applying more demanding criteria in areas where the risks arise primarily from imported as opposed to domestic products (5.5); and fourth, the SPS Agreement contains a range of provisions on conformity assessment, the testing and sampling of products at the border, for instance.

The role of international standards

Article 3 of the SPS Agreement deals with the relationship between domestic SPS regulations and international standards. There is a general obligation to base domestic SPS measures on international standards. This is subject to a right to deviate from international standards where the result is a higher level of protection. This right to deviate is in turn conditioned on the requirements of scientific risk assessment in the regulatory process detailed in Article 5 of SPS. In the *Hormones* case,³⁴ the Appellate Body (AB) held that the obligation to base measures on international standards was of an aspirational, 'best efforts' nature, and did not require that all SPS measures be based on international standards at the time of coming into force of the SPS Agreement.

In addition, measures that 'conform to' international standards—which according to the AB in *Hormones* implies a closer fit than 'based on'—are presumed to be consistent with the SPS Agreement as a whole as well as justified under Article XX of the GATT.³⁵ Thus, all of the obligations discussed below only relate to situations where measures do not 'conform to' international standards.

The term 'international standards' is defined in an Annex to the SPS Agreement. In the case of food safety, 'international' means primarily the standards of the Codex Alimentarius. Other organizations specifically mentioned as generating 'international

standards' within the meaning of SPS are International Office of Epizootics and the Secretariat of the International Plant Protection Convention. In addition, where the standards of none of these specifically mentioned bodies are applicable, then those of any other international standardization body, membership of which is open to all WTO Members, will serve as 'international standards' for SPS purposes.

The requirement of scientific justification

Article 2.2 of the SPS Agreement provides that SPS measures shall not be 'maintained without sufficient scientific evidence'. In the *Japan—Agricultural Products II* case, the AB held that this requirement is satisfied if there is 'a rational or objective relationship' between the SPS measure and the scientific evidence; the existence of such a relationship was to be determined on a case-by-case basis, and would depend on the characteristics of the measure at issue 'and the quality and quantity of the scientific evidence' (para. 84). Recently, in the *Japan—Apples* case,³⁶ the AB made it clear that this rational connection test does not, however, require deference by the WTO panel to the authorities of the regulating WTO Member, even where their handling of the scientific evidence is reasonable; instead, it is appropriate for the panel to review *de novo* the scientific evidence and its relationship to the measure (paras 163–7). This seems unnecessarily intrusive of domestic regulatory autonomy, and likely to give rise to renewed criticism that WTO tribunals are usurping democratic decision-making at the Member State level. It would have been more appropriate, as Japan was urging, for the panel to consider (much as do domestic courts in the USA and Canada in reviewing decisions of expert regulators) whether the Japanese regulators had acted in a reasonable, objective and unbiased fashion in the manner in which they obtained, weighted and utilized scientific evidence, i.e. a procedural rather than a substantive approach to 'rational relationship' that would avoid the panel itself purporting to become an arbiter of scientific method and scientific controversy.

In *Japan—Apples*, the panel held that Article 2.2 was violated by Japan because its measure was 'clearly disproportionate to the risk identified on the basis of the scientific evidence available' (para. 8.198). The notion that a measure cannot be maintained because it is disproportionate to the risk identified reads into the text of Article 2.2 a proportionality requirement that is nowhere to be found there. Article 2.2 deals with the sufficiency of evidence, not whether a risk is sufficient to regulate. The latter determination, as will be discussed below, has been held by the AB to be a matter for each individual WTO Member in setting its appropriate level of protection; it is entirely appropriate for a Member to regulate even to address a risk that is relatively remote, provided its levels of protection are not set in an arbitrary and protectionist manner, as across different kinds of risk. Unfortunately, the AB did not reverse the panel on this point; rather, the AB avoided the issue, by reading the panel's language of 'clear disproportion' as merely expressing the conclusion or result of the panel's (correct) application of the 'rational relationship' test, rather than as suggesting a different or additional test for proportionality (para. 163). Article 5.7 of SPS allows a Member to maintain a provisional SPS measure notwithstanding the requirement of 2.2 (and arguably notwithstanding also the risk assessment obligations in 5.1). In *Japan—Agricultural Products II*, the AB elucidated the four criteria that must be met in order for

a provisional measure to be maintained under 5.7: (1) the measure is imposed in respect of a situation where ‘relevant scientific evidence is insufficient’; (2) the measure is adopted ‘on the basis of available pertinent information’; (3) the Member which adopted the measure ‘seek[s] to obtain the additional information necessary for a more objective assessment of risk’; and (4) the Member which adopted the measure ‘review[s] the...measure accordingly within a reasonable period of time’. In the *Japan—Apples* case, the AB held that ‘insufficient’ scientific evidence means insufficient evidence to conduct a risk assessment in accordance with SPS Article 5.1. It is unclear why the AB chose to adopt a different meaning for the sufficiency or insufficiency of scientific evidence in dealing with SPS 5.7 than in the case of SPS 2.2. In the same case, the AB made the rather puzzling statement that ‘the application of 5.7 is ‘triggered not by the existence of scientific uncertainty but rather by the insufficiency of scientific evidence’ (para. 184). It is unclear what the AB thinks is meant by ‘scientific uncertainty’ here.

With respect to the obligation to review a provisional measure within a reasonable period of time, the AB held in *Japan—Agricultural Products II* that: ‘[W]hat constitutes a “reasonable period of time” has to be established on a case-by-case basis and depends on the specific circumstances of each case, including the difficulty of obtaining the additional information necessary for the review and the characteristics of the provisional SPS measure.’ The criterion that the provisional measure be adopted on the basis of ‘available pertinent information’ has not yet been considered by the AB.

While the treatment of sufficient scientific evidence in 2.2 and 5.7 seems undeferential to the substantive scientific and policy choices of domestic regulators, it must also be borne in mind that, in *Hormones*, the AB endorsed the Precautionary Principle—the notion that in the presence of uncertainty, it is appropriate for a regulator to act before resolving the uncertainty, if delay might result in an irreparable harm to human or animal life or the environment. The AB held that the Precautionary Principle did not have a status in the hierarchy of international legal norms that would result in it trumping the treaty obligations in SPS, but instead it was to be used in *interpreting* those obligations in which it could be considered to have been reflected. According to the AB:

We agree...with the European Communities, that there is no need to assume that Article 5.7 exhausts the relevance of a precautionary principle [to the interpretation of SPS]. It is reflected also in the sixth paragraph of the preamble and in Article 3.3. These explicitly recognize the right of Members to establish their own appropriate level of sanitary protection, which level may be higher (i.e., more cautious) than that implied in existing international standards, guidelines and recommendations. Thirdly, a panel charged with determining, for instance, whether ‘sufficient scientific evidence’ exists to warrant the maintenance by a Member of a particular SPS measure may, of course, and should, bear in mind that responsible, representative governments commonly act from perspectives of prudence and precaution where risks of irreversible, e.g. life-terminating, damage to human health are concerned.

(para. 124)

Neither *Japan—Agricultural Products II* nor *Japan—Apples* were cases where ‘risks of irreversible, e.g. life-terminating, damage to human health’ were at issue; rather, the concern was economic damage. In a different sort of case, where human health and life are at issue, one might expect to see interpretations of SPS 2.2 and 5.7 that are more reflective of the notion of precaution, and accordingly more deferential to the substantive regulatory choices of domestic governments.

Article 5.1 of SPS requires that a Member’s SPS measures (to the extent that they do not ‘conform to’ international standards) must be based on ‘an assessment, as appropriate to the circumstances, of the risks to human, animal or plant life or health, taking into account risk assessment techniques developed by the relevant international organizations’. Article 5.2, in turn, states the factors that Members ‘shall’ take into account in assessing risk, which are: ‘available scientific evidence; relevant processes and production methods; relevant inspection, sampling and testing methods; prevalence of specific diseases or pests; existence of pest- or disease-free areas; relevant ecological and environmental conditions; and quarantine or other treatment’. Risk assessment is further defined in SPS Annex A4: ‘The evaluation of the likelihood of entry, establishment or spread of a pest or disease within the territory of an importing Member according to the sanitary or phytosanitary measures which might be applied, and of the associated potential biological and economic consequences; or the evaluation of the potential for adverse effects on human or animal health arising from the presence of additives, contaminants, toxins or disease-causing organisms in food, beverages, and feedstuffs.’ Furthermore, Article 5.3 mandates that certain economic factors be considered in risk assessment, including potential damage in terms of loss of production or sales in the case of the spread of a pest.

In *Hormones*, the AB reversed the panel’s procedural reading that the requirement that measures be based on a risk assessment means that a risk assessment must actually have been taken into account in the regulatory process that gave rise to the measure. Instead, the AB read ‘based upon’ to mean that there is an objective, rational relationship between a risk assessment conforming to the criteria in SPS and the measure adopted, whether or not the regulating authority knew of or used the assessment in any way, or even whether it existed at the time the measure was adopted. The AB’s interpretation appears at first glance as an unwarranted intrusive reading of 5.1, which would involve the panel in *de novo* review of substantive scientific justification of a Member’s regulation, as opposed to ensuring that its regulatory process was informed by a risk assessment. At the same time, the SPS Agreement contains no grandfathering provision in respect of measures that existed prior to 1995, and thus the procedural reading of ‘based on’ in 5.1 would have had a dubious retroactive effect: thousands of existing measures would become illegal under SPS because, at the time at which they were adopted, no risk assessment was taken into account, no such requirement having existed, of course, at the time in question.

Having read 5.1 as thus entailing an examination of the substantive basis of a Member’s measures, the AB in *Hormones* went on, however, to make several interpretations of the requirement in 5.1 that provide a measure of deference to domestic regulators. First of all, the AB held that a risk assessment need not establish a minimum quantitative threshold or level of risk, provided that it goes beyond asserting merely theoretical uncertainty, and entails an actual empirical inquiry into the existence of risk.

This holding was marred by its expression in terms of the difference between probability and mere possibility, a misuse of the statistical concepts at issue.

Second, also in *Hormones*, the AB held that the distinction often used in academic literature between risk assessment and risk management does not preclude, under SPS, a WTO Member taking into account considerations of how different regulatory instruments are likely to address a given risk, and real-world human behaviour in the presence of risk. In the words of the AB: '[I]t is essential to bear in mind that the risk that is to be evaluated in a risk assessment...is not only risk ascertainable in a science laboratory operating under strictly controlled conditions, but also risk in human societies as they actually exist, in other words, the actual potential for adverse effects on human health in the real world where people live and work and die' (para. 187). There is a strong textual basis for the AB not to have read into SPS the distinction between risk assessment and risk management. Among the mandatory factors to be taken into account in risk assessment according to SPS 5.2 are regulatory tools such as inspection sampling and testing methods as well as 'quarantine or other treatment'. This makes it clear that the meaning of 'risk assessment' in SPS extends to the assessment of risk on alternative scenarios for its containment or management through human behaviour and its regulation. In this respect, SPS would seem to reflect the rethinking by scientists and regulatory economists of the soundness of a sharp distinction between risk assessment and risk management.³⁷

Third, and perhaps most important in addressing current disputes such as that between the USA, Canada and Argentina and the EU over genetically modified organisms (GMOs) where science is recent and contested, the AB held, in *Hormones*, that in the presence of scientific controversy or disagreement, SPS 5.1 permits a WTO Member to base its measures on minority, as opposed to mainstream, scientific opinion, if it so wishes, provided that the minority view comes from 'qualified and respected sources' (para. 194).

*The obligation to minimize trade restrictiveness and to avoid arbitrary
and protectionist differences in levels of protection*

Article 5.4 of SPS states that 'Members should, when determining the appropriate level of sanitary or phytosanitary protection, take into account the objective of minimizing negative trade effects.' In *Hormones*, the panel held that this provision was of a 'best efforts' nature, and thus that a Member has a sovereign right to set its level of protection as high as it wishes, even if the consequence is that only a highly trade-restrictive measure will serve to achieve that level of protection. The panel noted: 'Guided by the wording of Article 5.4, in particular the words "should" (not "shall") and "objective," we consider that this provision of the SPS Agreement does not impose an obligation. However, this objective of minimizing trade effects has nonetheless to be taken into account in the interpretation of other provisions of the SPS Agreement' (para. 8.166). In the *Australia—Salmon* case, the AB held that: 'The determination of the appropriate level of protection, a notion defined in paragraph 5 of Annex A, as "the level of protection deemed appropriate by the Member establishing a sanitary...measure" is a prerogative of the Member and not of the panel or of the Appellate Body... The "appropriate level of protection" established by a Member and the "SPS measure" have to be clearly

distinguished. They are not one and the same thing. The first is an objective, the second is an instrument chosen to attain or implement that objective' (paras 199–200). Article 5.6 of SPS requires that a Member's measure be no more trade-restrictive than necessary in order to achieve its appropriate level of protection. In the *Australia—Salmon* case, the AB set out the interpretive framework for applying SPS 5.6:

The three elements of this test under Article 5.6 are that there is an SPS measure which: (1) is reasonably available taking into account technical and economic feasibility; (2) achieves the Member's appropriate level of sanitary or phytosanitary protection; and (3) is significantly less restrictive to trade than the SPS measure contested. These three elements are cumulative in the sense that, to establish inconsistency with Article 5.6, all of them have to be met. If any of these elements are not proven, the measure in dispute would be consistent with Article 5.6. Thus, if there is no alternative measure available, taking into account technical and economic feasibility, or if the alternative measure does not achieve the Member's appropriate level of sanitary or phytosanitary protection, or if it is not significantly less trade-restrictive, the measure in dispute would be consistent with Article 5.6.

(para. 194)

Article 5.5 of SPS requires consistency in the establishment of levels of protection across different risks; however, differences in levels of protection are only prohibited where these are arbitrary and unjustified and are applied 'in a manner which would constitute a disguised restriction on international trade', in other words hidden protectionism. There are many reasons why citizens and governments choose a high level of protection against some risks and not others, even though such distinctions may seem 'irrational' to a scientist or regulatory economist. Sunstein and Pildes note:

For laypeople, many contextual features are relevant: (1) the catastrophic nature of the risk; (2) whether the risk is uncontrollable; (3) whether the risk involves some irretrievable or permanent losses; (4) the social conditions under which a particular risk is generated and managed, a point that connects to issues of consent, voluntariness, and democratic control; (5) how equitably distributed the danger is or how concentrated on identifiable, innocent or traditionally disadvantaged victims, which ties to both notions of community and moral ideals; (6) how well understood the risk process in question is, a point that bears on the psychological disturbance produced by different risks; (7) whether the risk would be faced by future generations; (8) how familiar the risk is.³⁸

In the *Hormones* case, the AB showed some appreciation for the complex considerations that enter into decisions concerning the appropriate level of protection that society seeks against particular risks. The United States had argued that the decision of the EU to ban synthetic growth hormones for livestock while doing nothing to counter the (even higher) incidence of such hormones in natural substances such as broccoli constituted an arbitrary

and unjustifiable difference in levels of protection. Reversing the panel, which agreed with the USA, the AB explained: 'we consider there is a fundamental distinction between added hormones (natural or synthetic) and naturally occurring hormones in meat and other foods. In respect of the latter, the European Communities simply takes no regulatory action; to require to prohibit totally the production and consumption of such foods or to limit the residues of naturally occurring hormones in food, entails such a comprehensive and massive governmental intervention in nature and in the ordinary lives of people as to reduce the comparison itself to an absurdity' (para. 221).

In *Hormones*, the AB did go on to find one difference in the levels of protection to be arbitrary and unjustified—namely certain hormones were banned in beef production but permitted in swine production. However, the AB found that the third prong of the test under 5.5, the requirement that the difference in levels of protection be applied so as to constitute a disguised restriction on trade, was not met. The AB noted that there were reasons for this inconsistency that had nothing to do with trade protection, namely the complex exercise of harmonizing Member State regulation in a federal political structure such as the EC. Rejecting evidence that the EC domestic beef industry had been lobbying for a ban on hormone-fed beef as a protectionist measure, the AB held that there was ample indication that EC-level action was a reaction to genuine public health concerns: 'The documentation that preceded or accompanied the enactment of the prohibition of the use of hormones for growth promotion and that formed part of the record of the Panel makes clear the depth and extent of the anxieties experiencing within the European Communities concerning the results of the general scientific studies (showing the carcinogenicity of hormones), the dangers of abuse (highlighted by scandals relating to black-marketing and smuggling of prohibited veterinary drugs in the European Communities) of hormones and other substances used for growth promotion and the intense concern of consumers within the European Communities over the quality and drug-free character of the meat available in its internal market' (para. 245).

Here the AB showed sensitivity to the real world of democratic regulation. There is hardly a regulatory measure that some producer pressure group will not lobby for as a matter of protectionist self-interest; to have qualified a measure as an impermissible 'disguised restriction on international trade' because some group or other happened to support it for protectionist motives would have sanctioned a massive interference with the capacity to respond to the health and related concerns of the citizenry at large.

In the later *Australia—Salmon* case, the AB developed the notion of 'warning signals' that would, cumulatively, lead to the conclusion that an arbitrary and unjustified difference in levels of protection is being applied as a disguised restriction on international trade. These might include extreme differences in the levels (a substance is prohibited while a substance posing comparable risks is left completely unregulated), as well as the failure to conduct a risk assessment as required in SPS 5.1.

Evidentiary issues

Under the SPS Agreement, the initial burden lies on the complaining party, which must establish a *prima facie* case of inconsistency of proof with a particular provision of the SPS Agreement on the part of the defending party, or more precisely, of its SPS measure or measure complained about. When the *prima facie* case is made, the burden of proof

moves to the defending party, which must in turn counter or refute the claimed inconsistency (*Hormones*, para. 98)

The issue presented itself once again in the context of the *Japan—Agricultural Products II* case. This time, however, with a slight ‘twist’ which actually bridges the gap between burden of proof and extent of control by WTO adjudicating bodies, the United States claimed that Japan did not use the least restrictive option to reach its objective.³⁹ According to the US argument, Japan should have conducted a ‘testing by product’ in order to ensure that its regulatory objective be met. The panel sought advice from experts to see if Japan indeed had not chosen the least restrictive option. It did so, however, not with respect to ‘testing by product’, as the United States had argued, but with respect to ‘sorption levels’—another method used to reach Japan’s revealed preference, which had not been argued by the United States. Hence, the question arose as to whether the panel had exceeded the limits of its power by seeking expertise to establish that another (potentially) less restrictive method, not argued by the complaining party, could have helped Japan reach its objective. The AB dealt with the issue in the following manner: ‘We note that the Panel explicitly stated that the United States, as complaining party, did not specifically argue that the “determination of sorption levels” met any of the three elements under Article 5.6.’⁴⁰ And later: Article 13 of the DSU [Dispute Settlement Understanding] allows a panel to seek information from any relevant source and to consult individual experts or expert bodies to obtain their opinion on certain aspects of the matter before it. In our Report...we noted the “comprehensive nature” of this authority...to enable a panel to discharge its duty imposed by Article 11 of the DSU’ (para 127). And then: ‘[W]e note that the present dispute is a dispute under the SPS Agreement. Article 11.2 of the SPS Agreement explicitly instructs panels in disputes under this Agreement involving scientific and technical issues to “seek advice from experts”’ (para. 128).

Article 13 of the DSU and Article 11.2 of the SPS allow WTO adjudicating bodies to select experts in consultation with the parties to the dispute. In the context of SPS, seeking outside expertise is a routine experience. This is so because of the issues involved: panellists are rarely accustomed to addressing scientific issues.

In the *Hormones* litigation, the panel first asked the parties to the dispute to name one expert each. It then named two experts (from a list prepared by the Codex Commission and the International Agency for Research on Cancer) and one additional expert in the area of carcinogenic effects of hormones.⁴¹ The European Community appealed the fact that one of the experts was a national of a party or third party and had links with the pharmaceutical industry. The AB, distinguishing the selection of expert witnesses in the context of SPS from expert review groups (Appendix 4 of the DSU), dismissed the EC argument and held that: ‘Once the panel has decided to request the opinion of individual scientific experts, there is no legal obstacle to the panel drawing up, in consultation with the parties to the dispute, *ad hoc* rules for those particular proceedings.’⁴²

In the *Australia—Salmon* case, the panel chose four experts after consultations with the Office International des Epizootics (OIE).⁴³ Finally, in the *Japan—Agricultural Products II* dispute, the panel chose three experts after soliciting suggestions from the Secretariat of the International Plant Protection Convention (IPCC).

Panels, it appears, will—in consultation with the parties to the dispute—seek expertise from outside sources following suggestions by the organizations mentioned in the SPS

Agreement (OIE, IPCC, Codex). In the *Hormones* litigation, the parties to the dispute were given the opportunity to name one expert each.

In these cases, the panels have exhibited some confusion about the appropriate role of scientific expertise. For example, in the *Australia—Salmon* case, panellists asked laboratory scientists questions that related to the costs and benefits of regulatory alternatives, an issue which bears on matters of politics and economics. It should not be presumed that the relevant expertise in SPS cases will always be that of natural scientists: following on the remarks of the AB in the *Hormones* case about the real world in which people live and die, expertise concerning the effectiveness and consequences—social and economic, or even cultural—of particular forms of risk management and regulatory intervention may be appropriate.

Other provisions

Article 4.1 of SPS requires that an importing Member recognize the standards of an exporting Member as equivalent, provided that ‘the exporting Member objectively demonstrates to the importing Member that its measures achieve the importing Member’s appropriate level of sanitary or phytosanitary protection’. Article 4.2 encourages the negotiation of mutual recognition agreements (MRAs). Annex B of SPS contains an extensive list of transparency obligations including notification and publication of SPS measures. Annex C imposes a variety of (mostly due process) obligations with respect to control, inspection and approval procedures.

The Agreement on Technical Barriers to Trade

The TBT Agreement applies to technical *regulations* and *standards*. Whereas compliance with the former is mandatory for market access to be granted to a foreign product, compliance with the latter is optional. However, because of the effect that standards might have on the market, the TBT Agreement also establishes disciplines that should be followed by WTO Members when they, or delegated bodies, set standards.

The term ‘technical regulation’ is defined in Annex 1 §1 TBT in the following terms:

Document which lays down product characteristics or their related processes and production methods, including the applicable administrative provisions, with which compliance is mandatory. It may also include or deal exclusively with terminology, symbols, packaging, marking or labelling requirements as they apply to a product, process or production method.

The AB held in paragraphs 175 and 176 of its report on *EC—Trade Description of Sardines*:⁴⁴

As we explained in *EC—Asbestos*, whether a measure is a ‘technical regulation’ is a threshold issue because the outcome of this issue determines whether the *TBT Agreement* is applicable. If the measure

before us is not a ‘technical regulation’, then it does not fall within the scope of the *TBT Agreement*...

We interpreted this definition in *EC—Asbestos*. In doing so, we set out *three criteria* that a document must meet to fall within the definition of ‘technical regulation’ in the *TBT Agreement*. *First*, the document must apply to an identifiable product or group of products. The *identifiable* product or group of products need not, however, be expressly *identified* in the document. *Second*, the document must lay down one or more characteristics of the product. These product characteristics may be intrinsic, or they may be related to the product. They may be prescribed or imposed in either a positive or a negative form. *Third*, compliance with the product characteristics must be mandatory [*italics and emphasis in the original*].

The AB went on to note that the requirement that a set of products is *identifiable* should not be equated to a requirement that a product is explicitly mentioned in the body of the technical regulation; it suffices that a product can be identified as being concerned with the discipline reflected in the body of the technical regulation. Omissions, hence, are not fatal. We quote from paragraphs 180 and 183:

Thus, a product does not necessarily have to be mentioned *explicitly* in a document for that product to be an *identifiable* product. *Identifiable* does not mean expressly identified.

...We observe that the EC Regulation does not expressly identify *Sardinops sagax*. However, this does not necessarily mean that *Sardinops sagax* is not an *identifiable* product. As we stated in *EC—Asbestos*, a product need not be expressly identified in the document for it to be *identifiable* [*italics and emphasis in the original*].

In the same report, the AB shows its willingness to avoid a formalistic interpretation of the definition of technical regulation. Hence, in its view, it is immaterial if the definition of the term makes a distinction between labelling and naming. We quote from paragraphs 190–1:

We do not find it necessary, in this case, to decide whether the definition of ‘technical regulation’ in the *TBT Agreement* makes a distinction between ‘naming’ and labelling... We are of the view that this requirement—to be prepared exclusively from fish of the species *Sardina pilchardus*—is a product characteristic ‘intrinsic to’ preserved sardines that is laid down by the EC Regulation...

In any event, as we said in *EC—Asbestos*, a ‘means of identification’ is a product characteristic. A name clearly identifies a product; indeed, the European Communities concedes that a name is a ‘means of identification’ [*italics in the original*].

The term ‘standard’ is also defined in Annex A as follows:

Document approved by a recognized body, that provides, for common and repeated use, rules, guidelines or characteristics for products or related processes and production methods, with which compliance is not mandatory. It may also include or deal exclusively with terminology, symbols, packaging, marking or labelling requirements as they apply to a product, process or production method.

Explanatory Note

The terms as defined in ISO/IEC Guide 2 cover products, processes and services. This Agreement deals only with technical regulations, standards and conformity assessment procedures related to products or processes and production methods. Standards as defined by ISO/IEC Guide 2 may be mandatory or voluntary. For the purpose of this Agreement standards are defined as voluntary and technical regulations as mandatory documents. Standards prepared by the international standardization community are based on consensus. This Agreement covers also documents that are not based on consensus.

Relationship of the TBT Agreement to the GATT and SPS

The rights and obligations in the GATT apply in parallel to the more specific rules in TBT, thus making it possible for the same measure to be challenged, for example, both under TBT provisions and under the National Treatment provision of the GATT. In such a case, the panel should examine the measure first under TBT, the more specialized regime, and then consider the GATT claim (*EC—Sardines*). The TBT Agreement does not apply to measures that fall within the definition of SPS measures (see above).

Least-trade-restrictiveness

Article 2.2 of the TBT Agreement requires that:

Members shall ensure that technical regulations are not prepared, adopted or applied with a view to or with the effect of creating unnecessary obligations to international trade. For this purpose, technical regulations shall not be more trade-restrictive than necessary to fulfil a legitimate objective, taking account of the risks non-fulfilment would create. Such legitimate objects are, *inter alia*: national security requirements; the prevention of deceptive practices; protection of human health or safety; animal or plant life or health, or the environment. In assessing such risks, relevant elements of consideration are, *inter alia*: available scientific and technical information, related processing technology or intended end-uses of products.

The various qualifications on the substantive criterion of necessity—for example (‘taking account of the risks non-fulfilment would create’) least trade-restrictive—distinguish the

TBT Agreement from Article XX of the GATT, which provides a means of justifying measures that have already been found to violate some provision of the GATT. Since it is not a matter of 'saving' measures that have already been impugned, the burden of proof is logically on the complainant to show that a least-restrictive alternative does exist, which would fulfil the defending Member's legitimate objective (see the discussion of this issue in connection with SPS, above).

Under 2.2, the obligation to ensure the least-trade-restrictiveness of regulations is relative to the kinds of risks that would arise in the absence of the regulations. Deliberation about the choice of regulatory instrument can be a costly and time-consuming process. How far a Member should be expected to go in exhausting all the regulatory alternatives to find the least trade-restrictive alternative is logically related to the kind of risk it is dealing with. Where what is at stake is a well-established risk to human life itself (as we will argue, is exactly the case with asbestos), a Member may be expected to act rapidly, rely on the scientific *acquis* to a large extent, and tend towards the more obviously effective and enforceable kinds of regulatory tools, as opposed to the more sophisticated and speculative ones.

It is important to note that Article 2.2 explicitly lists among the relevant elements of consideration in assessing risk 'available scientific and technical information' (emphasis added). This suggests that a WTO Member is not required to adopt or even explore a less restrictive alternative that has not been shown as effective in achieving its legitimate objective on the basis of *existing* scientific and other relevant information.

International standards

Article 2.4 TBT stipulates:

Where technical regulations are required and relevant international standards exist or their completion is imminent, Members shall use them, or the relevant parts of them, as a basis for their technical regulations except when such international standards or relevant parts would be an ineffective or inappropriate means for the fulfilment of the legitimate objectives pursued, for instance because of fundamental climatic or geographical factors or fundamental technological problems.

In the *Sardines* case, the AB largely avoided the key interpretive issue of how close a relationship is required between international standards and the domestic regulation in question (the meaning of 'on the basis of'); it merely observed that the domestic regulation cannot be in actual contradiction with the international standard, and accepted the dubious factual interpretation of the panel below that such a contradiction existed in the case at hand (paras 248, 250).

In *Sardines*, the AB also found that the obligation to use international standards as a basis for domestic regulations applies even to regulations that were originally adopted *before* the international standard in question was yet in existence; in so doing, the AB introduced an element of retroactivity not justified by the text of 2.4 (which in referring to situations where international standards *exist* or are *imminent* implies that the obligation is limited to where regulators would be aware of the international standards

when making the regulation). The implication, which seems to impose a heavy burden on domestic authorities, is that WTO Members must update their domestic regulations accordingly each time an international standard either comes into existence or is modified.

The AB, also in *Sardines*, came to the extraordinary conclusion that Members could be required to use international standards as a basis even where they have not been adopted by the consensus procedures of the international standardization organization in question. This was based on the AB's interpretation of an Explanatory Note, that read in relevant part, 'Standards prepared by the international standardization community are based on consensus. This Agreement also covers documents that are not based on consensus.' The AB read the second sentence to mean that, even though international standardization is a consensus procedure, international standards within the meaning of the TBT Agreement include standards not adopted by consensus, i.e. contrary to the practice of the international standardization community. This interpretation is puzzling, and indeed perverse, since it suggests that while the international standardization community requires consensus even for voluntary standards, the WTO by virtue of TBT 2.4 would make *mandatory* international standards that failed to attract consensus. The second sentence of the Explanatory Note cited above has the clear alternative meaning that it covers domestic as opposed to international standards adopted other than by consensus. This is understandable. The role of the TBT Agreement in relation to *domestic* standards is to ensure that they are prepared and used in such a way as not to lead to protection, and in accordance with best regulatory practices. The mere fact that a domestic standard has not been adopted by consensus does not in any way reduce the need to discipline its preparation and use so as to avoid protectionist effects. By contrast, the TBT Agreement has quite a different objective in relation to *international* standards, which is to *mandate* their use in domestic regulation, and consensus is important to that goal, for obvious legitimacy reasons.

Part of the problem is that, unlike with SPS, 'international standards' in TBT is not a defined term and there is no list of international standardization bodies whose standards count as 'international standards' for purposes of 2.4. In fact, there is the possibility that more than one international standardization body could promulgate standards relevant to a given measure (on GMOs, both Codex and the Biosafety Protocol for instance), in which case it would be presumably up to the regulating Member to choose which set of international standards on which to base its regulations.

With respect to the phrase 'relevant parts' of international standards in TBT 2.4, the AB held in *Sardines* that 'the regulating Member is not permitted to select only *some* of the "relevant parts" of an international standard. If a "part" is "relevant", then it must be one of the elements which is "a basis for" the technical regulation' (para. 250).

Finally, in *Sardines*, the AB provided an interpretation of the right to deviate from international standards where they are an 'ineffective or inappropriate means' for achieving a Member's legitimate objective. The AB distinguished between the idea of 'ineffective' and that of 'inappropriate' in the following way: the term 'ineffective' 'refers to something which is not "having the function of accomplishing", "having a result", or "brought to bear", whereas [the term] "inappropriate" refers to something which is not "specially suitable", "proper", or "fitting"' (para. 285). Furthermore, the AB held that the burden of proof remains on the complaining party to make a *prima facie*

case that the international standard is *not* an ineffective or inappropriate means for the defending Member to achieve its legitimate objective.

Other TBT obligations

Article 2.7 TBT provides that ‘Members shall give positive consideration to accepting as equivalent technical regulations of other Members, even if these regulations differ from their own, provided they are satisfied that these regulations adequately fulfil the objectives of their own regulations.’ Furthermore, according to Article 2.8 TBT, ‘Wherever appropriate, Members shall specify technical regulations based on product requirements in terms of performance rather than design or descriptive characteristics.’ Articles 2.5 and 2.9 TBT impose on WTO Members an *ex ante* transparency obligation: they have to notify, through the WTO Secretariat, all WTO Members of their upcoming technical regulations and, upon request, provide a justification of the regulatory intervention at hand. Article 2.12 TBT further imposes the obligation on WTO Members to allow a reasonable period of time between notification of their proposed technical regulation and its entry into force. Article 10 TBT contains elements of both *ex ante* and *ex post* transparency in the sense that it obliges WTO Members to establish in their jurisdiction an enquiry point whereby interested parties can be informed about the upcoming or already-in-force technical regulations. Finally, Article 2.11 TBT imposes a publication requirement for all technical regulations adopted. It pertinently reads to this effect:

Members shall ensure that all technical regulations which have been adopted are published promptly or otherwise made available in such a manner as to enable interested parties in other Members to become acquainted with them.

Code of Good Practice for standardization organizations

§D of the Code of Good Practice establishes a National Treatment obligation on standardization bodies:

In respect of standards, the standardizing body shall accord treatment to products originating in the territory of any other Member of the WTO no less favourable than that accorded to like products of national origin and to like products originating in any other country.

Article 4.1 TBT makes it clear that all WTO Members are bound by the disciplines laid down in the Code of Good Practice, which figures in Annex 3 of the TBT Agreement:

Members shall ensure that their central government standardizing bodies accept and comply with the Code of Good Practice for the Preparation, Adoption and Application of Standards in Annex 3 to this Agreement (referred to in this Agreement as the ‘Code of Good Practice’). They shall take such reasonable measures as may be available to them to ensure that

local government and non-governmental standardizing bodies within their territories, as well as regional standardizing bodies of which they or one or more bodies within their territories are members, accept and comply with this Code of Good Practice. In addition, Members shall not take measures which have the effect of, directly or indirectly, requiring or encouraging such standardizing bodies to act in a manner inconsistent with the Code of Good Practice. The obligations of Members with respect to compliance of standardizing bodies with the provisions of the Code of Good Practice shall apply irrespective of whether or not a standardizing body has accepted the Code of Good Practice.

Compliance with the Code amounts *ipso facto* to compliance with the principles of the TBT Agreement. Article 4.2 TBT pertinently reads in this respect:

Standardizing bodies that have accepted and are complying with the Code of Good Practice shall be acknowledged by the Members as complying with the principles of this Agreement.

In addition to National Treatment, some of the other most relevant disciplines in the Code of Good Practice include:

- §E standards must be least trade-restrictive means of achieving the legitimate objective
- §G to further harmonization among nationally defined standards, standardizing authorities are encouraged to participate in the work of standardizing bodies
- §H national standardizing bodies should avoid duplication of the work done at the international level
- §I standards should be drafted in terms of performance requirements, when feasible
- §J standardizing authorities should publish at least once every six months their work programme
- §P standardizing authorities should provide, if requested, information about their work programme
- §K standardizing authorities should join the ISONET
- §L WTO Members should allow 60 days, if possible, to lapse between adoption and entry into force of the standard
- §M *ex ante* transparency is required in the sense that draft standards must be made available to interested parties to comment upon
- §N comments received on draft standards should be, if appropriate, taken into account when drafting the final text
- §O all standards must be published.

Conformity assessment

Through conformity assessment, foreign products will (or will not) be accepted as equivalent to domestic products which respect the technical regulation or standard at hand. The TBT Agreement importantly:

- 1 obliges WTO Members to give foreign suppliers access to their facilities, under the same conditions applied to domestic producers, to have the conformity of their products with the technical regulation or standard at hand assessed (Article 5.1.1 TBT);
- 2 conformity assessment procedures must respect the necessity principle, in the sense that they should not be more trade-restrictive than what is required to achieve their objective (Article 5.1.2 TBT);
- 3 conformity assessment procedures must be published (Article 5.8 TBT) and further detailed to interested parties (Articles 5.2 and 5.6 TBT);
- 4 although there is no obligation imposed on WTO Members to accept other Members' conformity assessment procedures, they should do so if they are satisfied that such procedures are equivalent to theirs (Article 6.1 TBT);
- 5 WTO Members are encouraged to sign MRAs in the field of conformity assessment procedures (Article 6.3 TBT);
- 6 WTO Members are encouraged to participate in the work of international bodies aiming at harmonizing conformity assessment procedures (Article 5.5 TBT);
- 7 when it comes to standardizing bodies at the sub-central government level, WTO Members undertake more limited obligations (Article 7 TBT).

Special and differential treatment

Article 12.3 TBT explicitly requests that WTO Members take into account developing countries' interests when enacting technical regulations or standards:

Members shall, in the preparation and application of technical regulations, standards and conformity assessment procedures, take account of the special development, financial and trade needs of developing country Members, with a view to ensuring that such technical regulations, standards and conformity assessment procedures do not create unnecessary obstacles to exports from developing country Members.

Expert groups

According to Article 14.2 TBT, at the request of a party or on its own initiative, a panel has the possibility to invite the opinion of expert groups established to this effect. Annex 2 to the TBT Agreement regulates in detail the procedure to be followed:

- 1 Technical expert groups are under the panel's authority. Their terms of reference and detailed working procedures shall be decided by the panel, and they shall report to the panel.
- 2 Participation in technical expert groups shall be restricted to persons of professional standing and experience in the field in question.
- 3 Citizens of parties to the dispute shall not serve on a technical expert group without the joint agreement of the parties to the dispute, except in exceptional circumstances when the panel considers that the need for specialized scientific expertise cannot be fulfilled otherwise. Government officials of parties to the dispute shall not serve on a technical expert group. Members of technical expert groups shall serve in their individual capacities and not as government representatives, nor as representatives of any organization. Governments or organizations shall therefore not give them instructions with regard to matters before a technical expert group.
- 4 Technical expert groups may consult and seek information and technical advice from any source they deem appropriate. Before a technical expert group seeks such information or advice from a source within the jurisdiction of a Member, it shall inform the government of that Member. Any Member shall respond promptly and fully to any request by a technical expert group for such information as the technical expert group considers necessary and appropriate.
- 5 The parties to a dispute shall have access to all relevant information provided to a technical expert group, unless it is of a confidential nature. Confidential information provided to the technical expert group shall not be released without formal authorization from the government, organization or person providing the information. Where such information is requested from the technical expert group but release of such information by the technical expert group is not authorized, a non-confidential summary of the information will be provided by the government, organization or person supplying the information.
- 6 The technical expert group shall submit a draft report to the Members concerned with a view to obtaining their comments, and taking them into account, as appropriate, in the final report, which shall also be circulated to the Members concerned when it is submitted to the panel.

The NAFTA

The NAFTA provisions with respect to standards are closely similar to the Uruguay Round TBT and SPS Agreements.⁴⁵ There are a few important differences, which can be accounted for by the political context in which NAFTA entered into force. The adoption of NAFTA was stalled for two years in an effort to address the concerns of the increasingly powerful NGO community of the United States, particularly consumer, environmental and labour groups.⁴⁶ To some extent, the differences that exist between the two agreements reflect the varying degrees of power of the United States in two different trade negotiation contexts. In the trilateral NAFTA negotiations, the United States was by far the dominant economic power, whereas in the case of the multilateral WTO negotiations, its economic power was relatively more balanced. This fact is reflected in the NAFTA as compared to the WTO Agreement, which affords greater latitude to the

Parties to set health and safety standards at levels they deem appropriate, despite possible trade-restricting effects.⁴⁷

TBT Code

NAFTA's TBT Code is found in Chapter 9 and largely reiterates the rights and obligations found in the Uruguay Round TBT Agreement. The right to establish measures 'relating to safety, the protection of human, animal or plant life or health, the environment or consumers' is positively established in Article 904. NAFTA Parties are free to establish the level of protection deemed appropriate and are not obliged to harmonize. This would allow countries to vary in their level of allowable risk.⁴⁸ Parties are prevented from establishing standards with a view to, or having the effect of, creating an unnecessary obstacle to trade (Article 904(4)). An unnecessary obstacle to trade will not be deemed to be created where the purpose of the measure is to achieve a legitimate objective, which is defined to include sustainable development as well as the protection of human, animal and plant life, and health. This provides stronger protection for disparate standards than its Uruguay Round counterpart, which states that whenever a technical regulation is created for a legitimate objective and is in accordance with relevant international standards, it 'shall be rebuttably presumed not to create an obstacle to trade'.⁴⁹ This also represents a departure from the comparable Canada-US Free Trade Agreement (FTA) language which used the term 'legitimate domestic objective'. This provision may have been added to permit extraterritorial protection measures, a subject of controversy under the GATT.⁵⁰

The NAFTA TBT Code differs from the Uruguay Round TBT Agreement in that it does not contain an express 'least trade-restrictive' requirement. Both the NAFTA TBT Code and the Uruguay Round TBT Agreement differ from the SPS disciplines in that they permit national regulations to be more stringent than international standards without requiring that those standards be justified by scientific evidence. Article 907 uses permissive language—a Party 'may' take into account available scientific evidence etc. Again, Article 905 places a premium on the use of international standards by presuming them to be consistent with the obligations under this section.

SPS Code

Trade in agriculture within North America is large and rapidly growing.⁵¹ There is a heavy reliance on the SPS disciplines to facilitate this growth, making the NAFTA model an interesting test case. NAFTA's SPS Code in general contains the same disciplines as outlined above for the SPS Agreement, save for a few exceptions. NAFTA provides a more forceful articulation of the freedom of Parties to adopt such levels of protection as they see fit. Article 712(1) establishes the positive right of a Party to adopt any SPS measure necessary for the protection of human, animal or plant life or health, including measures more stringent than international standards. This is supported by Article 712(2) which states that notwithstanding any other provision, Parties remain free to establish 'appropriate levels of protection'. This has been interpreted as a clear statement that NAFTA countries are not obligated to harmonize their standards.⁵² Article 712 contains National Treatment language along with the obligation that SPS measures are to be

'applied only to the extent necessary to achieve [their] appropriate level of protection' and that they may not be applied 'with a view to, or with the effect of, creating a disguised restriction on trade between the Parties'. Article 712(3) requires that SPS measures be based on scientific principles and risk assessment, and Article 715 lists the factors that NAFTA countries must take into account when assessing risk and determining appropriate levels of protection. Like the WTO SPS Agreement, Parties are obligated to take international risk assessment methodologies into account along with other scientific considerations. NAFTA also introduces a cost-benefit analysis into the assessment of risk. If a NAFTA Party adopts standards based on international ones, such standards are presumed to be consistent with Article 712 and Parties are obligated to participate in international standardizing organizations. NAFTA 715(3) states that Parties shall 'avoid arbitrary or unjustifiable distinctions' in establishing levels of protection. Article 714 states that the Parties shall, to the greatest extent practicable, pursue equivalence in their SPS measures, as long as levels of protection are not reduced.

Absent full harmonization, the issue of equivalency and mutual recognition becomes especially salient. The problem of mutual recognition of SPS measures was dealt with in the *UHT Milk* case in 1992, where Canada initiated an action against the United States under Chapter 18 of the FTA regarding ultra-high temperature (UHT) milk.⁵³ After 14 years of trouble-free exports to Puerto Rico, UHT milk from Quebec was denied entry on the basis that it did not comply with recently adopted Puerto Rican health and safety standards. The Canadian government claimed that these standards, at least as applied to the facts in issue, were a sham, and were more properly characterized as a barrier to trade and an outright violation of the FTA. The US government claimed that it was free to set its own health and safety standards, and that its obligations under the FTA did not diminish that freedom.

In an effort to increase milk sales, Puerto Rico had adopted new regulations requiring that milk originating outside of Puerto Rico must either comply with specific pasteurizing requirements or have been processed under 'substantially similar regulations' and be inspected by a state official certified by the US Food and Drug Administration (FDA). Submissions were made to the FDA demonstrating that the technical standards under which UHT milk from Quebec was produced were at least equivalent to the new Puerto Rican regulations. The FDA denied this request for equivalency and revoked the licence of the Canadian firm which exported the milk on the basis of non-compliance. The FDA was unwilling to conduct an equivalency study and certify Canadian inspectors unless such a study formed part of a broader solution to dairy trade between Canada and the United States. The FDA did not feel that it was able to justify the expense involved to provide relief to only one Canadian firm.⁵⁴ Numerous diplomatic and intergovernmental interventions followed. The issue was discussed at the Technical Working Group on Dairy, Fruit, Vegetable and Egg Inspection and a 'UHT Subcommittee' was even established under the auspices of this technical working group to consider issues relating to equivalency. These efforts were ultimately unsuccessful.

Canada argued that the regulation violated National Treatment as, although the regulations applied equally to domestic and imported milk, the failure to allow a demonstration of equivalency made it impossible for Quebec producers to meet the requirements easily met by US producers.⁵⁵ Canada also noted that Puerto Rico failed in its obligation to facilitate trade by establishing equivalency, pursuant to its obligations

under the FTA, which requires the Parties to 'facilitate trade in agricultural products' by working together 'to improve access to each other's markets through the elimination or reduction of import barriers'. Canada further argued that Article 708.1 was breached by the failure to 'make equivalent their respective technical regulatory requirements and inspection procedures' where harmonization was not feasible and by the failure of Puerto Rico to 'establish equivalent accreditation procedures for inspection systems and inspectors' by its insistence that only FDA-certified inspectors could be employed to evaluate Quebec UHT milk. Finally, Canada argued that the regulation was a disguised restriction on trade designed to protect domestic UHT production.⁵⁶

The United States argued that it had the right to maintain and upgrade technical regulations for the protection of human, animal and plant life, and that it is the responsibility of the foreign producer to comply with such legitimate health regulations. The United States further argued that the upgrading of standards does not make them a restriction on trade, and that the safety and quality of the milk supply is a legitimate policy objective. Alternatively, if the FTA had been breached, then the GATT Article XX(b) exception for health and safety was applicable. The United States further argued that the denial of a licence was fully consistent with National Treatment as standards do not vary between imported and domestic products, and that equivalency rests with the discretion of the Puerto Rican authorities.⁵⁷

The panel prefaced its remarks by affirming that the setting of standards is a significant prerogative of states and stated that the central issue was one of determining equivalency and the appropriate standard by which equivalency should be judged. The panel ruled that Article III should not be examined on general GATT principles, but rather the case should be decided on the more specific FTA provisions. Consequently, the panel abstained from determining whether National Treatment had been violated. The panel rejected Canada's argument that the United States had failed to work together to facilitate access to each other's markets as only a best efforts-type obligation was imposed on the Parties, the observance of which is fundamentally a matter of acting in good faith, the absence of which was not demonstrated. The panel further noted that as no time limits are specified in the FTA for the resolution of either harmonization or equivalency, the rules are not strictly mandatory. The panel concluded that the Puerto Rican rules did not constitute an arbitrary or unjustified restriction on trade because, in the absence of an equivalency study, it was unclear whether any other measure would provide the level of health protection sought by those rules. However, somewhat surprisingly, the panel concluded by finding that there had been 'non-violation nullification and impairment' of Canada's reasonably expected benefits under FTA Article 2011 and recommended that an equivalency study be conducted within a reasonable period (preferably two months), with sharing of costs, and that Quebec UHT milk be readmitted to the Puerto Rican market if Quebec standards were found to have the same effect as the Puerto Rican standards. Interestingly, again, the panel sidestepped the issue of determining whether the measures afforded 'protection to domestic production' or were a 'disguised restriction on trade', perhaps out of concern for embarrassing a party to the dispute.

One commentator has argued that although the question before the panel related to substantive equivalency and comparison of the standards governing the production of milk, this was not the legal issue before the panel.⁵⁸ Rather, the panel 'had to consider

only the narrower issue of whether an opportunity to prove equivalency had been offered at an appropriate time and in an appropriate manner'.⁵⁹ Thus the question before the panel was one of legal process (were the rules followed?) rather than one of substance (are the production methods equivalent?). While it was not for the panel to make technical determinations, it still failed to determine whether the process differences, that is the failure to grant equivalency in a timely manner, constituted a violation of National Treatment obligations. In the case of the obligations imposed on the Parties under Articles 703 and 708 (the provisions which obligate the Parties to work together to achieve market access through harmonization, mutual recognition, etc.), the panel made its decision on the narrowest interpretation possible, supporting the contention that because certain obligations are not 'hard', they are therefore virtually non-existent. The Parties are under a reasonable duty to facilitate trade under these Articles, despite the absence of specific time limitations. This affords wide latitude to Parties in the imposition of health and safety measures which could be barriers to trade. Under such an interpretation, Parties could effectively use stalling tactics, and delay equivalency studies in the name of consumer protection.

NAFTA institutions

NAFTA further established a trilateral intergovernmental institutional structure to support and facilitate the application of the TBT and SPS Codes. A number of committees, subcommittees and working groups meet regularly in order to discuss issues that arise in the context of North American trade.⁶⁰ Groups that deal regularly with standards-related issues include an SPS Committee and its associated nine technical working groups (including one on pesticides), a Committee on Agricultural Trade and a Committee on Standards-Related Measures with associated subcommittees in the area of land transportation.

STANDARDS-SETTING BODIES

All of the trade agreements listed above rely heavily on the work of international standardizing organizations. As they largely immunize domestic standards from attack, their work is extremely important. The stringency of a country's chosen standard *vis-à-vis* the comparable international standard is key to an initial determination of whether such a measure is or is not consistent with the given trade agreement. This naturally puts such hitherto 'back room' organizations in a new light. How are such institutions governed? To whom are they accountable? To what extent do they permit public participation? How are their standards actually developed?

The international standards system

There are a number of international standardizing bodies mentioned in the text of the trade agreements. In the case of SPS measures, both the NAFTA and the WTO Agreements refer to the Codex Alimentarius Commission, the International Office of Epizootics, and the international and regional organizations operating within the

framework of the International Plant Protection Convention. In the case of TBT measures, both the NAFTA and the WTO Agreements refer to the International Organization for Standardization (ISO), the International Electrotechnical Commission (IEC), the Codex Alimentarius Commission, the UN Food and Agricultural Organization (FAO) and the World Health Organization (WHO).

The most important non-governmental international standards development institution is the ISO, a worldwide federation of national standards bodies from over 100 countries.⁶¹ It was founded in 1946 and has been the most prolific author of international standards to date, generating standards in almost all areas except for that of electrical standards, which is governed by the IEC.⁶² ISO members comprise the national bodies 'most representative of standardization in [their] countries'. The technical work of the ISO is highly decentralized and is carried out by over 2,700 technical committees, subcommittees and working groups which are coordinated by a central Secretariat located in Geneva.

Within the ISO, each Member body has the right to be represented on a committee if it has an interest in a subject. Standards are developed by a consensus process in order to be inclusive of the views of all stakeholders. They represent industry-wide interests, seek to promote global solutions and are voluntary. Standards are developed according to a six-step process. The ISO has developed these rules, on the whole, without controversy. But despite the wide membership, Esty notes that there are only 'limited opportunities for public involvement', and often the only people at the meetings are business representatives from industry. This view is supported by Audley, who additionally notes that the fact that only one organization per country can be represented at the meetings compounds NGO efforts 'to overcome technical and financial constraints that already greatly limit their participation in meetings'.⁶³

Some difficulties associated with the ISO are apparent with the work of ISO 14000, responsible for setting standards for industry environmental management systems. The ISO 14000 certification process requires a combination of adherence to national standards as well as compliance with voluntary standards, as enforced by third-party auditors. Audley notes that the information provided to those auditors 'is not necessarily available to the public, thereby restricting interest groups from access to performance data normally used to watchdog industry performance'.⁶⁴

The lack of public participation has encouraged discussion in other multilateral fora which may shape the work of the ISO, thereby improving the process.⁶⁵ A recent trilateral meeting of stakeholders in the ISO process outlined the concerns associated with the ISO process, which mainly centred around the ability of developing countries to comply or adapt to standards. International standards are perceived to be largely driven by multinational enterprises, eager to establish global standards and take advantage of decentralized global production processes. Developing countries are particularly concerned by the fact that such standardizing processes could be used in a way that excludes them from participation in the global marketplace, noting that 'developed countries are capable of formulating demanding requirements since they have more chances of observing them', and that 'norms in developing countries are a mutilated copy of standards prepared in developed countries; and therefore, they do not project the real possibility for implementing them'.⁶⁶ There is further concern that the extra costs of the technology that developing countries require to comply with standards and the related

certification process may increase the price of their products and undermine comparative advantages.⁶⁷ The 'right' of a country to choose its own standards as enunciated in a trade agreement must be evaluated in the context of the economic realities that surround it. As a simple reality of participating in the global marketplace, countries may be forced to standardize to gain market access or because customers and suppliers demand it. Smaller and less economically significant nations will in essence become 'regulation takers', thereby supplanting their own choice of domestic regulation in favour of the dominant market's choice.⁶⁸

The Codex Alimentarius Commission was established in 1962 as a joint undertaking of the FAO and the WHO. It has over 130 Member States and is responsible for 'protecting the health of the consumers and ensuring fair practices in the food trade' as well as preparing and coordinating all food standards undertaken by international governmental and non-governmental organizations.⁶⁹ A recent report by the OECD noted that 'the Codex is believed to become the focal point for regulatory design in the agro-food sector', which has led to an increased interest firms seeking to promote their own interests.⁷⁰ The Codex has been criticized for its closed-door policy and its lack of 'established protocols for ensuring a rational outcome based on scientific evidence'.⁷¹ Codex has evaluated more than 187 pesticides, 523 food additives and 57 food contaminants. It has also established over 3,019 maximum residue limits for pesticides, many of which are significantly less stringent in the United States, creating a potentially fertile source of trade conflict.⁷² In the *Hormones* dispute, the Codex standards were key to the ruling against the EU, despite the fact that the Codex standard for hormones 'was adopted by a vote of 33–29 with seven abstentions, [h]ardly a ringing endorsement of the safety of eating hormone-processed meat'.⁷³

Of considerable importance in the resolution of the current dispute between the United States and the European Union over GMOs will be not only the recently approved Codex Alimentarius guidelines on biotechnology but also the Cartagena Protocol on Biosafety, which endorses a precautionary, prior approval-based approach to trade in living modified organisms (LMOs). The Biosafety Protocol has been signed by most states with a serious interest in biotechnology, except the US, which, while remaining formally outside the Rio biodiversity regime, was actively involved in the negotiations, and has stated its endorsement of various aspects of the Protocol. The Biosafety Protocol contains a set of guidelines for risk assessment in the LMO context that might well be used as benchmarks by a WTO panel in evaluating risk assessment in the GMOs dispute.

FUTURE POLICY DIRECTIONS

Apart from being an issue addressed by the legal texts and jurisprudence of international trade agreements, the interface between trade and domestic regulation has been receiving increasing attention from the international policy-making community. The OECD recently completed a comprehensive two-year project designed to study how countries may address these problems through regulatory reform in a number of areas, including domestic health and safety standards.⁷⁴ Such reform is considered to be necessary to enhance competition and reduce regulatory costs, which will in turn 'boost efficiency,

bring down prices, stimulate innovation, and help improve the ability of economies to adapt to change and remain competitive'.⁷⁵

The report provides a review of the net negative effects on an economy and on trade that standards and conformity assessment procedures may have. Those issues which call for policy consideration include three categories of the domestic regulation and trade interface: regulations which are excessively trade-restrictive; divergences in regulatory requirements; and regulations biased towards domestic interests. The discussion and analysis of the trade and domestic regulation interface largely build upon and elaborate the principles (i.e. National Treatment, least trade-restrictive measures, policy transparency) discussed in this chapter. The report classifies recent approaches to reform into four categories: (1) standards development and conformity assessment procedures; (2) surveillance mechanisms for standards-related measures; (3) development of MRAs; and (4) increased business concerns and emerging initiatives.⁷⁶ From this analysis, a number of policy recommendations were set forth for consideration and subsequent implementation on the part of the OECD ministers.

With respect to the first category, a number of initiatives have emerged in the standards development process in an effort to reduce regulatory inefficiencies, one of which is the proliferation of voluntary standards. The report notes that 'although voluntary standards run a greater risk of being captured by private interests than mandatory standards (which calls for domestic and international surveillance), they are by nature more market driven and more capable of flexibility in the face of technological development'.⁷⁷ Consequently, the report recommends that countries periodically review standards development processes according to efficiency criteria.

The report also recommends increased use of harmonization to avoid trade friction, accompanied by an ongoing rigorous review of international standards. The report notes the possible efficiency gains and the increased transparency of a harmonization strategy, which may be appropriate on a case-by-case basis. The report further proposes a rationalization of conformity assessment procedures, urging that countries regulate in proportion 'to the intensity of the social concern or the risk involved' and engage in either pre-market or post-market surveillance according to the relative risk of the product. For example, sensitive medical devices or pharmaceuticals may require approval before entering a market, while lower-risk products, such as electrical safety regulations for appliances, may be more appropriately regulated by post-market surveillance mechanisms. The report also recommends increased vigilance regarding anti-competitive actions in the area of conformity assessment procedures. This concerns primarily the accreditation of the laboratories that certify various products etc. In the past, national accreditation bodies have had a virtual monopoly on the right to test and certify products, to the exclusion of any foreign competition.

With respect to the second category, international oversight of standards-related measures, the report calls for a strengthening of such regimes. 'International oversight' is another term for the TBT and SPS Agreements currently in place under the WTO. It has been referred to by Sykes as 'policed decentralization', which means that 'national authorities are largely free to pursue their own policy objectives but must do so subject to a set of broadly applicable legal constraints'.⁷⁸ Increased surveillance could be undertaken by ensuring that such agreements are fully implemented; by extending the scope of measures covered; by clarifying obligations of the parties; and by encouraging

the active participation of stakeholders in the process, particularly business stakeholders.⁷⁹ The report further encourages increased multi-stakeholder domestic surveillance of the trade impacts of standards and procedures.

The third category, the development of MRAs, is one of the more promising solutions to the tension between trade and domestic regulation. An MRA can apply to standards, conformity assessment or testing data. They have not been widely used to date, and consequently the report recommends the 'expanded recognition of conformity assessment of other jurisdictions through arrangements such as MRAs'.⁸⁰ One policy option for MRAs is the adoption of the principle 'once approved, accepted everywhere'. This is a quasi-Most Favoured Nation approach: once a product is deemed to be in compliance with a relevant standard in one country, that product could move freely without further restrictions or requirements.

The report describes the expected benefits of the increased use of MRAs with respect to conformity assessments to include improved trade opportunities and efficiencies as well as the streamlining of domestic regulatory systems. Concerns related to MRAs include the possibility that trade with non-participants will be impeded, and that MRAs will lead to a 'race to the bottom' as countries seek to gain competitive advantages through lax regulatory enforcement.⁸¹ The mutual recognition approach has been a cornerstone principle in the EU's quest for a single market, which has been largely successful, albeit among relatively homogeneous nations. Efforts beyond the EU have been limited as such agreements have been for the most part bilateral and confined to a specific product. The financial implications are significant—the US Department of Commerce forecasts savings of over \$100 million per year if planned MRAs with the EU are implemented.⁸² Indeed, comprehensive draft texts of MRAs are already well underway in various fora. The EU, building on its experience within the single market, has either concluded or is in the process of negotiating MRAs with Canada, the United States, Japan, Australia and New Zealand.⁸³ The draft MRA text between the US and the EU covers in comprehensive detail, *inter alia*, electrical safety, recreational craft, manufacturing processes for pharmaceutical goods, and medical devices.⁸⁴ Likewise, within the prospective Free Trade Area of the Americas (FTAA), a working group has been established to consider the development of future MRAs.⁸⁵ Within Asia Pacific Economic Cooperation (APEC), the Osaka Action Agenda' included MRAs as one of its non-binding goals, in part to respond to the increasing problem of divergent health and safety standards.⁸⁶ This has resulted in the completion of a pilot project which has produced the APEC Mutual Recognition Arrangement for Foods and Food Products. Next on the agenda for APEC MRAs are electronic equipment safety arrangements.⁸⁷

Last, there is potential for reform through emerging initiatives within business sectors. The report notes that 'as product life cycles are shortened by rapid technological development and trade opportunities are expanded by globalization, obstacles arising from product standards and conformity assessment have increased business concerns'.⁸⁸ This observation, along with the transparency issues arising from the decentralization of the standards development process and the fact that firms themselves are often the sole owners of specialized technical expertise, have led to the proposition that firms rather than governments may be in a better position to pioneer regulatory reform. Such a dynamic is evidenced by the Trans-Atlantic Business Dialogue (TABD), established in

1995, which has made contributions to the reform process by, for example, developing recommendations towards the 'functional equivalence of regulatory standards'.⁸⁹

CONCLUSION

Critics of the WTO and NAFTA often point to SPS- and TBT-type disciplines as examples of how these trading regimes threaten legitimate democratic regulation, including regulation that addresses fundamental interests such as human life and health. Critics ask why science, which is after all only one perspective on our relationship to the natural world, should trump the intuitions and anxieties of ordinary people about what they eat and how it will affect them.

Many of the strictures in SPS and TBT are of a procedural nature, at least on the face of it. Appropriately interpreted, they leave fundamental substantive regulatory choices to domestic institutions, provided that due regulatory process has been respected and protectionism avoided. In the case of the WTO, the AB has done a mixed job of crafting such sensitive and deferential interpretations. In the *Hormones* case, the AB came closest to an appreciation of the legitimacy issues at stake in interpreting SPS, particularly in its endorsement of governmental reliance on non-mainstream or dissident scientific views as appropriate, and also its affirmation of the precautionary principle as informing the interpretation of the requirement of sufficient scientific evidence, for example. In later SPS cases, especially *Apples*, and in the TBT case *Sardines*, the AB has seemed much less sensitive to the competences and mandates of domestic regulatory institutions.

8

Antidumping laws

INTRODUCTION

Among the trilogy of trade remedy regimes—countervailing duty, safeguard and antidumping actions—antidumping actions are by far the remedy of choice. By 2002, 71 Members had notified the WTO Committee on Antidumping Practices that they had some type of domestic antidumping legislation, 31 had indicated having no such legislation and 25 had not provided notification.¹ Under Article XVIII:5 of the GATT, a WTO Member must notify the Committee of ‘any changes in its laws and regulations relevant to this Agreement and in the administration of such laws and regulations’. Members and Observers must also notify the Committee of new or existing laws or regulations, or the lack thereof.² Between 1995 and 2002, 2,160 antidumping initiations were reported to the Committee (see Figure 8.1). Over this period, the People’s Republic of China was by far the most frequent target, drawing 14% of antidumping initiations—more than twice as many as any other country. India, the United States and the European Community initiated the most antidumping cases, with 15%, 13% and 12% of initiations respectively. The fourth and fifth most frequent initiators were Argentina at 8% and South Africa at 7%.³ This differs considerably both in terms of percentage distribution and countries involved from the period July 1980 to June 1988, when the actions of the United States, Australia, Canada

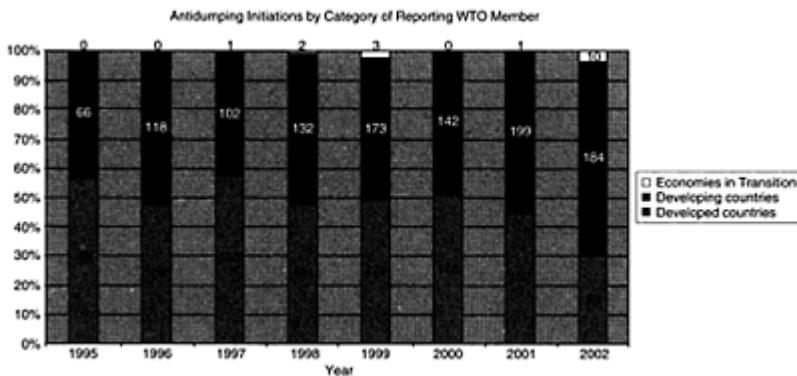


Figure 8.1 Antidumping initiations by category of reporting WTO Member.

and the European Union accounted for 97.5% of all actions. The more recent statistics suggest a trend towards greater initiation by developing countries of antidumping actions.⁴ From 2001 to 2003, the total number of antidumping investigations was consistently high, not just in the United States, which launched the highest number of investigations, but in China and India as well, respectively initiating the second and third highest number of investigations. Although in 2003 a reduced number of antidumping investigations was recorded, the general trend of the increased use of antidumping remedies is expected to continue.⁵

In antidumping proceedings, the following substantive issues are central: (a) whether the foreign exporter is engaged in ‘dumping’ goods into the importing country’s market. Determining whether dumping is occurring and what the margin of dumping is entails comparing a foreign firm’s export prices in the importing country’s market with either prices charged by the exporter in its home market in the ordinary course of trade (normal value) or, where insufficient transactions exist in the home country to yield a reliable set of home market prices, the exporter’s average total costs including overheads and a reasonable margin of profit; (b) if dumping is occurring, whether it is causing or threatening material injury to domestic producers of like products, which in turn requires interpretations of ‘domestic producers’, ‘like products’, ‘material injury’ and causation.

In this chapter, we review the GATT/WTO provisions on dumping and the domestic dumping regimes in Canada, the USA and the EU. We then develop a fundamental critique of dumping laws and argue for their replacement with harmonized domestic competition laws that focus on cross-border predation.

THE GATT PROVISIONS ON ANTIDUMPING

Article VI of the GATT contains general rules governing the application of antidumping and countervailing duties. The first paragraph of the Article condemns export sales below normal value when they

cause or threaten material injury to an established industry in the territory of the Contracting Party or materially retard the establishment of a domestic industry.

In addition, the Article describes the basis for determining when sales are below normal value: when the export price is less than ‘the comparable price, in the ordinary course of trade, for the product when destined for consumption in the exporting country’.⁶ When these criteria are satisfied, the importing country is entitled to levy an antidumping duty equal to the difference between the normal value and the export price.

However, the wording of the Article is vague in important respects, leading to inconsistent interpretations and applications of the provision. Moreover, two of the biggest users of antidumping duties—Canada and the USA—did not consider themselves bound by its terms because their domestic antidumping laws predated the GATT and to the extent of any inconsistencies were arguably ‘grandfathered’ under the Protocol of Provisional Application.⁷

The Kennedy Round Antidumping Code

In the Kennedy Round negotiations, beginning in 1963, many concerns about Article VI were addressed. The result was the 1967 Agreement on the Implementation of Article VI (the Antidumping Code), which laid out detailed criteria and procedures for the invocation of antidumping actions.⁸

Among the procedural rules contained in the Code was the requirement in Article 10(a) that provisional duties only be imposed following a preliminary finding of both dumping and injury. The imposition of retroactive duties was restricted by Article 11 of the Code, and Article 6 established rules of confidentiality and evidence. Finally, a notable feature of the Code is that it stated a preference for the imposition of a duty that is less than the dumping margin when the lesser duty will alleviate the injury.⁹

With respect to substantive issues, the first problem with Article VI is that it does not define the 'industry' whose injury justifies imposing antidumping duties. Article 4(a) of the 1967 Code clarified this issue, defining industry as 'the domestic producers as a whole of the like products or...those of them whose collective output of the products constitutes a major proportion of the total of those products'. A like product was defined in Article 2(b) as

identical, i.e., alike in all respects to the product under consideration, or in the absence of such a product, another product which, although not alike in all respects, has characteristics closely resembling [the dumped product].

These two definitions in combination identify a relatively narrow group of producers which must be injured in order for an action to be successful.

A second ambiguity in Article VI is in the requisite causal link between the dumping and the injury. The 1967 Code specified that the dumping had to be 'demonstrably the principal cause'¹⁰ of the injury.

The Tokyo Round Antidumping Code

Signatories to the Antidumping Code in 1967 committed themselves to ensuring that their domestic trade legislation was rendered consistent with the Code. For the USA, this task posed a substantial problem. The Code's test for causality was quite stringent and inconsistent with the US Antidumping Act.¹¹ The inconsistency between the Code and the Act led to unwillingness on the part of Congress to amend its laws or restrict the discretion of the administering authorities.¹² While the USA claimed that its applications were not inconsistent with the Code, the wording of the domestic law remained unchanged.¹³ Having adopted the Code's definitions, the EU sought to ensure compliance by the USA and insisted on reopening the Code during the Tokyo Round.

The main revisions to the 1967 Code related to causality and injury determination. Rather than requiring that the dumping be 'demonstrably the principal cause', the 1979 Code only specified that any 'injuries caused by other factors must not be attributed to the dumped imports',¹⁴ making it more consistent with the US position. The EU also now supported a relaxation of the causation requirements. With respect to injury, the factors to be used in evaluating the impact of the dumping were explicitly laid out, i.e.:

actual and potential decline in output, sales, market share, profits, productivity, return on investments, or utilization of capacity;...effects on cash flow,...wages,...growth.¹⁵

Also, the rules on the acceptance and administration of price and quantity undertakings were expanded in the 1979 Code (although their thrust remained the same). Finally, the Code required that, except under special circumstances, a proceeding should be completed within one year and that the rules permitting retroactive duties be more restricted.

The Uruguay Round Antidumping Agreement¹⁶

The 1979 Code left unresolved a number of problems and ambiguities.¹⁷ The incompleteness of the Code resulted in inconsistent antidumping practices and procedures throughout the world. The Antidumping Code received further attention in the Uruguay Round negotiations. The main changes reflected a growing tension between developed countries, especially the USA and the EU, which brought a substantial percentage of all antidumping actions, and newly industrializing countries (NICs) and developing nations, who were typically defenders rather than complainants. Thus far, 52 antidumping actions have been brought to the WTO Dispute Settlement Process and the Appellate Body (AB) has issued several reports. In its first report, the AB found the dispute was not properly before the panel.¹⁸

Determination of dumping

Article 2.1 of the Uruguay Round Antidumping Agreement defines products as being dumped—i.e. introduced into the commerce of another country at less than their normal value—if the export price is less than the comparable price, in the ordinary course of trade, for the like product when destined for consumption in the exporting country.

Japan raised two issues under Article 2.1 in the appeal of *US—Anti-Dumping Measures on Certain Hot-Rolled Steel Products from Japan*¹⁹ ('*US Steel*'). First, it argued that the '99.5 per cent' or 'arm's length' test as applied by the United States Department of Commerce (USDOC) was 'not an appropriate means of identifying sales made "in the ordinary course of trade"' (para. 134). Under this test, the USDOC found 'home market sales by an exporter to an affiliated customer as having been made at arm's length if prices to that affiliated customer are, on average, at least 99.5 per cent of the prices charged to unaffiliated customers' (para. 131). The USDOC also claimed to exclude high-priced sales if they were 'aberrationally' or 'artificially' high (para. 151). In making its decision, the AB emphasized the importance of a WTO Member exercising even-handedness and fairness to all parties when determining 'normal value' under Article 2.1. The AB further noted: 'If a Member elects to adopt general rules to prevent distortion of normal value through sales between affiliates, those rules must reflect, even-handedly, the fact that both high and low-priced sales between affiliates might not be "in the ordinary course of trade"' (para. 148). In *US Steel*, the AB concluded that the USA had violated Article 2.1 because the 'arm's length' test was applied automatically and involved no right for an exporter to show that a transaction priced below the 99.5% range

was in the normal course of trade. The ‘aberrationally high’ test, however, was only applied when requested by the exporter and involved no standard or guidelines for determining the meaning of ‘aberrationally high’. The impact of this was to make it far more likely that low-priced sales would be excluded, to the disadvantage of the exporter. Therefore, the AB found a lack of even-handedness between the two tests applied by the USDOC and a consequent violation of Article 2.1 (paras 154–5). The second issue Japan raised under Article 2.1 was an objection to the US substitution of downstream sales by affiliates to independent buyers for those transactions between the exporter and its affiliates excluded under the ‘arm’s length’ test. The AB found no violation, because Article 2.1 does not mandate consideration only of the exporter’s sales nor does it preclude including downstream transactions in the calculation of ‘normal value’ (para. 166). However, where downstream sales are used, the AB noted that it may be necessary to provide for appropriate ‘allowances’ under Article 2.4 because there may be an impact on the comparability of normal value and export price (para. 168).

Article 2.2 indicates that where there are no sales of the like product in the ordinary course of trade in the domestic market of the exporting country, or when because of the particular market situation or the low volume of the sales in the domestic market of the exporting country (a sufficient quantity must normally constitute 5% or more of the sales of the product to the importing country) such sales do not permit a proper comparison, the margin of dumping shall be determined by comparison with a comparable price of the like product when exported to an appropriate third country or with the cost of production in the country of origin plus a reasonable amount for administrative, selling and general costs, and for profits. Sales in the domestic market of the exporting country below per unit (fixed and variable) costs of production plus administrative, selling and general costs may be disregarded in determining normal value if made for an extended period of time (normally one year) in substantial quantities (more than 20% of transactions). Thus, all export sales, whether above or below total costs, will be averaged to obtain the export price, while generally only domestic sales above total costs will be averaged, increasing the likelihood of a finding of dumping.

Where there are no home-market or third-country sales on which to base price comparisons, constructed value may be used, which includes materials and labour costs and an amount for selling, general and administrative expenses (SG&A) plus profit. These latter costs—SG&A and profit—must now be based on actual data pertaining to production and sales in the ordinary course of business by the exporter. This precludes inclusion of home-market sales at a loss in the calculation of the exporter’s profits. In the absence of firm-specific data on SG&A and profits, the weighted average of the amounts incurred or realized by other exporters may be used, thus penalizing more efficient foreign producers. Where non-recurring start-up costs are incurred by new facilities, costs should be adjusted to reflect the costs at the end of the start-up period (Article 2.2.1.1).

Article 2.2.2 provides that a constructed value may be used to determine SG&A and profits when they cannot be determined based on actual data pertaining to production and sales in the ordinary course of trade of the like product by the exporter or producer under investigation. Article 2.2.2(ii) provides one basis for determining the amount: ‘the weighted average of the actual amounts incurred and realized by other exporters or producers subject to investigation in respect of production and sales of the like product in the domestic market of the country of origin’. The issue of what data may be included in

Article 2.2.2 and 2.2.2(ii) calculations has been the subject of WTO litigation. In *European Communities—Anti-Dumping Duties on Imports of Cotton-Type Bed Linen from India*²⁰ ('*EC Bed Linen*'), the AB found that the constructed value cannot be based on the Article 2.2.2(ii) method when there is only one exporter or producer (para. 74). Also, a Member may not exclude sales by other exporters that are not made in the ordinary course of trade when calculating SG&A and profits under Article 2.2.2(ii), because the text of the provision does not exclude anything from 'actual amounts incurred or realized' so all 'actual amounts incurred or realized' by other exporters or producers must be included regardless of whether or not they are in the ordinary course of trade (para. 80). *European Communities—Anti-Dumping Duties on Malleable Cast Iron Tube or Pipe Fittings from Brazil*²¹ ('*EC Pipe*') addressed a similar question under the *chapeau* of Article 2.2.2: whether data from low-volume sales must be excluded when determining SG&A and profits, if they were disregarded for normal value determination under Article 2.2 (para. 92). The AB noted that in the *chapeau* of Article 2.2.2, actual data outside the ordinary course of trade are excluded. However, in Article 2.2, both sales outside the ordinary course of trade and low-volume sales are excluded, confirming that low-volume sales are not excluded from the *chapeau* of Article 2.2.2, and that consequently actual data from low-volume sales that are in the ordinary course of trade may be included to derive SG&A and profits for the construction of normal value under the *chapeau* of Article 2.2.2 (para. 101).

Comparison between the export price and the normal value should be 'fair', as stipulated by several provisions under Article 2.4. Subject to these, Article 2.4.2 indicates that the existence of margins of dumping shall normally be established on the basis of a comparison of weighted average domestic sale prices and weighted average export market prices, or by a comparison of domestic prices and export prices on a transaction-to-transaction basis. This precludes comparing isolated low-priced export transactions with weighted average domestic prices to establish dumping. In *EC Bed Linen*, the AB found that the EC had violated this provision through its practice of 'zeroing'. 'Zeroing' arises when determining weighted averages of normal and export prices. According to EC practice in this investigation, where a normal value is found to be higher than the export price, a 'positive' dumping margin is found. However, where the normal value is higher than the export price, a 'negative dumping margin' is found. In other words, dumping has not occurred because the export price exceeds the normal value. The European Communities treated any such 'negative dumping margin' as zero—hence the use of the word 'zeroing'. Then, finally, having added up the 'positive dumping margins' and the zeroes, the European Communities divided this sum by the cumulative total value of all the export transactions involving all types and models of that product. In this way, the European Communities obtained an overall margin of dumping for the product under investigation (para. 47). As a consequence, the dumping calculation is inflated. The AB noted that this failure to fully account for the prices of all comparable export transactions was not a 'fair comparison' as required by Articles 2.4 and 2.4.2 (para. 55). Article 2.4 requires that due allowance be made for any differences that affect price comparability including differences in conditions and terms of sale, taxation, levels of trade, quantities, and physical characteristics. In *Argentina—Definitive Anti-Dumping Measures on Imports of Ceramic Floor Tiles from Italy*²² ('*Argentina Tiles*'), the panel found a violation of Article 2.4, noting that the Argentine local investigating authority (DCD) was

required to make adjustments for physical differences distinguishing tiles. Although the DCD had accounted for quality type and polish type, it did not account for the remaining physical differences, including size, and was held not to have made a 'fair comparison' (para. 6.117).

Determination of injury

In *Thailand—Anti-Dumping Duties on Angles, Shapes and Sections of Iron or Non-Alloy Steel and H-Beams from Poland*²³ ('*Thailand Steel*'), the AB identified Article 3 as focusing on the obligations on a Member when it makes an injury determination (para. 106). Footnote 9 indicates that 'injury', unless otherwise specified, is material injury or threat of material injury to a domestic industry, or material retardation of the establishment of such an industry. *US Steel* indicated that an injury finding should focus on the state of domestic industry, specifically the whole of domestic industry and 'not simply...one part, sector or segment' (paras 189–90).

Thailand Steel also identified Article 3.1 as 'an overarching provision that sets forth a Member's fundamental, substantive obligation' with respect to determining injury and 'informs the more detailed obligations in the succeeding paragraphs' (para. 106).²⁴ Article 3.2 expands on Article 3.1. The two read:

3.1 A determination of injury for the purposes of Article VI of GATT 1994 shall be based on positive evidence and involve an objective examination of both (a) the volume of the dumped imports and the effect of the dumped imports on prices in the domestic market for like products, and (b) the consequent impact of these imports on domestic producers of such products.

3.2 With regard to the volume of the dumped imports, the investigating authorities shall consider whether there has been a significant increase in dumped imports, either in absolute terms or relative to production or consumption of the importing Member. With regard to the effect of the dumped imports on prices, the investigating authorities shall consider whether there has been a significant price undercutting by the dumped imports as compared with the price of a like product of the importing Member, or whether the effect of such imports is otherwise to depress prices to a significant degree or prevent price increases, which otherwise would have occurred, to a significant degree. No one or several of these factors can necessarily give decisive guidance.

In *Thailand Steel*, the AB indicated that Article 3.1 allows an investigating authority to make an injury determination based on all relevant reasoning and facts before it, not just on disclosed or discernible reasoning and facts (para. 111). *US Steel* expanded on this discussion of Article 3.1 by defining the terms 'positive evidence' and 'objective examination'. The former indicates that the evidence authorities rely on when making an injury determination must 'be of an affirmative, objective and verifiable character, and that it must be credible' (para. 192). The latter 'requires that the domestic industry, and the effects of dumped imports, be investigated in an unbiased manner, without favouring

the interests of any interested party, or group of interested parties, in the investigation' (para. 193). One case where the investigating authorities were found not to have been objective was *European Communities—Anti-Dumping Duties on Imports of Cotton-Type Bed Linen from India—Recourse to Article 21.5 of the DSU by India*.²⁵ There, the European Communities only examined five Indian producers in its injury analysis and presumed all imports from unexamined producers to be dumped (para. 103). This increased the likelihood of finding injury to the domestic industry, and was not 'unbiased, even-handed, and fair' and consequently not 'objective' under Articles 3.1 and 3.2 (paras 132–3).

EC Pipe addressed the issue of whether an investigating authority must first examine the volumes and prices of dumped imports on a country-by-country basis under Article 3.2 before cumulatively assessing the effects of the dumped imports under Article 3.3. Brazil argued that to do otherwise could permit antidumping duties to be imposed on a country whose products were not causing injury to the domestic industry (paras 105–7). In determining injury, Article 3.3 permits the investigating authority in the importing country to assess cumulatively the effects of imports from more than one country where they are subject to simultaneous investigation if the level of imports from each country is more than *de minimis* and if it is appropriate to do so. The AB in *EC Pipe* disagreed with Brazil's argument, saying that there was no basis in the text or context of Articles 3.2 and 3.3 for Brazil's argument (para. 112). In its analysis, the AB indicated that Article 3.3 expressly lays out the preconditions that must be met for an investigating authority to cumulatively assess the effects of dumped imports from more than one country (para. 110). These are:

- (a) the dumping margin from each individual country must be more than *de minimise*
- (b) the volume of imports from each individual country must not be negligible; and
- (c) cumulation must be appropriate in the light of the conditions of competition
 - (i) between the imported products; and
 - (ii) between the imported products and the like domestic product.²⁶

Article 3.4 specifies those economic factors and indices that must be evaluated when examining the impact of dumped imports on the domestic industry. *Thailand Steel* held that an examination of the impact of the dumped imports on the domestic industry concerned must evaluate all factors listed in Article 3.4 (para. 128). *US Steel* found that Article 3.4 is an elaboration of the 'objective examination' in Article 3.1 (para. 194). The AB emphasized that Members may consider factors beyond those listed in Article 3.4, provided that they do not undermine the requirement of an 'objective examination' (para. 196). In *EC Pipe*, the AB addressed the issue of whether the EC had not fulfilled the requirements of Article 3.4, because the factor 'growth' in the provision was only evaluated implicitly and no separate evaluation of its record was made (para. 156). Drawing on the reasoning it had used in *Thailand Steel*, the AB pointed out that procedure and due process are dealt with in Articles 6 and 12 of the Antidumping Agreement, and that the manner in which evaluation of each injury factor is to be set out in published documents is not governed by Articles 3.1 and 3.4 (para. 159). Consequently, the AB held that a separate record of the evaluation of each Article 3.4 injury factor is not required in every antidumping investigation (para. 161).

Article 3.5 provides that the demonstration of a causal relationship between the dumped imports and the injury to the domestic industry shall be based on an examination of all relevant evidence, including any known factors, other than the dumped imports, which at the same time are injuring the domestic industry, and the injuries caused by these other factors must not be attributed to the dumped imports. In *US Steel*, the AB held that compliance with Article 3.5 requires investigating authorities to separate and distinguish the injury caused by other known factors from the injurious effects of the dumped imports (para. 226). If these effects cannot be separated, then investigating authorities cannot attribute the injury to the dumped imports (para. 228). However, there is no particular methodology prescribed for this by the Antidumping Agreement (para. 224). *EC Pipe* found that Article 3.5 does not require in every case that collective effects of other causal factors must be examined in addition to examining those factors' individual effects. An investigating authority may forgo examining the collective effects, provided that on the facts of the case, it can meet the requirement of not attributing injuries caused by other factors to dumped imports (paras 190–2). The AB in *EC Pipe* also disagreed with the panel's position that an alleged causal fact could be 'known' in the context of injury and dumping analyses, but not 'known' in the context of causality analysis. It emphasized that a factor cannot be known to an investigating authority in one stage of the investigation and unknown in a subsequent stage (para. 178).

Article 3.7 lists requirements for finding a 'threat of material injury'. In *Mexico—AntiDumping Investigation of High Fructose Corn Syrup (HFCS) from the United States—Recourse to Article 21.5 of the DSU by the United States*,²⁷ the AB indicated that these are requirements that must be met by the investigating authorities, not panels (para. 83). It also noted that for the purposes of Article 3.7, investigating authorities may make assumptions, because future events 'can never be definitively proven by facts'. Nevertheless, Article 3.7 does indicate that 'the situation in which the dumping would cause injury must be clearly foreseen and imminent' (para. 85).

Initiation, subsequent investigation and evidence

Article 5 expands the procedural rules that govern the initiation and investigation of a dumping action. Article 5.8 requires that an investigation should be terminated when a dumping margin is *de minimis* (less than 2% of the normal value) or when the volume of dumped products is negligible (i.e. if the volume of dumped imports from a particular country accounts for less than 3% of imports of the like product in the importing country unless countries that individually account for less than 3% of imports collectively account for more than 7% of imports).

The rules on evidence (Article 6) are also expanded, providing for assurances of disclosure and improved opportunities to make a full defence or argument, while still preserving essential confidentiality. Article 6.12 requires that in cases where the product is commonly sold at retail, industrial users and consumer organizations be given an opportunity to provide relevant information regarding dumping, injury and causality. Evidence provided by foreign parties shall not be disregarded even if it is not clear in all respects (Annex II).

A contentious provision has been Article 6.8, which provides that preliminary and final determinations may be made on the basis of facts available where any interested

party refuses access to, or otherwise does not provide, necessary information within a reasonable period or significantly impedes the investigation. Japan alleged in *US Steel*, and the AB agreed, that the United States violated this provision. The AB interpreted Article 6.8 with reference to Article 6.1.1 and Annex II of the Antidumping Agreement. A 'reasonable period' for any given case under Article 6.8 is to be interpreted flexibly by investigating authorities, considering multiple factors.²⁸ Furthermore, Articles 6.1.1 and 6.8, and Annex II of the ADA [Antidumping Agreement], must be read together as striking and requiring a balance between the rights of the investigating authorities to control and expedite the investigating process, and the legitimate interests of the parties to submit information and to have that information taken into account' (para. 86). In *Argentina Tiles*, the panel found that the DCD was not justified in disregarding the exporter's information based on reasons relating to the failure to comply with certain procedural requirements. The panel read Article 6.8 in conjunction with Annex 11(6) and suggested that there was a requirement for the DCD to (1) inform the exporters why certain information supplied by them was not accepted; (2) provide the exporters an opportunity to provide further explanations within a reasonable period; and (3) provide the reasons for the rejection of the evidence or information in a published determination (para. 6.80). In the case of two exporters in *US Steel*, the USDOC violated Article 6.8 by only considering its deadline, not other factors, when determining whether information was submitted 'within a reasonable period' (para. 87).

With respect to a third exporter which was having difficulty obtaining the information requested by the USDOC, the AB found that the USDOC had violated Article 6.8 and Annex II in applying 'adverse' facts in determining the exporter's dumping margin (para. 110). The panel correctly noted that if an interested party 'refuses access to' necessary information within a reasonable period, 'otherwise does not provide' necessary information within a reasonable period, or 'significantly impedes the investigation', the investigating authority may make determinations on the basis of the facts available. Thus, Article 6.8 ensures that an investigating authority will be able to complete an investigation and make determinations under the Antidumping Agreement on the basis of facts even in the event that an interested party is unable or unwilling to provide necessary information within a reasonable period. However, in this case, due to the absence of a justified conclusion that there was a lack of cooperation, there is no basis under paragraph 7 of Annex II for a result which is less favourable than would have been the case had the party cooperated.

The USDOC had relied on Annex II, paragraph 7, which states: 'where an interested party does not cooperate and thus relevant information is being withheld from the authorities, this situation could lead to a result which is less favourable to the party than if the party did cooperate'. However, the AB noted that there may be cooperation where information is not obtained, and that failure to provide information should not be equated with a lack of cooperation. The AB concluded that paragraphs 2 and 5 of Annex II provide sufficient context to indicate the degree of cooperation to be expected. Specifically, 'investigating authorities are entitled to expect a very significant degree of effort—to the "best of their abilities"—from investigated exporters. At the same time, however, the investigating authorities are not entitled to insist upon absolute standards or impose unreasonable burdens upon those exporters' (para. 102). In addition, Article 6.13 indicates: 'The authorities shall take due account of any difficulties experienced by

interested parties, in particular small companies, in supplying information requested, and shall provide any assistance practicable' (para. 103). In view of the exporter's efforts to obtain the information, its notification to the USDOC of its difficulties, and the absence of USDOC assistance to the exporter, the AB found that the exporter met its interpretation of 'cooperate' for the purposes of Annex II, paragraph 7 (paras 105–9). In *Argentina Tiles*, the EC argued, and the panel agreed, that the DCD violated Article 6.10 by failing to calculate individual margins as required and by failing to provide an explanation in the Final Determination as to why the DCD could not calculate individual margins. The panel also found a violation of Article 6.9, noting that the DCD failed to inform exporters that evidence on the record, other than that provided by them, would be relied upon. Although all of the facts relied upon were available, the panel suggested the existence of a positive obligation to inform the exporters of precisely which facts would be used, not clearly justified by the text of the AD Agreement.

Other provisions

Under Article 8, proceedings may be suspended or terminated on receipt of a satisfactory voluntary undertaking from any exporter to revise its prices or to cease exports at dumped prices. Price undertakings may not be sought or accepted unless preliminary determinations of dumping and injury have been made, and even if then sought and accepted, the exporter may elect to have the investigation completed. In the event of a negative determination, undertakings lapse. Article 9.5 requires the individual assessment of exporters who did not export during the period of investigation. This treatment replaces the prior application to uninvestigated exporters of the highest duty levied in a case. Articles 7 and 10 place restrictions on the imposition of provisional and retroactive duties. Article 11 includes a 'sunset review' clause which limits, subject to review, the duration of duties to five years from their imposition.

Under Article 12, public notification is required of the initiation of an investigation and of any preliminary or final determination along with findings and conclusions reached on all issues of fact and law considered material by the investigating authorities. Article 13 requires countries with antidumping regimes to maintain judicial, arbitral or administrative tribunals for reviewing initial determinations.

Article 15 recognizes the situation of developing-country Members and instructs that where antidumping measures 'would affect [their] essential interests', alternative 'constructive remedies' must be explored. The Decision on Implementation-Related Issues and Concerns,²⁹ adopted in the Doha Declaration³⁰ work programme, acknowledges that Article 15 'would benefit from clarification' and calls for the Committee on Antidumping Practices to recommend how to operationalize the provision. The Committee decided to discuss the issue based on written submissions, in informal sessions, with formal sessions if necessary. As of October 2002, 15 submissions had been circulated from Indonesia, Brazil, India, the EC, Canada, the USA and Turkey.³¹ The United Nations Development Programme (UNDP)³² indicates a number of difficulties that developing countries encounter under the current Antidumping Agreement. For example, the expense of initiating antidumping proceedings makes it difficult for developing countries to protect themselves from dumping. Meanwhile, the high cost of defending such proceedings also poses difficulties. Among the supporting evidence

raised by the UNDP is that Argentina's carbon steel wire rod exports to the USA dropped 96% the year after the USA filed an antidumping order. The UNDP also points to Prusa's³³ finding that even where antidumping charges were dismissed, imports into the USA fell on average by 15–20%. The UNDP recommends the following reforms for developing countries: higher *de minimis* dumping margins and import-share thresholds, technical support, and the availability of stronger domestic competition policy regimes.

Member countries were unable to agree on provisions to prevent circumvention of antidumping duties by exporters subject to duties on given products setting up local assembly plants using imported inputs to make the same products ('screwdriver plants'); this issue was remitted to the Committee on Antidumping Practices for resolution. The Committee then developed a framework agreed upon by Members in informal consultations and, at its October 1997 meeting, it established the Informal Group on Anticircumvention.³⁴ As of its October 2002 meeting, the Informal Group was still discussing the first three elements of the framework: 'what constitutes circumvention', 'what is being done by Members confronted with what they consider to be circumvention', and 'to what extent can circumvention be dealt with under the relevant WTO rules? To what extent can it not? And what other options may be deemed necessary?'³⁵

'Permissible interpretation': standard of review

Complaints over non-compliance with the Agreement may be referred to the integrated Dispute Settlement Body established by the broader Uruguay Round Agreement. Under Article 17.6, dispute resolution panels shall determine whether a domestic agency's establishment of the facts was proper and whether its evaluation was unbiased and objective. However, deferring to US concerns, Article 17.6 then provides that if the establishment of the facts was proper and the evaluation was unbiased and objective, the evaluation shall not be overturned even though the panel might have reached a different conclusion. Also, where a panel finds that a provision of the Agreement admits of more than one permissible interpretation, the panel shall find the agency's determination to be in conformity with the Agreement if it rests upon one of these permissible interpretations.

In 2001, the AB set out a framework for the standard of review under Article 17.6 of the Antidumping Agreement. In *Thailand Steel*, the AB indicated that Article 17.6 places no obligation on WTO Members, only on a WTO panel should the matter come before it (para. 114). It added: 'The aim of Article 17.6(i) is to prevent a panel from "second-guessing" a determination of a national authority when the establishment of the facts is proper and the evaluation of those facts is unbiased and objective. Whether evidence or reasoning is disclosed or made discernible to interested parties by the final determination is a matter of *procedure* and *due process*...comprehensively dealt with in other provisions, notably Articles 6 and 12' (para. 117). The AB added in *US Steel* that although the language of Article 17.6(i) indicates an obligation on the panel, the reality is that if investigating authorities do not meet the standards of the Article, they 'can be considered to have acted inconsistently with the Antidumping Agreement in the course of their "establishment" and "evaluation" of the relevant facts' (para. 56).

In *US Steel*, the AB also clarified that Article 17.6(ii) has two aspects to its application. First, a panel 'shall interpret the relevant provisions of the Agreement in

accordance with customary rules of interpretation of public international law'. This indicates that 'a permissible interpretation is one which is found to be appropriate after application of the pertinent rules of the *Vienna Convention* [i.e. Articles 31 and 32]' (para. 60). Second, the panel will assess an authority's conformity to the Antidumping Agreement in view of whether the measure in question is based on a permissible interpretation as determined in the first step (para. 59).

Cunningham and Cribb argue that *US Steel's* 'permissible interpretation' approach allows WTO panels and the AB to avoid the deferential standard of review intended by Article 17 because they may find that there is only one 'permissible interpretation'. The authors also point to other WTO decisions that they consider to have narrowed Article 17. Specifically, panels have allowed admission of new evidence not before the Department of Commerce when it made its decision; the AB refused to apply the 17.6(ii) standard of review to countervailing duty measures despite the US perspective that countervailing duty and antidumping dispute resolution should be consistent; and the AB finding that US law may be challenged 'as such', or 'on its face', under Article 17.4, not just 'as applied'.³⁶ Howse and Neven, in a critique of the panel decision in *Argentina Tiles*, argue that the panel failed to apply the correct standard of review required under Article 17.6, and 'In the end, willy nilly it ends up imposing a maximalist rather than a minimalist standard of administrative rationality and fairness'. Howse and Neven argue that Article 17.6 requires a minimalist standard of review that requires the panel to defer to the agency's establishment and evaluation of the facts, if the establishment was 'proper' and the evaluation was 'unbiased and objective', even though the panel 'might have reached a different conclusion'. The authors argue that, generally, the panels and the AB of the WTO have not applied this standard of review consistently.³⁷

In the United States, congressional concern that WTO trade remedy rulings may not be according the appropriate level of deference to US domestic agency determinations prompted a recent report on the standard of review and the impact of WTO trade remedy rulings. Although Article 17.6(ii) of the Antidumping Agreement excludes full *de novo* review of Members' interpretations of the Agreement by explicitly recognizing the possible coexistence of more than one permissible interpretation, there are concerns that panels and the AB are not actually accepting more than one possible interpretation.³⁸ The United States General Accounting Office was asked to determine whether the WTO was interfering with the ability of the USA to impose trade remedies and whether the WTO was treating the USA fairly in resolving trade remedy disputes. The United States General Accounting Office reported, in August 2003, that, 'When comparing rulings among WTO members on domestic determinations, the United States and other WTO members fared similarly. Overall...the WTO rejected almost the same proportion of the United States' and other WTO members' domestic determinations—57 percent and 56 percent, respectively.' Additionally, the majority of legal experts interviewed indicated that the panels and the AB have not exceeded their authority in applying the standards of review in Articles 11 and 17.6 in the trade remedy cases reviewed.³⁹ However, at least two recent articles argue that the standard of review applied is excessively intrusive and not deferential enough to domestic determinations under 17.6(ii), indicating that the controversy is far from resolved.⁴⁰

Appellate Body decisions regarding US antidumping legislation

US antidumping legislation has twice been held GATT-inconsistent by the WTO AB. The cases in which this occurred are *United States—Anti-Dumping Act of 1916*⁴¹ ('*US 1916*') and *United States—Continued Dumping and Subsidy Offset Act of 2000*⁴² (*US Byrd Amendment*'). In both cases, the legislation's challengers alleged that the United States contravened its WTO commitments by imposing penalties for dumping other than those permitted by the GATT. Most arguments under the Antidumping Agreement related to Article 17, Consultation and Dispute Settlement, and Article 18, Final Provisions.

The Antidumping Act of 1916 applied in particular circumstances, specifically where dumping was done 'with the intent of destroying or injuring an industry in the United States, or of preventing the establishment of an industry in the United States, or of restraining or monopolizing any part of trade and commerce in such articles in the United States'. In those circumstances, the Act of 1916 allowed any injured person to sue for three times their sustained damages and the cost of the private action against dumpers. It also made dumping a criminal offence punishable by fine or imprisonment.⁴³

The Act of 1916 was challenged by the EC and Japan on a number of grounds. One significant question was jurisdictional. Essentially, the United States argued that the law targeted predatory pricing, and that because it fell outside the three forms of antidumping measures specified in Article 17.4, i.e. definitive antidumping duty, price undertaking or, occasionally, provisional measure, it was outside the jurisdiction of the WTO to examine the Act under the Antidumping Agreement or the GATT (paras 55–6). Disagreeing with this position, the AB referred to several Articles of the Agreement, including Article 17.1 and 17.2. The AB indicated that Article 17.1 draws no distinction between disputes about antidumping legislation and those related to antidumping measures used to enforce the legislation, and consequently implies that legislation can be challenged under the Antidumping Agreement unless the action is excluded by Article 17 (para. 64). Article 17.2 reinforces this position by referring to consultation regarding 'any matter affecting the operation of this Agreement' (para. 65). Having resolved this and other issues before it, the AB found that the Act of 1916 violated Article VI:2 of the GATT 1994, which limits actions against dumping to definitive antidumping duties, provisional measures and price undertakings (para. 137). The Act of 1916 did so 'by providing for the imposition of fines or imprisonment or for the recovery of treble damages' (para. 138). Matsushita, Shoenbaum and Mavroidis note that the approach taken by the AB in *US 1916* seems to leave private parties injured by predatory pricing or price discrimination without a remedy, because Article VI of GATT 1994 and the Antidumping Agreement do not provide for private remedies, and competition law provisions addressing international predation or price discrimination are vulnerable to WTO challenge.⁴⁴

Two months after the AB report was issued for *US 1916*, the Continued Dumping and Subsidy Offset Act of 2000 ('Byrd Amendment') was passed by the US Congress as part of the Agriculture, Rural Development, Food and Drug Administration, and Related Agencies Appropriations Act 2001. The Byrd Amendment provides for distribution of antidumping and countervailing duties to 'affected domestic producers' if they made 'qualifying expenditures'.⁴⁵ Numerous complainants initiated *US Byrd Amendment*:

Australia, Brazil, Canada, Chile, the EC, India, Indonesia, Japan, Korea, Mexico and Thailand. They successfully argued that the Byrd Amendment violates Articles 18.1 and 18.4 of the Antidumping Agreement, as well as the GATT. Setting out guidelines for the interpretation of Article 18.1, the AB laid out two conditions precedent for the Article to apply to a particular measure. The measure must be 'specific' to dumping, and it must be 'against' dumping. If these are met, then one must determine if the measure in question was 'taken in accordance with the provisions of GATT 1994, as interpreted by this [Antidumping Agreement]' (para. 236). In *US 1916*, remarking on Article 18.1, the AB had indicated that a 'specific action against dumping' was minimally an action that may be taken only when the constituent elements⁴⁶ of dumping are present (para. 122). *US Byrd Amendment* clarified this as meaning that a measure must 'be inextricably linked to, or have a strong correlation with, the constituent elements of dumping', and that '[s]uch a link or correlation may, as in the 1916 Act, be derived from the text of the measure itself' (para. 239). The Byrd Amendment met this description, because its payments were contingent on a determination of dumping (para. 242). Addressing what is required for a measure to be 'against' dumping, the AB indicated that it is 'necessary to assess whether the design and structure of a measure is such that the measure is "opposed to", has an adverse bearing on, or, more specifically, has the effect of dissuading the practice of dumping...or creates an incentive to terminate [the practice]' (para. 254). The AB concluded that the Byrd Amendment acts 'against' dumping under Article 18.1 because it finances US competitors, having an adverse affect on foreign producers/exporters and acting as a disincentive for them to engage in dumping (para. 256). Finally, having judged a 'specific action against dumping', the AB addressed the GATT, finding a violation of GATT VI:2 and consequently of Article 18.1 of the Antidumping Agreement because Byrd Amendment payments were antidumping measures other than definitive antidumping duties, provisional measures or price undertakings (para. 265). Because of this violation, the United States was also found in violation of Article 18.4 of the Antidumping Agreement, for not ensuring conformity of its laws, regulations and administrative procedures with the Agreement (para. 302).

ANTIDUMPING LAWS: CANADA, THE UNITED STATES AND THE EU⁴⁷

Canada amended its *Customs Tariff* in 1904 to provide for antidumping duties and in so doing became the first country in the world to establish an antidumping regime.⁴⁸ The current legislation is set out in the Special Import Measures Act 1985 (the SIMA).⁴⁹ The first specific American antidumping statute, which is discussed above and still in force, is known as the Antidumping Act of 1916.⁵⁰ Because of the onerous predatory intent requirement, there is little judicial interpretation of the law. The law has never been reviewed by the US Supreme Court, and the US Department of Justice has never successfully prosecuted a criminal case under the Act. All court decisions addressing its meaning have involved civil complaints, not criminal prosecutions. Furthermore, no civil suit has resulted in recovery, although one case was settled.⁵¹ This parallels experience under predatory pricing provisions in domestic antitrust laws, where convictions or successful civil suits are rare. The US Congress enacted the Antidumping Act of 1921⁵²

to provide complainants with a greater scope for relief than the 1916 Act. The current American legislation is embodied in Title VII of the Tariff Act of 1930. Institutions of the European Union have had the authority to take action against dumped imports since 1968.⁵³

In Canada and the USA, the institutional responsibilities for determining 'dumping' and 'material injury' are separated. 'Dumping' determinations are made by the Deputy Minister of National Revenue (DMNR) in Canada⁵⁴ and by the International Trade Administration of the Department of Commerce (DC) in the United States. 'Material injury' determinations are made by the Canadian International Trade Tribunal (CITT) and by the US International Trade Commission (the ITC). The institutional arrangements in the EU are very different from those in the USA and Canada. The principal institution involved in the administration of the EU antidumping system is the Commission, specifically Directorate C in the Directorate-General in Charge of External Relations of the Union, which has the primary responsibility for the enforcement of the antidumping regime. It is responsible for all stages of the investigation, including the decision to initiate a proceeding. Following an investigation, the Commission can impose provisional duties or submit proposals for definitive action to the Council. It also has the authority to accept undertakings by the exporter and terminate the proceeding. Finally, the Commission makes recommendations to the Council with respect to antidumping legislation.

The Council's main role is to approve the provisional determinations of the Commission and to order the collection of the imposed duties. It also has legislative responsibility for the antidumping regulation. The role has usually been a *pro forma* one.

An advisory committee made up of a Commission representative and an official from each Member State is consulted by the Commission at various stages in the investigation. The committee's primary involvement is in determining the appropriate relief to be granted for an injury. An undertaking from the exporter cannot be accepted if there is not complete agreement from the Member States. Through their customs authorities, the Member States also help to ensure that duties are collected. Again, in practice the committee's role is largely *pro forma*.

In certain circumstances the European Court of Justice has the authority to review antidumping decisions. It can review the legality of Commission or Council determinations and redress 'manifest errors' in the assessment of facts or violations of procedural rules, although in practice the Court exercises its review function with restraint.

Finally, the European Parliament has an advisory role and issues non-binding opinions on EU legislation. In addition, its Committee on External Economic Relations serves as a forum for discussion of the administration of the antidumping system.

In Canada, once the CITT has determined material injury it may consider the potential effect of antidumping duties on 'the public interest'.⁵⁵ If the CITT is of the view that imposing antidumping duties would be contrary to the public interest, it must both publish a report in the *Canada Gazette* and report to the Minister of Finance, who has the discretion to lower or remove the duty.⁵⁶ The provision reflects the concern that 'concentration on producer interests alone is too narrow a focus and the consumer interest must be considered'.⁵⁷ In practice, however, public interest hearings⁵⁸ have been convened sparingly since the provision was enacted in 1985. One example relates to a

1998 case⁵⁹ in which the Department of National Revenue found dumping of prepared baby food by Gerber US and the CITT found material injury to Heinz Canada. The public controversy resulting when Gerber left the Canadian market led the CITT to hold a public interest hearing and to recommend that duties be reduced by approximately two-thirds due to concerns about the impact of price increases on low-income families, lack of consumer choice, security of supply, rates of innovation and quality of service with only one supplier to the Canadian market. Despite the implementation of this reduction, Gerber did not return to the market. Following a five-year expiry review of its findings to determine whether material injury to domestic industry was likely to result from an expiry, the CITT recently refused to extend the duties, finding that any injury that Heinz might suffer from Gerber's re-entry into the Canadian market 'would be due, for the most part, to the effects of the entry of renewed competition into the market, not to dumping'.⁶⁰ The United States does not have a public interest provision. The EU regulations provide that duties should only be imposed when doing so serves the Union's interest,⁶¹ but the typical reason for invoking the clause is to avoid domestic producers paying more for dumped inputs.⁶²

While the CITT's decision is 'final and conclusive',⁶³ the CITT may review its own findings if it is satisfied that such a review is warranted.⁶⁴ There are also appeals to the Federal Court of Appeal⁶⁵ and the Supreme Court of Canada, principally on issues of law.⁶⁶ In the United States, an appeal lies to the Court of International Trade from both DC and ITC decisions and then to the Court of Appeals for the Federal District.⁶⁷ The EU system has a limited right of appeal. As previously noted, the Court of Justice is reluctant to review Commission determinations in this area. The EU antidumping system has been characterized by discretion and secrecy; the reluctance of the Court to review the Commission's determinations increases the appearance (at least) of unfairness in the system's administration.⁶⁸ Arguably, the odd bifurcation of institutional functions in Canada and the USA serves a similar obfuscatory function.

Under Chapter 19 of the Canada-US Free Trade Agreement (FTA), and now under Chapter 19 of NAFTA, appeals from final determinations by domestic agencies in antidumping and countervailing duty proceedings may be taken to binational dispute settlement panels. This has proved an important innovation, with implications for the potential scope and role of the dispute resolution processes under the Uruguay Round Antidumping Agreement. It should be noted that Chapter 19 of the FTA was premised on an agreement that the current means of dealing with antidumping (AD) and countervailing duty (CVD) disputes are unsatisfactory. Article 1906 of the FTA called for an agreement within five years (with the possibility of a two-year extension) on a code between Canada and the USA regarding AD and CVD matters. The Article contemplated the possibility that the Agreement could be terminated (on six months' notice by either Party) if no accord was reached on a new regime for resolving disputes in this contentious area.⁶⁹ Thus, Chapter 19 was, on its face, a temporary expedient.

It begins with two other important limitations on its power and scope. The following Articles refer to NAFTA, but are largely identical to their predecessor sections in the FTA. Article 1901:1 states that the Article 1904 provisions outlining the procedures for the review of 'final determinations' in AD and CVD cases apply only to goods which the relevant authority in the *importing* Party has determined come from the other Party. Moreover, Article 1902 reserves the power to apply and amend domestic AD and CVD

law to each Party respectively.⁷⁰ However, Article 1902 imposes limits on the capacity to modify existing AD and CVD law: Parties must notify and consult each other about such changes; for changes to apply to the other Party, it must be named; and no change can be inconsistent with relevant GATT provisions or 'the object and purpose of this Agreement and this Chapter'.⁷¹ These restrictions are not as significant as originally anticipated. They had been seen as an attempt to ensure some degree of bilateral accountability in this area. This view is supported by the *Softwood Lumber* case, where the US Congress effectively repealed the decision by legal amendment, in apparent contradiction with the intent of these provisions.

Articles 1903 and 1904 are both designed to allow bilateral review of the amendment and application of AD and CVD law. Article 1903 allows a Party to request that a panel be set up to examine an amendment to determine whether it is consistent with relevant GATT and NAFTA provisions, or whether, in addition, it 'has the function and effect of overturning a prior decision' made under Article 1904.⁷² If the panel decides that an amendment is in fact objectionable, the Parties are then to enter into consultations to remedy the situation within 90 days, and if remedial legislation is not enacted within 9 months of the end of this consultation period, then the other Party is entitled to take comparable action or terminate the Agreement.⁷³

Article 1904 provides a set of procedures allowing binational panels to replace judicial review of the 'final determinations' of administrative agencies in AD and CVD cases.⁷⁴ At the request of either Party, a panel can review such determinations and issue a *binding decision* as to whether they conform to the AD and CVD law of the importing country subject to a procedure for an extraordinary challenge of a panel's decision to a binational panel of retired judges on various grounds (such as gross misconduct, bias or conflict of interest).⁷⁵ The standard of primary panel review is that laid down by the relevant statutes (as amended from time to time) of each Party, and by 'the general legal principles that a court of the importing Party would otherwise apply'.⁷⁶ Requests for panels must be made within 30 days of the publication of a final determination.⁷⁷ Only the Parties have the right to request a panel, but Article 1904:5 provides that a Party must ask for a panel when petitioned by a person otherwise entitled by domestic law to redress via judicial review.⁷⁸ The administrative agency whose determination is being reviewed has the right to be represented by counsel before the panel, as do all other persons entitled by domestic laws to standing before a court reviewing such determinations.⁷⁹ The panel reaches its decision by a majority vote of its members, and it issues its reasons (majority, concurring and dissenting) in a written report.⁸⁰ If a panel finds an error in a final determination, it may remand the determination to the relevant domestic administrative agency for 'action not inconsistent with the panel's decision'.⁸¹

Chapter 19—its committees and panels—is supported and administered by a Secretariat established under Article 1908. It has three branches, each run by a Secretary, one Canadian (located in Ottawa), one American (located in Washington DC) and one Mexican (located in Mexico City). The Secretariat operates as a division of the general NAFTA Secretariat, as established by Article 2002, and is responsible for servicing the meetings of panels and committees, and providing general administrative assistance.⁸² It is also charged with the task of receiving and filing all official papers connected with the operation of Chapter 19.⁸³

The final salient feature of Chapter 19 is its elaborate provisions regarding the composition of panels. Annex 1901.2 sets out the method of choosing these panels, and the pool from which they are to be drawn. A roster is established by consultation between the three Parties of 75 unaffiliated individuals—25 from each country—who are chosen for their good character, reliability and objectivity.⁸⁴ The roster shall also ‘include judges or former judges to the fullest extent practicable’.⁸⁵ A panel is composed of five members, a majority of whom must be lawyers. Each Party must choose, in consultation with the other Party, two members; each Party is allowed four peremptory challenges; and if panellists are not chosen within 30 days of the request for a panel, or alternative panellists are not chosen within 45 days, then a panellist will be chosen by lot from the Party’s candidates on the roster.⁸⁶ A fifth member must be chosen within 55 days of the request by the Parties, or, if they cannot agree, within 60 days by the already chosen panellists, or, if they cannot agree, by lot (on the 61st day).⁸⁷ The Chair of the panel is picked from among the lawyers by a majority vote of the panellists; if there is no majority vote, then the Chair will be chosen by lot.⁸⁸

Early critics of the FTA argued that the provisions did not go far enough to prevent administrative harassment of exporters by domestic competitors. The critics argued that no effective limits had been placed on the discretion of administrative trade agencies, and that panels would be as ready to defer to these agencies in reviewing their determinations as had been the US Court of International Trade and the Canadian Federal Court of Appeal.⁸⁹ But the experience with the mechanisms to date suggests that they do represent a significant improvement over what they replaced.

According to a study by Mercury,⁹⁰ between 1989 and 1995, when the FTA was largely subsumed into NAFTA, 49 requests for binational panel review were initiated. Panels as of 1995 had rendered decisions in 32 cases (most binational determinations are being appealed to binational panels). About two-thirds of US agency determinations that were appealed to binational panels resulted in panel remands to agencies for redeterminations (compared to a remand rate by the Court of International Trade of about one-third). Canadian agency determinations were subject to a markedly lower remand rate, reflecting in part the more deferential standard of judicial review of specialized agency decisions under Canadian domestic law. Panel decisions were mostly unanimous (with a few high-profile exceptions where panels divided on national lines) and mostly met the time limits prescribed by Chapter 19. However, delays have occurred as a result of the inability of panels to order relief but only remand matters to domestic agencies for redetermination, sometimes resulting in multiple remands. There have been three Extraordinary Challenges to panel rulings, all initiated by the USA, and all unsuccessful. These results have been largely confirmed by Davey, who has found the Chapter 19 process to work on the whole ‘reasonably well’.⁹¹ In the experience under the FTA, the great majority of appeals to binational panels have been of US agency decisions, originally initiated by US parties. However, in 1993, there was a surge in the review of Canadian agency decisions.⁹² Macrory notes (combining statistics concerning both AD and CVD reviews): ‘The Chapter 19 procedures have been used extensively, both under the FTA and under the NAFTA. Indeed, almost every appeal of a US decision involving Canadian or Mexican imports has been taken to a Chapter 19 panel rather than to the CIT. Between 1994 and mid-2002, 23 FTA and NAFTA panel reviews of US agency decisions involving Canadian imports and eight reviews of decisions involving Mexican

imports were completed, [footnote omitted].... The Chapter 19 panels have been fairly “aggressive. Of the 26 reviews of Commerce Department determinations completed under the FTA and the NAFTA through May 2002, only five were upheld without a remand. All five were AD cases.’ (Patrick Macrory, ‘NAFTA Chapter 19: A Successful Experiment in International Trade Dispute Resolution’, C.D.Howe Institute Commentary, Toronto, September 2002, p.6).

In most respects, the panel procedures under the FTA were preserved and made permanent by NAFTA. But two important changes carry the potential to reinstate the more traditional and deferential standard of judicial review that applied prior to the creation of the binational panel review process under the FTA. The first is the requirement that the roster include judges, rather than international trade lawyers, economists or other experts (Annex 1901.2). The second is that the Extraordinary Challenge procedure pertaining to panel decisions has been extended to permit a challenge in a case where a panel has failed to apply the appropriate standard of review (Article 1904(13)). Indeed, Davey has argued that in the case of NAFTA panel reviews of US antidumping decisions, ‘while the degree of deference accorded to Commerce seems to have varied somewhat from panel to panel, none of the panels appear to have been overly intrusive in their reviews’.⁹³ This contrasts with the review of Canadian decisions where ‘panel review has probably been somewhat more intrusive than judicial review’.⁹⁴

The second round of bilateral negotiations contemplated by the Canada-US Free Trade Agreement on new rules for antidumping, subsidies and countervailing duties appeared to have been abandoned. In their place, NAFTA provides that the trilateral Free Trade Commission shall establish a working group on trade and competition to make recommendations to the Commission within five years of the coming into force of the Agreement ‘on relevant issues concerning the relationship between competition laws and policies and trade in the free trade area’.⁹⁵ The Parties further agree to consult on ‘(a) the potential to develop more effective rules and disciplines concerning the use of governmental subsidies; and (b) the potential for reliance on a substitute system of rules for dealing with unfair transborder pricing practices and government subsidization’.⁹⁶ A trilateral side accord of 2 December 1993 committed the three governments to establishing a working group on subsidies and antidumping duties which was to complete its work by 31 December 1995. This working group failed to reach consensus on a reform agenda.

THEORETICAL RATIONALES FOR ANTIDUMPING LAWS

Economic rationales for antidumping laws

There are three ways in which dumping can be characterized: as international price discrimination, as predatory pricing, or as intermittent dumping. These characterizations, if well founded, each give rise to possible economic justifications for the existence of antidumping laws.⁹⁷

International price discrimination

Canada was the first country in the world to enact antidumping legislation and there is some evidence that this was prompted by fears of international price discrimination. According to Jacob Viner, Canada's first antidumping legislation was a response to the US Steel Corporation's practice of selling its exports at prices substantially below its domestic prices.⁹⁸ US antidumping laws are also often characterized as a means of responding to international price discrimination.⁹⁹

Both Canadian¹⁰⁰ and US¹⁰¹ antitrust laws prohibit various forms of domestic price discrimination. These laws have intricate and detailed requirements which make the legal definition of price discrimination complex. However, a standard economic definition of price discrimination is as follows:

It is discriminatory to charge significantly different product prices to two or more customers when there are no significant differences between the costs to the seller of supplying those customers.¹⁰²

A seller thus price-discriminates when selling an identical product in different markets for different prices. The seller must have some degree of control over the market price (or 'market power') to be able to price-discriminate, and the seller will only have market power under conditions of imperfect competition.¹⁰³

There are essentially two economic arguments for prohibiting domestic price discrimination.¹⁰⁴ First, a monopolist's¹⁰⁵ total output may decrease when it shifts from a single-price policy to a discriminatory pricing policy. Because a monopolist sells less output than is optimal, a further decrease in its output might exacerbate the scarcity and impose greater welfare losses on society. Once the monopolist price-discriminates between the two markets, some existing customers will be forced out of the higher-priced market, and new customers will be attracted to the lower-priced market. The total output produced and sold will decrease if the higher-priced market forces out more customers than the lower-priced market attracts.

The second argument against allowing price discrimination reflects two forms of social cost imposed on society. The first costs are those that the monopolist incurs in segregating its markets and computing its customers' elasticities of demand. If price discrimination were prohibited, resources invested in administering the price discrimination scheme could be put to socially beneficial uses such as product innovation, plant expansion, or research and development. Second, according to Posner,¹⁰⁶ the lure of monopoly profits induces competing sellers to seek monopolies. Sellers compete with each other to obtain, for example, licences and protectionist legislation in the hope of achieving a monopoly. In the monopoly contest, sellers may invest resources up to their expected monopoly profits. The monopoly rents gained by the ultimate victor may be wholly offset by the socially wasteful expenditures of the competing sellers. If price discrimination is allowed, expected monopoly profits will be higher, sellers will invest more resources in achieving monopolies, and resulting social costs would be higher than under a non-discriminatory pricing policy.

These traditional arguments for prohibiting price discrimination are inconclusive. Among antitrust scholars there is no consensus on whether domestic price discrimination should be prohibited.¹⁰⁷ First, whether output will increase or decrease under price discrimination is an empirical question.¹⁰⁸ In a wide range of—perhaps most—circumstances, a monopolist is likely to maximize profits by price-discriminating in a way that increases output over that obtaining with a single monopoly price; indeed, a perfectly discriminating monopolist will charge each consumer his or her reservation price and produce the competitive output (appropriating all consumer surplus in the process). However, perfect price discrimination is rarely feasible because it entails a monopolist acquiring information on every potential customer's elasticity of demand and preventing arbitrage between low-priced and high-priced consumers. Second, while the costs that the monopolist incurs in acquiring and segregating its market may be wasteful, if the monopolist produces more output under price discrimination, those costs may be outweighed by the benefits of the increased output. Third, since some monopolies are efficient, expenditures to secure such monopolies are not wasteful.

Even if one assumes the validity of the arguments for prohibiting domestic price discrimination (although they are often contested), the case for prohibiting dumping is not analogous. Domestic price-discriminators and dumpers have different effects on the export country. A seller only 'dumps' if it charges a lower price to its export market customers than it charges to its home market customers.¹⁰⁹ Therefore, while domestic price discriminators create both a higher-priced market and a lower-priced market within the same country, dumpers create only a lower-priced market in the country to which they are exporting.

The importing country benefits from lower import prices. The consumers in the importing country enjoy more consumer surplus since they receive more output at a lower price per unit. When the importing country imposes antidumping duties on low-priced imports, its consumers lose these benefits. By increasing the price of dumped goods to the exporter's supracompetitive home-market price, antidumping duties impose supracompetitive prices on consumers in the export market and force them to settle for an inefficiently low level of output. Those consumers who remain in the market pay higher prices and enjoy less consumer surplus, and some consumers are priced out of the market, generating a deadweight social cost.

In addition, when dumping occurs, the higher-priced market is by definition located in the dumper's home country. The dumper's home country thus bears the dumper's costs of identifying and segregating its markets, and any social costs associated with the dumper's monopoly profits. The efficiency losses associated with domestic price discrimination, which drive the arguments for prohibiting price discrimination, are borne entirely by the dumper's home market. Hence, the arguments for prohibiting domestic price discrimination do not justify a corresponding prohibition against dumping; dumping gives the export country the benefit of the price discriminator's low-priced market without the social costs of its high-priced market. Even if the importing country were concerned about the dumper's home-market abuses through some altruistic motive, forcing domestic consumers to pay the dumper's home-market monopoly price seems a wholly ineffective response. On this point, Trebilcock and Quinn note:

Although equality of exploitation has a certain egalitarian ring to it, it seems a little difficult to see any other virtue in replicating other people's miseries, particularly when in so doing we are in no way ameliorating the lot of our fellow sufferers.¹¹⁰

Finally, while the potential reduction in output is an argument against price discrimination, and whether total world output will rise or fall under international price discrimination is an empirical question, in the case of dumping, prices are by definition lower in the export market, so the output available to the importing country is unambiguously higher with dumping, rendering highly problematic the appropriateness of providing any remedy to producers in the latter country on this account. The losses to consumers will almost always outweigh any gain to producers who are thereby protected. This is borne out by the empirical evidence.¹¹¹

However, recent 'revisionist' literature by WTO officials¹¹² attempts to provide an economic rationalization for antidumping laws by drawing on the persistent and pervasive influence of concepts of reciprocity in international trade relations. This literature argues that international price discrimination is symptomatic of asymmetric market access and economic distortions in exporters' home markets that antidumping duties should properly seek to redress. An illustrative case is the antidumping complaint brought in Canada by General Motors and Ford against Hyundai for allegedly selling cars in Canada in the mid-1980s at 36% less than it sold them for in South Korea.¹¹³ One might argue that it is unfair for domestic automobile manufacturers to have to face competition in the Canadian market from Korean imports when these manufacturers lacked equivalent access to the Korean market. (The price differential presumably reflected some form of protection of the South Korean market from import competition.) Moreover, to the extent that the imposition of antidumping duties might induce Hyundai to reduce its home-market prices, this would remove the economic distortion in the allocation of resources reflected in overproduction for export markets and underproduction for the home market.

There are a number of responses to this line of argument. First, it is far from clear that the imposition of antidumping duties will in fact in many cases remove the distortion in the exporter's home market—the exporter will have to weigh the loss of sales (and profits) in export markets from the imposition of duties against the loss of profits entailed in abandoning supracompetitive pricing in the home market. Second, it is far from clear in most antidumping cases that the gravamen of domestic producers' concerns about dumped imports is denial of equivalent access to the exporter's home markets; hence this seems a curiously coincidental or indirect means of addressing market access problems in these markets. Third, to the extent that differences in prices between home and export markets are explained by export subsidies from the home country's government, these are not properly the domain of antidumping laws but countervailing duty laws. Fourth, to the extent that the price differences between the two markets are explained by trade restrictions (e.g. tariffs or quotas) in the home country's market, then their legality should be addressed directly. If the home country has high unbound or bound tariffs, it is entitled to maintain these under the GATT/WTO pending mutual negotiations to reduce them. If it is utilizing quotas, these may be objectionable under Article XI (quantitative restrictions). If it has conferred a state-protected monopoly on the exporter, it is entitled

to do so provided that it satisfies the non-discrimination conditions of Article XVII (state trading enterprises). If it is a developing country and is seeking to protect and promote an infant industry, it is entitled to do so provided it meets the conditions of Article XVIII. If the home country's domestic competition laws are being applied to the exporter in a preferential way, then this is likely to be challengeable under the National Treatment principle (Article III). Fifth, operationalizing this focus on market access conditions in exporters' home markets in antidumping proceedings seems intractable. If a precondition to imposing antidumping duties is a judgment by competition authorities in importing countries that conditions in exporting countries' markets would violate importing countries' domestic competition laws, this would seem a clearly unacceptable extraterritorial application of an importing country's domestic laws. If, on the other hand, this judgment is remitted to competition authorities in exporting countries (many of which, however, do not have such authorities) under a theory of positive comity, their judgments will often be viewed as non-credible and self-serving in importing countries.¹¹⁴

In short, it is not and never has been a precondition to international trade that the domestic policy environment in exporting and importing countries be in all respects the same—an extreme version of level playing field or reciprocity concepts—subject to the important explicit constraints on discrimination embodied in the above Articles of the GATT.

Predatory pricing

Predatory pricing is the second characterization of dumping that gives rise to an economic rationale for antidumping laws. It consists of 'systematically pricing below cost with a view to intimidating and/or eliminating rivals in an effort to bring about a market price higher than would otherwise prevail'.¹¹⁵

US antidumping laws were initially enacted out of a concern for predatory pricing by foreign competitors.¹¹⁶ Canadian, US and EU antidumping laws penalize predatory pricing in addition to international price discrimination by authorizing the constructed cost method of calculating the normal value. This penalization of below-cost pricing suggests that predatory pricing may be an additional rationale for current antidumping laws.

Canadian,¹¹⁷ US¹¹⁸ and EU¹¹⁹ domestic antitrust laws prohibit predatory pricing. A seller who engages in predatory pricing (the predator) ultimately harms competition by driving other sellers from the market and acquiring market power. Once the predator gains market power, it restricts its output and captures monopoly profits. Predatory pricing is unlikely to occur frequently.¹²⁰ An extensive antitrust literature argues that predatory pricing is not often an effective means of achieving market power,¹²¹ and economic theory suggests that systematic below-cost pricing is infeasible and irrational unless certain structural conditions are present. In order to compensate for the extensive losses suffered while selling at artificially low prices, the predator must achieve a monopoly position by driving its competitors from the market and preventing new competitors from entering. This will be difficult: competitors will only leave the market if there are low barriers to exit, and low exit barriers imply correspondingly low barriers to entry. Thus, even if the predator is successful in driving out its current competitors, it

may face competition from a new wave of competitors, thus precluding recoupment of predatory losses incurred. Also, as Hovenkamp¹²² and McGee¹²³ argue, if the initial competitors are driven into bankruptcy, other sellers may acquire their facilities at fire-sale prices and compete with the predator while incurring lower fixed costs. Since it is unclear whether the predator will succeed in creating a monopoly, the potential gains from predatory pricing are uncertain.

Predatory pricing allegations are also difficult to assess. As Areeda and Turner note:

[U]nhappy rivals may automatically assume predation when a competitor's price is below their costs, disregarding the possibility that the alleged predator's cost is well below theirs and more than covered by his price.¹²⁴

In both Canada and the USA, prices below the seller's marginal cost¹²⁵ or average variable cost¹²⁶ tend to be presumed predatory, although courts have experienced some difficulty in measuring those costs.¹²⁷ Prices above average total cost (including fixed costs) are generally presumed non-predatory. Prices between average variable cost and average total cost may or may not be predatory, depending on the circumstances, such as proof of predatory intent or ability to recoup short-run losses in the long run by raising prices without being undercut by remaining competitors or new entrants. The rejection of average total cost as an invariable reference point is important because there are many instances in which a seller may be forced to sell below cost. For example, in times of slack or declining demand, the seller may not be able to sell enough output to cover all of its costs. As long as the seller prices its output above its variable costs, the revenue in excess of its variable costs will defray a portion of its fixed costs. Thus, the seller suffers lower losses than it would by halting production altogether (in which case it would suffer losses equal to its full fixed costs).

The gains from predatory pricing are even more uncertain in the international arena. For a predator to achieve a monopoly in its export market, it must drive out not only domestic competitors from the export market, but other foreign competitors as well. Foreign producers compete with each other just as vigorously as they compete with domestic competitors in their export markets.¹²⁸ Thus, the likelihood of one seller achieving a world-wide monopoly is slim.¹²⁹

Although true international predatory pricing (predatory dumping) may be expected to occur infrequently, where it does occur it harms competition in the export market. Indeed, predatory dumping is more harmful than wholly domestic predatory pricing because resulting monopoly profits are captured by the foreign exporter. On efficiency grounds, antidumping laws are justifiable insofar as they prevent predatory dumping. However, the current antidumping regimes of Canada, the USA and the EU penalize behaviour which may be neither predatory nor prohibited by antitrust legislation. Indeed, Hutton and Trebilcock conclude that of the 30 cases between 1984 and 1989 in which Canada imposed antidumping duties, none could be supported on predatory pricing grounds.¹³⁰ An unpublished study for the OECD of a much larger sample of cases apparently reached similar conclusions.¹³¹ Currently, antidumping duties are imposed when 'fully allocated costs' exceed export-market prices. As argued above, below-total-cost pricing need not

be predatory. Hence, antidumping laws penalize conduct by foreigners that is not penalized when engaged in by domestic firms.

Moreover, even below-marginal-cost pricing by the exporter need not reflect an underlying predatory intention. When the exporter makes its production decisions, it estimates the price its output will eventually realize in the export market. As long as the estimated export-market price exceeds its marginal cost, it will produce output for sale in the export market. If, owing for example to fluctuating exchange rates or changed market conditions, the actual export market price turns out to be lower than estimated, the exporter will have no choice but to sell its output at the best available price. This price may be lower than the *ex ante* marginal costs the exporter faced when it made its production decision. However, the exporter will continue to sell in the export market because the output has already been produced and it can recoup a portion of its sunk costs by selling its output.¹³² Although the exporter is engaging in below-marginal-cost pricing, there is no predatory intention. The exporter is doing what it can to minimize its losses in the face of its inaccurate *ex ante* estimate of the market price. Hutton and Trebilcock find that frustrated *ex ante* market-price estimates accounted for below-marginal-cost pricing in four antidumping actions initiated in Canada against US exporters.¹³³

Finally, in some cases, below-marginal-cost pricing may actually promote competition. Depending on the product, sellers may engage in below-marginal-cost pricing to compete for market share. Deardorff¹³⁴ identifies two product characteristics, 'experience' and 'learning by doing', that make below-marginal-cost pricing likely for some goods. Consumers may pay more for 'experience' goods after their first and subsequent purchases than before their first purchase. This is because the quality of 'experience' goods is only discernible after their first use. To induce consumers to sample their goods for the first time, as a marketing strategy sellers may initially price their goods below their marginal cost. Sellers will recoup their initial losses once consumers pay more for the goods on their subsequent purchases.¹³⁵ Sellers produce 'learning by doing' goods when they experiment with new technology or new products. When they first enter the market with new goods, sellers may be inefficient and suffer losses. At this point, marginal costs may exceed the sale price. Sellers gradually reduce their costs as they 'learn' more about efficient production methods. In the meantime, they gain a valuable toehold in the market.¹³⁶

Below-marginal-cost pricing for 'experience' or 'learning by doing' goods is typical for sellers expanding into new markets and cannot be viewed as predatory. In fact, it increases consumer demand, competition and productive efficiency, and sellers can recoup their costs without acquiring market power. Many sellers, regardless of their degree of market power, may increase their market share by selective below-marginal-cost pricing. These legitimate roles for below-marginal-cost pricing suggest that antidumping laws should not categorically penalize below-marginal-cost pricing. Significantly, domestic antitrust laws do not prohibit these kinds of activities in the case of domestic firms.¹³⁷

Again, the recent 'revisionist' literature that seeks to provide an economic rationalization for antidumping laws contests this analysis of the constructed cost aspect of antidumping laws as inconsistent with notions of predation.¹³⁸ It is argued that European Commission decisions in domestic predation cases under EU competition laws have rejected pricing above average variable cost as presumptively non-predatory and

have in fact adopted an average total cost test, which is close to the constructed cost test employed in antidumping law, and that US courts have adopted divergent cost tests in domestic predation cases under US antitrust law, some of which are consistent with the constructed cost test. It is then argued that pricing below average total cost is irrational unless a firm plans to exit a market or is doing so only on a temporary basis (e.g. because of depressed demand), or is engaged in predatory behaviour towards its rivals.

Several responses are in order. First, while it is true that courts have taken different positions on appropriate cost tests in domestic predation cases, they all nevertheless require proof of some kind that the alleged predator's behaviour is in fact predatory—that is to say that the intent or effect of its behaviour is likely to entrench or reinforce a dominant market position, permitting it then to behave monopolistically. The constructed cost inquiry in antidumping cases never views as relevant any of the evidence that in a domestic predation case might be viewed as demonstrating predatory (monopolizing) intent or effect. For example, is it seriously arguable that Hyundai was using supracompetitive profits garnered in its protected South Korean market to finance below-cost exports to the North American market with a view to predating (monopolizing) the latter market? Thus, the argument that the constructed cost test is a close surrogate for predation tests in domestic competition or antitrust cases is wholly unpersuasive. It bears repeating that in the OECD and Canadian empirical studies of antidumping cases referred to above, few or no cases were found to satisfy conventional economic conceptions of predation. Second, even acknowledging room for debate about the appropriate tests to be applied under competition or antitrust law in domestic predation cases, surely the National Treatment principle requires that whatever tests are applied to domestic producers should also equally be applied to foreign producers? Manifestly, antidumping laws violate this precept by according domestic producers much greater pricing latitude than that accorded to foreign producers. Domestic firms are rarely found guilty of predation under domestic antitrust or competition law regimes; foreign firms are frequently found guilty of dumping, suggesting the extent of the discrepancy between the two regimes.

More transparently baseless economic rationalizations for antidumping laws are also advanced in this literature.¹³⁹ One is that exporters facing recessions in their home markets may export these recessions to export markets by below-full-cost pricing and thus antidumping duties are a useful anti-cyclical policy. Given that it is at the same time claimed that antidumping duties often affect only about 1 % of imports (let alone GNP), it is difficult to think of a more futile anti-cyclical policy. It is also argued that where importing countries devalue their currency for balance of payment reasons, this objective may be defeated by exporters into their markets adjusting their export prices downwards (below home-market prices) to offset the effect of the devaluation and thus to retain market share. Again, given the very small percentage of imports said to be affected by antidumping duties and the large and complex set of forces that determine exchange rates, it is difficult to believe that such a strategy could have any discernible impact on the balance of payments. Moreover, domestic producers who use imported inputs may be required to adopt the same strategy in order to remain competitive, yet would not be penalized on that account.

Intermittent dumping

The final characterization of dumping that gives rise to an economic rationale for antidumping laws is intermittent dumping. Jacob Viner defined intermittent dumping as systematic dumping which lasts for several months or years at a time.¹⁴⁰ Viner viewed this form of dumping as objectionable because it lasts long enough to injure domestic producers without providing consumers with a constant long-run supply of goods.¹⁴¹ A situation in which intermittent dumping might occur is in the context of oversupply of perishables. Agricultural producers often make planting decisions long before selling their produce. Because of the cyclical nature of supply in many agricultural markets, producers often find that they have excess produce and, rather than allowing it to rot, they sell at low prices. For these agricultural producers, the relevant cost at the time of selling is the cost of packaging and marketing. Hutton and Trebilcock¹⁴² find that the only Canadian antidumping cases that exhibited any indication of intermittent dumping were agricultural cases. They argue that the case of perishables is not a dumping problem and that agricultural price instability should be addressed, if at all, through income stabilization programmes rather than antidumping laws.¹⁴³

Non-predatory intermittent dumping cannot occur unless certain structural conditions are present.¹⁴⁴ First, exporters must be unable to compete with domestic producers under normal market conditions. Otherwise, exporters would provide a permanent source of supply instead of an intermittent one. Second, intermittent dumping must be so extensive that it substantially disrupts domestic production. The losses incurred by selling below-cost products into export markets make it unlikely that the dumping will last long enough to disrupt domestic production. Also, disruption will only occur if domestic purchasers substitute foreign goods for domestic goods. By substituting foreign goods for domestic goods during the intermittent dumping period, domestic purchasers will disrupt domestic production. As a result, when the intermittent dumping period is over, domestic producers will charge higher prices than before to recoup their post-intermittent-dumping readjustment costs. Domestic purchasers can avoid the higher price by not substituting away from domestic goods in the first place, although it must be acknowledged that collective action problems may inhibit this response.

The conditions necessary for non-predatory intermittent dumping to occur are rarely likely to arise. Moreover, the effect of non-predatory intermittent dumping on welfare is ambiguous. When foreign exporters dump, domestic producers in the export market must adjust to meet lower import prices. Some domestic producers may be forced out of the market and, if the dumping is only temporary, domestic producers will then have to readjust to fill the vacuum left by the departing dumper. The adjustment and readjustment costs incurred by domestic producers unquestionably harm *producer* welfare.¹⁴⁵ Corporate resources which would go to skills training, expansion, or research and development are diverted to maintaining the producer's market share in the more competitive market. Losses incurred during the dumping period may force some producers into bankruptcy. Since domestic capital markets may be imperfect, the producers forced into bankruptcy may not be the least efficient.¹⁴⁶

Adjustment and readjustment costs associated with intermittent dumping may also be passed on to consumers. Intermittent dumping harms consumers if they end up paying a

higher long-run average price for goods than they would pay if there were no dumping. If intermittent dumping occurs with sufficient frequency that the domestic producer's cost of capital is higher over the long run (reflecting higher risk) than it would be in the absence of intermittent dumping, this cost will be passed on to consumers. However, the dumping margin may so depress prices during the period of dumping that, notwithstanding the producer's increased cost of capital, the consumer ends up paying lower long-run average prices. The net effect of intermittent dumping on consumer welfare is thus ambiguous.

Given both the uncertain effect of intermittent dumping on consumer welfare and the low probability of the structural conditions for intermittent dumping being satisfied, it is questionable whether antidumping laws should seek to prevent intermittent dumping. In any event, the present antidumping laws of Canada and the United States are ill-adapted to addressing problems of intermittent dumping. Antidumping investigations assess dumping margins and material injury without regard to whether the dumping is temporary or permanent. This conclusion is borne out by Hutton and Trebilcock's finding that the possibility of intermittent dumping concerns was present in only four of the thirty Canadian cases they examined in which antidumping duties were imposed.¹⁴⁷

Non-efficiency rationales for prohibiting dumping

The standard literature on dumping generally considers only economic or efficiency-based rationales for prohibiting dumping.¹⁴⁸ However, efficiency-based rationales may not tell the whole dumping story. Typically, antidumping laws can be justified politically because they address the perceived 'unfairness' of low-priced foreign imports. A US Senate Committee has called dumping 'pernicious',¹⁴⁹ and American courts have characterized dumping as an 'unfair trade practice'.¹⁵⁰ The global increase in antidumping actions may therefore reflect growing domestic political objections to the unfairness of low-priced foreign imports. The previous section showed that the only economic justification for antidumping laws is the prohibition of international predatory pricing, but notions of fairness may offer different justifications.

Fairness is a difficult concept.¹⁵¹ Bhagwati characterizes the fairness terminology in antidumping laws as 'inherently vague',¹⁵² and remarks that it is 'reflective of the psychological mood of a nation losing hegemony in the world economy'.¹⁵³ The perceived unfairness of non-predatory dumping may result from the disruptive impacts of low-priced imports on domestic industries and workforces. By increasing the net price of imports, antidumping duties make domestic goods relatively more attractive to consumers and allow domestic producers to avoid direct competition with foreign exporters. Direct competition with low-cost suppliers may eventually force domestic producers to leave the market. This exit is likely to result in domestic workers losing jobs and shareholders of affected producers losing capital. Thus, while consumers would benefit from lower prices if antidumping duties were abolished, domestic producers might suffer severe losses from low-priced imports.¹⁵⁴

Hutton and Trebilcock examine distributive justice and communitarian rationales for antidumping laws.¹⁵⁵ Antidumping laws would be justified on a distributive justice rationale if they were to enhance the welfare of the least-advantaged members of society.¹⁵⁶ The least-advantaged group would include immobile, unskilled and low-

income workers.¹⁵⁷ Antidumping laws would be justified on a communitarian rationale where they minimized the disruptive effect of imports on established communities and their corresponding network of family and social relationships.¹⁵⁸

However, both theoretically and empirically, antidumping laws cannot be sustained on these non-economic rationales. First, there is no principled reason to distinguish between the harm caused by non-predatory dumping and the harm caused by non-dumped low-priced imports. Undeniably, low-priced imports inflict losses on domestic interests; however, the severity of these losses does not depend on the home-market price of those imports, which is what distinguishes dumped imports from other imports.

Empirically, most Canadian cases in which antidumping duties are imposed do not reflect distributive justice or communitarian rationales. Hutton and Trebilcock show that of the 30 Canadian antidumping cases in which antidumping duties were imposed between 30 October 1984 and 3 February 1989, two cases could be justified by a distributive justice rationale alone, five cases could be justified by a communitarian rationale alone, and four cases could be justified by a combined distributive justice/communitarian rationale. Nineteen of the thirty cases examined could not be justified on any normative rationale, either economic or non-economic.¹⁵⁹ Thus, not only do non-economic rationales fail to justify a prohibition against dumping, but antidumping authorities appear to ignore these rationales when they impose antidumping duties.¹⁶⁰ Indeed, Hutton and Trebilcock find that most Canadian antidumping cases benefit those workers and communities who are already better off than the majority of workers and communities in Canada,¹⁶¹ suggesting that the current Canadian regime may actually violate distributive justice concerns.

A different line of non-economic rationalization of antidumping laws (and trade remedy laws more generally) has been developed by Sykes in a political/Public Choice analysis of these laws.¹⁶² He argues that rather than attempting to ascribe an economic logic to them, or interpret, apply or refine them in economically rational ways, it is more persuasive to view them as part of a grand and complex political compact among major trading nations where in order to facilitate major trade liberalization concessions with respect to border measures such as tariffs and quantitative restrictions, the Contracting Parties by agreement reserved to themselves unilateral opt-out regimes against the contingency that the discrete impacts of import competition in particular sectors would prove politically unsustainable; in the absence of these opt-outs or safety valves, governments would have been more reluctant to assume the political risks of trade liberalization initiatives in the first place.

Sykes's argument is a subtle and disconcerting one, in that it is inherently non-refutable through any decisive *a priori* analysis. However, several reactions are in order. First, it seems implicitly to rest on a notion that there is a fixed quotient of protectionism in the world (and each of its trading partners), and that if protectionism is suppressed or curtailed in some dimensions it will re-surface in others (like water finding its proper level). This implicit assumption rests on murky theoretical foundations and is empirically sharply at odds with the post-war experience which on any measure has entailed dramatic trade liberalization (not only of border measures, but of many other trade restricting measures). Thus, whatever implicit political compact may have motivated the initial founders of the GATT, this compact has surely not remained static and immune from new learning, experience and changing preferences, but has evolved through time and

over (many more) countries. Adopting this more dynamic political perspective, there is no reason to believe that trade remedy laws (any more than the host of other protectionist measures that have been eliminated or liberalized) are part of some iron law of politics that is impervious to change. The fact that antidumping laws have not been seriously reformed to date is not necessarily decisive against future prospects of reform, in the same way that the fact that tariffs were high in 1947 (and had been for many years) was not decisive against their subsequent reduction. This is not to gainsay the continuing political salience of constituencies in importing countries whose interests may be jeopardized by trade liberalization, but it does argue for searching for better ways of accommodating these concerns that do least violence to the net welfare gains from trade. Whether such ways can in fact be found is indeed a major challenge and must await further discussion in later chapters, particularly the discussion of transition costs, safeguard regimes and domestic adjustment policies.¹⁶³

REFORMING ANTIDUMPING LAWS

Current antidumping regimes might seek to prevent international price discrimination, international predatory pricing and intermittent dumping. However, only predatory pricing gives rise to a legitimate economic rationale for prohibiting dumping: when dumping is merely international price discrimination, the export market benefits. Intermittent dumping can be expected to occur only rarely and its net welfare effects are ambiguous.¹⁶⁴ Yet antidumping laws are ill-designed to identify and penalize true international predatory pricing. Instead, they result in duties being levied upon goods priced at non-predatory levels, thereby imposing costs on consumers in export markets through supracompetitive prices and subjecting foreign firms to burdens that domestic competitors do not bear. In addition, antidumping and countervailing actions may create substantial distortions with negative effects on trade, particularly for developing countries.¹⁶⁵

Non-economic rationales for antidumping laws, such as concerns over distributive justice or communitarian impacts of low-priced imports, are more appropriately dealt with under safeguard regimes or, better still, under domestic adjustment assistance programmes. This conclusion leads us to propose that antidumping laws should be replaced by either supranational or harmonized domestic antitrust regimes which penalize international predatory pricing without at the same time penalizing non-predatory international price discrimination. Price discrimination laws should play no role in regulating cross-border trade. Among Member States of the European Union, this solution has largely been adopted, with the abolition of antidumping duties with respect to inter-Member trade and replacement with Union competition laws which bind Member States and their citizens. However, EU competition laws constrain not only predatory pricing but also price discrimination, including cross-border price discrimination.¹⁶⁶ Therefore, the European model is more expansive than our analysis suggests is warranted.

Instead, the more modest goal of harmonizing domestic antitrust laws, ideally under the aegis of the GATT, with respect to international predatory pricing seems a more appropriate goal. In this respect, the 1988 Protocol between Australia and New Zealand,

pursuant to the Australian-New Zealand Closer Economic Relations Trade Agreement (ANZCERTA) between the two countries, is much more apposite. Both countries agreed that as of July 1990, all antidumping actions between the two countries should cease and that any antidumping duties then in place should be terminated. In their place have been substituted harmonized provisions in both countries' competition laws pertaining to abuse of dominant position. These provisions permit a complainant located in one country to complain of abusive behaviour by a firm or firms located in the other country. The courts in the first country are then authorized to hold hearings in the second country and to use the second country's courts to enforce subpoenas and other orders. The provisions on abuse of dominant position clearly focus on cross-border predatory pricing, and not cross-border price discrimination. Canada and Chile have adopted a similar regime under their Free Trade Agreement. Warner has proposed a similar harmonized antitrust regime for bilateral Canada-US trade.¹⁶⁷ Here the political trade-offs seem promising. For example, between 1980 and 1988, US producers brought 22 antidumping actions against Canadian exporters, while Canadian producers brought 50 actions against US exporters. Canada imposed duties in 23 of the 50 actions, while the USA imposed duties in 14 of the 22 actions. In principle, such a regime could also be implemented multilaterally, through a GATT cross-border predatory pricing Code, which would require signatories to harmonize their domestic antitrust laws in line with the Code, in much the same way that at present, domestic antidumping laws must conform with the GATT Antidumping Agreement (or domestic intellectual property laws must conform with the WTO TRIPS Agreement). A variant on this approach would be to preserve antidumping regimes at a formal level but seek to agree on harmonization requirements that would incorporate predation concepts explicitly into these regimes (including tests for predation or abuse of dominant position in export markets; definition of relevant (not 'like') product (and geographic) markets; protection of competition, not competitors). The initial US Antidumping Act of 1916 in part exemplifies this approach. This would, in effect, turn antidumping actions into private actions for cross-border predation, with duties rather than damages as the available remedy. In moving in this direction, one of the major forms of the 'New Protectionism' would be radically constrained, while legitimate concerns about domestic impacts of surges in low-priced imports would be dealt with through a well-conceived multilateral safeguards regime¹⁶⁸ and domestic adjustment assistance programmes.¹⁶⁹ In this chapter, we have focused on one area of potential convergence between trade policy and competition policy.¹⁷⁰ Arguments for harmonizing domestic competition policies to facilitate international trade and investment in fact range much more broadly, and we take up these issues in a later chapter.

9

Subsidies, countervailing duties and government procurement

INTRODUCTION

Under Article VI of the GATT, countervailing duties can be levied by Member countries on imports that are causing harm to domestic industries due to subsidization by a foreign government.¹ After antidumping actions, countervailing duty actions were the most frequently initiated trade remedy actions between 1979 and 1988, accounting for 18% of all import relief measures initiated. During that period, one country was the main user: the United States initiated 371 actions, while all other countries initiated only 58.² From 1995 to 2003, this pattern was replaced by the predominance of developed countries more generally in reporting countervailing initiations: the United States reported 66 of 168 initiations, followed by the European Community with 42, Canada with 12, South Africa with 11, New Zealand and Australia with 6 each, Chile, Egypt and Argentina with 4 each, Peru with 3, Venezuela, Mexico, Israel and Brazil with 2 each and Costa Rica and Latvia with 1 each. Developed countries were responsible for 132, or 78.6% of, countervailing duty initiations. Developing countries and economies in transition were the object of the majority of initiations at 113.³ The historical predominance of the USA as a user of countervailing duties illustrates the distinctive view of subsidies held by the USA, and limited international agreement on the status of subsidies as policy instruments. In the USA, subsidies are often viewed as illegitimate distortions of international trade, while in other countries industrial subsidies have often been considered a legitimate instrument of domestic policy. According to Schwartz and Clements, subsidization as a percentage of GDP was 2.98% among industrialized countries between 1975 and 1990, while the average subsidy rate of the USA was 0.5%.⁴ However, empirical work by Bence and Smith, based upon data from the mid-to-late 1980s, concluded that, once defence procurement in the United States is taken into account, the US average rate of subsidies jumps to 2%.⁵ Bence and Smith, however, do not explain the methodology used to discern the subsidy component in defence procurement, and hence the 2% estimate should be regarded as speculative.⁶

Despite US concerns at the use of subsidies by other countries,⁷ there is a debate about the incidence of subsidies in the United States itself, particularly at the state level where subsidies (including tax incentives), such as locational inducements for new plants, are pervasive. Fry estimates that 'at the end of the 1980s, the total annual tab for targeted assistance at the subnational level was over \$20 billion for non-agricultural businesses; expenditures and lost revenues for the states approached \$200 billion'.⁸ Moreover, many of these state aids are highly visible, rather than being hidden in procurement policies, utility rate rebates, etc.⁹

Parties to the GATT are authorized to levy countervailing duties in response to injury caused or threatened by subsidized imports.¹⁰ However, there are three situations in which subsidies can distort trade, and in only one can countervailing duties be used directly to address any resulting distortions. First, if country A subsidizes its exports to country B, causing domestic producers in country B to be disadvantaged, country B can respond by countervailing those imports. Second, if country A subsidizes its domestic production, disadvantaging the exports of country B to country A, the only actions country B can take are to respond with equivalent subsidies, or complain of nullification or impairment of prior tariff concessions to a GATT dispute resolution panel.¹¹ Finally, if country A subsidizes exports to C, disadvantaging exports of country B into C's market, again there is little that country B can do unilaterally other than respond with equivalent subsidies.¹² It is necessary to consider both the rules on subsidies and those on countervailing duties in order to address the problems raised in these three scenarios.

THE GATT PROVISIONS ON SUBSIDIES

Article VI

Article VI of the GATT contains general rules governing the application of antidumping and countervailing duties. In section 3, countervailing duties are defined as 'a special duty levied for the purpose of offsetting any bounty or subsidy bestowed directly or indirectly upon the manufacture, production or export of any merchandise'. The fact that countervailing duties are linked with antidumping duties in this Article suggests that subsidies are actionable for the same reason that dumping is: because they result in below-normal value pricing;¹³ however, subsidization is distinguished from dumping on the grounds that the former is a distorting practice of *government* whereas the latter is a pricing policy of a private firm.¹⁴

Few rules are laid out in this Article. In order for a countervailing duty action to be authorized, the effect of the subsidization must be to cause or threaten material injury to an established domestic industry or to retard materially the establishment of a domestic industry. Section 5 specifies that no product may be subject to both antidumping and countervailing duties, and that any countervailing duties should be no more than the estimated bounty or subsidy determined to have been granted. Finally, two specific practices are exempted from countervailing duty actions. First, the exemption of exported products from duties or taxes borne by that product (or a product like or competitive with that product) when not destined for export (i.e. when destined for consumption in the country of origin) is not a countervailable subsidy.¹⁵ Second, the maintenance of price stabilization systems for producers of primary commodities is not countervailable if such systems lead to both high and low export prices and are not intended to stimulate exports or cause distortions.¹⁶

Article XVI

Article XVI of the GATT contains general provisions on subsidies. At the time of the formation of the GATT, Article XVI contained only one provision whose main purpose

was to encourage notification and consultation on the use of subsidies. Section A requires Parties to notify the GATT of any subsidies that affect imports or exports, directly or indirectly, and to consult with any Parties whose interests are threatened by or are suffering serious prejudice from such subsidies. This provision of the GATT was 'something less than an effective brake on the use of subsidies...[and] there is no record of any country ever having limited a subsidizing practice as a result of consultations under Article XVI, paragraph 1'.¹⁷

In 1955, Article XVI was expanded to include a more specific provision on export subsidies.¹⁸ The provision is relatively weak, and in any event not all countries accepted it.¹⁹ Under section B, Parties were obliged to seek to avoid the use of subsidies on the export of primary products. Any such subsidy should not be applied in such a way as to result in that Contracting Party having a 'more than equitable' share of world export trade in the subsidized product. With respect to non-primary products, Parties were to seek to avoid the use of subsidies that would result in export sales of a product at prices below the comparable price for the sale of the like good in the domestic market. The different treatment of primary and non-primary products was interpreted by developing countries as discrimination against their trade and they did not endorse this section of the Article.²⁰ The final amendment to Article XVI was made in 1960 when an illustrative list of export subsidies was developed to aid Parties in interpreting the provisions.²¹

The Tokyo Round Subsidies Code

As was the case with antidumping, the presence of an injury requirement in Article VI of the GATT did not affect the administration of countervailing duty laws in the USA. By virtue of the Protocol of Provisional Acceptance, domestic laws in existence at the time of the signing of the GATT took precedence over GATT obligations, leaving the US government 'free to countervail without demonstrable economic justification'.²² For most nations, subsidies other than export subsidies were considered matters of national or internal policy. Thus, the aim of the Tokyo Round negotiations on subsidies was to secure a binding requirement that countervailing duties only be imposed on subsidized products that were causing material injury to domestic producers. However, the USA, which felt strongly about the unfairness of subsidies, insisted that rules on countervail should only be addressed if an agreement to discipline subsidies more generally was reached.²³ In essence, there was a fundamental difference in approach to the issue of subsidies/countervailing measures.²⁴ The result of the conflict between the USA and other countries was the two-track approach laid out in the Tokyo Round Code on Subsidies and Countervailing Duties. It should be noted that the Code was a plurilateral, not multilateral, agreement and was in fact adopted mostly by OECD countries and by a small number of the most advanced developing countries, leaving non-signatories uncommitted to the disciplines and disentitled to its benefits.

Track I

Track I of the Tokyo Round Subsidies Code dealt entirely with unilateral responses to subsidies—i.e. the imposition of countervailing duties on subsidized imports causing injury to a domestic industry. Signatories had the authority to impose countervailing

duties sufficient to counteract the foreign subsidy, or a lesser duty if this would be sufficient to alleviate the injury.²⁵ The procedural and substantive provisions are very similar to those on antidumping, as are unilateral arrangements for their determination in the USA, Canada and the EU. Article 2(1) requires that sufficient evidence of subsidization, injury and a causal link between the imports and the injury be furnished before an investigation can be launched. The main weakness in the Code was that there was no clear definition of a countervailable subsidy. Because of the Code's silence on this issue, countries were given a great deal of latitude in defining 'subsidy' for countervailing duty purposes.²⁶

Track II

Track II is the multilateral route for addressing subsidies.²⁷ It was primarily concerned with obligations undertaken by signatories to reduce the incidence of trade-distorting subsidies and for the most part was an elaboration of Article XVI of the GATT. Countries agreed to notify the Contracting Parties of any subsidies that might impact on exports or imports and undertook to avoid granting export subsidies²⁸ on other than primary products. Moreover, signatories were expected to avoid export subsidies on certain primary products if they served to increase the signatory's share of world trade beyond what is equitable, account being taken of the share of the signatory in trade during a previous representative period. If an export subsidy was being maintained in a manner inconsistent with the Code, a signatory could request consultation with the offending country under Article 12(1). The matter could be referred to conciliation and panel review under Part VI of the Code if a mutually acceptable solution was not reached in 30 days.

Expanding on Article XVI of the GATT, the Code addressed domestic subsidies in Article 11. Signatories recognized that domestic subsidies were important instruments for the promotion of social and economic policy. The policy objectives recognized in the Code²⁹ were:

- 1 the elimination of industrial, economic and social disadvantages of specific regions;
- 2 to facilitate the restructuring, under socially acceptable conditions, of certain sectors, especially where this has become necessary by reason of changes in trade and economic policies, including international agreements resulting in lower barriers to trade;
- 3 generally to sustain employment and to encourage retraining and change in employment;
- 4 to encourage research and development programmes, especially in the field of high-technology industries;
- 5 the implementation of economic programmes and policies to promote the economic and social development of developing countries;
- 6 redeployment of industry in order to avoid congestion and environmental problems.

Furthermore, signatories 'do not intend to restrict the right of signatories to use such subsidies to achieve these and other important policy objectives which they consider desirable'.³⁰ When adopting policies that involve the granting of subsidies, Parties shall 'weigh, as far as is practicable, taking account of the nature of the particular case,

possible adverse effects on trade'.³¹ While recognized as legitimate, domestic subsidies could be challenged if they caused one of three effects:³²

- injury to the domestic industry of another signatory;
- nullification or impairment of the benefits accruing to another signatory under the General Agreement;
- serious prejudice to the interests of another signatory.³³

Unlike the Track I procedure, Track II did not permit the complainant to impose duties unilaterally to counteract an offensive subsidy, but did address all three basic subsidy scenarios identified above. First, the complainant signatory was required to consult with the country providing the subsidy. If no mutually acceptable solution to the matter was reached, then a panel would be formed by the Committee on Subsidies and Countervailing Measures.³⁴ After consideration of the panel's report, the Committee would make recommendations to the parties to the dispute. If these recommendations were not followed within a reasonable amount of time, the Committee could authorize counter measures—including the withdrawal of GATT concessions or obligations.

The Code also recognized the role of subsidies in the economic development policies of developing countries and laid out somewhat stricter rules governing actions against them under Track I. There were also restrictions on the rights of other signatories to take action against them under Track II.

The Tokyo Round Subsidies Code proved only modestly effective, and contentious cases involving EC subsidies on the export of wheat flour and pasta and on domestic oilseed production were not satisfactorily resolved, precipitating further negotiations over subsidies disciplines during the Uruguay Round.

The Uruguay Round Subsidies Agreement³⁵

The Uruguay Round Subsidies Agreement, unlike the Tokyo Round Code, is an integral part of the WTO and binds all Member States. *Brazil—Measures Affecting Desiccated Coconut*³⁶ ('*Brazil Coconut*') concluded that the Subsidies and Countervailing Measures (SCM) Agreement and the GATT 1994 are inseparable, but that the former will prevail in the event of a conflict. Apart from the Uruguay Round Subsidies Agreement, the Tokyo Round Agreement on Trade in Civil Aircraft and a 1992 Agreement between the EU and the USA constrain subsidies in the civil aircraft industry. A 1994 Agreement among some OECD Members also constrains subsidies in the civil shipbuilding and repair industry.

Definition of subsidies

Agreement on tighter constraints on subsidies was facilitated by recessionary conditions and rising government deficits during the Uruguay Round Subsidies Agreement negotiations. Subsidies are defined for the first time. They will be deemed to exist if there is a financial contribution by government or any public body where the government practice involves a direct transfer of funds (e.g. grants, loans and equity infusion); potential direct transfers of funds or liabilities (e.g. loan guarantees); government revenue that is otherwise due but is foregone; government provision of goods or services other than general infrastructure; government payments to a funding mechanism; or direction

to a private body to carry out any of the foregoing functions (Article 1.1), **and** if a benefit is merely conferred on the recipient.

The meaning of 'financial contribution' and 'benefit' under Article 1 has been the subject of appeal in several WTO cases. The Appellate Body (AB) in *United States—Tax Treatment for 'Foreign Sales Corporations'*³⁷ ('US FSCs')³⁸ addressed Article 1.1(a)(1)(ii), specifically the meaning of 'otherwise due' in the phrase 'government revenue that is otherwise due is forgone or not collected'. It found that 'otherwise due' requires, on the basis of a 'normative benchmark', comparison between revenues raised and that which would otherwise have been raised. This benchmark will vary between Members, however, according to their tax scheme (para. 90). *United States—Tax Treatment for 'Foreign Sales Corporations'—Recourse to Article 21.5 of the DSU by the European Communities*³⁹ ('US FSCs 21.5') clarified what is expected of a panel in identifying a 'normative benchmark'. The AB indicated that in some cases, it may be possible to apply a 'but for' test, such as when a measure 'might be described as an "exception" to a "general" rule of taxation'. However, the complexity and variety of tax laws may mean such a test is not always practicable. Consequently, a panel should 'compare the fiscal treatment of legitimately comparable income' for 'taxpayers in comparable situations' (paras 91–2). The recent AB decision in the *U.S.—Lumber CVD* case upheld the panel determination that the Canadian provincial governments made a 'financial contribution' by providing goods (the right to harvest standing timber) to timber producers through governmental stumpage programmes. This financial contribution was held to fall under the definition set out in Article 1.1(a)(1)(iii) of the SCM Agreement despite Canada's argument that the right to harvest standing timber did not involve 'trade-able items' or was not technically 'provided' (paras 50–5).

*Canada—Certain Measures Affecting the Automotive Industry*⁴⁰ ('Canada Auto') addressed Canadian measures allowing importation of certain motor vehicles duty-free by certain manufacturers, contingent in part on the manufacturer's attaining a specified level of Canadian value added in its local production. Canada attempted to argue that this measure fell under the exception to a subsidy specified in footnote 1 of the SCM Agreement, but the AB disagreed and pointed out that footnote 1 applies to exports, whereas the Canadian measure in question applied to imports (para. 92).

Among the US arguments in *US FSC* was that footnote 59 of the Agreement, which indicates when a deferral of direct taxes or social welfare charges to an enterprise is not an 'export subsidy', provides an exception to 'subsidy' under Article 1.1. Disagreeing, the AB noted that the definition of 'subsidy' in Article 1.1 applies wherever the term 'subsidy' is employed throughout the entire Agreement, and that even if an FSC measure were not an 'export subsidy' per footnote 59, it may still be a 'subsidy' under Article 1.1. As indicated by footnote 5, it is simply not a prohibited subsidy under the Agreement (para. 93). In *Canada—Measures Affecting the Export of Civilian Aircraft—Recourse by Brazil to Article 21.5 of the DSU*⁴¹ (*Canada Aircraft 21.5*'), the AB stated: 'Not all subsidies are inconsistent with the SCM Agreement. The only "prohibited" subsidies are those identified in Article 3 of the SCM Agreement' (para. 47). It added in *US FSC 21.5* that Article 1.1 only defines, not prohibits, 'subsidy' (para. 85).

*Canada—Measures Affecting the Export of Civilian Aircraft*⁴² ('Canada Aircraft') examined and upheld the panel interpretation of Article 1.1(b). The panel found that in order to confer a 'benefit', a financial contribution must '[be provided] on terms that are

more advantageous than those that would have been available to the recipient on the market'. It also indicated that 'cost to government' mentioned in Annex IV and Annex IV itself are not relevant to defining 'benefit', but that Article 14 is relevant (paras 149–50). The AB added that a 'benefit' can only exist where there is a beneficiary or recipient, whether 'a person, natural or legal, or a group of persons'. Thus, the determination of benefit is to be with consideration to the market, and the specific recipient (para. 154). *United States—Countervailing Measures Concerning Certain Products from the European Communities*⁴³ ('US Countervailing Measures') clarified the latter point by indicating that a firm and its owner could together constitute 'a recipient'. Similarly, a 'group of persons' may include only 'legal persons', only 'natural persons', or a combination of both 'natural and legal persons' (para. 108). *US Countervailing Measures* also rejected an argument by the United States that the panel should have considered the economic impact of privatization 'from the perspective of the legal person producing the subject merchandise' (paras 88 and 99). The AB reiterated that 'benefit' is to be assessed in terms of market value, and that in this case, 'the utility value of [privatized] equipment to the newly-privatized firm is legally irrelevant' (para. 102). The AB noted that although there was a presumption that a 'benefit' no longer exists after a firm is privatized at market value in an arm's length sale transaction, there may be market conditions where the value of a continuing benefit from a past financial contribution (i.e. to the pre-privatized firm) will not be 'fairly' reflected in the market price at which the new owner purchases the firm from the government.

Issues raised in the recent Canada-US softwood lumber dispute⁴⁴ demonstrate the economic complexity of the 'benefit' concept. Article 14 of the SCM Agreement sets guidelines for the calculation of the amount of a subsidy in terms of the benefit to the recipient. Article 14(d) indicates that the provision of goods or services or purchase of goods or services by a government only confers a benefit where the provision is made for less than adequate remuneration, or the purchase is made for more than adequate remuneration. Adequate remuneration is to be based on prevailing market conditions in the country of provision or purchase. The United States claimed in the softwood lumber case, however, that the Department of Commerce was justified in relying on US stumpage rates as the benchmark for finding whether there was benefit to Canadian lumber producers. Its argument was that prevailing market conditions in Canada did not reflect 'fair market value' of timber in Canada, because of the large involvement of government in that market (para. 7.44). However, the panel found no justification in the text for holding that prevailing market prices may be disregarded because they are distorted (para. 7.51). Because of this, the United States was found in violation of Article 14 and 14(d) by not using Canadian private prices in its benefit calculations, and violated Articles 10 and 32.1 for imposing countervailing duties based on these calculations (para. 7.65). The AB reversed the panel decision and held instead that 'an investigating authority may use a benchmark other than private prices in the country of provision, when it has been established that private prices of the goods in question in that country are distorted, because of the predominant role of government in the market as a provider of the same or similar goods' (paras 100–1). Nonetheless, the AB held that it was 'unable to complete the legal analysis' to find whether or not the US Department of Commerce determination of benefit was consistent with Article 14(d).

Article 1.2 of the SCM Agreement indicates that in order for a subsidy to be actionable, prohibited or subject to countervailing duties under the SCM Agreement, it must meet the definition of ‘specific’ in accordance with Article 2. This definition closely follows existing US countervailing duty law. It includes subsidies that are on their face limited to an enterprise or industry (or group of enterprises or industries), as well as subsidies that are *de facto* specific in terms of how governments exercise their discretion in the administration of a subsidy programme or who actually benefits from it.

In Korea-Vessels, which was released just as this volume was going to press (*Korea—Measures Affecting Trade in Commercial Vessels*, WT/DS273/R, Report of the Panel, March 7, 2005, so far not appealed) the panel held that various government supports for restructuring of Korean shipbuilding enterprises did not ‘confer’ a benefit since there was unrefuted evidence that the going concern value of the enterprises was greater than the liquidation value, thus raising the possibility that a private investor might have supported the restructuring on commercial considerations.

Classification of subsidies

Subsidies are classified as actionable, non-actionable and prohibited.⁴⁵ Prohibited (export) and actionable subsidies are subject to challenge under either the multilateral dispute resolution track or the domestic countervailing duty track. Non-actionable subsidies are immune from challenge under both tracks (Article 10, note 33), although where a non-actionable subsidy is causing serious adverse effects to the domestic industry of a Member State, the Subsidies Committee may recommend a modification to the programme. Actionable subsidies have not yet been the subject of an AB decision. Non-actionable subsidies expired in 2000, pursuant to Article 31 of the SCM Agreement. Previously, however, they included general (non-specific) subsidies such as spending on education or infrastructure, as well as some specific subsidies (Article 8). First, specific assistance for research activities conducted by firms or by higher education or research establishments on a contract basis with firms was not actionable if the assistance covered not more than 50% of the costs of basic industrial research or 25% of the costs of applied research.⁴⁶ Second, assistance to disadvantaged regions given pursuant to a general framework of regional development, and non-specific within eligible regions, was not actionable subject to certain conditions. Each disadvantaged region had to be a clearly designated, continuous geographical area with a definable economic and administrative identity. The region had to be considered as disadvantaged based on neutral and objective criteria, indicating that the region’s difficulties arise out of more than temporary circumstances. The criteria included some measure of economic development based on at least one of the following factors (as measured over a three-year period): one of either income per capita or household income per capita, or GDP per capita, which must not have been above 85% of the average for the country concerned; the unemployment rate, which must have been at least 110% of the average for the country concerned. Even these two forms of specific subsidies could be objectionable if a signatory could demonstrate that they had resulted in serious adverse effects to its domestic industry. Third, assistance to promote adaptation of existing facilities to new environmental requirements was non-actionable provided it was a one-off measure, was limited to 20% of the adaptation costs, did not cover the cost of replacing and operating the assisted investment, was directly

limited to planned reduction in a firm's pollution and did not cover any manufacturing cost savings, and was available to all firms that could adopt the new equipment or processes. These three kinds of subsidies required notification to the Committee on Subsidies and Countervailing Measures prior to implementation to ensure compliance with the various conditions that attach them.

Two kinds of non-agricultural subsidies are prohibited *per se*: subsidies contingent in law or in fact upon export performance (illustrated in an Annex to the Agreement), and subsidies contingent upon use of domestic rather than imported inputs (Article 3). The AB discussed the phrase 'contingent in fact' in Article 3.1 (a) in *Canada Aircraft*, beginning with the recognition that 'contingent' imports the same legal standard for both *de jure* and *de facto* contingency, i.e. 'conditional' or 'dependent for its existence on something else' (para. 166). On the facts of the case, the AB upheld the panel finding that the provision of assistance to the regional aircraft industry by Canada through the Technology Partnerships Canada (TPC) programme was sufficient to meet this condition, thereby placing Canada in violation of Article 3.1 (a). *Canada Auto* indicated that a "'tie" amounting to a relationship of contingency' is also sufficient (para. 107). What distinguishes *de facto* and *de jure* contingency, per *Canada Aircraft* is the evidence that may be used in proving each. It will be more difficult to prove *de facto* than *de jure* contingency, because the former demands inference. Furthermore, the standard specified in footnote 4 for determining 'contingency in fact' requires demonstration by fact that the granting of a subsidy is tied to 'anticipated exportation or export earnings'. However, there is no general rule regarding which facts must be taken into account, and those that should be taken into account will vary from case to case. The three elements required by footnote 4 are 'granting of a subsidy', 'is...tied to', and 'actual or anticipated exportation or export earnings'. The first indicates that one should focus on the actions of the granting authority, not the recipient. The second, supported by the second sentence of footnote 4, requires demonstration of conditionality or dependence; anticipation that exports would result is insufficient. The third requirement is discrete from the second and should be drawn from objective evidence (paras 167–73). *De jure* contingency, in contrast, is based on the text of the legislation in question, according to *Canada Auto*. Although contingency may be apparent on the face of the text in some cases, it is not a requirement. A panel may also find *de jure* contingency where the legislation is 'clearly, though implicitly', conditional on export (para. 100). In *Canada Auto*, the AB stated that the same legal standard applies to 'contingency' under Article 3.1 (a) and 3.1(b), with respect to both the definition of 'contingency' and what evidence may be used to demonstrate *de jure* contingency (para. 123). It also found that Article 3.1(b) includes contingency both in fact and in law (para. 143).

Article 3.1 (a) refers to Annex I of the SCM Agreement as illustrating subsidies contingent on export performance. *Brazil—Export Financing Programme for Aircraft*⁴⁷ ('*Brazil Aircraft*') and *Brazil—Export Financing Programme for Aircraft—Recourse by Canada to Article 21.5 of the DSU*⁴⁸ ('*Brazil Aircraft 21.5*') discussed item (k) on this list, in particular the meaning of 'used to secure a material advantage'. Item (k) provides for 'the grant by governments...of export credits at rates below those which they actually have to pay for the funds so employed...or the payment by them of all or part of the costs incurred...in obtaining credits in so far as they are used to secure a material advantage in the field of export credit terms.' In *Brazil Aircraft*, the AB indicated that the Commercial

Interest Reference Rates (CIRRs) defined in Article 15 of the OECD Arrangement may be regarded as one benchmark for ‘used to secure a material advantage’. The AB describes the CIRR as the ‘minimum commercial rate available in that range for a particular currency’. If the net interest rate, i.e. the ‘actual interest rate applicable in a particular export sales transaction after deduction of the government payment’, is below the relevant CIRR, it is a ‘positive indication’ that the government payment in question was ‘used to secure a material advantage in the field of export credit terms’ (paras 181–2). *Brazil Aircraft 21.5* supported the panel finding in that case that the CIRR is not the only possible benchmark. Another benchmark, such as an alternative ‘market benchmark’, may be used where the CIRR does not reflect available market rates (paras 63–4).

In *Korea-Vessels*, the panel held that the illustrative list of export subsidies in Annex A could not be used, on ‘a contrario’ theory to mount a defense that, because a subsidy’s features do *not* correspond to the design features described in one or more of the items in the list, it should *not* be considered as contingent on export performance.

Footnote 59 provides for an exception to Article 3.1 (a), according to *US FSCs 21.5* (para. 132). The provision reads in relevant part: ‘Paragraph (e) is not intended to limit a Member from taking measures to avoid the double-taxation of foreign-source income earned by its enterprises or the enterprises of another Member.’ Paragraph (e) of the illustrative list indicates that ‘[t]he full or partial exemption, remission, or deferral specifically related to exports, of direct taxes’ constitutes an export subsidy. *US FSCs 21.5* defined ‘double taxation’ as when ‘the same income, in the hands of the same taxpayer, is liable to tax in different States’ (para. 137). Defining ‘foreign-source income’ required the AB to balance two considerations. First, ‘footnote 59 does not oblige Members to adopt any particular legal standard to determine whether income is foreign-source for the purposes of their double taxation-avoidance measures’ (para. 139). Second, the definition of ‘foreign-source income’ cannot be permitted under footnote 59 to be so broad as to reflect whatever definition of ‘foreign-source’ that a Member may choose because that would ‘seriously undermine the prohibition on export subsidies in the *SCM Agreement*’ (para. 140). The AB therefore interpreted ‘foreign-source income’ as ‘income generated by activities of a nonresident taxpayer in a “foreign” State which have such links with that State so that the income could properly be subject to tax in that State’ (para. 145).

Article 4.7 indicates that if a prohibited subsidy is found, the panel will ‘recommend that the subsidizing Member withdraw the subsidy without delay’ and ‘specify...the time-period within which the measure must be withdrawn’. In *Brazil Aircraft 21.5*, Brazil argued that withdrawing its prohibited export subsidies would force it to breach its contractual obligations under domestic law (para. 46). In *US FSCs 21.5*, the United States submitted that its taxpayers have a right to an ‘orderly transition’ when tax rules are changed (para. 224). The AB did not find either of these arguments convincing, and found a violation of Article 4.7 in both cases.

Krympotic notes that a particularly contentious issue is the evolving understanding of ‘withdrawn’. He argues that GATT panels typically required conformity with the GATT and that, although the judgment was later limited to the particular case, *Australia—Subsidies Provided to Producers and Exporters of Automotive Leather*⁴⁹ was a departure from the GATT approach because it indicated that Article 4.7 ‘may encompass

repayment of the prohibited subsidy' (para. 6.39).⁵⁰ However, the requirement that a subsidy illegally provided be disgorged could be related to the notion that, otherwise, the firms in question may continue to receive a benefit from past subsidization. Thus, a requirement of disgorgement could be reconciled with a future-oriented remedy. Although paying back the whole subsidy may be too much or too little to assure that no further illegal benefit is received, it would be very likely to be enough to repair harm to competitive opportunities from the increased competitive position of the firm due to having received subsidies in the past.⁵¹

Actionable subsidies

Subsidies that are neither prohibited nor non-actionable are placed in the actionable category. Actionable subsidies are defined as specific forms of government assistance to firms or industries (Article 5). The list of legitimate grounds for domestic subsidies found in Article 11 of the Tokyo Round Subsidies Code has been dropped. Actionable subsidies may be objectionable if they cause injury to the domestic industry of another country, if they entail nullification or impairment of benefits accruing to another country under the GATT, including the benefits of concessions bound under Article II of the GATT, or if they cause serious prejudice to the interests of another country. 'Serious prejudice' may occur in any of the following situations (6.3): '(a) the effect of the subsidy is to displace or impede imports of a like product of another Member into the market of the subsidizing Member; (b) the effect of the subsidy is to displace or impede the exports of a like product of another Member from a third country market; c) the effect of the subsidy is a significant price undercutting by the subsidized product as compared with the price of a like product of another Member in the same market, or significant price suppression, price depression or lost sales in the same market; the effect of the subsidy is an increase in the world market share of the subsidizing Member in a particular subsidized primary product or commodity [footnote omitted] as compared to the average share it had during the previous period of three years and this increase follows a consistent trend over a period when subsidies have been granted'.

In the *US-Cotton* and *Korea-Vessels* cases, decided around the time this volume went to press, the panels viewed price suppression or depression as referring to the world price of a product in which the complaining Member competes in export markets. In its ruling in *US-Cotton*, the AB upheld the panel's decision that the 'same market' in which the products of the parties compete can mean the world market. Both panels placed emphasis on the need for economic evidence to establish a *causal relationship* between the subsidy and the price effects in question. Along the same lines, both panels considered it appropriate to consider factors other than subsidies that might have caused, in whole or in part, the price effects in question.

Countervailing measures

Part V of the Agreement sets out detailed rules governing countervailing duty actions. In most respects they follow the Tokyo Round Code. Countervailing duties may only be imposed in respect of actionable or prohibited subsidies as defined in the Agreement. Article 11.4 of the SCM Agreement is identical to Article 5.4 of the Antidumping

Agreement, and requires investigating authorities to determine whether an application was ‘made by or on behalf of the domestic industry’ based on the percentage of certain domestic producers who have expressed support for the application. In *United States—Continued Dumping and Subsidy Offset Act of 2000*⁵² (*US Byrd Amendment*), the AB emphasized that this requirement is quantitative, and requires neither that the investigating authorities examine the motives of domestic producers, nor that certain motives be the reason for expressed support (para. 283). Article 11.9 contains a *de minimis* provision which requires an investigation to be terminated if the amount of a subsidy is less than 1 % *ad valorem* or where the volume of subsidized imports or the injury is negligible. Under Article 15.5, in determining material injury from subsidized imports, injuries caused by factors unrelated to the subsidized imports cannot be attributed to the imports; a number of these extraneous factors are enumerated in the Article.

Article 21 of the SCM Agreement discusses the duration and review of countervailing duties and undertakings. *United States—Imposition of Countervailing Duties on Certain Hot-Rolled Lead and Bismuth Carbon Steel Products Originating in the United Kingdom*⁵³ (*US—UK Steel*) discussed Article 21.1 and 21.2, and addressed the panel’s implication that the standard of review for establishing a ‘benefit’ is the same under an Article 21.2 administrative review as in an original investigation. The AB explained that Article 21.2 provides the mechanism for compliance with the Article 21.1 requirement that countervailing duties will apply ‘only as long as and to the extent necessary to counteract subsidization’. The panel may operate under a rebuttable presumption under an Article 21.2 review that a ‘benefit’ still results from an ‘untied, non-recurring “financial contribution”’ (para. 62). However, Article 21.2 provides that an interested party may submit ‘positive information substantiating a need for review’. According to the AB, this information may show that the ‘benefit’ ceases to accrue or that the ‘financial contribution’ in question was repaid or withdrawn, and an investigating authority must consider such information when making its decision under Article 21.2 (para. 61). *US Countervailing Measures* affirmed this requirement (para. 144). With respect to the difference between an original investigation and an administrative review, the AB in *US—UK Steel* noted that an administrative review need only address those matters brought before it by interested parties or, in a review initiated by the investigating authority, those matters that ‘warranted the investigation’. In contrast, an original investigation requires the investigating authority to show that ‘all conditions set out in the *SCM Agreement* for the imposition of countervailing duties’ are met (para. 63). Under Article 21.3, duties must be terminated within five years of their imposition unless renewed following a review by the relevant domestic agency prior to that date. WTO jurisprudence regarding this provision relates to the question of whether or not certain standards in Article 11 apply to sunset reviews under Article 21.3. *United States—Countervailing Duties on Certain Corrosion-Resistant Carbon Steel Flat Products from Germany*⁵⁴ (*US—German Steel*) concluded that the *de minimis* standard of Article 11.9 is not implied in Article 21.3 (para. 92). It also decided that self-initiation of an investigation under Article 21.3 is not constrained by any evidentiary requirements for initiating investigations, including those found in Article 11 (para. 116).

Other provisions

With respect to institutional arrangements, the Subsidies Committee constituted under the Agreement shall establish a permanent group of five experts to prepare opinions on the existence of prohibited subsidies and to provide advisory opinions to the Committee on the existence and nature of any subsidy. The Group of Experts may be consulted by any signatory and give advisory opinions on the nature of any subsidy proposed to be introduced or currently maintained by that signatory, although such opinions may not be invoked in proceedings before the Committee itself (Article 24). The consolidated dispute resolution mechanisms provided elsewhere in the Uruguay Round Agreement empower the Committee to constitute panels to review subsidy complaints, including, importantly, application by domestic agencies of Member States of domestic counter-vailing duty laws at variance with the terms of the Agreement (for example, the application of the specificity test).

Under Part VII of the Agreement, substantially enhanced notification and surveillance procedures with respect to subsidies are instituted, requiring signatories to report annually to the Committee the existence of subsidies (as defined by the Agreement), and to provide substantial detail on the nature and effects of the subsidies. The Committee itself is required to engage in regular surveillance of these notifications.

Article 32 lists 'other final provisions' of the SCM Agreement. *US Byrd Amendment* discussed Article 32.1, which reads: 'No specific action against a subsidy of another Member can be taken except in accordance with the provisions of GATT 1994, as interpreted by this Agreement.' 'Specific action' exists where the measure is 'inextricably linked to, or [has] a strong correlation with, the constituent elements of...a subsidy'. This connection may be drawn from the text of the measure. 'Constituent elements' are found in Article 1 of the Agreement (paras 239–40). 'Against' requires assessment of whether a measure's design and structure is 'opposed to', adverse to, dissuades, or 'creates an incentive to terminate' subsidization. Subsidization in this context should be considered in terms of a practice, not 'the imported subsidized product or a responsible entity' (paras 253–4). The United States attempted to argue that actions falling under footnote 56, i.e. those 'under other relevant provisions of GATT 1994', are not 'specific actions' and so not WTO-inconsistent. The AB rejected this submission, saying to accept it would amount to treating footnote 56 as the primary and Article 32.1 as the residual provision (paras 260–2). To complete its analysis of Article 32.1, the AB addressed the interpretation of 'in accordance with the provisions of the GATT 1994, as interpreted by this Agreement'. To meet this requirement, a response to a countervailable subsidy must fall within one of the following categories: '(i) definitive countervailing duties; (ii) provisional measures; (iii) price undertakings; and (iv) multilaterally—sanctioned countermeasures under the dispute settlement system' (para. 269).

Special and differential treatment for developing-country Members

With respect to developing countries, Part VIII provides some partial exemptions from the strictures in the Agreement. The provisions on prohibited subsidies do not apply to least-developed countries, and other developing-country signatories are provided with an

eight-year grace period to bring themselves into compliance with the prohibited subsidy provisions (Article 27.4). Footnote 55 of the SCM Agreement indicates that 'For a developing country Member not granting export subsidies as of the date of entry into force of the WTO Agreement, [Article 27.4] shall apply on the basis of the level of export subsidies granted in 1986.' *Brazil Aircraft* interpreted 'granted' in footnote 55 to mean 'actual expenditures, rather than budgeted amounts or appropriations' (para. 150). The presumptive rules, providing when actionable subsidies shall be deemed to result in serious prejudice (Article 6(1)), do not apply to developing countries with respect to whom such prejudice must be demonstrated by positive evidence. With respect to actionable subsidies, the dispute resolution process may not be invoked unless the subsidy entails nullification or impairment of tariff concessions or other obligations under the GATT in such a way as to displace or impede imports of like products into the market of the subsidizing country, or unless injury to the domestic industry in the importing market of a signatory occurs as defined in the Agreement. Moreover, countervailing duty actions shall not proceed if a domestic agency determines that the overall level of subsidy granted by a developing country upon the product in question is 2% or less of its value calculated on a per unit basis, and that the volume of the subsidized imports represents less than 4% of the total imports for the like product in the importing signatory. This exemption from countervailing duties only applies where developing countries collectively account for no more than 9% of the total imports for the like product in the importing country. The comparable *de minimis* rule in the case of subsidies originating in developed countries is 1% *ad valorem* (Article 11.9). In the case of countries in the process of transformation from a centrally planned to a market economy, prohibited subsidies must be phased out within a period of seven years from the date of entry into force of the Agreement. Subsidy programmes involving forgiveness of government debt and grants to cover debt repayment are not actionable for the same period under the dispute resolution processes of the Agreement. With respect to other actionable subsidies, the provisions applicable to developing countries, which require nullification or impairment of tariff concessions or other obligations under the GATT, are adopted (Article 29).

Reform of GATT Article VI and the SCM Agreement is ongoing. The Doha Declaration⁵⁵ work programme agrees to negotiations that will clarify and improve those provisions that participants specify (para. 28). The Doha Declaration also adopts the Decision on Implementation-Related Issues and Concerns⁵⁶ and agrees that the work programme will include negotiations on outstanding issues in the Decision. The Decision itself introduces reforms advantageous to developing countries. For example, the Ministerial Conference agreed that Annex VII(b) of the SCM Agreement, which exempts certain countries from provisions otherwise applicable to developing-country Members under Article 27.2(b), will cease to exempt such countries once their 'GNP per capita reaches US \$1,000 in constant 1990 dollars for three consecutive years' (para. 10.1). The text of the Agreement reads only that the exemption ends when the GNP per capita of these countries reaches US\$1,000 annually. Also, the Decision indicated that a country may be re-included under Annex VII(b) if its GNP per capita again falls below US\$ 1,000 (para. 10.4).

However, it is unlikely that the Doha Round will address all concerns held by developing countries with respect to the SCM Agreement. The United Nations

Development Programme (UNDP) indicates that, in practice, the loan conditions of international financial institutions preclude developing countries from making full use of the concessions provided to them in the WTO Agreement by requiring reduction and elimination of non-actionable subsidies.⁵⁷ The UNDP also points out that current subsidy classifications are 'significantly biased against developing countries' because subsidies most commonly used by industrial economies, such as research and development subsidies, are non-actionable while those most commonly used by developing economies, such as national industry subsidies, are prohibited or actionable. Furthermore, small countries with GNPs per capita above \$1,000 must rely on exports for the success of their industries, yet face the challenge of prohibitions on industrial export subsidies.

DOMESTIC ADMINISTRATION OF COUNTERVAILING DUTY LAWS⁵⁸

Institutional context

Because the USA has historically been the predominant user of countervailing duty laws, it is important to understand the institutions and methodologies it employs to administer those laws. Four institutions are involved in the administration of US countervailing duty laws: the International Trade Administration (ITA) of the Department of Commerce (DC), the International Trade Commission (ITC), the Court of International Trade (CIT) and the review panels initially established under Chapter 19 of the Canada—US Free Trade Agreement (FTA) and now NAFTA.

The ITA is the branch of the DC responsible for the enforcement of antidumping and countervailing duty laws. It is responsible for conducting antidumping and countervailing duty investigations and has the authority to initiate investigations.⁵⁹ In countervailing duty cases, the DC determines whether the products under investigation are being unlawfully subsidized, and if so, calculates the margin of subsidization and the appropriate duties. Further responsibilities include conducting administrative reviews of outstanding countervailing duty orders and ensuring that these orders are properly administered by customs officials.

The ITC is the body responsible for establishing the existence of actual or threatened material injury due to subsidized imports. The CIT is the American court with competence to review determinations of the DC and ITC (and thereafter the Court of Appeals for the Federal District). Under Chapter 19 of the FTA and NAFTA, binational panels are appointed to hear disputes arising out of countervailing duty determinations between the Parties to the Agreement.

Substantive law

In the USA, laws dealing with unfair foreign subsidization date back to the Tariff Act of 1897. Current US legislation is found in the Trade Agreements Act of 1979 which amended the Tariff Act of 1930. In a countervailing duty action, two central questions must be answered: Is the foreign producer who is selling into the domestic market receiving an actionable subsidy from its home government? Are domestic producers of

products like or competitive with those being subsidized suffering or being threatened with material injury as a result of the subsidized imports?

Subsidies

According to the Tariff Act, a countervailing duty will be imposed on imported goods when it is found that the country is directly or indirectly subsidizing the manufacture, production or exportation of goods imported into the USA.⁶⁰ The application of this provision depends on the meaning given to the word 'subsidy'. Defined broadly, the term could include everything from the provision of basic infrastructure to government-financed education and regional development programmes. Such a definition would effectively undermine liberal trade since virtually every product would benefit from these kinds of government assistance⁶¹ and hence could be subject to a countervailing duty. The US legislation begins its definition in §1677(5) by making clear that the term 'subsidy' has the same meaning as the phrase 'bounty or grant' and includes but is not limited to export subsidies and domestic subsidies.

Export subsidies

As reflected in Track I of the Tokyo Round Code and the definition of prohibited subsidies in the Uruguay Round Agreement, export subsidies are considered the most objectionable form of government assistance. An export subsidy can be defined as government programmes or practices that increase the profitability of export sales without similarly increasing the profitability of domestic sales.⁶² The US legislation has no explicit definition of this concept, and instead refers in §1677(5)(A) to the illustrative list of export subsidies found in the Tokyo Round Subsidies Code (largely reproduced in Annex I to the Uruguay Round Agreement). Some examples of the enumerated practices are:

- the provision by governments of direct subsidies to a firm or an industry contingent upon export performance;
- currency retention schemes or any similar practices that involve a bonus on exports; and
- internal transport and freight charges on export shipments provided or mandated by governments, on terms more favourable than for domestic shipments.

The DC has the authority to find that practices not on the list are export subsidies.⁶³ Even with the benefit of the list, identification is often difficult.⁶⁴ Because export subsidies will generally result in assessment of larger duties than would be applicable to domestic subsidies, the determination of whether a subsidy is an export or domestic subsidy is important.⁶⁵

Domestic subsidies: the specificity test

International rules are more lenient with respect to subsidies not targeted specifically at exports. The hostility to pure export subsidies probably reflects the view that most legitimate domestic policy rationales for subsidies would not differentiate between production intended for domestic consumption and production intended for export. In

addition, export subsidies raise concerns over the prospect of mutually destructive international export subsidy wars. However, in the countervailing duty provisions of the Tokyo and Uruguay Subsidies Codes there is no differentiation between domestic or export subsidies. In the USA, practices that cannot be characterized as export subsidies are countervailable if they fall within the definition of domestic subsidies in §1677(5) of the Tariff Act. Countervailable domestic subsidies are defined as subsidies targeted to a *specific* enterprise or industry, or group of enterprises or industries. In addition, the subsidies must provide some opportunity or advantage to the targeted producers that would not otherwise be available to them in the marketplace.⁶⁶ The wording of this definition has given rise to the specificity test for the assessment of the countervailability of domestic subsidies. This test has developed over time into one that investigates not only *de jure* but also *de facto* specificity. Under this test, where either the purpose or the effect of a government programme is to benefit a specific enterprise or industry, or group of enterprises or industries, the DC will find that a countervailable benefit has been conferred. Included in this definition are forms of assistance such as capital, loans or loan guarantees on terms inconsistent with commercial considerations, goods or services at preferential rates, funds or forgiven debts to cover operating losses, and the assumption of costs or expenses of manufacture, production or distribution.

In the early 1980s, there was a significant degree of controversy in the USA over whether the specificity test should be retained in its current form.⁶⁷ The CIT, on review of DC decisions, also created some confusion on this issue. In *Carlisle Tire and Rubber Co. v. United States*,⁶⁸ the Court upheld the DC's decision in favour of Korean exporters benefiting from a generally available accelerated depreciation programme. The Court found that in order for a countervailable domestic subsidy to exist, there must be evidence of a regional or industry preference. However, subsequent cases suggest that this interpretation of the specificity test no longer obtains. For example, in *Cabot Corp. v. United States*,⁶⁹ the CIT held that the specificity test upheld in *Carlisle* is not the correct legal standard to apply; it would erroneously allow the recipients of subsidies purportedly of general availability to avoid countervailing duties even though the subsidies in fact only benefit specific industries or enterprises.

The *Cabot* decision resulted in a change in DC methodology. It led to the articulation of the DC's current approach: the four-pronged specificity test.⁷⁰ The DC now proceeds through a series of steps in its investigation before being satisfied that the subsidy in question is not countervailable. First, a *de jure* limitation on the availability of a subsidy is sufficient to find specificity. Second, if the subsidy is generally available but few enterprises actually use the programme, or third, if there are disproportionate or dominant users, the DC will find *de facto* specificity. Fourth, if a foreign government is exercising its discretion in such a manner that a *de jure* generally available programme is *de facto* specifically targeted, the DC will again find *de facto* specificity. This formulation of the specificity test has increased the DC's discretion and thus reduced predictability for exporters in countervailing duty cases. This definition of specificity is largely adopted in the Uruguay Round Agreement definition of actionable subsidies.

There are a number of noteworthy aspects of US countervailing duty laws.⁷¹ First, countervailing duty actions cannot be taken against non-market economies,⁷² although given the recent transformation of many of the former command economies, there is considerable room for ambiguity as to which countries presently qualify as non-market

economies. Second, subsidies indirectly received by an exporter, such as through a subsidized input source, can be countervailable. However, if it is alleged that an indirect subsidy was received by a company via a subsidy given to another company upstream,⁷³ the DC will not assume that benefits conferred by the subsidy are passed on to the second company.⁷⁴ In cases entailing allegations of these 'upstream subsidies', it must be shown that there is an indirect subsidy before countervailing duties will be assessed. In addition, the upstream subsidy must confer a competitive benefit on the goods under investigation and have a significant effect on their cost of production.⁷⁵ It is also not sufficient to show that a subsidy programme exists; the specific product being investigated must have been subsidized.⁷⁶ Benefits conferred by private individuals may be countervailable if the evidence indicates that the benefit was conferred at the request of the government.⁷⁷ Finally, countervailing duty petitions or orders cannot be suspended or overturned by the executive for political reasons.⁷⁸

Calculation of countervailing duties

According to Article 19.4 of the Uruguay Round Subsidies Agreement, 'No countervailing duty shall be levied on any imported product in excess of the amount of subsidy found to exist, calculated in terms of subsidization per unit of the subsidized product and exported product.' Article 19.4 provides that it is desirable that the duty should be less than the total amount of the subsidy if such lesser duty would be adequate to remove the injury to the domestic industry, and that procedures should be established which would allow domestic authorities to take account of representations by domestic interests, including consumers, who may be adversely affected by the imposition of duties.

The task of the DC is to determine the amount of the countervailing duty required to protect US producers from the injury created by the subsidy.⁷⁹ In order to achieve this, the value of the subsidy is measured with reference to the benefit conferred upon the targeted industry rather than the cost of the subsidy to the government.⁸⁰ However, the DC does not evaluate the effect of the subsidy on the cost of production, quantities produced, or prices charged by the foreign exporting firm. As a result, it is not clear that the methodology accurately captures competitively salient benefits to the firm. The subsidy may not result in lower costs or higher production; it may, for example, result in greater inefficiency on the part of the producer. Alternatively, the subsidy may have no effect on the costs of production because of the nature of the subsidy. For example, if the grant is to pay for the decommissioning of an old plant or assistance to displaced workers, there would be no effect on the marginal costs of production of the firm.⁸¹

The net subsidy is found by making certain adjustments to the subsidy amount conferred.⁸² The countervailing duty is found by dividing the net subsidy by the total sales of the company receiving the subsidy. If the government practice is found to be an export subsidy, then the countervailing duty is calculated by dividing the net subsidy by the total exports of the company receiving the subsidy; since total sales will typically be greater than exports, export subsidies will generally result in higher duties.⁸³ The DC will not impose duties against subsidies that are *de minimis*, constituting less than 0.5% of the *ad valorem* value of the merchandise (increased to 1 % under Article 11.9 of the Uruguay Round Agreement).

Injury⁸⁴

Prior to the Tokyo Round, US law on countervailing (and antidumping) duties did not contain an injury requirement; both forms of duties could be applied without any showing of harm to domestic firms from the foreign action. The purpose of an injury test is to ensure that duties are only imposed in cases in which a causal nexus is found between the unfair foreign practice and harm suffered by the domestic industry. The injury requirement adopted in the Tokyo and Uruguay Round Subsidies Codes is the same as that in the Antidumping Code, and antidumping and countervailing duty cases are treated in the same way by the ITC.⁸⁵ The subsidized imports must cause material injury or a threat of material injury to a domestic industry, or material retardation to the establishment of a domestic industry. There are three components to the injury test: (1) the definition of domestic industry; (2) evidence of material injury; and (3) a causal nexus between that injury and the subsidized imports.

Domestic industry

The injury proceeding before the ITC requires that the ITC first define the relevant US industry. The Uruguay Round Subsidies Agreement defines 'domestic industry' as referring to 'domestic producers as a whole of the like products or to those of them whose collective output of the products constitutes a major proportion of the total domestic production of those products'.⁸⁶ The US legislation adopts a similar definition.⁸⁷ Under the Uruguay Round Subsidies Agreement, no investigation may be initiated if the domestic producers expressly supporting the application account for less than 25% of total production of the product by the domestic industry (Article 11.4). In special circumstances the ITC can divide the industry into separate geographical markets if two conditions are met: (1) the companies in that region must sell all or almost all of their output of the like product in the geographical region; and (2) demand in that region must not be substantially supplied by US producers outside of the region.⁸⁸ As is the case with antidumping investigations, a narrow construction of the relevant domestic industry can make a finding of injury more likely.

The 'like product' is defined as 'a product which is like, or in the absence of like, most similar in characteristics and uses with' the product under investigation.⁸⁹ In analysing a complaint, the ITC must focus on the narrowest range of products that includes the like product, but in many cases must investigate a broader industry due to the unavailability of data. In addition, there may be more than one like product.⁹⁰

Material injury

There is no precise definition in the Uruguay Round Agreement of 'material injury', but the Agreement directs authorities to examine a number of specific factors such as changes in output, prices, employment or profitability in the domestic industry.⁹¹ In the USA, most cases focus on actual or threatened material injury, which is defined as harm that is not 'inconsequential, immaterial or unimportant'.⁹² The injury test requires an analysis of domestic industry conditions. The factors typically considered by the ITC in this determination are the volume of subsidized imports, their effect on domestic prices of like products and their impact on domestic producers of like products. In its evaluation of

the volume of imports, the ITC considers both the absolute level of imports at the time of the proceeding and whether the level is increasing either relatively or absolutely.⁹³ With respect to the effect on prices, the ITC considers any evidence of undercutting and determines whether there is any indication that the effect of the subsidization has been to depress domestic prices.⁹⁴ The presence of certain negative factors such as plant closures or unprofitability will often be sufficient to convince the ITC that the injury test has been satisfied. In other cases, the ITC will compare certain economic variables to their levels in previous years, inferring from a decline in such variables the presence of injury.⁹⁵ Such variables might include capacity utilization, employment or return on equity. If these factors do not provide the ITC with evidence of material injury, the investigation will be terminated and no duties will be assessed against the exporters. The ITC's investigations are divided into a preliminary and a final phase. In the preliminary phase, the ITC must determine if there is a reasonable indication of injury. Inconclusive or incomplete evidence related to the key elements may support an affirmative preliminary finding of injury but may not be adequate to support a final determination of injury. In both cases, the ITC must make its determination on the basis of all the evidence before it.

Causation⁹⁶

There is no precise definition in the Uruguay Round Agreement of 'cause', beyond a list of factors that may be examined,⁹⁷ leaving the appropriate standard to the discretion of the investigating authorities. The ITC looks for a causal nexus between the subsidization and the effects on the domestic industry. Factors typically considered in this context are the presence of underselling, evidence of lost sales, and import trends in the industry.⁹⁸ There are a number of weaknesses with this approach to causation. First, these three factors do not define a test capable of resolution: 'the test mixes analysis of trend information unrelated to dumping or subsidization with analysis of the effects of dumped or subsidized imports',⁹⁹ and the US legislation does not 'identify a method of integrating these factors into a cogent analytical structure'.¹⁰⁰ Moreover, the assumption that declining performance alone is evidence of harm caused by imports does not account for other factors that affect performance, or the possibility that the harm is due to import competition and not subsidization. Thus, because the ITC methodology focuses on the imports rather than the subsidization, an affirmative finding might result when the harm is caused by reason of comparative advantages that the imported goods possess. Finally, the three criteria usually considered—evidence of underselling or lost sales and import trends—do not serve to identify clearly the relationship between the subsidization and the harm. For example, evidence of lost sales suffered by the domestic industry only provides relevant causal information if it can be shown that those sales were gained by the subsidized importers by reason of the subsidization. At present, the ITC does not evaluate the kind of evidence or perform the kind of counterfactual that would justify a determination of causation.

Rights of appeal

The CIT is the US court vested with jurisdiction to review ITC and DC rulings. In practice, the CIT has been highly deferential to these administrative bodies. Underlying

this disposition is the view that administrative bodies have extensive expertise and therefore have comparative competence in those matters that fall within their jurisdiction. The CIT typically requires that the agency determination be supported by substantial evidence on the record.¹⁰¹ The CIT also normally requires that the ITC and DC provide the reasons supporting their determination. However, if those reasons allow the CIT 'reasonably to discern the agency's path', a decision of 'less than ideal clarity' will be upheld.¹⁰²

Chapter 19 of NAFTA provides for the establishment of binational panels to review final agency determinations.¹⁰³ Either Party may request review by a binational panel and its determinations are final except in extraordinary circumstances. These panels have authority to determine either that there has been an error of law by the administrative agency or that the evidence on the record was insufficient to support the decision at that level. While a panel cannot overturn the administrative decision, its remanding of the decision to the appropriate agency generally forces compliance due to political repercussions that would result if no action were taken. Evidence to date suggests that the binational panel review process has led to significant improvements in the level of rigour required of the ITA and ITC in countervailing and antidumping duty determinations.¹⁰⁴ However, the gains from disciplining agency analysis can easily be eroded by political action, a major weakness of a regime that focuses entirely on review of application of the law, rather than disciplining the law itself.

The complexities and opaqueness of USA countervailing duty law are well exemplified in a long-running trade dispute between Canada and the US over Canadian softwood lumber exports to the US.¹⁰⁵

Four separate countervailing duty investigations have been undertaken by US authorities (in 1982, 1986, 1991 and 2001) following allegations by US softwood lumber producers that low stumpage rates (royalties) charged by Canadian federal and provincial governments for harvesting lumber on Crown lands constituted a countervailable subsidy that was injuring US softwood lumber producers. In the first case, the ITA found no countervailable subsidy on the grounds that any subsidy was non-specific. In the 1986 and 1991 cases, it reversed itself and found a specific countervailable subsidy, and the ITC subsequently found material injury. The material injury determination was the subject of three remands by binational panels under the FTA. The subsidy determination was subject to two remands by binational panels—the second a 3–2 decision on national lines which the US government then challenged before an Extraordinary Challenge Committee of judges under the FTA, which also split 2–1 on national lines. Congress later enacted legislation vindicating the basis of the US agencies' determinations, temporarily ending a 15-year saga driven by private parties' ability to invoke (and re-invoke) US countervailing duty laws. Issues that proved contentious in these proceedings included: (a) whether Canadian stumpage rates were 'too low' so as to constitute a subsidy—relative to what?—private stumpage rates in the US, private stumpage rates in Canada, Canadian governments' costs of maintaining Crown lands, costs of reforestation, government stumpage rates in other countries; (b) whether, assuming a subsidy, the subsidy was specific—the US petitioners claimed that it benefited principally two industries, solid wood products, and pulp and paper products, while the Canadian defendants claimed that it benefited 3,600 firms distributed across 27 industries (as defined by output); (c) whether, even assuming a subsidy and that the subsidy was

specific, the subsidy was a cause of any injury to US softwood lumber producers; and (d) what standard of review binational panels should apply to domestic agency determinations.

This unbecoming subsidies imbroglio yields several lessons: first, the intractability or indeterminacy of many of the key elements in US countervailing duty law; second, the fact that US new home-buyers were the principal beneficiaries of cheaper Canadian lumber imports almost entirely disappeared from view in the process; third, privately driven trade remedy litigation is open to serious risks of protectionist abuse; and fourth, it may be appropriate to re-evaluate fundamentally the Chapter 19 binational dispute resolution regime (despite its qualified successes) and remit subsidy disputes instead to state-to-state dispute resolution before demonstrably neutral GATT/WTO panels (and the AB) under the Uruguay Round Subsidies Agreement.¹⁰⁶

In 2001, US lumber producers filed a new petition. The ITA made its final affirmative countervailing duty determination and placed an 18.79% duty on Canadian softwood lumber imports in March 2002.¹⁰⁷ This was appealed under NAFTA¹⁰⁸ and the WTO.¹⁰⁹ A WTO panel¹¹⁰ later held that the ITA's preliminary countervailing duty and critical circumstances determinations had been inconsistent with the SCM Agreement. Specifically, the panel found that the ITA failed to show, as required by Article 1.1 (b) of the SCM Agreement, that a benefit accrued to Canadian producers (para. 8.1). The WTO panel decision on the ITA's final determinations¹¹¹ indicated again that the United States had failed to prove the conferral of a benefit on Canadian lumber producers and had failed to conduct a required 'pass-through' analysis, i.e. it did not show that alleged subsidy benefits from stumpage rates were passed through by timber harvesters in their sales to unrelated softwood lumber producers or when they sold lumber to re-manufacturers (paras 7.31–7.99). The ITC's finding of material injury¹¹² has also been appealed under both NAFTA¹¹³ and WTO.¹¹⁴ A related WTO case, *United States—Measures Treating Export Restraints as Subsidies*,¹¹⁵ found that export restraints are not financial contributions under Article 1.1 and consequently not subsidies under the SCM Agreement (para. 9.1). The Canadian government claims that this decision undermines US claims that Canadian export controls on raw lumber constitute a subsidy.¹¹⁶

RATIONALES FOR COUNTERVAILING DUTY LAWS

Traditionally, the legitimacy of countervailing duty laws has depended on the characterization of subsidies as harmful in some way and on evidence that offsetting countervailing duties repairs that harm.¹¹⁷ Advocates of countervailing duty laws offer two main characterizations of subsidies that give rise to an argument in favour of countervailing duties. First, subsidies are often characterized as inefficient and as introducing economic distortions into world trade. Second, subsidies are characterized as being unfair and disturbing the 'level playing field' of international trade.

Efficiency rationales

The traditional argument for countervailing duties is that subsidies distort comparative advantage and hence lead to the inefficient allocation of global economic resources.

While this may often be true, a plausible characterization of many subsidies is that they correct or compensate for market imperfections or externalities that would otherwise exist, and thus enhance efficient resource allocation.¹¹⁸ In many cases, subsidies serve to produce 'a more efficient resource allocation, that is, resource allocation more consonant with the actual production possibilities and consumer preferences than that yielded by wholly private transactions'.¹¹⁹ The task of evaluating whether subsidies contribute to or derogate from efficient resource allocation is daunting.¹²⁰ According to Schwartz and Harper, the exercise is at best highly indeterminate due to three factors: (a) the pervasiveness of externalities which subsidies may help internalize; (b) what the authors rather opaquely call potential private-public intersectorial economies, which embrace the collective validation of all kinds of preferences that may not be adequately captured in private market transactions (e.g. protection of national security, preserving the family farm and rural lifestyles, promoting regional development, etc.); and (c) the possibility that a positive government benefit to a firm may be designed to offset some other burden that has been imposed by government (e.g. high minimum wage laws, stringent occupational health and safety requirements, plant closing or environmental obligations).

Even if subsidies are truly distortive of international trade, the question that remains is whether countervailing duty laws improve resource allocation. It is clear from the previous section that the methodology currently used by US agencies in the calculation of subsidy margins does not serve to determine accurately the duties needed to offset the effects of trade distortions. Moreover, it has now been convincingly demonstrated¹²¹ that in almost every conceivable set of circumstances, countervailing duties reduce domestic social welfare in the *importing* country, where social welfare is defined as the maximization of producer, consumer and government surplus. Gains to domestic producers from the higher prices induced by the duties are offset by losses to consumers who remain in the market and pay the higher prices, while some consumers who would have purchased the product are priced out of the market and suffer deadweight welfare losses. Even accounting for the increase in government surplus in terms of increased revenue from duties, consumer losses outweigh all gains, leaving total welfare lower. Thus, however ambiguous the welfare effects of a subsidy either in the country providing it or globally, there is nothing ambiguous about the welfare effects of the subsidy in the importing country. This analysis suggests that rather than condemning foreign subsidies, importing countries should send expressions of gratitude to the subsidizing country, noting only their regret that the subsidies are not larger and timeless.

A further efficiency argument that is sometimes directed against subsidies is that government support in the form of export subsidies is intended to assist firms in practising predatory pricing. It is argued that subsidies may enable a firm to sell at a lower price in the foreign market in order to eliminate competition and thereafter reap monopoly profits.¹²² Predation nationally or internationally is a practice that unambiguously lowers economic welfare. However, in the previous chapter on antidumping laws, we argued that there is little theoretical or empirical basis for allegations of predation in international trade. Moreover, current countervailing duty laws do not consider factors that would support a claim of predation, such as industry concentration and barriers to entry. As in the case of antidumping, concerns over predation (potentially a valid reason for the prevention of some forms of subsidization) do not justify existing countervailing duty laws.

Fairness rationales

The level playing field rationale

Some advocates of countervailing duties argue that subsidies constitute unfair trade and disturb the 'level playing field' in international trade. The late Professor Robert Hudec, a distinguished international trade law scholar, has provided a useful taxonomy of many of the unfair trade claims that presently enjoy wide currency.¹²³ He draws a basic distinction between what he calls offensive 'unfairness' and defensive 'unfairness'. With respect to offensive unfairness, the claim is often made that domestic policies adopted by governments in exporters' countries of origin provide them with unfair advantages in competing in importing-country markets or in third-country markets. With respect to defensive unfairness, the claim is often made that a country has adopted domestic policies that unfairly favour its own products and unfairly penalize foreign producers who wish to sell into this country's market.

In the case of countervailing duty laws, the complaint of offensive unfairness focuses on the fact that foreign firms are able to outcompete domestic firms in the latter's market as a result of an artificial advantage that the foreign firms enjoy by virtue of government subsidies or other benefits conferred on them in their country of origin. This unfairness claim is difficult both to unravel and to contain.¹²⁴ At one level, even in the case of an explicit export subsidy, one can reasonably argue that, as suggested above, consumers in the export market are better off as a result of the foreign subsidy and that it should be viewed as a form of foreign aid that on balance increases the welfare of citizens in the importing country. At another level, the claim of unfairness relating to foreign governments' actions has no natural limits to it. Unless one is prepared to adopt a *laissez-faire* baseline as one's normative reference point, and to view every government deviation from this baseline as a form of unfairness where it has some impact on the pattern of international trade, one is quickly forced to accept that almost everything that modern governments do is likely, either directly or indirectly, to affect the pattern of economic activities within a country and therefore, by extension, the pattern of international trade flows to which that country contributes. For example, such basic activities of governments as investments in physical infrastructure (e.g. roads and communication systems), investments in public education and basic research, investments in law and order, investments in healthcare systems, etc. all shape in one way or another a country's comparative advantages or disadvantages in international trade.

According to liberal trade theory, only if differing productive conditions exist across countries can gains be derived from international trade; countries will specialize in the production of the goods that they can produce relatively cheaply, and will purchase from abroad, at lower cost, goods in which they have a comparative disadvantage. If all countries were to have identical productive conditions, then no country would have a comparative advantage in the production of any good and there would be no gains from trade. Thus, if subsidies disturb the 'level playing field', they serve to increase potential gains from trade.¹²⁵ It is at least arguable that differing subsidization policies across countries, like different education levels or different tax structures, are simply one of the factors that contribute to different productive conditions across countries. Moreover, it is to point out the obvious that, given an assumption of scarce resources, a country that

chooses to subsidize one set of activities cannot at the same time subsidize another set of activities, which some of its trading partners may, as a matter of domestic policy priorities, choose to subsidize instead.

In debates where these kinds of claims of offensive unfairness are made, three areas have emerged.¹²⁶ First, it is sometimes argued that the quiescent state of Japanese competition/ antitrust law permits Japanese firms, through acquisition of dominant market positions or through collusive arrangements in Japan, to garner supra-normal profits in the Japanese market and to use these to fund subsequent aggressive export initiatives. Second, it is widely claimed that lax environmental laws in many countries constitute a form of implicit subsidy that confers on firms originating in these countries an artificial advantage in export markets. Third, it is often argued that weak labour laws pertaining to such matters as minimum wages, hours of work, child labour and workplace safety conditions again operate as implicit subsidies to firms located in countries with such policies and confer on them an artificial advantage in export markets. In all three cases, the policy choices for governments in importing countries are either to attempt to persuade or induce the country of origin to harmonize its laws up to the standards prevailing in the importing country; or for the importing country to harmonize its laws down to the level of those prevailing in the exporting country; or to harmonize to some agreed intermediate solution; or to impose unilaterally some border measure, like a countervailing duty, designed to neutralize whatever artificial advantages are claimed to be associated with these domestic policy differences.

As Bhagwati points out,¹²⁷ fairness arguments can be pushed to almost any lengths:

If Bangladesh has a current comparative advantage in textiles, due to lower wages, we no longer need to worry about being scolded as protectionists when we reject imports of Bangladeshi textiles as unfair trade caused by her 'pauper labour'. After all, the low Bangladeshi wages are a result of inadequate population control *policies* and of inefficient economic policies that inhibit investment and growth and hence a rise in real wages. In like manner, if the United States continues to produce textiles, which rely heavily on immigrant labor, often illegal, this is unfair trade, since American immigration *policy* encourages this outcome, and therefore a Structural Impediments Initiative demand for changed immigration policy needs to be made against the United States simply to ensure level playing fields.

This is not to argue that claims of unfairness have no role at all in international trade law. Debates within the European Union over a Social Protocol and the negotiation of side accords to the NAFTA on labour and environmental standards highlight the importance that these issues have assumed. Issues pertaining to harmonization of environmental, labour and competition policies are pursued in later chapters. Rather, it must be emphasized that economists, lawyers and other trade policy analysts now face an urgent task in introducing a substantial measure of coherence and discipline into these fairness claims, at both the theoretical and the operational level, so that they can be contained within defensible bounds.

Unfair impact rationales

Even if there are no efficiency or fair trade rationales that justify countervailing duty laws, there are possible arguments for countervailing duty laws that take account of the disruptive impact of imports on vulnerable members of society. In particular, it may be that distributive justice or communitarian values can be vindicated through the use of this form of protectionism. On distributive justice grounds, countervailing duty laws might be justifiable to the extent that they improve the lot of the least-advantaged members of society.¹²⁸ However, countervailing duty laws are not designed to address these concerns. As was suggested in the previous section, the application of countervailing duties focuses on factors ill-suited to uncovering any injury suffered by an industry as a result of foreign subsidies and factors even less well suited to discovering the impact on the least-advantaged stakeholders in these industries. In addition, as noted in the previous chapter on antidumping, it is clear that in practice, distributive justice concerns have not been addressed through antidumping cases; it is unlikely that the evidence is any different for countervailing duty cases. Moreover, there is no principled reason to treat some of the least advantaged as more deserving of protection because the threat to their welfare derives from subsidized imports rather than unsubsidized imports, domestic competition or other internal factors.

Similarly, the vindication of communitarian values would require that policies be adopted that prevent the disruption of long-standing communities. However, countervailing duty laws are also poorly suited to the achievement of this end. Current formulations of the injury test inquire into the adverse impacts on the domestic industry without investigating whether these impacts are being sustained by dependent communities. Finally, it must be emphasized that, in general, protectionist trade remedies such as countervailing duties are not the most appropriate policy instruments for vindicating these values. Instead, as we argue in the next chapter, labour adjustment assistance programmes, or short-term safeguard relief where appropriate, more directly and effectively address transition costs suffered by workers. Such an approach would be a more efficient means of dealing with disruptive impacts of competition from any source on the most vulnerable members of our society without excessively burdening consumers with the costs of trade protectionism.

REFORMING SUBSIDY LAWS¹²⁹

There are two basic problems with countervailing duty laws: their unilateral nature serves to increase international trade frictions and perhaps protectionist tendencies; and they fail to distinguish between subsidies that are distortionary and those that are benign. Reform of the laws on subsidies must address both these concerns. There has been some debate in the recent literature about whether reform proposals should focus on the theoretically defensible or the politically feasible;¹³⁰ the approaches that follow are grouped into regimes that represent varying degrees of trade liberalization and, correspondingly, varying degrees of political realism.

The US cash-flow approach: the *status quo*

There are substantial problems with the current administration of countervailing duty laws by the USA. In an exhaustive critique of current and proposed DC practices in the administration of US countervailing duty law, Diamond concludes:

The rules promulgated and proposed cannot be squared with any known purpose which countervailing duty law may serve. Surrogates are chosen which have no conceivable relationship to the effect which the foreign subsidy has on the ability of the foreign firm to compete. Internal inconsistencies arise when [DC's] intuitive grasp of competitive effects causes it to over-ride the cash-flow principle which it has adopted. Conceptual lacunae arise where [DC] can find no answer to questions regarding implementation and can only declare that the necessary economic and financial principles do not exist.¹³¹

The thrust of Professor Diamond's critique of current and proposed DC practices is as follows: in determining the existence of a countervailable subsidy, and in determining the appropriate level of the countervailing duty, the cash-flow or benefit-oriented approach adopted by the DC fails to make consistent distinctions between benefits accruing to a foreign firm from a subsidy and *competitive* benefits accruing from a subsidy. Under the cash-flow or benefit-oriented approach, government action confers a countervailable subsidy on a foreign firm whenever such action allows the foreign firm to receive something of value which it would not have received in a free market. The difference which occurs in the firm's cash flow as a result of the subsidy is *prima facie* the benefit which a countervailing duty will be set to neutralize by pro-rating the value gained by the company (and hence the countervailing duty) over the output produced. As Diamond points out, this approach generates all sorts of largely intractable difficulties. It does not distinguish between subsidies that alter a firm's production costs and those that do not—a subsidy to decommission a plant and underwrite adjustment costs for displaced workers or to clean up environmental damage is treated in the same way as a wage subsidy or output-related subsidy. In the case of foreign firms with multiple product lines, pro-rating capital subsidies over product lines is arbitrary. Determining the amount of the subsidy in the case of equity infusions or loans is also arbitrary, as is the allocation of the benefit over time (when the subsidy may in fact be received upfront). The issue of causation is also problematic: is it the impact of foreign imports, which happen to be subsidized, on domestic producers that is central, irrespective of the competitive significance of the subsidy, or is it the latter? But if the latter, this requires a prior determination of the competitive significance of the subsidy, which the cash-flow or benefit-oriented approach explicitly eschews. Diamond's description of the contortions of the DC over time in adopting, rejecting, revising and readopting various rules of thumb to address these issues reflects the inherent arbitrariness and, in a conceptual sense, futility of this exercise.

The entitlement approach

As a more coherent alternative to the cash-flow or benefit-oriented approach, Diamond develops an entitlement theory of countervailing duties,¹³² building on an approach initially proposed by Goetz, Granet and Schwartz.¹³³ The entitlement theory is premised on the notion that US producers should be entitled to an outcome which limits the direct impact of the subsidized firm in the US market to what it would have been had the government subsidy not been available. This entails an analysis of the impact of subsidies on foreign exporters' marginal costs of production. If the subsidy reduces marginal costs, leading a firm to equate marginal revenues and marginal costs at higher levels of output to increase its sales in the USA at the expense of US producers, the latter's entitlement to 'fair competition' has been violated and countervailing duties are *prima facie* in order.

This entitlement theory differs from the cash-flow or benefit-oriented approach currently taken by the DC because of its focus not simply on benefits conferred by governments on foreign firms that export into the USA, but on *competitively salient* benefits. Thus, causation and injury requirements would emphasize the extent to which subsidies that reduce the marginal costs of imports cause injury to domestic firms by reducing their market share. The entitlement theory also differs from the economic distortion approach, which would target countervailing duties on foreign subsidies that distort the globally efficient allocation of resources.

Diamond proposes the entitlement theory as some form of potentially coherent and tractable middle ground between the cash-flow or benefit-oriented approach on the one hand, which he views as incoherent, and the economic distortion theory on the other, which he rejects as indeterminate. However, his approach is also problematic at the operational level. The entitlement approach, given the central role it assigns to the impact of a subsidy on foreign firms' marginal costs of production and the causal linkage between this and alleged injury to domestic producers, is highly data-intensive, which is likely to exacerbate problems of data manipulation and lack of transparency in decision-making. Measuring marginal costs is a notoriously difficult exercise, exacting in its data demands and inherently error-prone. Firms do not record their costs in this fashion, and so one would likely quickly be driven to the concept of average variable costs as a compromise. Even then, in multi-product firms, problems of joint cost allocation are likely to be pervasive. Moreover, the counterfactual with which the subsidy-impacted marginal cost function of a foreign firm must be compared is likely to be highly speculative. Is it the *status quo ante* of the firm before the conferral of the subsidy, or alternative courses of action that the firm might have taken to reduce its production costs in the absence of a subsidy?

Problems well known in antitrust law and public utility regulation¹³⁴ suggest that in the countervailing duty context, these difficulties would be even more pronounced. Here one is dealing with *foreign* firms, typically more than one, each with its own cost functions. Nor do the problems stop with estimating marginal cost functions for foreign firms. Even where subsidies are found to reduce the marginal costs of production of foreign firms with respect to exports into the USA, it will still be necessary to address causation and injury issues, and then to determine the correct level of duty. Diamond suggests that injury will largely be a function of the elasticity of domestic demand for the

product: the more elastic the demand, the less the injury. But again we know from antitrust experience in defining relevant product and geographic markets that these elasticities are often highly speculative. Even in cases where domestic demand is relatively inelastic so that increased sales by subsidized foreign exporters *prima facie* will erode the market shares of domestic producers, it is easy to envisage cases where loss of market share would occur absent the subsidy.¹³⁵ Thus, again, a counterfactual which is necessarily highly conjectural is required not only at the foreign firms' end of the process, but also at the domestic end of the process. Moreover, these comparisons presumably cannot be excessively static, but once a duty is imposed would require constant review in light of changing circumstances over time at either end of the process. Finally, should foreign firms be able to argue that the subsidies they have received are wholly or partially offset by subsidies received by domestic producers, and that only the net subsidy advantage should qualify as a countervailable subsidy? Goetz, Granet and Schwartz are frank enough to acknowledge these complexities:

Admittedly, the neutralization approach would often be difficult to implement because of the empirical issues that it implicates... Experience with this approach might well yield useful generalizations so that 'rules of thumb' could, in some situations, effectively replace detailed case-by-case enquiry. This is not to suggest that coherent implementation of the protectionist rationale will ever be anything but a very costly and error-prone process... Facing the implications of mandating this approach may also lead some legislators to become less certain of the desirability of implementing the protectionist [entitlement] rationale. It is no doubt clear by now that this is a result which would not be uncongenial to us.¹³⁶

Taxonomizing subsidies

In the Tokyo Round, no agreement was reached regarding the classification of domestic (non-export) subsidies as acceptable or unacceptable (countervailable). Thus, an approach that has been pursued in the Uruguay Round Subsidies Agreement is to spell out more definitively the different categories of subsidies. Under a first-best regime, our preference would be to abandon this approach. The development of a three-way taxonomy of subsidies as benign ('white'), prohibited ('black') and ambiguous ('grey') is, in many respects, problematic. First, conventional understanding has it that pure export subsidies are the most objectionable and trade-distorting forms of subsidies and provide the strongest case for both international and domestic countervailing sanctions.¹³⁷ This understanding is reflected in the Tokyo and Uruguay Rounds Subsidies Codes. It may be that such subsidies represent a foolish misallocation of resources by the subsidizing state—in effect giving away its goods to foreigners below cost—and may distort the efficient global allocation of resources by squeezing out more efficient third-country producers from the importing country's market, who should perhaps be entitled to make a claim for nullification or impairment under Article XXIII of the GATT. However, in terms of its own economic welfare, the importing country has no grounds for objection. The general economic case for countervailing duties in the case of pure export subsidies is as tenuous as the general economic case against dumping.¹³⁸ While we

recognize the broader international risk of Prisoner's Dilemma-type export subsidy wars, negotiated reductions of, or restrictions on, such subsidies in given contexts, as reflected in the Uruguay Round Agreement on Agriculture, the Tokyo Round Code on Trade in Civil Aircraft, and the OECD Agreement on civil shipbuilding and repair, seem an appropriate response to this problem. We also recognize that pure export subsidies will typically be harder to justify in terms of non-trade-related domestic policy objectives, most of which can be better served by subsidies or other policy instruments that are not targeted exclusively on exports, but again it is not clear why this should be of concern to the importing country.

Similarly, generally available subsidies under the Uruguay Round Agreement are not seen as trade distorting with respect to either imports or exports, presumably because they do not disproportionately influence the price of particular categories of goods. However, this view reflects a rather static conception of comparative advantage; most modern international trade theorists believe comparative advantage is a dynamic concept and is not entirely exogenously determined.¹³⁹ Clearly, many developed countries owe a significant part of their international comparative advantage to social investments in health, education, law and order, basic research, and physical infrastructure. It may be the case that generally available subsidies are more benign than selective subsidies because they are less likely to be the product of rent seeking by special interest groups. It may also be the case that generally available subsidies are reflected more fully in exchange rate adjustments than selective or targeted subsidies. But in an international environment, where exchange rates are determined increasingly by international capital flows rather than goods flows, it is not clear how robust this assumption is, or when one can be confident that generally available subsidies have induced appropriate exchange rate adjustments while more selective subsidies have not.

Finally, in the context of countervailing duty law, there remain selective domestic subsidies with export spillovers. In this case, the economic analysis is the same as that for the case of pure export subsidies: the importing country receives lower-priced goods and increases its welfare. To the extent that such subsidies squeeze out a third-country's exports, then the third country should, as in the case of pure export subsidies, have a right to bring a nullification and impairment claim before a GATT dispute resolution panel.

A first-best alternative to countervailing duty law: negotiated reciprocity

The preceding analysis illustrates the normative incoherence as well as the technical difficulties associated with current and proposed countervailing duty laws. Our first-best reform proposal would be to abandon the attempt to develop a taxonomy of subsidies and to admit that 'unfair' subsidies are a largely incoherent idea. The protectionist tendencies that drive countervailing duty actions should be disciplined by being subjected to the strictures of a revamped Article XIX on safeguards. To advocate the replacement of 'unfair' trade remedy laws with a comprehensive safeguards regime is not to deny that global economic welfare might be enhanced by the reduction of government subsidies to industry. Rather, it is the case for countervailing duties that makes no sense, not the case for reducing some subsidies. Although it has been suggested that the appropriate use of countervailing duties may actually lead to a reduction in the use of subsidies, there is

little empirical evidence to suggest that the imposition or threat of contingent protection actually alters states' domestic policies.¹⁴⁰

However, the GATT may have an appropriate role to play in facilitating agreement among states to reduce subsidies. The GATT is more likely to achieve success, not through a ban of some supposedly pernicious subclass of subsidies enforceable through unilateral retaliation, but through facilitating negotiation of mutually advantageous concessions among the Contracting Parties. It is through negotiated reciprocity that the GATT has achieved its greatest success—the dramatic reduction in tariffs, which were never classified as prohibited, actionable or non-actionable. The enhanced notification and surveillance procedures in the Uruguay Round Subsidies Agreement may indeed facilitate such an approach to disciplining subsidies.

When subsidy wars threaten a tragedy of the commons, mutual agreement to halt or constrain subsidization in a particular sector may be possible. In comparison, tariff reductions did not occur because trading states suddenly recognized the cogency of the economic arguments that tariffs distort global allocative efficiency. Similarly, the focus regarding subsidies should be on facilitating, through the GATT, Pareto-superior bargains, where subsidies are reduced reciprocally, or 'traded' against removal of other trade restrictions.

A particularly forceful case for mutual reduction of subsidies exists where several states are sustaining excess capacity in declining industries through constantly increasing subsidization or are competing with each other in granting locational inducements to attract new plants. At some point, the cost of matching the increases of every other state's subsidy becomes a negative sum game, thereby making negotiated restraints attractive. Such restraints might, for example, involve an agreement to focus subsidy policies on orderly reduction of capacity through severance pay settlements to older workers, other public assistance for worker retraining and relocation, or regional subsidies to create jobs in other sectors in the region concerned.

Although there are quite broad prohibitions on subsidies in the Treaty of Rome, from the beginning the European Commission has not viewed the prohibitions on state aid as reflecting a *laissez-faire* paradigm of non-intervention in markets.¹⁴¹ Article 92 of the Treaty of Rome prohibits 'any aid granted by a Member State...which distorts competition' by favouring certain enterprises, provided that an effect on trade be demonstrated. The Commission only began to intervene actively in the aid policies of Member States during the sectoral crises of the 1970s and early 1980s when Union producers were faced with excess capacity in a variety of sensitive sectors such as steel, autos and textiles. In this context, subsidization appeared as a beggar-thy-neighbour attempt by each subsidizing country to maximize its share of a declining world market for Community production as a whole. The subsidizing countries then externalized onto other Member countries the adjustment costs of sectoral decline. Political norms of interstate cooperation, and the 'race to the bottom' effects of intra-Union subsidies wars, justified intervention. The intervention occurred without the Commission having to decide on an appropriate normative baseline for government intervention in mixed economies, i.e. how much intervention is compatible with free competition, or the *laissez-faire* ideal. Moreover, in many cases, the Commission's response was to accept readjustment of the aid in question with a view to restructuring and reducing capacity. The latter was aimed at alleviating the crisis of surplus capacity within the Union as a

whole.¹⁴² Finally, the Commission has taken a positive view of subsidies aimed at development of new environmentally safer production processes, as well as development of disadvantaged regions (as the Uruguay Round Subsidies Agreement did initially). Nevertheless, the Commission has insisted on justification of the specific measures in question, and has not sustained measures to prop up failing firms just because they happened to be located in underdeveloped regions. Instead, the Commission has sought evidence that the aid in question will contribute to long-term development of the local economy. Backed by technical expertise and capacity for ongoing monitoring and scrutiny of government policies, the Commission has been able to engage in a fruitful (although sometimes tense) dialogue with aid-granting Member States about the relationship between means and ends, in which the broader social goals behind government intervention have been accepted at the outset as legitimate, as well as the principle that one Member State should not impose on another the costs of attaining those goals within its own borders. The Union jurisprudence on subsidies has, therefore, a much less *laissez-faire* tone than that of US domestic trade tribunals applying American countervailing duty law, which presume the illegitimacy of any foreign subsidy that is not generally available.

Following the EU experience, the WTO requires better institutional machinery for negotiation and supervision of these kinds of subsidy regimes. However, creating an institutional framework to facilitate such regimes is a more appropriate task for the WTO than the elusive search for a universal taxonomy of good and bad subsidies. A transparency agency operating under the aegis of the WTO, now to an important extent contemplated in the detailed notification and surveillance mechanisms of the Uruguay Round Subsidies Agreement (Articles 25 and 26), could also play a positive role by monitoring subsidy policies and calculating subsidies in tariff equivalents, or effective rates of protection, thus providing a kind of common bargaining currency. Clearly, in order to make such commitments plausible, some kind of independent surveillance mechanism is required to conduct verifications and ensure against flagrant cheating. Current WTO machinery is not designed to handle this verification function, but were such machinery developed, we might see more agreements that address domestic subsidies. Thus, the reduction of subsidies should be treated in the same way as tariff-cutting has been treated in previous GATT rounds: the aim should be periodic global welfare-enhancing bargains based on a broad balance of concessions (negotiated reciprocity).

Second-best reforms

It must be acknowledged that, at least in the short run, it is unlikely that the first-best solution of removing all *a priori* general constraints on subsidies and leaving their reduction to negotiated reciprocity in particular contexts would be acceptable to the USA. The second-best solution accepts the general taxonomic approach embodied in the Uruguay Round Subsidies Agreement. However, on our preferred approach,¹⁴³ the regime would consist primarily of Track II, and unilateral application of countervailing duties (Track I) would be restricted to a narrow class of prohibited pure export subsidies, perhaps defined as subsidies where at least 80% of the output of subsidized foreign firms is exported, provided that the subsidies are competitively salient subsidies (as discussed

above with respect to the entitlement approach). Track II would be the exclusive avenue of recourse for addressing actionable subsidies; no remedy of any kind would be available in the case of non-actionable subsidies. If a subsidy has some trade effects, but is also serving legitimate non-trade-related domestic policy goals, remedial action should only be taken following investigation by a multilateral panel. The panel would determine whether the subsidy is objectionable and the Committee of Signatories to the Subsidies Agreement would mandate appropriate remedial or retaliatory action. In formulating the standards to be applied by subsidies panels, the experience of review panels established under Chapter 18 of the FTA may be helpful.¹⁴⁴ In cases involving disagreements about the legitimacy of government policies that influence trade, the panels adopted a least restrictive means test. For example, in the case *In the Matter of Canada's Landing Requirement for Pacific Coast Salmon and Herring* (1989), it was argued that a Canadian requirement that all catches of these fish be landed in Canada before processing was an essential component of resource conservation which was exempted by Article XX(g) from the GATT prohibition on export restrictions under Article XI.¹⁴⁵ However, because the objectives of the policy could have been achieved through sampling and other monitoring requirements less restrictive of trade, the policy was not sustained by the panel.

The paradigmatic formulation of the least restrictive means test is found in the case law under section 1 of the Canadian Charter of Rights and Freedoms.¹⁴⁶ In order for a limit on a Charter right to be sustained, the limit must have a valid objective, and the means chosen to reach that objective must be rationally connected to the objective and must be the least restrictive means, or the means that impairs minimally the right in question. This approach should be adopted to deal with the indeterminate class of reviewable (actionable) subsidies: if a subsidy is causing serious prejudice to other countries (in the sense employed in the Uruguay Round Subsidies Agreement) in any of the three subsidy scenarios outlined at the outset of this chapter (subsidized exports by A to B; subsidized exports by A to C, displacing B's exports to C; subsidized domestic production by A displacing B's imports), but is nevertheless rationally connected to a legitimate non-trade-related policy objective (such as those previously set out in Article 11 of the Tokyo Round Subsidies Code), and is the least trade-restrictive policy instrument available to achieve that objective, it should be sustained, but not otherwise. This test should encourage governments to seek out domestic policy instruments that will minimize trade distortions.

In summary, we envision that an international subsidies regime could feasibly aspire to define a category of subsidies that are immune from challenge either multilaterally or unilaterally, along the lines of 'non-actionable subsidies' in the Uruguay Round Subsidies Agreement, and another category of subsidies (principally subsidies that are *de jure* or *de facto* pure export subsidies) that are *per se* objectionable both multilaterally and unilaterally. For the wide array of intermediate subsidies that do not fall into either of these two categories, we envisage only a multilateral complaints route, with panels applying a least trade-restrictive means test, and an adverse determination by a subsidies panel being required before retaliation can be undertaken. Invocation of domestic countervailing duty regimes would not be possible unless and until such a determination had been made.¹⁴⁷ This would largely place all three subsidy scenarios on the same legal footing, subject to the same substantive disciplines and the same multilateral review

process. This proposed approach also recognizes the complex welfare judgments entailed in evaluating the economic effects of subsidies and is respectful of the domestic sovereignty of Member states to pursue a wide range of non-trade-related domestic policy objectives of their choosing without risking unilateral punitive measures from other countries with divergent perspectives on the wisdom of those policies, while at the same time constraining subsidy policies that are gratuitously or disproportionately trade distorting.

PROTECTIONISM IN GOVERNMENT PROCUREMENT¹⁴⁸

Government procurement policies pose a problem closely related to that of potentially trade-distorting subsidies. In most countries, the government is the largest single purchaser in the economy. In common law jurisdictions (like Canada), the government's procurement contracts are usually governed, in principle, by the same contract law that applies to private transactions.¹⁴⁹ The process of government procurement is, however, unlike private contracting in that governments often use their large purchasing power as a tool to promote various domestic political, social and economic policies. These purposes of government procurement contracting lead to the adoption of a wide range of measures that qualify the objective of obtaining the best product or service for the lowest price.¹⁵⁰

The three most common areas for domestic preference in government procurement are: (1) to protect employment in declining industries; (2) to protect the supply of 'strategic' defence goods; and (3) to support emerging domestic high-tech industries. However, McCrudden argues that the intersection between international trade and non-economic issues such as human rights and environment cannot be ignored.¹⁵¹ For example, he points out that several countries have been the object of actual or proposed restrictive public procurement legislation in the United States, designed to express disapproval of those countries' human rights practices. These include Nigeria, Switzerland, China, Egypt, Kuwait, Myanmar,¹⁵² Turkey, Saudi Arabia and Indonesia.¹⁵³

Domestic preference in government procurement contracting is usually expressed in the form of either official domestic preference policies (overt discrimination against foreign suppliers) or exclusionary tactics 'hidden' as something else (less visible forms of discrimination).¹⁵⁴ Overtly discriminatory tactics include:

- 1 Price differentials applied against foreign bids (whereby foreign bids may be accepted only if the lowest domestic bid is more than a certain percentage higher than the foreign one).¹⁵⁵
- 2 'Discounts' for the domestic content of the bid.
- 3 Selective sourcing policies (whereby only domestic firms are invited to bid).¹⁵⁶
- 4 Set-asides of certain procurements to specific domestic sectors.
- 5 Assignments of certain procurements for domestic industries only (for example defence spending).
- 6 Requiring foreign contractors to procure from the local market as a condition of the award of the contract.

Less visible forms of discrimination include:

- 1 Selective tendering procedures, employed to (unofficially) exclude foreign competition.
- 2 Manipulating the time and method of giving notice of tender solicitations to favour domestic suppliers.
- 3 Short deadlines for submitting bids, which foreign suppliers are unable to meet.
- 4 Product or service standards which are only readily met by domestic producers.

The GATT Tokyo Round Code on Government Procurement

The GATT initially refrained almost completely from regulating government procurement policies: paragraph 8(a) of Article III makes government procurement an exception to the National Treatment obligation. However, this issue was re-examined during the Tokyo Round, and it was decided that the eventual elimination of discriminatory procurement practices was desirable.¹⁵⁷ The result of the ensuing negotiations was the Agreement on Government Procurement (the Code), a plurilateral Agreement with about twenty signatories.¹⁵⁸

The Tokyo Round Code on Government Procurement sought to achieve greater liberalization of government procurement through the establishment of an agreed framework with respect to regulations, procedures and practices regarding government procurement. The Code established the obligation of National Treatment, and also set out detailed rules for transparent procurement procedures that were to be followed in order to ensure that foreign suppliers indeed receive fair treatment.

The Code was, however, quite limited in scope and coverage. It only applied to contracts of a value of SDR 130,000 or more¹⁵⁹ (about US\$170,000). Service contracts were not covered at all by the Code,¹⁶⁰ and Article VIII provides for other exceptions, notably in the area of defence spending. Also, the Code only applied to government agencies that 'contributed' to the Code, as listed in Annex I:13; signatories excluded numerous departments from this list. State or municipal governments were also not covered by the Code.

The Code's provisions for National Treatment also raised several difficulties. First, these provisions were only available to suppliers from other signatories to the Agreement, thus requiring rules of origin.¹⁶¹ Second, these principles did not exempt foreign suppliers from customs duties. Third, Article V:15(b) allowed governments to continue to demand offset industrial benefits (such as local content, licensing of technology, investment requirements, counter-trade or similar requirements) from potential foreign suppliers as a condition for awarding a contract.

The key mechanism of the Code was a set of detailed and transparent tendering procedures. The preferred procedure under the Code was the 'open' tender, in which a notice of each proposed purchase (NPP) is published in the designated publications, containing all of the information necessary for the timely submission of both foreign and domestic bids.¹⁶² 'Selective' tendering procedures were also allowed, either by the use of previously established lists of suppliers, or by a qualification requirement as a precondition for the submission of bids; however, such lists and qualifications were required to be published, and not to be used as a means of excluding foreign suppliers.¹⁶³ More problematic is the use of 'single' tendering procedures, where the government only considers tenders from a single source. In order to control the protectionist abuse of

single tendering, the Code required a justification to be published in an appropriate publication (as defined by the Code) in the event of a single tendering.¹⁶⁴

The Code required that a contract shall be awarded to the lowest tender, or to the tender which in terms of the specific evaluation criteria set forth in the NPP is determined to be the most advantageous.¹⁶⁵ The use of technical specifications to refuse the award to a foreign firm, a common device used by governments to exclude foreign suppliers from tender competition, was regulated under Article IV:2(a). Technical specifications prescribed by procurement entities should be in terms of performance rather than design, and should also be based on international standards if possible.

The Code provided for a system of enforcement and dispute resolution. The emphasis has been on the settlement of disputes between the states involved, rather than the granting of a private right of action to an aggrieved supplier: mechanisms for the hearing of private complaints were left to the discretion of the procuring agency.¹⁶⁶ Between governments, Article VII of the Code envisaged a three-stage complaints proceeding: first, bilateral consultations would be held; second, if these produced no result, the Committee on Government Procurement would mediate; and third, if mediation failed, the Committee would constitute an *ad hoc* panel to make recommendations. Panel decisions were non-binding, but the Committee could recommend the authorization of the suspension of the application of the Code *vis-à-vis* the suppliers of the non-complying Party.¹⁶⁷

Under these provisions in 1991, the United States challenged a procurement on the part of the government of Norway for electronic toll collection for the city of Trondheim.¹⁶⁸ The USA contended that Norway had violated its obligations under the Agreement on Government Procurement in choosing a Norwegian supplier of electronic equipment. The dispute primarily centred around the fact that 'the Government of Norway had single tendered the equipment from a Norwegian supplier, excluding viable and eager competition from a capable United States'.¹⁶⁹ Norway justified this classification on the basis that it was a research and development contract and thus excluded from the disciplines of the Agreement. The panel found that a single tendering of this procurement could not be justified in the present case and accepted the argument of the United States.

The Uruguay Round Government Procurement Agreement¹⁷⁰

Overview of the Agreement

The Tokyo Round Government Procurement Code was substantially revised during the Uruguay Round negotiations in an attempt to address some of the difficulties in the Code's operation.¹⁷¹ These revisions have the effect of largely harmonizing the GATT Code with the NAFTA Agreement on Government Procurement (see below). There are four key areas of change in the revised GATT Agreement: first, the scope and coverage of the Agreement has been expanded to include service and construction contracts; second, entities covered have been extended beyond central government entities to sub-national government entities and to public enterprises (e.g. public utilities);¹⁷² third, contracting entities are no longer able to demand offsets as a condition for the awarding

of contracts;¹⁷³ and fourth, the Parties are now required to establish effective bid challenge procedures.¹⁷⁴

The establishment of mandatory bid challenge procedures, by which aggrieved foreign suppliers may challenge alleged breaches of the Agreement directly, is potentially the most important change in the Uruguay Round Agreement. Under this requirement, each Party to the Agreement will have to establish impartial review bodies to adjudicate procurement disputes in a timely fashion. However, as noted in Article XX:7(c), the compensation provided to the aggrieved supplier may be limited to the costs of tender preparation or protest, a sum which may be insufficient to deter governments from effectively breaching their obligations under the Agreement.

An important new aspect of the Uruguay Round Agreement is the expansion of the scope and coverage of the Agreement to include 'sub-central government' (state, provincial and municipal) entities and public enterprises as well as central government entities. Each Party is responsible for listing in Appendix I all entities within its jurisdiction to be covered by the Agreement, and each Party may withdraw one of the listed entities at will (subject to objections from other Parties, which are to be resolved in accordance with the procedures on consultations and dispute settlement contained in Article XXII). If major changes to the existing structure are requested by one of the Parties, such as transfers of entities between categories within Appendix I, the Committee on Government Procurement (established by Article XXI) will consider the proposed change and determine if compensatory adjustments are necessary.

Unfortunately, the Uruguay Round Government Procurement Agreement (GPA), like its Tokyo Round predecessor, is a plurilateral, not multilateral, Agreement (with 28 signatories),¹⁷⁵ and did not undergo the important status change of most of the Tokyo Round Codes, which have now been fully integrated into the WTO and bind all Member States—presumably a testament to the influence of powerful domestic constituencies who benefit from preferential government procurement. This raises complex questions as to when a procuring government is entitled to discriminate between GPA and non-GPA signatories in awarding contracts, given that the GPA contains no explicit exemption from the general Most Favoured Nation obligation in the GATT. Also, even among GPA Members, numerous derogations and the adoption of a reciprocity rule mean that signatories often deny access to procurements by categories of entities to suppliers from certain GPA signatories or deny access to procurement for certain classes of goods or services where other signatories have not made reciprocal commitments in these same areas. Differential treatment both between signatories and non-signatories and among signatories is likely to raise formidable complexities in identifying the origins of goods or services and also has the potential for creating significant trade diversion.¹⁷⁶ Thus, the Agreement can only be counted as modest progress towards liberalizing government procurement markets around the world.

Special and differential treatment for developing countries

Article V of the GPA provides for special and differential treatment for developing countries. In particular, it requires that signatories consider developing-country needs, including balance of payment and reserve protection, and domestic industry development (Article V:1). Developing countries may negotiate exclusions from rules on National

Treatment under the GPA (Article V:4). Signatories must facilitate increased imports from developing countries; also, developed-country Parties must provide government procurement-related technical assistance where requested and establish information centres to respond to reasonable information requests from developing countries (Articles V:2, V:8 and V:11). A further provision mandates annual review of Article V operation and effectiveness (Article V:14).

The UNDP notes that although increased transparency in government procurement will benefit developing countries, there are difficulties associated with wider market access. In particular, transparency may increase welfare by reducing procedural inefficiency and increasing available resources, reduce corrupt practices in procurement, and increase exports to other procuring governments. However, National Treatment in procurement may adversely affect governments' capacity to protect small businesses, and GPA compliance can be a costly endeavour in itself.¹⁷⁷

Arrowsmith argues that Article V is meaningless in practice.¹⁷⁸ She suggests two future reforms that may persuade developing countries to join the GPA.¹⁷⁹ First, the Agreement should incorporate tariffication as a means of moving away from sectoral reciprocity, allowing a graduated approach to government procurement concessions.¹⁸⁰ Second, Parties could offer concessions to developing countries in other trade areas.¹⁸¹

In 2000, a panel report, *Korea—Measures Affecting Government Procurement*¹⁸² ('*Korea Procurement*'), was issued addressing a dispute between the United States and Korea regarding government procurement related to construction of the Incheon International Airport. Specifically, the United States accused Korea of violating the GPA by imposing tender submission deadlines of less than 40 days, by not establishing effective domestic challenge procedures, by requiring a foreign bidder for prime contractor to obtain a licence that requires the presence of manufacturing facilities in Korea and by imposing certain domestic partnering requirements on foreign bidders. Korea responded that the particular government entities referred to by the USA were not in Appendix I of the GPA, and consequently were not covered by it (paras 7.1–7.3).

The panel began by addressing two questions: first, are the entities covered in Appendix I?; second, if not, might the entities still be covered by the GPA (para. 7.29)? In this case, although the Ministry of Construction and Transportation (MOCT) was listed in Appendix I and covered by the GPA, the successive entities responsible for the airport project were not covered by the GPA. Consequently, the panel did not address US allegations that Korea violated the GPA (para. 7.83). The panel also rejected a secondary US argument under Article XXII:2 of the GPA (para. 8.2). In the course of its analysis, the panel indicated the type of affiliation necessary to make an unlisted entity subject to the GPA. The panel noted that Members may affirmatively list or explicitly exclude an entity from their schedules, decide in which Annex the schedule will be included, and qualify what is covered (paras 7.30–7.31, 7.71). If there is neither affirmative listing nor explicit exclusion of an entity, its relationship with a listed entity might determine whether the unlisted entity is covered by the GPA. In this case, the panel asked whether the unlisted entities were 'legally unified' with the MOCT, or 'acting on [its] behalf. The former question seeks to avoid uncertainty among negotiating parties over what the GPA actually covers. The latter recognizes that a listed entity ought not to be able to circumvent the GPA by having others act on its behalf (para. 7.59).

Doha Round reform

The Doha Declaration calls for negotiations on transparency and explicitly excludes other government procurement issues from discussion. These negotiations are to build on work already done by the Working Group on Transparency in Government Procurement.¹⁸³ This group was established by the Singapore Ministerial Declaration with a mandate to 'study... transparency in government procurement practices, taking into account national policies, and ...develop elements for inclusion in an appropriate agreement'.¹⁸⁴ According to Rege, the USA and the EU suggested an interim agreement on transparency as a stepping stone towards GPA accession by developing countries.¹⁸⁵ He argues that developing countries will best be able to realize the benefits of an agreement on transparency, i.e. reduced corruption and efficiency gains, if that agreement considers the following factors: 'political pressures imposed by foreign governments on behalf of their firms', 'the proportion of tied aid requiring countries to obtain goods and services from the providers of the aid', 'the revolutionary changes taking place both in the methods for procuring goods and services and in the regulatory mechanism used', and 'the specific situation and needs of developing countries', such as levels of corruption, available human capital and the extent of regulatory capacity.¹⁸⁶

Government procurement under the Canada-US FTA

As a result of the limited coverage of the Tokyo Round Government Procurement Code, many Canadian and US firms were still subject to the protectionist procurement policies of each other's governments. In the USA, these measures included the Buy American Act, which required that only domestic supplies be purchased for public use, subject to an exception for 'unreasonably' priced domestic alternative products. The American government also protects domestic concerns through various 'set-aside' provisions, notably to benefit businesses owned by 'socially or economically disadvantaged individuals', a category which automatically excludes foreign suppliers.

The Canadian procurement policies are not regulated by statute, but rather by administrative directives. The most important of these is the Canadian Content Premium Policy, under which the Department of Supply and Services will apply a premium of 10% of the difference in foreign content on competing bids in favour of sources with greater Canadian content. Moreover, when the value of a procurement exceeds \$2 million, the 'procurement review mechanism' is triggered, with the purpose of ensuring that the awarding of the contract will achieve the 'maximum benefit to Canada'.¹⁸⁷ These administrative directives are only in effect for government contracts not covered by international agreements, but before the implementation of the FTA they were an important method of ensuring domestic preferment for contracts not covered by the GATT Code.

The FTA represented an attempt to liberalize government procurement that was not covered under the GATT Tokyo Round Code from the effects of these domestic preference policies. However, Chapter 13 of the FTA actually changed little from the Code.¹⁸⁸ The most important changes it made were: first, to lower the threshold of eligibility from SDR 130,000 to US\$25,000; second, to enable eligible Canadian goods to be treated like US goods (including 'Buy American' differentials);¹⁸⁹ and third, the

establishment of a requirement for domestic procurement review, available to aggrieved suppliers.

In Canada, the Canadian International Trade Tribunal (CITT) fulfils this obligation. Governed by both the procedures of the WTO Code and the 'expanded' obligations under Article 1017 of the NAFTA, the CITT has the authority to order the government to postpone the awarding of a contract pending the completion of the agency's investigation.

Government procurement under NAFTA

NAFTA's Chapter 10 provides for considerably wider coverage than either the Tokyo Round Government Procurement Code or the FTA, in terms of both entities and types of contracts covered. Not only does NAFTA extend the improvements available under the FTA to Mexico, it also extends coverage to many federal government agencies not covered by either the FTA or the Code, although not to sub-national levels of government.¹⁹⁰ NAFTA also closed some previously existing exclusions in the earlier agreements, such as construction and service contracts (which are now covered) and the imposition by procurement entities of offset requirements (which are now prohibited).¹⁹¹

Threshold values were, however, raised under NAFTA to US\$50,000 (this provision, however, applies only to Mexico: for Canada and the USA, the FTA threshold of US\$25,000 still applies). For the newly covered area of construction services, the threshold has been set at US\$6.5 million. For 'government enterprises', as opposed to federal government entities, the thresholds are higher still: US\$250,000 for goods and services, and US\$8 million for construction services.

One major problem with the NAFTA procurement rules lies in the area of tendering procedures. Article 1009 of NAFTA allows more restrictive 'qualification procedures' than the FTA, which may be used to exclude foreign tenders.

The process of liberalizing North American government procurement markets under NAFTA is still far from complete. Under Article 1024, the Parties agreed to commence further negotiations no later than 1998, with a view to further liberalization of their respective government procurement markets. The NAFTA Government Procurement Working Group (Chapter 10 of the Agreement) was established by the Parties to provide a forum for such negotiations. In lieu of a finalized agreement on government procurement, the Parties have continued to attempt to obtain the voluntary acceptance, by state and provincial government entities, of the principles contained in Chapter 10. This has also been extended to other free trade agreements including the Free Trade Agreement of the Americas. In addition, Canada and the United States also agreed to increase their obligations and coverage under this chapter to a level at least commensurate with their requirements under the Uruguay Round Agreement.

Procurement markets in the European Union¹⁹²

The European Union has attempted to regulate the domestic preferment policies of its Member States with regard to government procurement through a series of coordination directives. The legal effect of these directives is that aggrieved suppliers can, at least in

principle, invoke the provisions of the procurement directives directly in the national courts of the Member States.

The original directives issued by the Commission were the Public Works Directive and the Public Supplies Directive.¹⁹³ These directives were based on three main principles: first, community-wide advertising of contracts, in order to give equal opportunity to firms from all Member States; second, the banning of 'discriminatory' technical specifications; and third, the use of objective and non-discriminatory criteria in tendering and award procedures.

The major problems with these directives were their limited coverage (the so-called 'excluded sectors' included energy, water, transportation and telecommunications), and their high value thresholds (after amendment, ECU 5,000,000 for the Works Directive, and ECU 130,000 for the Supplies Directive). Another major problem lay in the excessive discretion given to awarding entities to choose their tendering procedures.

Under the coordination directives, three different tendering procedures are allowed: 'open' and 'restrictive' competitive tendering, and non-competitive 'negotiated' tendering. In 'restrictive' tendering, the awarding authority advertises its intention to receive requests to participate in the tender for a specific contract; the authority may then choose the applicants to whom invitations to submit tenders will be sent. This system can obviously be abused, although amendments to the directives now curtail the awarding authorities' discretion somewhat (requiring, for example, justification for the use of 'restrictive' tendering procedures under the Supplies Directive, and the publication of the reasons for both winning and losing bids under the Works Directive). An additional opportunity for abuse was created by the fact that non-competitive tendering was originally allowed in exceptional circumstances, although the Member State's use of these exceptions was required to be reported.¹⁹⁴

Experience with the operation of the coordination directives soon demonstrated that redress for aggrieved suppliers in the offending nation's national courts was uneven. To remedy this situation, the Review Directive was implemented.¹⁹⁵ This directive requires Members to provide effective domestic review procedures with the power to suspend the awarding of contracts, to set aside awarding entities' decisions, and to award damages to aggrieved suppliers. As of June 1996, Germany, Greece, Portugal and Spain had still not implemented the directive in national law, despite a 1991 deadline.¹⁹⁶ In addition to this particular issue, Reich points out other shortcomings related to the directive. For example, time frames and the manner in which a review process should be conducted are not specified. Also, the extent of compensation is not clear.¹⁹⁷

The European Commission also made an attempt to apply the Union procurement rules to the traditionally excluded utilities sectors by implementing the Utilities Directive.¹⁹⁸ This directive applies both to public authorities and to private firms operating on the basis of 'special or exclusive rights' granted by a Member State (to avoid the public/private distinction in the legal status of the entities involved). Due to the 'special nature' of the concerned undertakings, awarding entities were allowed considerable discretion in their choice of tendering procedures, and were in addition allowed to use an unspecified 'qualification system' to screen potential tenders. As with the Review Directive, Reich indicates that several Member States did not implement the Utilities Directive by the deadline. Reich adds that the extent of the flexibility and discretion allowed to Member States under the agreement makes it possible for them to

circumvent free competition. In particular, he refers to the broad permissibility of non-competitive procedures under the directive.¹⁹⁹

The Commission, recognizing the special status of the 'excluded sectors', also adopted a Utilities Review Directive applicable only to the Utilities Directive.²⁰⁰ Like the regular Review Directive, it requires Member States to provide effective review procedures in relation to all decisions taken by their contracting entities. As an alternative to this mandatory remedy, the Utilities Review Directive adopted two voluntary procedures: the attestation system, in which the awarding entity submits to systematic review by attestors (independent and objective witnesses to the entity's conformity with the requirements); and the conciliation procedure, in which aggrieved bidders and contracting entities settle their disputes through a non-litigious process of negotiation mediated by a Commission-appointed conciliator. In general, these review procedures allow the Member States wide discretion in determining what procedures they will follow.²⁰¹

10

Safeguard regimes and domestic adjustment policies¹

INTRODUCTION

Article XIX of the GATT and the WTO Agreement on Safeguards allow a WTO Member in certain circumstances to suspend WTO concessions, where increases in imports cause serious injury or threat of injury to domestic industries of a product like, or competitive with, one whose importation is increasing.² The increase in imports must be caused by unforeseen developments and prior WTO obligations. Measures taken under Article XIX and the Agreement on Safeguards are intended to be temporary, lasting only long enough to prevent or remedy the injury, and are applied in a non-discriminatory way to all Parties exporting the product. Finally, they can only be undertaken when Parties with substantial interests have been consulted and agree to the import restraint or receive proper compensation in the form of offsetting trade concessions.³

Between January 1995 and October 2002, 103 safeguard investigation initiations were reported to the WTO Committee on Safeguards, as required by Article 12.1 of the Agreement on Safeguards. India notified the Committee of the most initiations during that same period, at 14, followed by the United States, at ten, Chile, at nine, and the Czech Republic, at nine. Jordan reported the most initiations, seven, between October 2001 and October 2002.⁴ The number of safeguard investigation initiations per year increased markedly in 2001 and 2002. Between 1995 and May 2000, there were nine cases annually;⁵ however, there were 18 in 2001 and 36 in 2002.⁶ The proportion of cases initiated by developed countries was 20% in the period January 1995 to November 2000, 22% in 2001 and 5% in 2002.⁷ Compared with other trade remedies, safeguard actions are infrequently initiated: from 1995 to 2002, 2,160 antidumping initiations⁸ and 153 countervailing actions⁹ were reported to the WTO.

THE GATT SAFEGUARD REGIME

Article XIX

Article XIX is a direct derivative of the escape clause found in the 1943 Reciprocal Trade Agreement between the USA and Mexico.¹⁰ Prior to 1943, escape clauses to protect against specific risks had been contemplated by trade agreements, but never a general escape clause.¹¹ Then in 1947, responding to concerns in Congress over impending GATT trade liberalization, a US executive order required that all trade agreements

entered into by the USA include a general escape clause similar to the one found in the Reciprocal Trade Agreement.

Among the Contracting Parties, there was general agreement during the initial GATT negotiations that an escape clause was desirable, but there was some controversy about its scope.¹² The rationale for the inclusion of a safeguard provision was twofold:¹³ to encourage greater trade liberalization, and to increase the trade regime's flexibility. The goal of the GATT was to remove all trade barriers except customs duties (tariffs), and then to reduce these duties through successive, binding multilateral negotiations. Safeguards were believed to be necessary to protect against unforeseen economic difficulties that might result from liberalization. It was thought that with the existence of a form of relief from obligations in extreme circumstances, countries would be more likely to agree to broad reductions in trade barriers in the first place. Second, it was believed that the flexibility provided by safeguards would increase the long-term stability of the system. If nations were able to protect their import-sensitive industries temporarily within the GATT regime, then they would be less likely to abandon the multilateral system in favour of protectionism or some more discriminatory trading system.

The escape clause agreed upon in 1947 is 'extraordinarily oblique, even for GATT language',¹⁴ resulting in difficulty in interpretation and uncertainty in application.¹⁵ Very few rules define the required procedure for invocation of the safeguard. The safeguard user must notify the Contracting Parties and afford those with a substantial interest an opportunity for consultation with respect to the proposed action. A striking feature of the regime is that the importing country is responsible for the substantive determinations, and while notification to the GATT is mandatory, there is no requirement of surveillance or external confirmation. The lack of international involvement encourages informal, secret negotiation since exporters feel their interests are inadequately protected by the formal mechanism. In addition, actions that are taken under Article XIX must be taken by the executive branch of the government of the Contracting Party and are thus political, not administrative actions like antidumping and countervailing duty actions. The need for executive approval forces an invoking government to justify the action to its constituents and to foreign governments. Also, it may be difficult if the action is prompted by a genuine emergency to explain why it is necessary to pay compensation in terms of offsetting tariff concessions. By creating greater political costs, the safeguard regime creates incentives to substitute relief through less accountable mechanisms like antidumping duties or countervailing duties.

Tokyo Round negotiations

One of the key issues relating to safeguards during the Tokyo Round negotiations was selectivity. It was clear prior to the Tokyo Round negotiations that countries were reluctant to use the safeguard regime because it disrupted the trade of nations that was not causing significant harm, and required complex negotiations and compensation schemes. Instead, nations frequently negotiated 'voluntary' export restraint arrangements (ERAs) with the main sources of disruptive imports. This practice mainly disadvantaged newly industrializing countries (NICs) and developing countries who were vulnerable to pressure from the larger economies; they agreed to these arrangements in order to avoid more adverse impacts that might result from resort to unilateral formal remedies. There

are also benefits to exporters from ERAs, especially the opportunity to reap monopoly rents from the artificial scarcities induced by quotas (if allocated to foreign exporters), although this does not imply that they are necessarily supported by exporting countries. There was a strong desire on the part of developing countries to strengthen the GATT safeguard regime, making grounds for invocation clearer and stricter. Knowing what alternatives they faced in formal mechanisms, they would then have greater bargaining power in bilateral negotiations. Essential to their view of the regime was the incorporation of safeguards, and alternative escape actions, into a system of non-discriminatory application. To relax the discipline of Article XIX was thought likely to encourage, rather than constrain, the incidence of bilateral, managed trade arrangements, which are antithetical to the founding premises of the multilateral system. An opposing view was taken by the EU, which advocated the right to apply Article XIX selectively. Selectivity was believed necessary to enhance stability in international trade. As Winham observes:

[D]eveloping countries are less well served by stability than by rapid changes in traditional trading patterns...the effort to negotiate selective safeguards was motivated by a desire to force developing-country exporters to adjust to a pace of change that would not create dislocation in competing industries in the developed countries.¹⁶

When safeguard negotiations began in 1978, near the end of the Tokyo Round, selectivity was the focus of discussions, but the developing countries and the EU could not reach agreement.¹⁷ Developing countries were prepared to compromise on the issue of selectivity in exchange for multilateral surveillance. This compromise was reflected in the Secretariat Draft of April 1979, which specified that in cases where serious injury would result from unusual (not just unforeseen) circumstances, restraints could be taken selectively, either with the agreement of the exporting country or with the approval of a proposed international safeguard committee. This compromise was acceptable to Canada, the USA, Japan and developing countries,¹⁸ but the EU was unable to accept such a system of review: the administration of international trade laws in the EU is not very transparent, and because of the competing interests in the Union, public scrutiny may have caused political difficulties. The right to make determinations of injury without being monitored by an international agency became an issue of economic sovereignty and put an end to any chances of agreement. Ultimately, the only decision made at the Tokyo Round was that a committee should meet to try to elaborate supplementary rules and procedures to provide 'greater uniformity and certainty'¹⁹ in implementing the Safeguard Clause. Following the negotiations, the committee collected data on safeguard use and met to discuss problems of reform, but no further progress was made towards a common approach to the matter.²⁰

While the ultimate stumbling block to agreement on a new safeguards regime in the Tokyo Round negotiations was the issue of selectivity, the determination of injury was also controversial. The definition of injury in Article XIX is very imprecise and there was disagreement on the appropriate test to adopt. Because of the conflict over selectivity, the issue was not resolved. Approaches to the question vary dramatically. Some advocated a substantial loosening of the criteria for invocation combined with a reduction in the

number and scope of measures available.²¹ One improvement in this area would be to make safeguard protection on proof of injury available to industries as of right, like protection from dumping, rather than a matter of political discretion. Others advocate a tightening of the requirements.²² Ways of achieving such a tightening vary. One possible system would have two tiers: governments could negotiate agreements with other states undertaking to satisfy stricter criteria before invoking safeguard relief and in return be relieved of the obligation to pay compensation; those without such agreements would follow the less restrictive criteria and pay normal compensation.²³

Another proposal contemplated that an industry should only be protected if injury is being suffered by 'less-endowed and immobile workers or long-established and dependent communities'.²⁴ This injury test is more attractive than the *status quo* because the cost of protection borne by consumers would be balanced against the gains by another vulnerable group 'able to make normatively defensible claims not vulnerable to a utilitarian social welfare calculus'.²⁵ In addition, the concept of worker and community interests as the only legitimate interests justifying protection suggests a link between revenues from protectionist measures and adjustment programmes which these revenues can help finance. Along with the altered injury requirement could also be a condition that the country invoking safeguard relief show that there are no less drastic (less trade distortive) policy instruments available to vindicate these values.

The Uruguay Round Agreement on Safeguards²⁶

Case law has highlighted the relationship of GATT Article XIX with the WTO Agreement on Safeguards. In *Argentina—Safeguard Measures on Imports of Footwear*²⁷ ('*Argentina Footwear*'), the Appellate Body (AB) indicated that a safeguard measure must satisfy both the Agreement on Safeguards and Article XIX of the GATT, if that measure was imposed after the WTO Agreement came into effect (para. 84). Also, the two are to apply 'cumulatively, except to the extent of a conflict between specific provisions' (para. 89).²⁸ In particular, the 'unforeseen development' requirement of Article XIX must still be met, despite the absence of such a requirement in the WTO Safeguards Agreement. Below is a discussion of safeguard requirements under GATT Article XIX and the Agreement on Safeguards.

Increased imports and 'Unforeseen Developments'

According to Article XIX, the importing country must show that the imports in question are increasing, either relatively²⁹ or absolutely, due to unforeseen developments and GATT obligations. The meaning of this requirement was discussed by the AB in *Argentina Footwear*.³⁰ First, it interpreted 'as a result of unforeseen developments' to mean 'developments [leading] to a product being imported in such increased quantities and under such conditions as to cause or threaten to cause serious injury to domestic producers must [be] "unexpected"'. Second, it found that 'of the effect of the obligations incurred by a Member under this Agreement, including tariff concessions' means 'it must be demonstrated, as a matter of fact, that the importing Member has incurred obligations under the GATT 1994, including tariff concessions' (para. 91). The same ideas were articulated in *Korea Dairy* (see below), in which the AB's report was issued on the same

day as that of *Argentina Footwear*. The AB in *United States—Safeguard Measures on Imports of Fresh, Chilled or Frozen Lamb Meat from New Zealand and Australia*³¹ (‘US Lamb’) elaborated on the requirement that unforeseen developments must be demonstrated as a matter of fact before the safeguard measure is applied, stating that ‘the demonstration...must also feature in the same report of the competent authorities’ (para. 72).

Articles 2.1 and 4.2(a) of the Agreement on Safeguards also mention increased imports. Article 2.1 indicates that safeguard measures may only be imposed when a ‘product is being imported...in such increased quantities...as to cause or threaten to cause serious injury to...domestic industry’. Article 4.2(a) discusses the relevant factors to consider when investigating the impact of increased imports on domestic industry, among them ‘the rate and amount of the increase in imports of the product concerned in absolute and relative terms’. *Argentina Footwear* examined these two provisions. The AB indicated that Article 4.2(a) requires competent authorities to consider trends in imports over the period of investigation, and that it is not adequate to compare the end points of the same period. Furthermore, Article 2.1 of the Agreement on Safeguards and Article XIX: 1 (a) of the GATT imply a sudden and recent increase in imports. The AB placed particular emphasis on the idea that not any increase is sufficient, but ‘that the increase in imports must have been recent enough, sudden enough, sharp enough, and significant enough, both quantitatively and qualitatively, to cause or threaten to cause “serious injury”’ (paras 129–31).

Serious injury

Under GATT Article XIX, increased imports must cause or threaten serious injury to domestic producers of like or directly competitive products.³² There are three questions that arise: (1) what is needed to establish causation; (2) what constitutes serious injury or threat of serious injury; and (3) what qualifies as a like or competitive product? The injury test adopted in the Uruguay Round Safeguards Agreement is a modest improvement over the ambiguities of Article XIX. Serious injury is defined in Article 6 as ‘a significant overall impairment in the position of the domestic industry’. The factors to be considered in this determination are specified: rate and amount of the increase in imports in absolute and relative terms; the share of the domestic market taken by increased imports; and changes in the level of sales, production, productivity, capacity utilization, profits and losses, and employment.

Case law: causation

According to AB case law, there are two requirements for causation under Article 4.2(b) of the Agreement on Safeguards. There must be a ‘causal link between increased imports of the product concerned and serious injury or threat thereof. Also, ‘injury caused by factors other than increased imports must not be attributed to increased imports’.³³

The AB in *Argentina Footwear* laid out the framework for analysing causation under Article 4.2(b), upholding the panel’s finding that ‘causation analysis and determination’ centre on ‘the relationship between the movements’ in imports and injury factors. The

AB also agreed that where there is causation, there will normally be a coincidence between an increase in imports and a decline in the relevant injury factors (para. 144).

In *United States—Definitive Safeguard Measures on Imports of Wheat Gluten from the European Communities*³⁴ ('US Wheat Gluten'), the AB found that although the 'causal link' under Article 4.2(b) indicates a cause and effect relationship in which increased imports contribute to 'bringing about', 'producing' or 'inducing' the serious injury, this does not mean that the increased imports need be the sole cause of the serious injury. In fact, there may be other factors contributing to the situation of the domestic industry at the same time (para. 67). In order to determine whether causation is present, competent authorities must complete a two-stage process of analysis. First, they must distinguish the injury caused to the domestic industry by increased imports from that caused by other factors. Second, they must attribute to increased imports and to other causes, respectively, the injury they caused. This will prevent injury not caused by increased imports from being attributed to them, and will allow determination of whether there exists a 'genuine and substantial relationship of cause and effect' and consequently a 'causal link' under Article 4.2(b). However, this does not require that the increased imports be capable, on their own, of causing serious injury (paras 69–70). By analogy to two other cases,³⁵ the AB in *United States—Definitive Safeguard Measures on Imports of Circular Welded Carbon Quality Line Pipe from Korea*³⁶ ('US Line Pipe') determined that fulfilment of the second sentence of Article 4.2(b) requires an explicit, reasoned, adequate, clear and unambiguous explanation by competent authorities showing that injury not caused by increased imports is not attributed to them (paras 216–17).

Alan Sykes is highly critical of AB case law to date on safeguard causation analysis, which he finds offers no clarity as to when safeguards may and may not be applied. Sykes fears that this may lead states to return to extra-legal alternatives and that all discipline over the magnitude and duration of protection for troubled industries will be lost.³⁷ Sykes is particularly critical of the AB's approach to causation. His main criticism is that any attempts to separate out various potential causes of serious injury or threat thereof are doomed because of the endogeneity of increased imports to other causal factors. For instance, suppose that domestic demand for a good rises due to rising consumer incomes. A natural *result* of this increase in demand would be for imports to increase. Similarly, one can imagine input costs rising domestically, causing the costs of domestic production to increase, and thereby advantaging foreign producers. Increased quantities of imports will be a natural *result*. While the AB looks for increased imports to explain why injury may be occurring, increases in imports are probably the result, not the cause, of unfavourable shifts in market conditions. The 'non-attribution' analysis is therefore deeply flawed—the AB might try to distinguish the injury caused by increased imports from the injury caused from higher labour costs or energy costs, or changing demand patterns, for example, but such an exercise ignores the causal relationship that exists between potential factors. Sykes further notes that the AB has never seriously addressed the relationship between correlation and causation. Sykes is also critical of the AB revival of the 'unforeseen development' requirement, which he regards as impossible to apply on a predictable and principled basis.

Case law: serious injury or threat of serious injury

According to *Argentina Footwear*, a panel must consider two elements when reviewing a determination of ‘serious injury’ under Article 4.2(a). First, the competent authorities must have, minimally, considered all relevant factors, including those listed explicitly under Article 4.2(a). Second, a panel must consider the definition of serious injury found in Article 4.1 (a) when reviewing a determination of serious injury (para. 139). Article 4.1 (a) defines serious injury as ‘a significant overall impairment in the position of a domestic industry’.

The AB discussed what is meant by ‘all relevant factors’ in *US Wheat Gluten*. To begin, it pointed out an internal qualification to Article 4.2(a), indicating that competent authorities must only consider factors ‘objective and quantifiable’ which ‘[have] a bearing on the situation of that industry’ (para. 51). Considering this in conjunction with Article 3.1, the AB emphasized that it is the responsibility of the competent authorities, and not the interested parties, to determine what factors are relevant in a given case. This requires that where the competent authorities are uncertain whether a factor is relevant, they must fully investigate it to meet the requirements of Article 4.2(a) (para. 55). *US Lamb* added that the phrase ‘factors of an objective and quantifiable nature’ implies the evaluation of objective data (para. 130). That data must be sufficiently representative to give a ‘true picture’ of domestic industry, but need not include data for all domestic producers who constitute a major proportion of domestic industry (para. 132). In this case, the AB held that the International Trade Commission (ITC) had failed to meet these requirements.

US Lamb also clarified the AB’s position on the definition of ‘serious injury’ in Article 4.1 (a), stating that it indicates a very high standard, ‘much higher’ than the standard of ‘material injury’ used in the Antidumping Agreement, the Agreement on Subsidies and Countervailing Measures, and the GATT (para. 124).

The AB went on to explore the meaning of ‘threat of serious injury’. Under 4.1(b), ‘threat of serious injury’ requires that serious injury is ‘clearly imminent’, in other words it must be factually demonstrated that serious injury to the domestic industry will occur in the very near future (para. 125). A determination cannot be made based on ‘conjecture or remote possibility’ (para. 125; emphasis in original).

Under Article 4.2(a), the AB agreed with the panel finding that the United States did not meet the requirements of the Safeguards Agreement as it had reached its determination based on data that was not sufficiently representative of the domestic industry, noting that the ITC itself had acknowledged the inadequacy of the data (paras 133–4).

Whether or not the Agreement on Safeguards requires under Articles 2.1, 3.1, 4.2(c) and 5.1 that there be a discrete determination of either serious injury or threat of serious injury was addressed in *US Line Pipe*. The panel found that such a discrete determination was necessary, but the AB disagreed. In its report, it indicated that the issue was whether or not there was a right to apply a safeguard in a particular case. The AB found that for a right to exist, there must minimally be a threat of serious injury, which is a concept encompassed in, but not exceeding, ‘serious injury’. Consequently, the phrase ‘cause or

threaten to cause' should be taken to mean 'either one or the other, or both in combination' (paras 170–1).

Case law: like or competitive product

AB reports have addressed some questions surrounding causation and serious injury, but like or competitive product is still an uncertain area. The range of producers that can be protected by a safeguard action are more diverse than those contemplated by an antidumping action, extending to producers of competitive as well as like products. But what kinds of competitive products are eligible for protection remains unsettled.

In *US Lamb*, the AB stated that the identification of those products that are like or directly competitive with the imported product is the first step in determining the scope of the domestic industry (para. 87). The term 'directly competitive' was not at issue in this dispute but there was some discussion of the definition of a 'like product'. In the case at hand, there was no dispute that the like product at issue was 'lamb meat'. However, there was disagreement over which producers qualified as producers of 'lamb meat'. The USITC argued that the domestic industry included the growers and feeders of live lambs as producers of the 'like product' for two reasons: (1) there is a continuous line of production from the raw product, live lambs, to the end product, lamb meat; and (2) there is a 'substantial coincidence of economic interests' between the producers of the raw product and the end product (para. 89). The AB rejected this argument as having no legal basis in the Agreement on Safeguards, deeming the two criteria put forth by the US as irrelevant. In doing so, the AB indicated that the determination is to be based on an examination of the actual products at issue and not the means of processing by which they are produced (para. 94). In *US—Cotton Yarn*, a safeguard action arising out of Article 6.2 of the Agreement on Textiles and Clothing, a similar US argument that the like product determination alone would not justify a safeguard action, unless the like product was also shown to be directly competitive with the imported product, was rejected. The AB held that, 'In permitting a safeguard action, the first consideration is, therefore, whether the domestic industry is producing a like product as compared with the imported product in question. If this is so, there can be no doubt as to the reasonableness of the safeguard action against the imported product' (para. 97).

Unfortunately, the determination of what is a like or directly competitive product in the safeguard context is still an area of uncertainty given the limited case law in which this issue has been raised directly. However, there are a number of provisions in the WTO Agreements that refer to 'like products' and, although each must be interpreted in the particular context of the Agreement it is found in, there may be some guidance to be found in the voluminous case law under these provisions, such as the well-developed definition under Article III:2 of the GATT 1947. In *Japan—Alcoholic Beverages*, the AB noted that

there can be no one precise and absolute definition of what is 'like'. The concept of likeness is a relative one that evokes the image of an accordion. The accordion of 'likeness' stretches and squeezes in different places as different provisions of the WTO Agreement are applied. The width of the accordion in any one of those places must be determined by the particular

provision in which the term 'like' is encountered as well as by the context and the circumstances that prevail in any given case to which that provision may apply.

Application, duration and review of safeguard measures

The GATT obligation that is causing or threatening the injury can be suspended or modified 'to the extent and for such a time as may be necessary to prevent or remedy such injury'. Article 5.1 of the Agreement on Safeguards has a similar requirement. *Korea—Definitive Safeguard Measure on Imports of Certain Dairy Products*³⁸ ('*Korea Dairy*') confirmed that it is an obligation that a safeguard measure, regardless of its form, be applied in a manner commensurate with its aims, i.e. 'preventing or remedying serious injury and...facilitating adjustment' (para. 96). According to *US Line Pipe*, this means that safeguard measures may only be applied to the extent of addressing serious injury attributed to increased imports, and not injury caused by other factors (para. 260).

Some Contracting Parties, particularly the EU, have argued that GATT obligations can be suspended selectively so that the concession is only withdrawn with respect to the particular trading nations who are causing the injury. This argument is inconsistent with the Article XIX interpretation developed during the Havana Charter negotiations,³⁹ and with the GATT's apparent historical insistence on non-discriminatory application of safeguard actions.⁴⁰ The Uruguay Round Agreement on Safeguards resolved the issue of selectivity as follows: under Article 2.2, safeguard measures shall be applied to a product being imported irrespective of its source. In *US Wheat Gluten*, the AB indicated that imports included under Articles 2.1, 2.2 and 4.2 of the Agreement on Safeguards should correspond with one another (this is commonly referred to as 'parallelism') (para. 96). In this particular case, the AB found that it was not permissible for the United States to have included imports from all sources in its investigation of increased imports and their consequent effects, while excluding imports from Canada in the ultimate application of the safeguard, because the USA did not establish explicitly⁴¹ that imports from those sources to which the safeguard was applied, excluding Canada, satisfied Articles 2.1 and 4.2 (para. 98). There was a similar finding in *US Line Pipe*, when the USITC excluded Canada and Mexico from a safeguard measure while basing its investigation on imports from all sources (paras 187–8). Under Article 5.2, where a quota is employed, if agreement among all affected Parties on the allocation of the shares of the quota is not feasible, shares shall be allocated among exporters based on proportions of imports supplied during a previous representative period. This rule may be departed from where: (a) imports from certain Parties have increased disproportionately to the total increase in imports; (b) the reasons for the departure are justified; and (c) the conditions of the departure are equitable to all suppliers. Such a departure may not exceed four years in duration. In the case of developing countries, safeguard measures may not be applied against their exports if in the case of a given country exports do not exceed 3% of all imports of the product in question, provided that developing countries with less than a 3% import share collectively do not account for more than 9% of total imports (Article 9.1).

The safeguard remedy seemed designed for temporary relief, but no precise requirements are specified under Article XIX of the GATT in this respect. One of the

most significant aspects of the Uruguay Round Safeguards Agreement is the introduction of provisions for limited duration and digressivity of relief. The Agreement specifies that no action shall be maintained for longer than four years (Article 7.1). It may be extended for up to an additional four years if there is evidence that the industry is adjusting and the protection is shown still to be necessary to remedy serious injury (Articles 7.2 and 7.3). Any measure of more than a year in duration must be progressively liberalized so that the amount of protection decreases over the duration of the measure (Article 7.4). In addition, there are limits on the application of new restrictions to a product that has already been subject to restraint: effectively, no new measure can be introduced for a period of time equal to that during which the previous measure was in effect (Article 7.5). There is some risk that being aware of the need to progressively remove the restraint, Parties will impose initially tighter restraints than are necessary. The surveillance of the WTO Committee on Safeguards, discussed below, is designed to discourage any such overprotection.

Compensation

Ultimately, the safeguard provision can be invoked without agreement from trading partners, but, according to Article XIX: 3 of the GATT, if the restrained Parties are dissatisfied with the action, they have the right to suspend concessions of substantially equivalent value or other obligations. This aspect of the safeguard regime has been interpreted as establishing a right to compensation. Compensation usually takes the form of other trade concessions by the Party invoking the safeguard relief and requires negotiations between the injured country and all exporting countries. The Uruguay Round Safeguards Agreement retains the obligation to compensate, but if the escape measure lasts less than three years, the right of exporters to suspend concessions of equivalent value is withheld (Article 8), thus reducing their leverage in demanding compensation.

Tumlrir states:

[I]t is destructive of the spirit of reciprocity for a country in an emergency to be obliged to pay for taking *bona fide* temporary action, to negotiate such a payment and to be threatened with retaliation if it does not offer enough.⁴²

In addition to the fact that the compensation requirement forces concessions for *bona fide* emergency actions, the generally low level of tariffs makes it increasingly difficult for countries to compensate with equivalent concessions; few tariffs are high enough for meaningful reductions except for products which are already sensitive to imports.⁴³ Thus, the requirement is often politically difficult to meet and it increases pressure to find alternative escape routes. Rather than negotiate with a number of exporters over the appropriate compensation for all or face retaliation, a country will find it more attractive to conclude a bilateral arrangement. However, supporters of the compensation requirement, like Sykes, insist that it discourages use of the regime in non-emergencies or in circumstances in which the gains are insufficient to justify the real costs.

Grey-area measures

As noted previously, the integrity of the safeguard regime has been undermined by measures taken outside the framework of the GATT, such as ERAs. The obvious solution would be to bring these other measures into the system and then restrict their use or ban them. Some fear that to legalize other trade measures would be to encourage their use.⁴⁴ Some proposals for reform have suggested that the other contingent trade remedies be subject to some of the same criteria for invocation. This harmonization would also imply, for example, that the kind of injury required to sustain antidumping measures would be similar, in order to prevent domestic producer interests from attempting to substitute one form of contingent protection for another.⁴⁵

The Uruguay Round Safeguards Agreement makes substantial progress in constraining ERAs as follows: Article 11 provides that a Contracting Party shall not seek, take or maintain such arrangements nor encourage or support the adoption or maintenance by public and private enterprises of equivalent non-governmental measures. In addition, those currently in existence shall be brought into conformity with the Safeguards Agreement or be phased out within four years of the coming into force of the Agreement, with an exception permitted for one specific measure per Contracting Party subject to review and acceptance by the Safeguards Committee and subject to termination not later than 31 December 1999.

Notification and consultation

Notification and consultation requirements under Article 12 of the Agreement on Safeguards have been the subject of AB interpretation. Article 12.1 requires immediate notification to the Committee on Safeguards upon initiating an investigation, making a finding of serious injury or threat of serious injury, and deciding to extend or apply a safeguard measure. The AB indicated in *US Wheat Gluten* that the urgency and immediacy required by the term 'immediately' in Article 12.1 should be determined on a case-by-case basis, considering such factors as the complexity of the notification and the need for translation into a WTO official language. Ultimately, the Committee on Safeguards and Members should receive the 'fullest possible period', not merely a sufficient period, 'to reflect upon and react to an ongoing safeguard investigation' (paras 105–6).

Korea Dairy addressed Article 12.2, which requires provision to the Committee of 'all pertinent information' when making a finding of serious injury or threat of serious injury, or when applying or extending a safeguard measure. The AB found that the minimum requirement for notification is for the Member to address what is listed under Article 12.2 as 'all pertinent information', in addition to Article 4.2 listed requirements for a safeguard investigation. Any additional information that the Council for Trade in Goods or the Committee on Safeguards requests is meant to relate to information outside these requirements as may be considered necessary. Although 'all pertinent information' is an objective standard, it is not necessary for a Member to provide the same level of detail as will be in the report of competent authorities (paras 108–10).

Article 12.3 provides: A Member proposing to apply or extend a safeguard measure shall provide adequate opportunity for prior consultations with those Members having a substantial interest as exporters.’ The AB indicated in *US Wheat Gluten* that Article 12.3 requires that the exporting Member receive, prior to consultation, the information specified under Article 12.2. There must be sufficiency of time and information to allow for ‘meaningful exchange’. Otherwise, there can be no ‘adequate opportunity’ for consultation under Article 12.3 (paras 136–7). *US Wheat Gluten* and *US Line Pipe* both recognized the explicit connection between Articles 8.1 and 12.3 of the Agreement on Safeguards and indicated that prior consultations under Article 12.3 are a requirement for a Member to have ‘endeavored to maintain’ a substantially equivalent level of concessions as required by Article 8.1 (para. 146).

Surveillance

While the developing countries were prepared to compromise on selectivity, the Tokyo Round negotiations ultimately foundered on the issue of multilateral surveillance. The Uruguay Round Safeguards Agreement now provides for a Safeguards Committee which will monitor the implementation of the Agreement and compliance with its procedural and substantive requirements by Contracting Parties. All decisions to initiate or implement safeguard actions must be notified to the Committee, along with evidence justifying the measures. The Committee will also oversee the phasing out of grey-area measures and report as appropriate to the Contracting Parties through the Council for Trade in Goods on the operation of the Agreements. The general dispute resolution mechanisms of the GATT apply to the new Agreement (Article 13).

US steel safeguards

In 2002, eight complainants—Brazil, China, the EC, Japan, Korea, New Zealand, Norway and Switzerland—requested that panels⁴⁶ be established to address US safeguard measures applied to ten steel products.⁴⁷ Tariffs ranged from 8–30%, but imports from Canada, Mexico, Jordan and Israel were excluded. The panels found the safeguards in violation of the Agreement on Safeguards and GATT 1994 based on four general reasons, but it is important to note that not all of these reasons applied to each product (see paras 11.1–11.4). First, the panel found that the United States violated GATT Article XIX:1 and Article 3.1 of the Agreement on Safeguards by failing to provide a reasoned and adequate explanation demonstrating ‘unforeseen developments’. Second, it found that the United States violated Articles 2.1 and 3.1 of the Agreement on Safeguards by failing to provide a reasoned and adequate explanation of how the facts supported the US ‘increased imports’ determination. Third, it found that the United States violated Articles 2.1, 4.2(b) and 3.1 of the Agreement on Safeguards by failing to show a ‘causal link’ between increased imports and serious injury. Finally, the US safeguards were inconsistent with Articles 2.1 and 4.2 of the Agreement on Safeguards because the US did not meet the ‘parallelism’ requirement (i.e. using the same products under Articles 2.1 and 4.2 of the Agreement on Safeguards).

On appeal, the AB substantially upheld the panel’s findings for all ten products, opening the way for so-called retaliatory tariffs. The EU then indicated that it would

apply tariffs amounting to \$2.2 billion on goods such as citrus fruit, textile products and manufactured goods in order to apply political pressure in 'swing' voting states. In December 2003, President Bush announced the termination of the safeguard measures. The US steel industry had gained \$240 million in profits because of the tariffs' effects on prices, saving an estimated 5,000 jobs, though it is worth noting that employment in the steel industry over the 18-month period during which the tariffs applied declined by 6,000 jobs nonetheless. Significant costs were borne by US steel users—they lost \$600 million in profits and 26,000 jobs have disappeared. The steel safeguards failed because of three basic shortcomings in the ITC's analysis:⁴⁸ the failure to explain how the asserted unforeseen developments *resulted* in increased imports causing or threatening to cause harm, in violation of Article XIX: 1 (a) of the GATT and Article 3.1 of the Agreement on Safeguards; the failure to show that imports had in fact *increased* in such quantities as to cause or threaten to cause serious injury under Articles 2.1 and 3.1 of the Agreement on Safeguards; and the failure to meet the parallelism requirement, that is to explicitly exclude imports from countries against whom the safeguards were not applied, in violation of Articles 2.1 and 4.2 of the Agreement on Safeguards. Most importantly perhaps, the AB clarified the rather contentious issue of what 'reasoned and adequate' standard of review it will apply to the findings of competent domestic authorities. A reasoned and adequate explanation means that the domestic authority must 'give an account of a judgment or statement which is reached in a connected or logical manner or expressed in logical form, distinctly, or in detail'.⁴⁹ It must publish 'a detailed analysis of the case under investigation as well as a demonstration of the relevance of the factors examined'.⁵⁰ The explanation 'must be clear and unambiguous. It must not merely imply or suggest an explanation. It must be straightforward in express terms'.⁵¹

Future reform

In many respects, the Uruguay Round Safeguards Agreement is a substantial improvement over Article XIX of the GATT: in bringing existing grey-area measures within its purview and prohibiting further such measures; in establishing firm time limits; in achieving a compromise on the issue of selectivity; and in improving multilateral notification and surveillance. There are a number of other reforms that should be considered in future. First, some relaxation of the principle of non-discrimination seems justified in order to avoid pointless 'side-swiping' of exporters who are not contributing importantly to the serious injury in question. Here, a *de minimis* provision along the lines of that to be found in NAFTA would seem appropriate. Second, a radical reconceptualization of the injury test also seems appropriate, so that while firms or industries may be able to petition for safeguard relief, the success of such petitions should depend on a showing that imports are causing serious injury to less well-endowed and immobile workers or long-established communities, and that alternate remedies less distortive of trade are not available, in the form of various domestic adjustment assistance policies, to redress such injury. Third, the only forms that safeguard relief should be permitted to take should be either tariffs or auctioned quotas, in part because these two forms of relief render the cost to domestic consumers more transparent, and more importantly, because they generate a source of revenue out of which domestic assistance policies can be financed. Fourth, safeguard relief should be available as a matter of

administrative rather than political decision (like antidumping and countervailing duties), so that incentives to substitute away from the safeguard regime are reduced.

Other escape clauses

Article XIX is not the only provision of the GATT that allows signatories to suspend their obligations. Articles XII and XVIII(b) permit the imposition of import controls to relieve temporary balance of payments pressures and economic development problems of less-developed countries. In addition, Article XXVIII provides for the renegotiation of concessions during specified renewal periods.

Outside of the GATT there is a further safeguard regime worthy of note: Chapter 8 of NAFTA, which slightly adapts Chapter 11 of the Canada-US Free Trade Agreement (FTA).⁵² It differs from the GATT regime in a number of important ways. First, bilateral emergency actions are only permissible within the ten-year transition period.⁵³ Second, these actions have several features distinguishing them from those allowed under the GATT: they must be limited to three years; there is no right to renew; the increase in imports causing the serious injury has to be absolute, so if the imports' share of the market increases due, for example, to a decline in purchases of domestic goods, no action can be taken; the increase in imports must constitute a substantial cause of serious injury; and the only actions permitted under the clause are tariffs, which may be only raised to the lesser of the Most Favoured Nation (MFN) rate applicable when action is taken or the MFN rate applicable at the time NAFTA came into force.⁵⁴ In addition, in order to address the problem of 'side-swiping', the Chapter provides for exemption of Member countries from the impact of actions taken by another Member country under the GATT multilateral safeguard regime unless their imports account for a substantial share of total imports or are contributing importantly to the serious injury. This shall not normally be considered to be the case if a Party is not among the top five suppliers of the good in question. As under Article XIX of the GATT, there are notification and consultation requirements and an obligation to provide compensation or risk retaliation.

In January 1998, a NAFTA panel issued its report on a safeguard action against corn brooms from Mexico⁵⁵ that the United States had applied in response to an industry group petition under the Trade Act of 1974,⁵⁶ Section 202 (para. 8). Article 802 of NAFTA indicates that NAFTA members may impose global safeguard measures pursuant to GATT Article XIX and the WTO Agreement on Safeguards (para. 5). Article 2.1 of the Agreement on Safeguards allows for the imposition of safeguard measures where increased imports of a product 'cause or threaten to cause serious injury to the domestic industry'. Mexico and the United States disagreed on what should be regarded as 'domestic industry' in this case. The United States argued that 'domestic industry' comprised producers of corn brooms alone, while Mexico believed it should include makers of plastic brooms as well. Ultimately, the panel found that the ITC had inadequately explained its 'domestic industry' finding, consequently violating Annex 803.3(12) of NAFTA, which requires 'reasoned conclusions on all issues of law and fact' (paras 71–2).

Theoretical rationales for the safeguard regime

Trade liberalization

In 1970, Kenneth Dam observed that ‘the GATT escape clause is a useful safety valve for protectionist pressures’.⁵⁷ In his view, the clause, in addition to being a prerequisite for essential US participation, encouraged trade liberalization more generally. According to Dam, the GATT escape clause ‘encourages cautious countries to enter into a greater number of tariff bindings than would otherwise be the case’.⁵⁸ Sykes develops this observation into the primary rationale for a safeguard regime.⁵⁹ His thesis is not unlike the traditional argument for the inclusion in the GATT of a safeguard regime: that broader liberalization will be undertaken when there is an opportunity to suspend those obligations. His approach is novel in its use of public choice theory to explain the role of this trade remedy.

Public choice theory predicts that policy-makers will be more concerned about trade impacts on producers than on consumers because the former are both better organized and more politically influential than the latter. According to Sykes, the consequence of the self-interested behaviour of policy-makers is that they may not liberalize trade even if the current environment is favourable to such an action. Their reluctance will result from knowledge that unanticipated changes in economic conditions may create circumstances in which political rewards to an increase in protection (or the political costs of an irrevocable commitment to reduce protection) are great.⁶⁰

The safeguard is therefore essential to any liberalizing scheme. This conclusion depends on two important and challengeable assumptions: that adequate substitutes do not exist for the formal safeguard regime, and that signatories feel bound by their obligations and will generally not wish to abrogate them.⁶¹ In Sykes’s view, the *ex ante* nature of the safeguard regime implies that it is different from bilateral negotiations over ERAs which occur *ex post*. The increased use of grey-area and other contingent measures to avoid obligations, combined with the infrequent use of Article XIX, challenges both these assumptions. By modelling Article XIX, Sykes shows how the criteria for invoking the safeguard serve to maximize political gains from protection. In addition, he argues that requirements such as compensation reduce illicit use of the escape clause. The optimal safeguard regime would constrain protection to cases in which the gains to the importing country are greater than any losses to other countries (typically where the importing country’s domestic industry is declining, entailing job displacement etc., while foreign suppliers may be expanding industries where restraints will merely curtail future growth).

Economic adjustment

Jackson advances an economic adjustment rationale for safeguards:

Imports, particularly recently increasing imports, often cause harm to select groups within an importing society, even though they may in the long term and in the broader aggregate increase the welfare of that

society. Competing firms will be forced to 'adjust' to the imports...a temporary period of time of some relief from imports will allow the domestic competing industry to take the necessary adjustment measures.⁶²

This rationale can be reformulated in different terms: the safeguard remedy provides an opportunity for domestic industries to improve their competitiveness with imports. Hufbauer and Rosen have studied the effectiveness of various programmes for facilitating adjustment of US industries being impacted by import competition. Their study focuses on three trade policies: special trade protection, such as exceptional restraints on imports that go well beyond normal border or tariff restrictions; trade-related adjustment assistance to labour in affected industries; and escape clause relief.⁶³ Hufbauer and Rosen find that among the various policies, the escape clause is the most effective at inducing adjustment. Of the sixteen industries studied, ten received tariff increases, two obtained orderly marketing arrangements, and the other four received quota protection. The adjustment of these firms was relatively successful since twelve no longer required protection.⁶⁴ one of these adjusted by expanding; the rest contracted either to a competitive core or out of the industry. The relative success of escape clause relief results from three factors: the relief is temporary, which gives firms a strong incentive to adjust quickly; labour adjustment programmes in the USA are inadequate and incapable of effectively inducing or easing adjustment; and the escape clause in the USA is administered by the ITC and while the President authorizes the granting of relief, the primary mechanism is not political lobbying as it is for special forms of trade protection.

The adjustment rationale does not, standing alone, support a role for safeguards. Its inadequacy stems from the distinction that it draws between competitive impacts from imports and those from domestic sources. If there are social gains to be realized from facilitating adjustment to economic changes, why should not all firms experiencing competitive pressures from whatever source receive such assistance? The answer is clearly that in competition within domestic industries, there are at least two sets of domestic producer interests, differently affected, whereas foreign firms causing harm to domestic industries do not have any political 'allies'. There are few political losses to be suffered from harming a foreign industry so that there are incentives to provide adjustment assistance to domestic firms suffering from import competition through safeguard relief.

Non-economic rationales

There may be important non-economic rationales for the protection offered by the safeguard regime. Despite the efficiency gains to be achieved through trade liberalization, substantial losses resulting from unconstrained imports may justify protection of domestic interests. Vulnerable domestic interests may include less well-endowed and immobile workers and long-established communities whose viability substantially depends on domestic industries that are facing contraction or collapse due to import competition. Distributive justice and communitarian values would require sensitivity to these vulnerable interests and justify policy initiatives to alleviate adverse impacts.

However, trade protection is a very costly way to vindicate these values. The cost to consumers for each job saved by trade protection typically far outweighs the average

compensation per worker in the industry affected.⁶⁵ To cite some examples, the cost to US consumers of protection of the specialty steel industry was \$1 million per year for each job preserved when the annual compensation was less than \$60,000 for those jobs. US consumers of automobiles paid \$160,000 per year for each job saved through protection when annual compensation in this industry was less than one quarter of this figure.⁶⁶ In Canada, the statistics are similar: consumers of footwear were 'taxed' through trade protection between \$53,668 and \$69,460 per job saved, while compensation per year for a worker in the industry was \$7,145; consumers of textiles and clothing were 'taxed' between \$40,600 and \$50,982 per year for each job saved when average earnings were \$10,000; and consumers of automobiles paid between \$179,000 and \$226,394 per year for each job saved when average compensation in the industry was between \$29,000 and \$35,000.⁶⁷ Given the substantial cost to domestic consumers of trade restrictions, it is likely that other policy instruments can vindicate distributive justice values at lower cost; whether alternative policies can succeed in preserving jobs in particular communities is more questionable.

DOMESTIC ADJUSTMENT ASSISTANCE POLICIES

Each of the major industrialized nations has adopted its own policy approaches to the challenge of economic adjustment, including adjustment to trade liberalization and shifts in comparative advantage. We have reviewed these policies extensively elsewhere.⁶⁸ We confine ourselves to some brief comments on one class of such policies—industrial subsidies—and offer a somewhat more extended set of comments on labour market adjustment policies.

Industrial subsidies

In many industrialized countries, beginning in the early 1970s, sectors like shipbuilding, coal, steel, textiles, clothing and footwear, and in some cases automobiles, experienced substantial competitive pressures from imports. Apart from trade restrictions, countries under import pressure often had resort to various kinds of industrial subsidies. In general, these subsidy policies have not been effective in avoiding the ultimate need for adjustment or moderating its severity. Pure output-related subsidies have been the least effective in this respect in that they flatly deny the need for adjustment and, while they maintain output and employment in an industry, this typically can only be sustained if the subsidies are endless and often increasing. Other forms of industrial subsidies have been designed to facilitate the modernization of obsolete capital. Here it is argued that state assistance to facilitate capital modernization may be necessary to make a distressed industry internationally competitive again. However, obsolete plants are often the result, and not the cause, of the loss of international competitiveness. Firms which are only able to cover variable costs are constrained to allow their fixed assets to run down and with them their long-term capacity. If an adequate return could be made on new fixed assets, presumably private capital markets would provide the funds required to make the investment. A governmental judgment that such an investment will yield long-run

competitiveness and profitability will typically be at variance with these private capital market judgments and should, for this reason, be viewed with extreme scepticism.

Much less frequently, industrial subsidies have been provided to ease exit costs. Japan has most prominently invoked industrial subsidies for this purpose in industries like coal mining and steel. It is argued in this context that if there is some degree of indivisibility in plant or firm size so that efficient industry adjustment to a decline in demand requires that firms exit in some orderly temporal sequence, market forces may not produce this sequence. A case may thus arise, so it is argued, for a governmental role in managing adjustment to the contraction in demand, perhaps through recession cartels, active promotion of mergers, or compensation for scrapping physical capacity. While Japanese policies seem to have registered some successes in this context, there are reasons for caution in assigning a proactive role to government in facilitating firm exit. First, this view assumes that governments can economize on transaction costs in this context in ways not open to private firms, through mergers, specialization agreements and other means. Also, there are clear dangers of bureaucratic involvement in detailed industrial restructuring in terms of relative institutional competence, and also dangers of fostering anti-competitive forms of collusion in seeking agreement on future industry structure.

More generally, the normative case for subsidies to firms in import-impacted sectors is weak. Firms may be able to diversify away the risk of increased import competition through their investment strategies. More importantly, shareholders in these firms can diversify away this risk through portfolio diversification. This risk is no more serious or unforeseeable than many of the risks which firms and shareholders routinely assume, e.g. technological change, shifts in consumer demand, which they are prepared to bear for an appropriate risk-adjusted return.

Labour market adjustment policies

The case for active labour market adjustment policies is substantially more compelling. Under conditions of close to full employment, there would be little reason to be concerned about the dislocation effects of trade liberalization. The market, in effect, would soon reabsorb the dislocated workers, although even here, from a number of ethical perspectives, it might be appropriate for governments to bear some of the transition costs faced by these workers.

If, more realistically, we assume that re-employment is likely to be far from automatic, then the question arises as to what measures are required to facilitate it. The concept of adjustment is complex. At one level, the adjustment problem may be understood as the time lag between a worker being displaced from one job and finding another that is an adequate replacement. From this perspective, provision of temporary income support and search, counselling, and relocation assistance would seem obvious and appropriate to address the problem.

However, the fact that employment is being created primarily in sectors other than those where jobs are being lost raises serious questions about the adequacy of the unemployment insurance model. It may be necessary to go far beyond this model, and provide training and retraining of workers for new types of employment within the economy. This is well expressed in the Canadian De Grandpré Report, which contrasts

the trampoline approach (which emphasizes training and retraining) with the unemployment insurance model (the 'safety net' approach).⁶⁹ The report suggests:

The 'trampoline' approach seeks to prepare Canadian workers to prosper in a world of increasing technological change and international competition, in which Canada must use its access to the larger North American market to achieve greater economies of scale and higher productivity.⁷⁰

In terms of economic efficiency (i.e. allocative efficiency), it may seem unclear why either income support or a trampoline ought to be provided by the state to trade-dislocated workers. Kaplow, for example, has argued that from an efficiency perspective, compensation for regulatory change (of which trade liberalization is one example) makes no sense absent convincing proof that markets are incapable of allocating the risks of such changes.⁷¹

In fact, however, there are certain inherent limits to the efficient private *ex ante* allocation of the risk of job loss from trade liberalization. It is very difficult to make sound *ex ante* predictions as to the nature and extent of these risks.⁷² As a consequence, although worker self-insurance through personal savings undoubtedly exists, such savings are very likely to be too high or too low, given lack of good information about risk. With respect to private insurance, one simply does not observe such markets. Their absence cannot be explained by the presence of basic public unemployment insurance in most industrial democracies, since it is unclear why a market for supplemental benefits would not exist. After all, public insurance benefits cover only a portion of income loss and in some countries only for relatively short periods of time. An additional explanation for the absence of such private insurance would be the arguably quite severe adverse selection and moral hazard problems involved. Only those facing higher risks of job dislocation would seek insurance, hence rendering the insurance very costly or even unavailable. Moreover, full insurance of the risk of dislocation due to trade liberalization would very likely lead some workers and firms to take greater risks, or to under-invest in precautions against the risks in question (e.g. skill diversification). It should be emphasized that these possible market failures do not suggest that government will be any better at *ex ante* allocation of risks of job loss from trade. However, the absence of viable private insurance markets may argue for government intervention based upon the desirability of the existence of insurance that would otherwise not be provided, a desirability to be established on independent normative grounds.

A further possibility would be contractual allocation of risk between employer and employee through bargaining of notice periods in the event of dislocation. While such notice periods are the subject of contractual bargaining in some subset of cases, there is empirical evidence that the existence and nature of such provisions are very poorly correlated to the actual risk of dislocation in the industry and region in question.⁷³ This suggests that serious information failures may plague *ex ante* allocation of these risks through contractual bargaining between employer and employee.⁷⁴ In addition, it is often very difficult for workers to address the risk of dislocation through *ex ante* diversification of their skills. Indeed, powerful incentives exist for workers increasingly to specialize in

firm-specific knowledge and skills, as it is these investments that usually have larger pay-offs in promotions and bonuses.

Naturally, firms themselves are likely to invest most heavily in those training programmes that involve highly firm-specific skills. They have little incentive to train workers to be able to move to other sectors or firms, and indeed, arguably, a disincentive, since the longer a worker stays with a particular firm, the greater will be that firm's return on the investment in that worker. Of course, if the firm is a conglomerate encompassing a wide range of economic activities (i.e. highly diversified in its operations), it may have an incentive to provide training that is not narrowly job-specific, with a view to workers moving between diverse activities within the firm. Yet, even in this case, it is far from clear that in the absence of a long-term employment contract or implicit contract (such as company loyalty in Japan), workers would not take the newly acquired skills and apply them elsewhere.

A somewhat different economic efficiency rationale for adjustment policies stems from the very real danger that, absent appropriate government intervention, trade-induced worker dislocation may result in an erosion of human capital. Workers who lose their jobs due to freer trade, or other structural changes, may out of desperation, and in the absence of retraining assistance, seek employment at lower wage levels, and in occupations of lower skill and labour productivity. Empirical evidence suggests that a significant percentage of dislocated workers end up in lower-wage, lower-skill occupations, and, in fact, never regain the earnings levels of their previous employment.⁷⁵ Worse still, a protracted period of unemployment—especially when uncushioned by adequate income support—may also entail physical and mental illness, family break-up, alcoholism, and drug use, which, in addition to creating added costs for various social safety nets, are almost certain to reduce the productive capacity of workers and reduce the chances that they will return to the workplace, leading instead to dependence on the social welfare system. All of these factors are likely to be aggravated by the problem of 'sour grapes'⁷⁶ or adaptive preferences: the longer workers are unemployed or underemployed in an occupation, the less likely they will be to *believe* in their own inherent capabilities, and hence actively to seek better opportunities.⁷⁷ In sum, the *human* effects of dislocation on workers and their families may well lead to long-term suboptimal deployment of workers' capacities, absent positive adjustment measures.

Many of the most important, and most controversial, arguments about the justification for trade-linked adjustment assistance measures centre around the notion that it is desirable to compensate the losers from freer trade. In economic theory, the notion of Kaldor-Hicks efficiency, applied to the analysis of policy change, suggests the desirability of a given policy change where the benefits to the winners from this change outweigh the losses to the losers. However, unless one adopts a very crude or extreme utilitarian position, the complete sacrifice of particular groups in society for the sake of the common good is ethically problematic.

There are important political and social reasons for attempting to spread across society the costs of adopting particular measures to improve the general welfare. The attitudes of particular groups towards the political process, and their sense of citizen solidarity with the community as a whole, may be adversely affected by having to pay the largest part of the price for a given improvement. The common good itself may be lost sight of as acrimonious debates about who wins and loses increasingly dominate the political

process. This range of concerns has been evoked by Michelman in his discussion of demoralization and disaffection costs,⁷⁸ and is well expressed by Calabresi:

A decision which recognizes the values on the losing side as real and significant tends to keep us from becoming callous with respect to the moralisms and beliefs that lose out...it tells the loser that, though they lost, they and their values do carry weight and are recognized in our society, even when they don't win out.⁷⁹

Comparative experience with labour market policies in various industrialized countries yields a very mixed record. Countries like the UK, France, Canada, the USA and Australia have tended to favour a safety-net approach, rather than proactive labour market policies. In contrast, Sweden, Japan and, to a lesser extent, Germany tend to favour more proactive labour market policies that provide generous assistance to workers for training, retraining and relocation. The empirical evidence generally suggests the superiority of the latter class of policies in terms of facilitating adjustment, although designing effective job training and retraining programmes, particularly for unemployed youths and older workers, has proven a demanding challenge for governments and empirical evidence on their efficacy is quite mixed.⁸⁰

Another controversial issue relates to whether special labour market policies should be adopted in trade-impacted sectors. For example, the US Trade Expansion Act of 1962 and the 1974 Trade Act both sought to provide adjustment assistance to workers dislocated by import competition. The 1962 Act, with its very strict eligibility criteria (to be eligible for assistance it was necessary to demonstrate that imports were a more important factor than all others combined in causing injury and that tariff concessions and injury must have occurred simultaneously), was largely unsuccessful as an instrument of assistance. From 1962 to 1974, only 54,000 workers were certified for assistance involving total expenditures of US\$85 million.⁸¹ Adjustment assistance grew substantially under the 1974 Trade Act, under which the level of benefits was increased and the eligibility criteria were greatly relaxed. Between 1977 and 1981, 1.2 million workers received benefits. Spending on trade adjustment assistance in 1981 reached US\$1.5 billion, although subsequently the programme budget was severely cut.⁸² However, for the most part, assistance under the Trade Act turned out to be an instrument of compensation for temporarily laid-off workers rather than an instrument to promote adjustment out of declining industries.⁸³

These are not arguments against trade-related adjustment assistance programmes *as such*—rather, they suggest that policies should be designed to ensure that priority is placed on job losses that are likely to be permanent, and that eligibility criteria are not tilted in favour of sectors that are represented by powerful lobby groups.

A second but related argument against linking adjustment assistance with trade liberalization is that singling out trade-displaced workers from other displaced workers is morally arbitrary and unfair. This kind of argument assumes that *only* trade-displaced workers are being offered assistance beyond that provided by the general social safety net (including unemployment insurance). However, when a variety of programmes exist that are targeted at specific groups of workers, and with a range of eligibility requirements, it

is much less clear that providing a programme for trade-displaced workers is giving them an unfair advantage.

The logic of targeting or disaggregating adjustment assistance is that workers displaced for different reasons have different needs. Workers displaced by trade liberalization, for example, may be more likely to require retraining than those who lose their jobs due to cyclical downturns or the bankruptcy of a particular firm, since trade-induced dislocation may reflect a need to restructure an entire industry or sector in response to enhanced import competition. As Peter Morici suggests, in the wake of NAFTA:

In the United States and Canada, jobs in low- and medium-technology activities must make way for jobs in high-technology activities. Generally this will entail the loss of low-skill/wage jobs in industries such as consumer electronics and the gain of high-skill/wage jobs in industries such as advanced telecommunications equipment.⁸⁴

It might reasonably be argued that a *worker's* right to adjustment assistance in the case of trade-induced displacement would, on both efficiency and ethical grounds, be a superior alternative to the right to safeguard relief presently accorded to *firms* under import pressure.⁸⁵ One of us has suggested that such a right to worker adjustment should be entrenched in a parallel accord to NAFTA.⁸⁶ The right could be satisfied by governments providing domestic adjustment assistance programmes that are generally available to all displaced workers (unemployment insurance, retraining and reskilling benefits, job counselling, etc.), or alternatively, by programmes more directly targeted at workers displaced by trade. Where workers believed that domestic policies of their own countries did not satisfy the right to adjustment, they (or their representatives) would, on this scheme, be able to petition a Trilateral Committee of Experts, which would examine and rule on the adequacy of the adjustment programmes in the country concerned. Ideally, once a right to adjustment was in place, a country would be permitted to invoke traditional safeguards only if it could show that domestic adjustment policies that satisfied the right to adjustment were nevertheless insufficient to cope with the nature or scale of the social and economic disruption caused by import surges.

Unfortunately, from a political perspective, incentives on the part of both demanders and suppliers of public policies tend in the direction of a complete inversion of the policy prescriptions implied by the analysis in this chapter. That is to say, in the face of trade-related adjustment pressures, politicians will face strong pressures to maintain or increase trade restrictions, in part because these entail off-budget expenditures and in part because they simultaneously buy off investor, worker and other dependent interests. As a second-best policy, industrial subsidies will be favoured because while they involve, to a greater or lesser extent, on-budget expenditures, they are responsive to demands not only by workers but also by investors and other affected interests. As a distinctly third-best policy option, labour market adjustment policies may be favoured, but even then with a bias towards stay-oriented labour policies rather than exit-oriented labour policies. Most labour market policies involve on-budget expenditures and are responsive only to the demands of workers and not to those of investors and other affected interests; and stay-oriented (safety-net) labour policies avoid an acknowledgement by government that the

sector cannot or will not be preserved in its present form or on its current scale. The new constraints embodied in the WTO Safeguards Agreement discussed earlier in this chapter may help tilt domestic political forces more strongly in the direction of proactive labour market adjustment policies, enhancing simultaneously domestic and global economic welfare.

The interrelationship between trade and labour policies extends, however, far beyond the context of domestic adjustment assistance. Many critics of free trade have argued that it is unfair that producers and their workers in the developed industrial world should have to compete with imports from countries with very low wage rates and weak labour standards. This is a sufficiently important and contentious issue for us to take up in a separate chapter.

CONCLUSION

The WTO Safeguards Agreement, if supplemented with further reforms to the regime along the lines discussed earlier in this chapter, and adequate domestic labour market adjustment policies, should adequately address the adjustment costs associated with trade liberalization or shifting patterns of comparative advantage. In particular, the normative case for retaining broadly cast domestic antidumping and countervailing duty regimes, either to address the impact of growth of imports on domestic industries or to address claims of 'unfair trade', will have been substantially negated. Empirical evidence tends to suggest that rising levels of income inequality (particularly with respect to unskilled workers) in North America and high levels of unemployment in many European countries, while properly a matter of concern, are only attributable to a small extent to increased trade and are mainly attributable to other factors such as technological change.⁸⁷ Seeking trade-related responses to these problems is likely to aggravate rather than ameliorate them.

11

Trade in agriculture

INTRODUCTION

Over the last three decades, trade in agriculture has become one of the most prominent and acrimonious issues on the world trade agenda. Progress to some of these controversies, particularly those surrounding agricultural export subsidies and related domestic measures (such as price supports and production quotas), was crucial to the successful conclusion of the Uruguay Round of GATT negotiations and is equally crucial to the current Doha Round of multilateral negotiations. Protectionism has been pervasive in the agricultural sector in Canada, the United States, the EU and Japan. Prior to the Uruguay Round Final Act, the GATT itself placed fewer strictures on agricultural protection than was the case with most other sectors. Moreover, a number of the major exporting states had come close to ignoring GATT requirements altogether, even to the point of refusing to implement GATT panel decisions. The OECD has estimated that its Members' support for agriculture was about US\$311 billion in 2001.¹ Elimination of export and domestic subsidies in this sector would result in a net annual economic gain of US\$50 billion to OECD countries and US\$12 billion to developing countries.²

Despite the economic welfare case for liberalizing trade in agriculture, a number of rationales are still often invoked for treating the agricultural sector as a special case. These rationales include: exceptional price and income instability; the importance to national security of agricultural self-sufficiency; and the cultural and social value of preserving rural lifestyles. At the same time, liberalization—while leading to eventual substantial net gains in welfare, both global and domestic—poses significant adjustment and transitional equity issues.

In this chapter, we will consider the pre-Uruguay Round treatment of agriculture in trade law and practice; the extent to which it is justifiable to treat agriculture as a special case; the liberalization achievements of the Uruguay Round Final Act, with particular attention to managing the challenge of adjustment; and the prospects for the current Doha Round negotiations.

The issue of health and safety standards in agricultural trade, including the Uruguay Round Sanitary and Phytosanitary Agreement, is considered in Chapter 7.

TRADE IN AGRICULTURE AND THE PRE-URUGUAY ROUND GATT³

Historical origins of special treatment for agriculture

The special treatment of agriculture in the General Agreement was largely, if not exclusively, a reflection of the power and influence of the United States at the end of the Second World War. The negotiators of the GATT did not, generally speaking, see any need for a special regime for agriculture. Import quotas and export subsidies were, however, an integral feature of the American supply management system for agricultural products that existed at the time, and as Dam suggests, ‘no treaty that impinged upon the U.S. Farm program could receive the constitutionally required senatorial approval’.⁴ As will be discussed in detail below, the special treatment of agriculture contained in the General Agreement has led to a large number of disputes over the interpretation of the GATT. Moreover, in this area—more so than in any other—Members found it impossible to live with GATT panel decisions limiting their capacity to engage in agricultural protection. Thus, for the United States, the special treatment it won under the General Agreement for import restrictions linked to domestic supply management proved insufficient, leading the US Administration to seek a waiver of Article XI GATT obligations as early as 1955, with respect to a variety of agricultural products, including sugar, peanuts and dairy products.⁵ Similarly, the European Union has either blocked the adoption of, or refused to implement, panel decisions that threaten elements of its Common Agricultural Policy.

Quantitative restrictions

Article XI of the GATT prohibits quantitative restrictions on trade, subject to certain exceptions. Several of the exceptions are of particular relevance to trade in agriculture. First of all, Article XI: 2(a) permits export ‘prohibitions or restrictions’ of a temporary nature in order to address critical food shortages in the exporting country. Second, XI:2(b) permits ‘import and export restrictions’⁶ necessary to the application of standards or regulations for the classification, grading or marketing of commodities in international trade. Third, and most importantly, XI:2(c) permits import restrictions on ‘any agricultural or fisheries product’ where necessary to enforce domestic restrictions on the marketing or production of a similar product or product substitute. Import restrictions are also permitted where necessary to remove a temporary surplus of a domestic like product or product substitute. Note the addition of Annex I in the Uruguay Round which amends paragraph 2 and defines the phrase ‘in any form’ in paragraph 2(c) and the term ‘special factors’ in paragraph 2, the last sub-paragraph. Article XIII sets out detailed rules on the use of quantitative restrictions in cases where one or more of these exceptions apply.

In theory, at least, an important constraint on the protectionist impact of these exceptions to the ban on quantitative restrictions is that the import restrictions in question must be accompanied by like domestic measures. Foreigners cannot be singled out or targeted—hence, import restrictions must not reduce the total value of imports

proportionate to domestic production below that 'which might reasonably be expected to rule between the two in the absence of restrictions' (Article XI:2). If this condition were applied rigorously, it would mean that domestic price supports could be operated in a manner consistent with comparative advantage. If, for example, a Member placed a quota of 10 million chickens a year on domestic marketing of poultry, and chickens from another Member would have had a 60% market share under *unrestricted market* conditions, then the other Member would be entitled to a market share of 6 million chickens.

This, of course, involves a difficult counterfactual exercise—i.e. determining comparative advantage in agriculture absent the price distortions created by domestic price support policies in the import-restricting country. Nevertheless, in theory, it should make quantitative restrictions a rather unattractive instrument of agricultural protection, since foreigners end up with a market share equal to that which would exist in the absence of protection.

Perhaps for this very reason this condition on the use of quantitative restrictions was never effectively enforced. An attempt in the 1950s to enforce the even more general condition that import restrictions be 'necessary' to enforce domestic marketing and production limits resulted in a threat from the United States that it would leave the GATT. A GATT working party found that US import restrictions on dairy products were not accompanied by domestic restrictions on the production of the raw material for the products (milk), and retaliation was authorized under Article XXIII when the United States failed to remove the restrictions in question.⁷ In the face of the threat of US withdrawal from GATT, the United States was granted a non-time-limited waiver from the strictures of Article XI with respect to agricultural products. This exemption for the United States may well have had the effect of dampening efforts to enforce Article XI strictly against other Contracting Parties—given that the United States was granted a waiver, it might have been difficult, on principled grounds, to have refused one to others.

Nevertheless, in several later panel decisions, a stricter view of the provisions of Article XI was taken. For instance, in ruling on an American complaint concerning Japanese quantitative restrictions on a wide variety of agricultural product groups, a GATT panel held that Article XI:2(c)(i) should be construed narrowly, and, in particular, that there was a burden of proof on the import-restricting state to show that it had granted to foreign producers the market share that would exist if there were no restrictions.⁸ The panel decision did not, however, establish a methodology or detailed guidelines for making such a determination—the panel merely held that Japan had not attempted to discharge the burden of proof. In another case, which concerned import restrictions imposed by the European Union in the face of a surplus of apples, a panel held that the exemption in Article XI:2(c)(ii) did not apply, because the surplus was not temporary, but rather a chronic side-effect of the Union's own agricultural price support policies.⁹ In a case that concerned Canadian quantitative restrictions on imports of yoghurt and ice cream from the United States, Canada argued before the panel that these restrictions were 'necessary' to render effective domestic production restrictions on milk, in the sense that the higher cost of milk generated by these restrictions made secondary products manufactured with the higher-cost Canadian milk vulnerable to imports. Therefore, Canada claimed, the requirements of Article XI:2(c)(i) had been met. The panel took a narrow view of the word 'necessary', finding that it did not include import restrictions

aimed at neutralizing the competitive disadvantage to other domestic industries of higher domestic prices for agricultural inputs. In effect, without the restrictions, Canada would still be able to enforce domestic restrictions on milk production and hence keep the price of milk high—albeit at some cost to Canadian yoghurt and ice cream makers. This ruling is arguably quite important, since it prevents Article XI:2(c)(i) from being used by Contracting Parties to shift the costs of their agricultural protectionism from their own agrifood industries on to foreign competitors in these industries.

Export subsidies

Article XVI of the General Agreement prohibits export subsidies, subject to an exception for 'primary products'. These are permitted, with the proviso that 'they shall not be applied in a manner which results in that Contracting Party having more than an equitable share of world export trade in that product'. In defining what constitutes an equitable share, 'shares of the contracting parties in such trade in the product in a previous representative period' are to be taken into account. This suggests that the essential issue is whether the export subsidy has caused an increase in market share over that which prevailed in the period before the subsidy was introduced. A 'primary product' is defined in an Interpretive Note to Article XVI as 'any product of farm, forest, or fishery at an early stage of processing'.

These provisions were incorporated into the Tokyo Round Subsidies Code (Article 10), with minor variations. In particular, the expression 'more than an equitable share of world trade' was defined to apply to those cases where 'the effect of an export subsidy granted by a signatory is to displace the exports of another signatory bearing in mind the developments on world markets' (Article 10(2)(a)). As well, the 'previous representative period' would normally be 'the three most recent calendar years in which normal market conditions existed' (Article 10(2)(c)).

Even with these criteria, it proved very difficult to interpret the concept of 'an equitable share of world trade'. In a 1958 case that concerned French subsidies on the export of wheat flour, the panel ruled that the subsidies did not comply with the GATT because France had attained more than an equitable share of the world market. Three considerations formed the basis of this finding: (1) France's exports of flour to the market in question (Southeast Asia) had increased over a previous period; (2) the complainant's (Australia's) exports to the same market declined; and (3) the subsidy was found to be a 'substantial cause' of the displacement.¹⁰ In a later case,¹¹ however, a panel found that European Union subsidies on wheat flour were permissible under Article XVI, even though the Union's share of the world market had increased from 29% to 75% between 1962 and 1981, while the complainant (the United States) had seen its share over a comparable period decline from 25% to 9%. The panel noted the difficulty in determining whether, in fact, changes in market share could be attributable to a particular export subsidy, as opposed to other factors. It seemed to be suggesting that specific evidence of price undercutting in the market in question would be required to establish that export subsidies were unambiguously resulting in displacement—shifts in market share alone were insufficient, however dramatic.

The United States objected strongly to this approach, and vetoed adoption of the panel report. However, the report is defensible on at least two grounds: (1) as Jackson notes, the

United States itself was selling its own wheat in the same market on non-commercial terms, through a food aid programme,¹² and therefore neither country's market share could be considered over the period in question to have been based on undistorted market conditions; and (2) although dramatic increases in market share had occurred, this had taken place over a period of twenty years, whereas the text of the Subsidies Code itself suggested that market share changes should be considered in terms of changes occurring within a three-year representative period. More generally, by the time of this dispute, world trade in agriculture had become so distorted by the domestic and export policies of the main producers that the panel's difficulty in finding a clear benchmark against which the distorting effect of one particular subsidy could be measured was entirely understandable.

In the *Pasta* case, the United States argued that subsidies paid by the European Community to exporters of pasta violated Article 9 of the Tokyo Round Subsidies Code, which prohibited export subsidies on 'non-primary' products.¹³ The EU responded that the subsidy should be viewed as a subsidy on primary product inputs into pasta production, in particular European durum wheat. The effect of the subsidy, according to the EU, was simply to compensate EU pasta exporters for the higher than world prices of EU flour, thereby allowing them to be competitive on world markets despite purchasing wheat at higher prices than foreign competitors. This argument was rejected by a majority of the panel, which read Article 9 literally to include all subsidies *paid* to exporters of non-primary products, without regard to whether the intended or actual effect was to subsidize indirectly a primary product. One of the four panellists, however, wrote a dissenting opinion, taking the view that in negotiating the Tokyo Round Subsidies Code, governments had generally understood or assumed that subsidies on primary components of non-primary products would not be prohibited by Article 9.

The EU blocked adoption of the majority ruling by the Subsidies Committee and eventually reached a negotiated settlement with the United States of the dispute in question. But the ultimate consequence was continued uncertainty about the legality under GATT of one of the most pervasive and controversial features of the European Union's Common Agricultural Policy—export subsidies on products that use EU agricultural inputs.

Domestic subsidies and related domestic support measures

One GATT ruling narrowed the scope for granting *domestic* subsidies to users of a product rather than its producers. As discussed in Chapter 9, domestic subsidies were not prohibited by the GATT, although, in accordance with the rules set out in the Subsidies Agreement, they might be countervailable. However, in the *Oilseeds*¹⁴ case, a GATT panel found that a subsidy paid to European Union users of oilseeds violated Article III, the National Treatment principle of the GATT. Here, the panel took a quite literal approach to the wording of Article III, which only exempts subsidies from the National Treatment obligation if they are paid 'exclusively' to domestic producers of the subsidized product (Article III:8(b)). The EU revised the form of assistance so that it appeared to comply with the requirements of Article III. However, a subsequent panel found that this new form of assistance still constituted non-violation nullification or impairment of a benefit that the United States could reasonably have expected from

previous GATT concessions. Here, the United States was able to point to an early GATT tariff binding on oilseeds by the EU, which gave it reason to expect at least some level of access to the EU market.¹⁵ Bilateral negotiations between the EU and the USA concerning implementation of the panel's ruling were initially unsuccessful; the dispute was finally resolved within the framework of a broader US/EU agreement on negotiating positions in the Uruguay Round (the Blair House Agreement, discussed in a later section of this chapter).

THE CANADA-US FREE TRADE AGREEMENT (FTA) AND THE NORTH AMERICAN FREE TRADE AGREEMENT (NAFTA)

Chapter 7 of the FTA deals with trade in agriculture. The main impact on agricultural trade is the phased-in reduction and eventual elimination of tariffs on many agricultural commodities. However, because the FTA contains few strictures with respect to domestic support measures, its overall liberalizing effect is quite modest. Article 701 does, however, prohibit export subsidies on agricultural goods moving from one FTA partner to the other. It should be noted that this does not prohibit the use of export subsidies when Canada and the USA are competing against each other in third-country markets. Instead, there is a weak obligation to take into account the harmful effects of such subsidies of exports to third countries on the other FTA partner (Article 701.4).

As well, although the FTA does not contain a general prohibition on non-tariff border measures, such as quotas imposed to implement supply management schemes, the United States was able to obtain from Canada minimum market access commitments under some of these schemes. For instance, with respect to chicken and chicken products, the United States is entitled to an import quota no less than 7.5% of the previous year's domestic production of chickens in Canada (Article 706). In addition, the Parties agree to work towards harmonizing technical standards, and a number of technical working groups were established for this purpose (Article 708).

In the case of NAFTA, there is, generally speaking, little substantial progress over the FTA with respect to trilateral trade liberalization, due largely to Canadian intransigence with respect to supply management schemes (which, of course, will now have to be modified in light of the Agreement on Agriculture in the Uruguay Round Final Act).¹⁶ However, the NAFTA contains much more promising provisions with respect to US—Mexico agricultural trade, including a waiver of GATT rights with respect to the imposition of quantitative restrictions connected to domestic supply management (Article XI:2(c) of the GATT). There is a complicated scheme for tariff reductions, with tariffs on some commodities to be eliminated between all three countries immediately, whereas tariffs on other commodities are to be phased out in either a five-, ten- or fifteen-year period, again depending upon the commitments each country has made with respect to that particular commodity. Canada insisted on excluding poultry, milk and eggs from these commitments. However, in some other areas, Canada has agreed to lift quantitative restrictions on imports from Mexico, including cereals, meats and margarine (with respect to the United States, US rights of market access where Canada maintains quantitative restrictions remain governed by the provisions of the FTA which have been

substantially incorporated into the NAFTA). The NAFTA provisions on technical barriers to trade are very similar to those agreed to in the Uruguay Round Final Act.

An economic model of the effects of liberalization commitments in NAFTA with respect to agricultural products predicts that, when NAFTA is fully implemented, agricultural trade between the USA and Mexico will be 15% greater than it was in the 1988 base year.¹⁷ US exports to Mexico are predicted to increase more rapidly than Mexican exports to the USA, in part because Mexico's pre-NAFTA level of border protection on these commodities was substantially higher than that of the USA.¹⁸ A major shortcoming of this kind of model is, of course, the difficulty of predicting other factors such as exchange rate movements, changes in agricultural demand and supply in other countries, etc. that may affect the impact of the NAFTA. Significantly, Canada was not treated in the model as a NAFTA partner, because the impact of NAFTA on its agricultural trade was assumed to be minimal.

RATIONALES FOR DIFFERENTIAL TREATMENT OF THE AGRICULTURAL SECTOR: A CRITICAL OVERVIEW

Although much agricultural protectionism can be attributed to the influence of powerful farm lobbies in North America, Europe and Japan, there are a number of long-standing rationales for the justification of protection that are specific to this sector.

Self-sufficiency/national security

In the most literal sense, a nation's survival can be said to depend upon access to food. Famines have appeared periodically throughout history, and continue to do so in much of the developing world, whether caused by war, pestilence or drought. In times of shortage, access to food from foreign imports may well dry up, as countries impose export restrictions to ensure that their own populace gets fed first. As we noted above, this kind of export control is in fact explicitly authorized by the GATT. Under these circumstances, it is not surprising that self-sufficiency is often cited as a rationale for agricultural protection, or more precisely, as a rationale for measures that maintain agricultural production in a country where it would be more efficient for most of its needs to be met from imports. A variant on the self-sufficiency argument is the purported advantage of not having to rely on foreigners who may be one's enemies in war (or potential enemies) for the supply of food.

Exceptional price instability

Agricultural commodities are subject to price fluctuations often considerably greater than those experienced by many other goods that are traded, in significant part because supply is so susceptible to unpredictable factors such as weather. As a consequence, farmers' incomes are highly volatile. On the other hand, their costs (debt service on land, equipment, etc.) are likely to be fixed to a significant extent. In the end, it is argued, unless supply is restricted, or prices stabilized by other means, a single bad year may well result in many farmers being put out of business altogether, although in some sense they

nevertheless have an ongoing comparative advantage in producing food. Much of the agricultural industry in developed countries is now constituted by large commercial producers, and products such as beef, pork, lamb, milk, butter, eggs and poultry are not subject to the same price fluctuations as crops (although the latter are often an input into the production of the former). However, the image of the family losing its farm, and therewith a lifetime of work together, remains a powerful and poignant image in popular culture.

Preservation of the rural way of life/environment

Over the last few decades, agricultural productivity has increased enormously in most developed countries. Therefore, even if a certain level of domestic food production could be seen as necessary for self-sufficiency reasons, or even if price stabilization could be justified as a means of making farm incomes less volatile, nevertheless there would still be a long-run shift of both land and people away from agricultural production—one can simply meet existing demand with less land and fewer people. Hence, in recent years an oftenheard argument for agricultural protection has been that keeping land and people in farming is a social good in itself. With respect to land, the implicit assumption is that, but for agricultural usages, the countryside would be much more heavily burdened with ugly, polluting industries, or simply replaced by industrial or commercial towns. A closely related argument is that agriculture sustains rural *communities*, which would either disappear or lose their distinctive character if economic activity in the countryside were shifted away from agricultural production.

Wilson and Finkle suggest, writing primarily of the Canadian context:

Farmers enjoy an undercurrent of sympathy among urban voters which confers political power on them quite out of proportion to their numbers...most urbanites are attracted to the idealized image of the countryside: the hard working farm family, the noble virtues and traditional values which they imagine motivate their rustic compatriots. It is not a lifestyle most urbanites would care to live themselves but they are glad someone is doing it and they are willing to pay a bit to see it maintained.¹⁹

As well, Europeans in particular are fond of arguing that their countryside is a natural and cultural treasure that would be fundamentally threatened if land were taken out of agricultural production.

None of these three main kinds of rationales is entirely bogus, although assumptions that the agricultural industry is largely composed of needy farm families or that modern farming operations are more aesthetically or environmentally friendly than other kinds of contemporary economic activity deserve critical scrutiny. The more fundamental issue is whether any of these goals really necessitates measures that radically distort world trade and cost non-farm households more than a \$1,000 per year both in higher food prices and in taxes that pay for farm subsidies. For example, with respect to the price instability of agricultural products, the real issue is the stability of farmers' incomes. Farmers' incomes could be stabilized directly, through income-averaging techniques or income insurance,

rather than distorting domestic prices and limiting foreign competition in order to maintain artificially high domestic prices. With respect to rural lifestyle values, careful regional development plans seem a more finely tuned instrument than agricultural protection to ensure balanced economic activity in the countryside. As we shall argue below, much of the potential for reforming agricultural trade comes from this potential for the ‘decoupling’ of policy goals such as income stabilization from trade-distortive policies.

INSTRUMENTS OF AGRICULTURAL PROTECTION

Domestic price control and supply management systems and related trade measures

The European Union Common Agricultural Policy

In theory, the Common Agricultural Policy (CAP) is based on the objectives in Article 39 of the Treaty of Rome, including market stabilization, increased agricultural productivity and reasonable agricultural prices for consumers. During the 1960s and 1970s, the CAP developed into a complex web of price and sales guarantees, subsidies, and other support measures that largely insulated farmers’ incomes from market forces. For most agricultural products, a minimum price was set to apply to all sales within the EU. In order not to undermine this price, it was essential that lower-priced imports be prohibited. This was achieved by a Variable Import Levy—a charge on imported goods equivalent to whatever difference exists at the time of entry between the world price and the Union price. In effect, through the levy, the Union was able to neutralize whatever price advantage a foreign competitor might enjoy.

As Martin has remarked, ‘European farmers have demonstrated beyond a shadow of a doubt that they are economically rational.’²⁰ Hence, in the face of guaranteed prices considerably above world prices and no production controls, they expanded production. It should be remembered that since the price was set so that the least efficient producers in Europe could make a profit, it offered significant rents or *supra-normal* profits to the more efficient producers. In addition, given that technological developments were increasing the efficiency of *all* farmers, it is not surprising that enormous surpluses soon developed. Since prices could not be lowered, there was no obvious way to dispose of the surplus in an orderly fashion. In consequence, the Union came to make undertakings to farmers to purchase their surplus at the high Union price. Enormous stockpiles of many commodities soon developed, and by the 1980s close to 80% of the Union budget was spent on agricultural programmes. Once again, farmers behaved entirely rationally, and now that they had not only prices but also sales guaranteed, further invested to expand production.

It is in the context of these pressures that the Union established a rebate on export sales, where in order to encourage disposal of the surpluses on world markets, the Union pays exporters the difference between the high Union price and the world price. Although these rebates have often been characterized and condemned as export subsidies, in theory it should be noted that they do not actually undercut the world price although they may

depress it. However, critics of the CAP have often charged that, in practice, rebates are given which exceed the difference between the Union and the world price, because the EU authorities tend systematically to underestimate world price in their calculation of the rebates. What is certainly true is that the CAP went from a programme that affected trade by keeping foreign producers out of the EU market to one that, at the same time, because of the massive surpluses being disposed of through the rebate scheme, made it increasingly difficult for foreign producers to sell their agricultural products in *third-country* markets.

The EU engaged in closely observed domestic agriculture policy reforms during the course of the Doha Round negotiations.²¹ In June 2003, the EU announced controversial reforms to the CAP.²² The scheme to 'decouple' subsidies and production will 'guarantee to farmers flat rate payments based on historical records in exchange for greater market orientation'²³ but the overall budget for the CAP will remain unchanged at nearly half of the total EU budget.²⁴ Furthermore, payment-for-production may be maintained where necessary to keep a farm in business²⁵ and, although 'decoupling' is to occur in 2005, EU Member States may delay this until 2007.²⁶ Finally, there are a number of exceptions to full 'decoupling', including beef, cereals, mutton, olive oil and sugar.²⁷

North America

Although Americans have tended to single out the CAP as the main villain in the agricultural trade wars, it must be remembered that it was US agricultural protection that led to weak GATT rules in agriculture in the first place. These have included price support measures, coupled however with production restrictions. There is a legitimate argument that these measures were less harmful than the CAP price support mechanism—since production restrictions were in place, keeping prices high did not result in the generation of massive surpluses. Also, since the mid-1980s, the United States has attempted permanently to reduce production by paying farmers to take land out of service. As well, instead of keeping the market price artificially high, for some commodities the United States now pays to farmers the difference between the price they can get on the market and a target price based on a formula that reflects the revenue farmers need to break even. Although Americans often claim that US export subsidies are a competitive response to EU and other foreign programmes, in fact such subsidies long predate the CAP. However, it is true that during the 1960s and 1970s, US use of export subsidies declined considerably, until in 1985 a new set of aggressive subsidies was introduced in response to the CAP.²⁸ In May 2002, the United States adopted the 2002 US Farm Bill, which provides for an estimated increase of \$83 billion in the agricultural budget between 2002 and 2012.²⁹ Mayrand, Dionne and Paquin point out that there are several possible ways in which this could impact US WTO commitments. Under the Farm Bill, US subsidies may exceed the maximum US\$19.1 billion permitted under the Uruguay Round Agreement on Agriculture for trade- and production-distortive domestic support measures. There is also concern that those domestic support measures which are classified under the Agreement on Agriculture as minimally trade distorting and which are not limited by the Agreement may become trade distorting with the increase in support envisioned under the Farm Bill.³⁰

Canada maintains marketing and production restrictions on poultry and eggs, enforced through domestic and import quotas. These import quotas have been justified under Article XI:2(c) of the GATT, discussed earlier in this chapter. In addition, Canada actively subsidizes the sale of wheat and other grains, often through concessional financing by the Canadian Wheat Board, which actively tries to undercut competitors in many export markets. However, Canada tends to view these subsidies as a response to similar behaviour on the part of its competitors, particularly the European Union, where a grain industry would be largely non-existent but for the CAP. In addition, both Canada and the United States provide a variety of forms of assistance to farmers that, arguably, do not directly distort world or domestic prices, such as crop insurance, low-interest loans and loan guarantees for purchase of land and equipment, and generous tax write-offs (the latter, in the case of Canada, have created a new class of 'gentlemen-farmers'). The arguments concerning whether such subsidies are objectionable as leading to inefficient or unfair trade are much the same as for any other domestic subsidy.

Japan

Japan's domestic market for agricultural products is one of the most protected in the world, at least with respect to some commodities. A wide range of instruments is employed that includes price stabilization, control of supply by state or quasi-state monopolies, coupled with import quotas and extremely high tariffs. According to Gilson,³¹ in 1988, the Japanese domestic price for wheat was eight times the world price. Rice is often estimated to cost ten or eleven times as much in Japan as on world markets and beef is heavily protected as well. Japan, however, is not a major exporter of agricultural products, and therefore does not participate in the export subsidy wars between North America and the European Union.

Costs and benefits of agricultural protection

There have been many estimates in recent years of the costs and benefits of agricultural protection, using different methodologies and different definitions of what constitutes protection.³² With respect to costs, these include the expense to the taxpayer of on-budget measures such as export and domestic subsidies, and commitments to purchase surpluses, costs to consumers of more expensive food, and allocative efficiency losses as resources are misdirected to agricultural production where no comparative advantage exists in the farm sector.

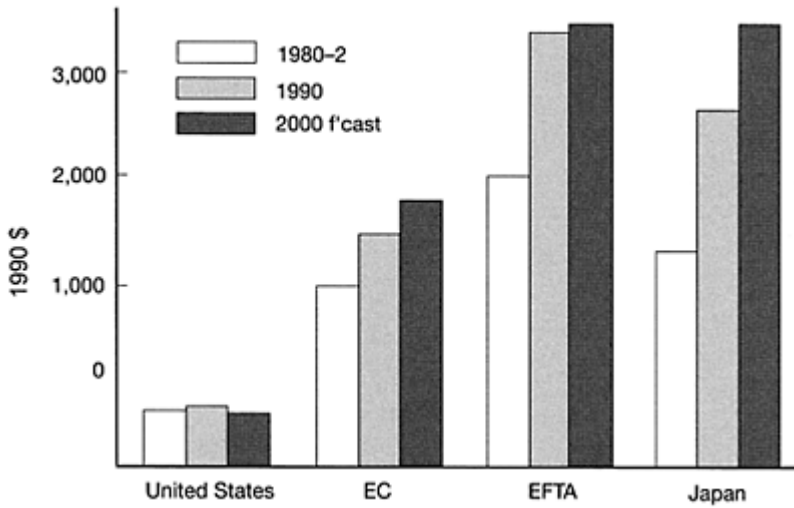


Figure 11.1 Cost of agricultural support per non-farm household.

Source: *The Economist*, December 12, 1992.

Figure 11.1, taken from a survey by *The Economist*³³ magazine, contains estimates of the per household per year costs of agricultural protection in the United States, Western Europe and Japan (including both higher taxes and higher food prices). These costs, which globally average around \$ 1,400 per household per year for the countries concerned, represent a considerable welfare loss. To these costs must be added the environmental costs of over-farming due to incentives to increase production in the European Union, and the deadweight loss of resources devoted to lobbying for protection. As well, the effect of protection in the developed countries is to shut out to a large extent the developing countries and the newly liberalizing countries of Central and Eastern Europe from many agricultural markets, thereby further retarding growth and adjustment (although some developing countries may benefit, at least in the short run, from lower food prices due to subsidized food exports of developed countries).³⁴ In addition, developed countries such as Australia and New Zealand, which have undertaken unilateral liberalization of their own agricultural support policies, see themselves as having much to gain from more open policies elsewhere, and have been leading forces behind the Cairns Group, which pressed for comprehensive agreement on agriculture as part of the Uruguay Round.³⁵ The effects of protection on farmers' incomes in various countries, including industrialized and developing countries, are displayed in Figure 11.2.

The gains to farmers in the EU and Japan are clearly very large. As *The Economist* notes,³⁶ since the gains from protection are proportional to the amount produced, small or poor farmers receive a small percentage of these gains, and highly efficient, large 'industrial' farms capture the lion's share. These gains, however, do not easily translate into the purported rationales for or social benefits from agricultural protection discussed above. First of all, while prices have been supported domestically, protection has led to

increased instability in world prices, as surpluses have rapidly developed in various commodities.

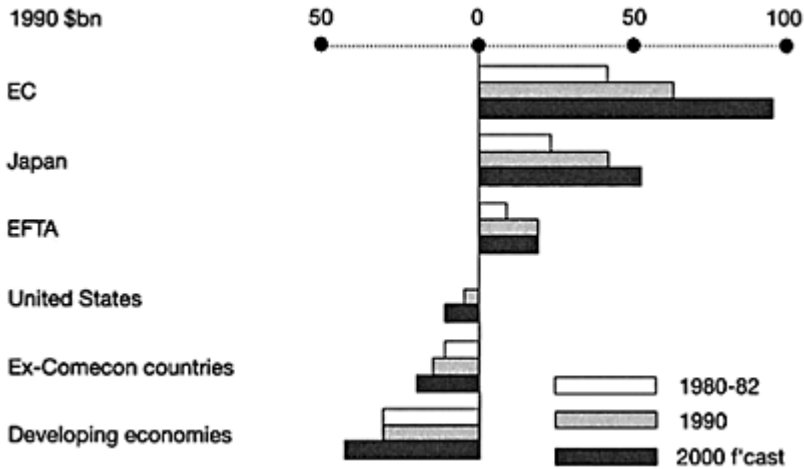


Figure 11.2 Effect on farmers' income of rich countries' policies.

Source: *The Economist*, December 12, 1992.

This in turn has made domestic price support increasingly costly. Second, even very high levels of protection have not saved the family farm—the exodus to the cities continues, because increased efficiency means that more can be produced with fewer farmers, and because small family farms often do not have access to the capital needed to invest in the expansion of production and particularly the technology that would allow them to capture major gains from protection. Finally, agricultural protection does not appear to have prevented environmental and aesthetic degradation in rural areas—indeed, as mentioned earlier, over-farming or mono-cropping with intensive use of fertilizers and other chemicals has begun to contribute significantly to environmental degradation.

Clearly, the elimination or reduction of agricultural protectionism could result in dramatic benefits to developed and developing-country Members. A recent World Bank report predicted the potential gain in global income from a new agricultural trade deal at between \$290 billion and \$520 billion per year, with over 60% of this gain benefiting developing countries.³⁷ Reducing agricultural protection by phasing out trade-distorting tariffs, quotas, other export subsidies, and anti-development tariff escalation and tariff peaks could lead to an estimated increase in income of \$ 150–400 billion in developing countries in the five years after completing reforms.³⁸

THE URUGUAY ROUND AGREEMENT ON AGRICULTURE

Given the extremely high costs and dubious benefits of agricultural protection—and particularly the increasing cost of beggar-thy-neighbour subsidy wars—the case for removing agricultural protection is a particularly strong one, and was accepted at the level of principle by both the United States³⁹ and the European Union as a basic goal of the Uruguay Round negotiations. Indeed, as early as 1982, the OECD Ministerial Council had adopted a declaration that ‘agricultural trade should be more fully integrated into and within the open and multilateral trading system’, also agreeing that multilateral negotiations should address ‘adjustments in domestic policies’.⁴⁰ This ultimately resulted in a major initiative on agricultural policy reform in the OECD, which culminated in a 1987 ministerial agreement to undertake major reforms without delay. Such reforms were to include ‘measures which, by reducing guaranteed prices and other types of production incentives,...will prevent an increase in excess supply’.⁴¹ Ministers also undertook to ‘refrain from confrontational and destabilising trade practices’.⁴² Despite this apparent consensus within the OECD on the need for and the direction of reform, agricultural issues proved to be among the most contentious in the negotiations, and understanding the evolution of the bargaining positions of the major actors—the USA and the EU—is of considerable importance in appreciating the compromise on agriculture that finally permitted the Uruguay Round to close in mid-December 1993.

At one level, the problem was clearly political. Agricultural lobbies exercise enormous influence in the key countries concerned. This influence is usually quite disproportionate to the percentage of the population at large engaged in agricultural production. In some countries (Canada is an example), the boundaries of legislative districts have not changed in such a way as to reflect fully the shift in population from rural to urban areas, thereby resulting in the former being over-represented in legislatures. In some European countries, the electoral politics are such that forming a governing coalition may be difficult, if not impossible, if some rural-based parties are not included. As well, in some countries, of which Germany is a prime example, the shift away from agricultural production to other economic activities as the major source of employment has not necessarily been accompanied by a population shift of comparable magnitude from the rural areas to the cities, and electoral boundaries are based on where people live, not where they work. Philip notes: ‘[in the Western part of Germany] a majority of the population is still living in rural areas, even though they don’t necessarily work there’.⁴³

Just as the American agricultural lobby was adamant that US negotiators accept nothing less than radical reductions in EU export subsidies, the European (and especially the French) farm lobbies were equally adamant that the basic level of protection in the CAP be preserved. However, even where they had the political will to resist the most extreme demands of the farm lobbies, EU policy-makers had a series of legitimate concerns about adjustment and the management of transitional costs during the shift to a more liberal regime for agriculture.

Rapid removal of protection would lead to massive bankruptcies and significant job losses, as farm revenues plummeted in those countries with the highest costs of production. In addition, and perhaps most difficult of all, land values that now reflected

rents from protection would decline dramatically⁴⁴—as would the market value of quotas in supply management systems such as that of Canada. Here there would be a transitional gains trap⁴⁵ problem because, while older farmers who saw the value of their land go up as rents from protection increased have arguably done very well from protection over the years and may not be deserving of further compensation, there is a much greater difficulty in the case of those who acquired quotas or land more recently, paying a price that reflected an expected income stream based on the assumption of continued protection. The removal of protection in these instances might be viewed as a ‘regulatory taking’ and therefore require extremely costly compensation for the reduction in the value of land or quotas. Containment of transitional costs generally implies an incremental approach to the removal or at least restructuring of agricultural protection—a process already begun on a small scale in the mid-to-late 1980s in the United States but overshadowed by subsidies wars that are a result of the excess capacity produced by past protectionist practices. An incremental approach, however, has its own drawbacks. First of all, a basic principle of equity suggests that each country should pull its own weight in the overall reduction in protection, but the setting of targets is made more difficult by the diversity of policy instruments employed by different countries. It is necessary to achieve consensus on a methodology for reducing the protectionist impact of these instruments to a common measure.⁴⁶ There are a variety of alternative techniques for doing this, each of which has its strengths and weaknesses.⁴⁷ A related requirement is effective monitoring of a complex variety of domestic policy changes to ensure that these changes are indeed being made in such a way as to reduce each country’s common measure of protection by the targeted amount.

These are some of the transitional issues that set the scene for a dispute between the United States and the European Union over the approach to liberalization which lasted from the intensification of the Uruguay Round negotiations towards the end of the 1980s until the very last days of the round in December 1993.

Although it showed rather early in the negotiations some flexibility with respect to its opening position that all protection (including domestic support) be eliminated within a ten-year period, the United States insisted that a major thrust of liberalization must be very substantial reductions in one particular instrument of protection, export subsidies, over a ten-year period. This intransigence was probably the result of a variety of factors, including scepticism concerning the ability to monitor more complex domestic policy shifts⁴⁸ and an increasing sense of frustration at European unwillingness to comply with existing GATT strictures (which reached a peak, as mentioned above, with the European refusal to implement the 1991 *Oilseeds* ruling). In addition, some of the negotiating positions of the EU seemed almost calculated in their manner of presentation to raise the ire of the United States—for instance, at one point the EU, while offering to reduce domestic support by 30% over ten years (an apparently substantial concession), insisted that the offer be backdated to 1986, so that the 30% target would be significantly met by reductions that had already occurred.⁴⁹

The European Union, although prepared to make some concessions with respect to domestic support measures, insisted on the continuing capacity to subsidize exports, if only because as long as the other measures were to be phased out gradually, incentives to overproduction would continue to exist, and there would be a continued need to use export subsidies to reduce surpluses. The European Union also insisted on the ability to

pay income support to farmers as a substitute for protection.⁵⁰ From the European perspective, any move away from price- and trade-distorting policies would necessarily require adjustment policies that would include a significant element of domestic support, even in the medium or long term.⁵¹ The Union argued that adjustment-oriented measures such as income support were not trade distorting and therefore ought not to be disciplined under the GATT. The USA was sceptical; income support might nevertheless preserve incentives to farmers to continue overproduction, thereby perpetuating the pressure to resort to directly distortive measures, such as export subsidies, to reduce the resulting surpluses.

The 1991 'Dunkel Draft' of a possible Uruguay Round Agreement attempted to set forth a compromise aimed at breaking the impasse in negotiations between the USA and the EU. The Draft proposed: reduction of domestic support measured in terms of a common standard (the Aggregate Measure of Support or AMS) by 20% from 1993 to 1999, with credit to be given for reductions that occurred since 1986; tariffication of border measures other than tariffs (e.g. the import quotas used by Canada to sustain its supply management system); and reduction in export subsidies by 36% between 1993 and 1999 in terms of outlays (aggregate expenditures) and by 24% in terms of quantities of output subsidized (Part B, para. 11). The Dunkel Draft was ambiguous as to whether income support payments to farmers, as conceived by the EU in the MacSharry Report on CAP Reform,⁵² would be viewed as exempt from domestic support reduction commitments.

Negotiations based on the Dunkel Draft made limited headway until, after intense internal discussions, in May 1992, the European Council adopted a revised version of the plan for agricultural reform contained in the MacSharry Report. This entailed a substantial reduction in price support for cereals, accompanied by compensation in the form of income support to farmers, in most instances conditional upon their willingness to 'set aside', or take out of cereals production, a part of their land. However, in other areas (livestock and particularly dairy), the agreed reforms were much less significant—reflecting a difficult intra-European bargain (and above all, the compromises required to gain acceptance by France). In November 1992, the USA and the EU reached a bilateral agreement concerning the liberalization of agricultural trade, the so-called Blair House Agreement. Under the Blair House Agreement, the USA and EU agreed to support the following reductions as a basis for a Uruguay Round Agreement: a 20% reduction in domestic support in terms of the AMS, with 1986–88 as a base period; a 21 % reduction in the volume of export subsidies and a 36% reduction in the cash amount of export subsidies, with the base period as defined in the Dunkel Draft; and exemption of income support to farmers from domestic support reduction commitments provided that these payments are made on only a limited part of the total production of each farm (so as not to encourage future overproduction).⁵³ These agreed terms for a Uruguay Round settlement on agriculture certainly represented very substantial concessions by the United States to the European Union, at least in terms of previous US negotiating positions. For instance, the USA ended up accepting a 1986 baseline for domestic support commitments—an element that it had rejected when it appeared in earlier EU negotiating positions. In return, however, the USA received satisfaction on a number of specific bilateral concerns, foremost among them the oilseeds controversy. Here, the EU agreed to reduce subsidies on oilseeds once oilseed acreage reached a certain trigger level. The EU

also agreed to facilitate market access for US corn to Spain and Portugal. A mutually satisfactory resolution of bilateral disputes between the Parties with respect to corn gluten feed and malted barley sprouts was also achieved.

The Blair House Agreement represented an important breakthrough, but the future of the Uruguay Round was still clouded due to the unwillingness of the French to accept Blair House as a definitive basis for CAP reform. Finally, an adjustment of the Blair House Agreement was achieved through discussions between US Trade Representative Mickey Kantor and EU External Affairs Commissioner Leon Brittan at a meeting in Brussels on 7 December 1993—just a week before the final deadline for the Uruguay Round negotiations. The major new US concession was to allow back-loading of commitments for reduction in export subsidies, so that smaller reductions would be possible in the first few years of the six-year transition period.⁵⁴ A new feature was, however, added to what had been agreed on at Blair House with respect to the basis for a Uruguay Round settlement on agriculture—a commitment to a minimum level of market access for foreign producers equivalent to 3% of domestic production, rising to 5% at the end of a six-year period.

In terms of general structure and basic principles, the key elements of the Agreement reflect, in the first instance, the Dunkel Draft. With respect to specific commitments, the Agreement is largely based upon the bilateral understandings between the United States and the EU in the Blair House Agreement, as modified by the 7 December Kantor/Brittan meeting (not surprisingly, some smaller countries, including developing countries, found it a source of irritation at the end of the round that the final Agreement should be closely modelled on a bilateral deal between the USA and the EU).

The Uruguay Round results, although still leaving much work to be done in liberalizing farm trade, can be described as the start of a fundamental shift in thinking about the importance and difficulty of liberalizing this area of trade. At the time, the agricultural sector was suffering from decades of increasing protection and generously supported domestic producers in the EC and the United States. Developing countries also maintained protection and support programmes, while a significant group of competitive agricultural producers—notably the countries forming the Cairns Group—began to press for a radical change that would see farmers on the same footing as manufacturers of industrial goods. The Uruguay Round package ‘set aside the vastly complicated, non-transparent and discriminatory assortment of quantitative restrictions on market access for farm products’⁵⁵ and required the tariffication of non-tariff barriers. The continued high levels of domestic support in developed countries are criticized as a major shortcoming of the Uruguay Round. The OECD estimates that developed countries continue to provide close to \$1 billion per day to their farmers. While the Uruguay Round did encourage countries to shift from trade-distorting subsidies to non-trade-distorting subsidies, more than 60% of the support provided to farmers in developed countries still distorts trade. The Uruguay Round disciplined export subsidies, but did not eliminate them. Agricultural export subsidies are particularly harmful to developing countries as they artificially lower world-market prices for their exports. In the short term, poor countries benefit from the lower prices, but in the long term, their farmers and entire industries are forced out of business due to the effects of the very high post-Uruguay Round export subsidies.⁵⁶

Domestic support

Domestic support is to be quantified in terms of a common metric, the Aggregate Measure Support (AMS) (Article 1(a); Article 6; Annex 3), with mandatory minimum reductions amounting to 20% over a six-year period, with 1986–88 as the base period (i.e. at the end of six years from the entry into force of the Agreement on Agriculture, domestic support must be 20% lower than it was in the 1986–88 base period). ‘Direct’ payments to farmers, when made under ‘production-limiting programmes’, are not subject to reduction commitments, provided the payments are based on fixed area and yields, or are made on 85% or less of the base level of production, or (in the case of livestock) on a fixed number of head (Article 6.5(a)(i)–(iii)). Where these payments also conform to the more specific exemption criteria contained in Annex 2, they are also non-countervailable.

Domestic support measures were raised in *Korea—Measures Affecting Imports of Fresh, Chilled and Frozen Beef*⁶⁷ (*Korea Beef*). In this case, Australia accused Korea of exceeding its *de minimis* level for domestic supports. However, the Appellate Body (AB) did not reach a decision due to insufficient information. A key question was what methodology must be used to determine AMS. Article 1 (a)(ii) of the Agreement on Agriculture requires two things: that AMS be ‘calculated in accordance with the provisions of Annex 3 of the Agreement’, and that the calculation ‘tak[e] into account the constituent data and methodology used in the tables of supporting material incorporated by reference in Part IV of the Member’s Schedule’. This accords higher priority to Annex 3 than to the schedule. However, because there was no constituent data and methodology for beef in Korea’s schedule, the AB did not deal with how to resolve a conflict between Annex 3 and a schedule (paras 110–14).

Export subsidies

Export subsidies are to be reduced over a six-year period by 21 % in terms of the volume of agricultural products that receive such subsidies and by 36% in terms of total cash value. Except for certain permitted minor adjustments (Article 9.2), Members undertake not to expand export subsidies beyond the levels reached after the achievement of their six-year reduction commitments. This in effect alters, with respect to agricultural products, the operation of Article XVI of the General Agreement, which permits export subsidies on primary products.

The export subsidy provisions of the Agreement on Agriculture were addressed in *Canada—Measures Affecting the Importation of Milk and the Exportation of Dairy Products*⁵⁸ (*Canada Dairy*) and in *United States—Tax Treatment for ‘Foreign Sales Corporations’*⁵⁹ (*US FSCs*). *Canada Dairy* involved a challenge by the United States and New Zealand to two aspects of Canada’s industrial milk supply management system.⁶⁰ First, they challenged Canada’s tariff rate quota (TRQ) for fluid milk. Second, they challenged one aspect of Canada’s Special Milk Classes Scheme (CSMCS) as export subsidization under the Agreement on Agriculture. The CSMCS is a mechanism for pricing five different milk classes, the fifth of which is the ‘Special Milk’ class consisting of five subcategories. Class 5(d) includes milk exported to the USA and UK under a negotiated quota system. Class 5(e) includes surplus milk from the domestic market. To access milk under Class 5(d) and 5(e), exporters and processors must negotiate the price

with the Canadian Dairy Commission on a transaction-by-transaction basis. The panel found that this scheme provided milk to processors and exporters 'at a price significantly lower than the domestic milk price...and on terms and conditions which are more favourable than those under any other alternative source'. Also, the scheme guaranteed Canadian processors for export a margin covering the cost of 'transforming milk' and a return on investment (paras 7.58–7.59).

Article 9.1 of the Agreement on Agriculture lists export subsidies subject to reduction commitments under the Agreement. One of these is direct subsidies, including payments-in-kind, by governments or their agencies under Article 9.1(a). Canada disputed the original panel's finding that payments-in-kind necessarily constituted a direct subsidy. The AB agreed that the panel had erred, finding that a payment-in-kind, i.e. a transfer of non-monetary economic resources, is not necessarily a direct export subsidy. A recipient may give full consideration for a payment-in-kind and consequently receive no benefit. A subsidy exists where a grantor transfers economic resources for less than full consideration (paras 87–9). The same case also defined 'government agency' for the purposes of Article 9.1 (a) as an entity exercising government-delegated powers, with some discretion permitted, to regulate, restrain, supervise or control private citizens' conduct (para. 97).

Article 9.1(c) indicates that 'payments on the export of an agricultural product that are financed by virtue of governmental action' are subject to reduction under the Agreement on Agriculture. The AB found that payments include non-monetary payments, such as payments-in-kind and revenue foregone (paras 109 and 112). According to the AB in the first recourse to Article 21.5 of the Dispute Settlement Understanding (DSU), 'payments' must be found comparatively by reference to an objective basis of comparison that 'reflects the proper value of the goods or services to their provider'. The benchmark or standard used will vary according to the facts and circumstances surrounding the measure in question (paras 74–6). Janow and Staiger comment that neither the Subsidies and Countervailing Measures (SCM) Agreement nor the Agreement on Agriculture provides a methodology for determining what is a 'subsidy' or a 'payment', and that the relationship between the two Agreements is still unclear. The authors also note that in *Canada Dairy*, the AB did not rely on strict legal interpretation to determine its methodology on the facts of the case. They point out that the original AB decision focused on 'below market rates', while the DSU Article 21.5 AB compliance decision emphasized 'average total cost of production'. Furthermore, Janow and Staiger suggest that if the AB was aiming for precision in its methodology for determining 'payment', it might have provided a hierarchy of methodologies to use, depending on what economic information is available.⁶¹ Whether a payment is 'financed by virtue of government action' also requires case-by-case consideration, according to the AB in its Article 21.5 decision. The word 'financed' must be interpreted to include both payments and payments-in-kind. 'Governmental action' includes the power to restrain the conduct of, regulate, control or supervise private citizens. The phrase 'by virtue of' requires a 'demonstrable link' showing that payments are financed 'as a result of or 'as a consequence of governmental action. This link may exist despite the fact that government is uninvolved in 'significant aspects of the financing'. However, it will not be present when government-established regulation simply enables a third person to finance payments (paras 112–15).

Under US law, Foreign Sales Corporations are exempt from certain US taxes. The EU argued that this constituted a prohibited export subsidy under both the SCM Agreement and the Agreement on Agriculture. With respect to the latter claim, the AB addressed Article 9.1(d) of the Agreement on Agriculture, which indicates that ‘subsidies to reduce the costs of marketing exports or agricultural products’, other than ‘widely available export promotion and advisory services’, are subject to reduction under the Agreement on Agriculture. The AB indicated that ‘costs of marketing’ are more specific than general business costs like income tax liability, administrative overhead costs and debt financing costs. The phrase ‘costs of marketing’ encompasses those costs ‘incurred *as part of* and *during* the process of selling a product’ (para. 130). Consequently, the AB found that the US FSC exemptions did not violate Article 9.1(d) of the Agreement on Agriculture.

Article 10 of the Agreement on Agriculture contains obligations to prevent circumvention of subsidy commitments. Article 10.1 provides that those export subsidies not listed in Article 9.1 ‘shall not be applied in a manner which results in, or threatens to lead to, circumvention of export subsidy commitments’. The AB in its Article 21.5 decision in *Canada Dairy* emphasized that this provision is residual to Article 9.1. Consequently, a particular export subsidy cannot fall under both provisions (para. 121). The AB in *US FSCs* noted that ‘export subsidies’ are required to be ‘contingent on export performance’ under Article 1(e), and the AB treated the latter phrase as having the same interpretation under both the Agreement on Agriculture and the SCM Agreement (para. 141). The AB then interpreted ‘export subsidy commitments’ to mean Members’ obligations under Articles 3, 8 and 9 of the Agreement on Agriculture. These obligations are divided into two categories under Article 3.3. First, Members are obligated not to provide Article 9.1 export subsidies with respect to scheduled agricultural products in excess of what is specified in the schedule. This may be referred to as either ‘reduction commitments’ or ‘export subsidy commitments’. Second, Members may not provide any Article 9.1 export subsidies with respect to unscheduled agricultural products. This may be referred to as ‘export subsidy commitments’. Whether or not a measure violates Article 10.1 requires consideration of the measure’s structure and characteristics. Applying these guidelines to the facts of the case, having previously found that the FSC measures constituted subsidies contingent on export performance (para. 142), the AB noted that US FSC measures create a legal entitlement to export subsidies, with unlimited possible foreign trade income exemptions. Because the possibility for subsidies is unlimited, the FSC measures threaten to lead to circumvention of export subsidy commitments, in both the scheduled and the unscheduled categories, allowing Members the opportunity to transfer, through tax exemptions, those economic resources they are prohibited from otherwise providing under Articles 3.3 and 9.1. Consequently, the AB found that the FSC measures violated Articles 10.1 and 8 (paras 144–54). The panel and the AB in the recourse to Article 21.5 of the DSU reaffirmed this conclusion.

In a second recourse to DSU Article 21.5 in *Canada Dairy*, the AB indicated that Article 10.3 is an incentive for Members ‘to ensure they are in a position to demonstrate compliance with their quantity commitments under Article 3.3’. It does so by reversing the usual burden of proof. Once a complaining Member proves that another Member is exporting in greater quantities than permitted by its commitments, the complaining Member does not have to establish a *prima facie* case that the excess amounts are

subsidized. Rather, it is for the exporting Member to prove that no export subsidy has been granted (paras 30–3).

The *Sugar* case (*European Communities—Export Subsidies on Sugar* (WT/DS265/R, WT/DS266/R, WT/DS283/R), on appeal to the Appellate Body at the time this volume went to press, deals with a number of issues concerning the nature and interpretation of scheduled commitments on export subsidies, and the definition of export subsidy in the Agreement on Agriculture. In the *Cotton* case (*United States—Subsidies on Upland Cotton* (WT/DS267/AB/R), decided as this volume was going to press, the Appellate Body addressed a range of issues in interpreting the export subsidies provisions of the Agreement on Agriculture, including the relevance of related concepts in the SCM Agreement, the meaning of export contingency, and the treatment of export credit guarantees in the Agreement on Agriculture, as well as the ‘anti-circumvention’ clause (10.1).

Tariffs and existing non-tariff border measures

Tariffs (including existing non-tariff border measures that have been converted to tariffs) are to be reduced by at least 36% overall by each Member over the six-year phase-in period, with a minimum 15% reduction on *each* product category. Existing non-tariff border measures, such as import quotas, voluntary export restraints (VERs) and the EC Variable Import Levy, are to be converted into tariffs (Article 4.2, footnote 1), and *new* measures of this kind are to be prohibited (Article 4.2).⁶² This modifies Article XI:2(c) of the General Agreement, which permits quantitative restrictions on agricultural and fisheries products where necessary to the enforcement of the domestic marketing scheme. In addition, existing non-tariff border measures *must* be reduced to the extent required to allow foreign producers a minimum of 3% market access in terms of total domestic production of each product category, rising to 5 % at the end of the six-year phase-in period.

The *Bananas* case⁶³ concerned the allocation of tariff quotas for bananas by the European Community pursuant to preferences granted under the Lomé Convention. Among the arguments of the complainants (several Central American countries and the United States) was that the allocation of tariff quota shares as between Members violated Article XIII of the GATT, which provides for non-discriminatory administration of quantitative restrictions. The EC had claimed that the Agreement on Agriculture had the effect of exempting tariff quotas in its bound schedule from the requirements of Article XIII. In particular, the EC pointed to Article 4.1 of the Agreement on Agriculture which states that ‘Market access concessions contained in Schedules relate to bindings and reductions of tariffs, and to other market access commitments as specified therein.’ The AB rejected the view that, by virtue of this language, the concessions in the schedules referred to were no longer subject to Article XIII disciplines. The AB noted a number of explicit limitations to the application of the GATT contained in the Agreement on Agriculture and concluded: ‘the negotiators of the Agreement on Agriculture did not hesitate to specify such limitations elsewhere in that agreement; had they intended to do so with respect to Article XIII of the GATT 1994, they could, and presumably, would have done so’.⁶⁴ Another interesting feature of this case is that the AB took the view that provisions of the General Agreement on Trade in Services (GATS) could apply to the

allocation of import licences to banana importers and distributors ('operators' within the meaning of the EC regulations). The AB held that the activities of these intermediaries came within the classification 'wholesale trade services' in respect of which the EC had taken a full commitment in its Schedule of Specific Commitments. Thus, discriminatory allocation of such licences was in violation of not only the GATS Most Favoured Nation provision (Article II) but also the National Treatment obligation (Article XVII), which applies only to activities bound in a Member's Schedule of Specific Commitments (paras 217–28). Where in fact wholesaling services have been bound in a Member's schedule, this ruling may have significant implications for the operation of various kinds of marketing licence and quota allocation schemes that continue to characterize the agricultural sector in a number of countries.

In *Chile—Price Band System and Safeguard Measures Relating to Certain Agricultural Products*⁶⁵ ('*Chile Price Band*'), Argentina argued that Chile's price band system, a system for determining the duties applied to certain product categories,⁶⁶ was inconsistent with Article 4.2 of the Agreement on Agriculture, which indicates that '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.' Footnote 1 indicates that the measures that must be converted 'include 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'. As background to the issue, the AB interpreted Article 4.2 as applying as of the date the WTO Agreement came into force, 'regardless of whether or not a Member converted any such measures into ordinary customs duties before the conclusion of the Uruguay Round' (para. 212). Argentina's argument was that Chile's price band system was either a 'variable import levy', a 'minimum import price' or a 'similar border measure other than ordinary customs duties' (para. 220). The AB interpreted each of these. It found that a 'variable import levy' includes the following features: a formula causing automatic and continuous variability of duties, a lack of transparency, and a lack of predictability in the level of resulting duties. These latter two features are liable to restrict import volumes, and contribute to distorting import prices (para. 234). Chile and Argentina did not dispute the panel definition of 'minimum import price':

Notifications on minimum import prices indicate that these measures are generally not dissimilar from variable levies in many respects, including in terms of their protective and stabilization effects, but that their mode of operation is generally less complicated. Whereas variable import levies are generally based on the difference between the governmentally determined threshold and the lowest world market offer price for the product concerned, minimum import price schemes generally operate in relation to the actual transaction value of the imports. If the price of an individual consignment is below a specified minimum import price, an additional charge is imposed corresponding to the difference.

(Panel, para. 7.36(e))

Ultimately, the AB found that Chile's price band system was a 'similar border measure' in its operation and overall nature, because the system was similar to the others in footnote 1 in the way it impeded the transmission of international price developments to the domestic market. The AB also emphasized that there was a lack of transparency and predictability in the way that the price bands and reference price were determined (paras 246–52).

Another important feature of the AB's analysis was its reversal of the panel's interpretation of 'ordinary customs duty' in Article 4.2. The first element with which the AB disagreed was the panel's position that '[a]s a *normative* matter,...those scheduled 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'. It also rejected the panel statement that duties calculated based on exogenous factors, such as world market prices and domestic price developments, are not ordinary customs duties. The AB noted that 'the *second* sentence of Article II:1 (b) of the GATT 1994, does *not* specify what form "other duties or charges" must take to qualify as such within the meaning of that sentence'. Also, Annex 5 and Attachment to Annex 5 of the Agreement on Agriculture only require that 'ordinary customs duties' take the form of '*ad valorem* or specific rates' and do not prohibit basing duties on 'exogenous factors' (paras 271–8).

The AB concluded that the system was incompatible with Article 4.2 of the Agreement on Agriculture (para. 280). Notably, it did not offer its own definition of 'ordinary customs duty', implicitly assuming that, because the system was similar to a variable import levy or a minimum import price, it could not be an 'ordinary customs duty'.⁶⁷

In the *Agricultural Tariffication* case, a NAFTA panel considered the relationship between Canada's tariffication of domestic support measures in its schedule pursuant to the WTO Agreement on Agriculture and its tariff elimination obligations in the NAFTA.⁶⁸ The United States argued that, by virtue of its obligation to eliminate tariffs on most of the products concerned in NAFTA, Canada was prohibited from applying its tariff equivalents for quantitative restrictions with respect to US imports. Canada argued that the WTO Agreement on Agriculture was an agreement later in time within the meaning of the Vienna Convention and therefore prevails over the conflicting NAFTA provisions. Canada also relied upon a provision of the FTA (Article 710), later incorporated into NAFTA, which stipulates that 'the Parties retain their rights and obligations with respect to agricultural, food, beverage and certain related goods under the *General Agreement on Tariffs and Trade* (GATT) and agreements negotiated under the GATT, including their rights and obligations under GATT Article XI'. The US view was that this provision applied only to such agreements as were already in force at the time of the FTA, or alternatively, when this FTA provision was incorporated into NAFTA, which would thereby exclude the WTO Agreement on Agriculture—this view relied heavily on the use of the word 'retain' in the provision. The panel found that, despite the word 'retain', Article 710 referred to an evolving system of law, not a set of obligations frozen in the past. It noted that elsewhere when the Parties had sought to incorporate only pre-existing obligations or rights, they had used expressions such as 'existing provisions' or 'existing obligations'. Perhaps more fundamentally, the panel noted that a bizarre consequence would follow from the American interpretation of Article 710 as incorporated into NAFTA—the pre-Uruguay Round GATT right to adopt

quantitative restrictions pursuant to Article XI:2(c) would be incorporated into NAFTA, thereby creating with respect to Canada-US trade a less liberal regime (inasmuch as quantitative restrictions are regarded as more distortive of or threatening to free trade than tariffs) than prevailed multilaterally. Thus, 'to adopt the approach of the United States would be to endorse an interpretation of Article 710 that does not further the NAFTA objective of trade liberalization' (para. 167).

There was a further issue of whether, even if Article 710 did apply prospectively, the WTO Agreement on Agriculture actually established tariffication as a 'right' or 'obligation' within the meaning of Article 710. As noted earlier in this chapter, the final text of the Agreement on Agriculture was produced following a last-minute compromise between the EU and the United States which required frantic drafting exercises. In the *Agricultural Tariffication* case, the United States was able to show that, if one read the text of the Agreement very carefully, in fact there was no clear language that established tariffication as a right or obligation, despite the fact that (as noted above) tariffication of quantitative restrictions was a crucial element in the overall deal, including from the perspective of the United States itself. The panel made a careful examination of the *travaux préparatoires* for the Agreement on Agriculture, including the Dunkel Draft and the Modalities Document that had been the fundamental basis of negotiations, and came to the conclusion that

the arrangement under which agricultural non-tariff barriers were eliminated rested on a simple bargain. States agreed to eliminate their non-tariff barriers as a *quid pro quo* for the right to replace them with 'tariff equivalents'. That is, they were replacing protection in the form of quotas or other non-tariff barriers with protection in the form of tariffs. This right to establish such tariffs was also subject to certain reduction and volume commitments.

(para. 185)

In a related finding, the panel held that the schedules annexed to the Marrakesh Protocol 'crystallized the arrangement for eliminating non-tariff barriers' (para. 189), and that, by accepting each others' schedules as part of the 'package', Members had essentially consented to the manner in which non-tariff barriers had been converted into tariffs by each country. Thus, the United States could not now claim that some of Canada's tariff equivalents were not in fact based on prior non-tariff measures but actually constituted new, additional protection. While there is no legal reason why a WTO panel would have to defer to this interpretation of the Agreement on Agriculture and related instruments, if such an approach were followed, it would effectively preclude any challenges to a Member's tariffication as not properly based on methodologies agreed in the negotiations. This obviously has implications that go well beyond the interrelationship between NAFTA and the Agreement on Agriculture. We are not entirely certain of the soundness of such an approach, which implies that if a Member failed to object to another Member's tariff equivalents between the publication of schedules in February 1994 and the signing of the Marrakesh Protocol two months later, it is forever estopped from invoking dispute settlement, if it considered that a particular tariff equivalent did not reflect the terms of the fundamental tariffication bargain. The panel's position would

have been stronger had it actually adduced evidence that Members were aware of the need to examine the schedules of other Members for consistency with that bargain before the Protocol was signed, or at least before the coming into force of the WTO Agreement on 1 January 1995.

Special safeguard provision

There is a special safeguard provision in the Agreement on Agriculture which permits imposition of an additional level of duty (but not reimposition of non-tariff measures) in the case where imports of a particular product exceed a trigger level in a given year or where the price of imports falls below a trigger price.

The trigger level for *volume* of imports varies between 125% and 105% as against the quantity imported over the last three years, depending on the level of existing market access opportunities for imports of the product in question. Thus, for example, where existing market access opportunities for imports amounted to 10% or less of domestic production, an additional 'safeguard' level of duty could only be imposed where imports of the product increased by 25% in the year in question over the average annual quantity imported for the previous three years. However, if existing market opportunities for imports were above 30% of domestic production, a safeguard could be imposed if the volume of imports of the product surged by only 5% over the average annual quantity imported over the previous three years. Where the volume of domestic consumption has changed, the volume of imports must exceed the sum of the trigger level *and* domestic changes in consumption. This reflects the fact that increases in domestic consumption are likely to mitigate the extent to which domestic producers are injured by import surges—there is a larger domestic market to absorb the additional imports. On the other hand, where imports surge at the same time as domestic consumption is decreasing, the injury to domestic producers is likely to be aggravated.

The trigger *price* level is set at an average 1986 to 1988 reference price. Varying levels of 'safeguard' duties may be imposed depending upon the extent to which the price in a given year falls below this trigger price level. For instance, where the price in a given year is 40% less than the trigger price level, a 10% duty would be permitted. If, on the other hand, the price were 60% less than the trigger price level, a duty of 20% would be permitted. The formulae for calculating these various rates of safeguard duty are contained in Article 5.5(a)–c) of the Agreement.⁶⁹

In the *Poultry* case, a panel had occasion to interpret the special safeguard regime in Article 5 of the Agreement on Agriculture. One of the claims of the complainant, Brazil, was that the EC had not followed the procedures set out in Article 5.1 in its imposition of a price-based special safeguard on imports of frozen poultry. Article 5.1, as discussed above, provides that safeguards may be imposed if the price of imports falls below a certain trigger price, determined in relation to a 1986–88 reference price. The EC had calculated the price of imports without adding in the bound duty amount—Brazil argued that this was an incorrect application of Article 5.1. The panel referred to the fact that Article 5.1 stipulated that the price for purposes of comparison with the trigger price was that at which 'imports may enter the customs territory of the Member granting the concession'. Since imports cannot 'enter' without duty having been paid, the correct price for purposes of comparison with the trigger price would include the amount of duty to be

paid.⁷⁰ The panel also noted that the ‘terms of Article 5.1(b) should be construed narrowly, so as not to frustrate the attainment of the security and predictability in trade through the tariffs-only regime in Article 4.2’ (para. 280). One member of the panel dissented from this conclusion, suggesting that there was some evidence that the drafters had considered but rejected explicit language that would have referred to ‘duty paid c.i.f. import price’. According to this panel member, the fact that in several places Article 5 refers only to ‘c.i.f. import price’ without any qualification suggests an unambiguous rejection of the notion that the price should be calculated inclusive of duties. However, this might equally have been because negotiators considered that the language ‘may enter’ made it sufficiently clear that the price would be one based on duty having been paid. The panel member made another, very obscure argument that including duty in the price could in some cases result in the impossibility of imposing a safeguard regardless of how low the pre-duty price had fallen, and that another result, presumably unacceptable, would be that in some cases, imports with lower pre-duty prices but higher post-duty prices would not be eligible for safeguard protection, whereas some other imports with higher pre-duty prices (but lower duties) would be eligible. In our view, these results are not at all anomalous, but entirely consistent with the objective of creating a ceiling on the amount of protection that imports can enjoy—the higher the existing level of protection, the less room there should be for the imposition of additional safeguards. The main purpose of the safeguards is after all to provide some leeway where Members have taken a chance on significantly reducing their level of protection. On appeal, however, the AB adopted the view of the dissent, referring to ‘customary usage in international trade’ of the acronym ‘C.I.F.’ which did not include customs duties, an interpretation that ignores the context of this expression in 5.1(b). Nevertheless, the AB found a violation of Article 5.5, which requires that only the CIF price, and no other methodology, be used to calculate safeguard duties. The EU regulation had provided for an alternative method, where the importer did not require that the CIF price be used or did not meet certain conditions.

Operationalizing the commitment to liberalization; other selected features of the Agreement on Agriculture

It is impossible in this chapter to do full justice to the complex definitional and methodological framework which the Agreement on Agriculture establishes for the operationalization of the reduction commitments sketched above. The Agreement contains finely crafted provisions that set out basic rules for the calculation of AMS in the case of domestic support measures (Annex 3) and for the calculation of tariff equivalents in the case of non-tariff border measures (Attachment to Annex 5). For instance, with respect to domestic price support measures (characteristic of the CAP), these are included in the AMS by calculating the difference between a ‘fixed external reference price’ (i.e. a world price) and the higher administratively set domestic price, and multiplying this difference by the volume of production to which the administered price applies (Annex 3, Article 8). Annex 2 of the Agreement provides a very detailed set of criteria for determining which domestic support measures are exempt from reduction commitments, including income support measures for farmers.⁷¹ To be exempt, domestic support measures must meet the ‘fundamental’ requirement that ‘they have no, or at most

minimal, trade distortion effects or effects on production' (Annex 2, Article 1). Measures are considered to have met this requirement where they conform to the following two criteria: (1) they are provided through a publicly funded government programme that does not involve transfers from consumers; and (2) the measures in question do not have the effect of price support (Annex 2, Article 1). Several pages of much more specific criteria and examples of exempt measures follow, and these are based on the general concepts of Article 1 of the Annex. Some of the exempt measures include: research and training programmes; inspection services for health, safety, grading or standardization purposes; and various forms of adjustment assistance to farmers, including income support, where the measures meet very specific conditions aimed at ensuring that the effect is not to reward and thereby perpetuate current levels of production.

Due restraint

Article 13 of the Agreement, known as the 'peace clause', stipulates that domestic support measures that are exempt from reduction commitments by virtue of Annex 2 are to be non-countervailable (Article 13.1 (a)). The 'peace clause' expired in January 2004. 'Due restraint' is also to be exercised in the initiation of countervail investigations of measures exempt from reduction commitments under Article 6.5 ('direct' payments to farmers in connection with a production-limiting programme).

In the *Desiccated Coconut* case, the panel considered the applicability of provisions of the Agreement on Agriculture to countervailing duty investigations undertaken prior to entry into force of the WTO Agreements. Among the arguments of the complainant, the Philippines, was that pursuant to Article 13 of the Agreement on Agriculture, Brazil was prohibited from continuing countervailing duties against its exports of coconut, since the subsidies on coconut fully complied with provisions of the Agreement on Agriculture concerning reduction of domestic support measures.⁷² The panel cited note 4 to Article 13, which provides that the countervailing duties referred to in the Article are those covered by Article VI of the GATT 1994 and Part V of the WTO Subsidies Agreement. Having already determined that these countervailing duties, by virtue of being imposed on the basis of an investigation prior to entry into force of the WTO Agreements, were not covered by Article VI or the Subsidies Agreement, the panel found that Article 13 did not apply. The Philippines had argued that Article VI could apply independently of the Subsidies Agreement, and that the phase-in provisions of the latter should not be used to exclude a claim based exclusively on Article VI—the panel noted that the reference to Article VI and the Subsidies Agreement together in Article 13 in fact reinforced its prior conclusion that an Article VI action was not available where the Subsidies Agreement itself did not apply, because the measures were based on an investigation that pre-dated the entry into force of the Agreement. The Philippines did not appeal the panel's interpretation of the Agreement on Agriculture, and the AB upheld the findings of the panel on the broader issue concerning applicability of Article VI and the Subsidies Agreement.

Developing countries⁷³

Agriculture is a particularly sensitive issue for developing countries, accounting for 70% of employment in low-income countries and acting as a major foreign exchange earner in both Africa and Latin America.⁷⁴ The Agreement on Agriculture is central to the antiglobalization debate due to the perception that it serves as a tool for the EU and the US to continue agricultural subsidization while developing countries liberalize.⁷⁵ Despite the Agreement on Agriculture, the US and EU together spend about US\$ 150 billion annually on agricultural subsidies.⁷⁶ In fact, subsidies in OECD countries have increased 28% since 1997, partially due to an EU and US transfer of resources to areas of domestic support not limited by the Agreement.⁷⁷ Developing countries also argue that WTO rules should allow them the flexibility to meet their development and environmental needs and to permit continued support of subsistence agriculture.⁷⁸

Article 15 of the Agreement on Agriculture provides for special and differential treatment for developing countries; some related provisions are described below. Developing-country Members may implement reduction commitments over ten years, while least-developed-country Members need not commit to reductions at all (Article 15.2). Developing countries are also exempt from reduction commitments otherwise applicable to the following subsidies: investment subsidies generally available to agriculture; agricultural input subsidies generally available to low-income or resource-poor producers; and domestic support to producers to encourage them to diversify from growing illicit narcotic crops. These domestic supports need not be included in developing countries' calculations of their current total AMS (Article 6.2). Developing countries have a lower threshold for accessing current total AMS exclusions for product-specific domestic support under Article 6.4(b) and for subsidies in excess of their commitment levels under Article 9.2(b)(iv). Reductions of export subsidies specified in Article 9.1(d) and 9.1(e) are not mandatory for developing-country Members, unless the subsidies are applied to circumvent reduction commitments (Article 9.4). Another important provision relates to the food security needs of net food-importing and least-developed countries and calls for developed-country Members to take action under the Decision on Measures Concerning Possible Negative Effects of the Reform Programme on Least-Developed and Net Food-Importing Developing Countries (Article 16). Part of the Decision provides for measures to ensure that implementation of the Agreement on Agriculture does not negatively impact developing countries' abilities to meet their food needs.

The United Nations Development Programme suggests several possible reforms that would make the Agreement on Agriculture more sensitive to developing-country needs. First, Members should agree to eliminate tariff escalation and to reduce tariff peaks; developing-country tariffs are currently relatively lower than those of developed countries. Second, domestic support that is exempt from the Agreement on Agriculture by reason of not having a distortive effect must be more clearly defined to prevent abuse. Other exemptions should be phased out, as should domestic support that distorts trade and production. Third, Members should set a time frame for eliminating export subsidies, with a shorter time frame for those most harmful to developing-country production and trade. Fourth, they should also agree to eventually eliminate export dumping. Finally,

Members should adopt measures, including a revised safeguard provision, that afford developing countries the ability to protect the jobs and food security of their low-income populations.⁷⁹

Future reforms

Implementation of the Uruguay Round Agreement on Agriculture does not obviate the need for continued reform.⁸⁰ According to Hoekman and Kostecki, agricultural protection in high-income countries exceeds barriers to trade in manufactures.⁸¹ Hertel and Martin argue that OECD farm policies continue to cause US\$40 billion of welfare loss annually to developing countries; furthermore, they estimate that a US\$60 billion increase in global real income would result from an additional 40% reduction in agricultural tariffs and export subsidies.⁸²

Paragraph 13 of the Doha Declaration⁸³ commits to build on the negotiations commenced under Article 20 of the Agreement on Agriculture and to negotiate 'substantial improvements in market access; reductions of, with a view to phasing out, all forms of export subsidies; and substantial reductions in trade-distorting domestic support'. It also agrees to special and differential treatment for developing countries, considering their food security and rural development needs, and to consider the non-trade concerns of Members. There are several contentious areas with respect to the interpretation of the Declaration, according to the International Centre for Trade and Sustainable Development (ICTSD). For example, Members disagree as to whether 'with a view to phasing out' indicates a commitment to eliminating export subsidies. It is also unclear whether 'all forms of export subsidies' includes export credit schemes such as those used by the US.⁸⁴ Members failed to meet the 31 March 2003 deadline for establishing 'modalities on further commitments'. The special session Chair planned additional negotiating sessions for June and July and committed to continue informal consultation on several issues, including strategic products and a safeguard mechanism for developing countries, food aid, tariff rate quotas, domestic support, export credits, preferential trade schemes, and state trading enterprises.⁸⁵

In view of the recent controversial reforms to US and EU domestic agriculture policies, Steinberg and Josling's argument about the bargaining power of Article 13 may come in to play. Specifically, they argue that EC and US subsidy policies will be vulnerable to challenge following expiry of the 'peace clause' in January 2004.⁸⁶ They view an attack under SCM Agreement Articles 6.3(a)–(c) and 6.4 as most likely to succeed and suggest that economic models and regression analysis are the best way to approach the most challenging aspect of the argument—proving *causation* of 'adverse effects' resulting in 'serious prejudice'.⁸⁷ Assuming 'peace clause' expiry does pose a threat to EU and US agricultural subsidy policy, it may become a tool for developing countries and the Cairns Group in the late stages of Doha negotiation to pressure the EU and US for commitments to subsidy reduction and more open markets.⁸⁸ The *Cotton* dispute, decided around the time this volume went to press, illustrates such a possibility. There may also be far-reaching implications from the recent WTO challenge brought by the United States alleging the WTO-illegality of the Canadian Wheat Board (CWB). In *Canada—Measures Relating to Exports of Wheat and Treatment of Imported Grain*⁸⁹ ('*Canada Wheat*'), the United States challenged the entire grain marketing, promoting

and exporting scheme set up by the Canadian government. The CWB is a state trading enterprise and has been granted 'special and exclusive privileges' in accordance with Article XVII of the GATT. The CWB benefits from borrowing guarantees, initial payment guarantees, preferred interest rate loans and a monopoly on the sale of Canadian wheat for human consumption. The United States alleged that Canada's failure to ensure that the CWB does not misuse the special and exclusive privileges to sell wheat at below market prices is a violation of Article XVII of the GATT. The dispute also involved claims that certain requirements related to the import of grain into Canada violated Article III:4 of the GATT. The United States arguments under Article XVII were dismissed by the Panel. In particular, the Panel rejected the United States contention that the term 'commercial' in Article XVII:1(b) means that State Trading Enterprises (STEs) must act like commercial actors that maximize profit, do not enjoy government-conferred privileges, and are disciplined by market forces. The Panel ruled that 'neither the text of the first clause of subparagraph (b) nor 'logic' requires or authorizes us to interpret the first clause so as to prevent export STEs from using their exclusive or special privileges to the disadvantage of "commercial actors"'.⁹⁰ In addition, the Panel found that the United States had not demonstrated that the CWB had incentives to make sales based on considerations which are not commercial in nature, and, therefore, there was no basis for concluding that the CWB has an incentive to discriminate between markets for reasons which are not commercial.⁹¹ The Panel's findings with respect to Article XVII were upheld by the Appellate Body on appeal. The Appellate Body added that there is no basis for interpreting Article XVII:1 as imposing comprehensive competition-law-type obligations on STEs.⁹² With respect to the United States claims that certain requirements related to the import of grain into Canada are inconsistent with the WTO, the Panel found that Canada's bulk grain handling system established under Section 57 of the Canada Grain Act and Section 56 of the Canada Grain Regulations, and Canada's rail revenue cap established under Section 150 of the Canada Transportation Act are inconsistent with Article III:4 of the GATT. These findings of the Panel were not appealed by the parties. The Panel and Appellate Body rulings regarding Article XVII may have demonstrated that the current WTO rules do not pose significant constraints on the operation of STEs. This situation may change with the Doha Round of negotiations since WTO members agreed in the framework agreement of July 2004 to negotiate the issue of use of monopoly powers and the end of trade distorting practices with respect to exporting STEs.

CONCLUSION

The Uruguay Round Agreement on Agriculture marks a vital turning point with respect to the regulation of trade in agricultural commodities. Implementing the Agreement, and particularly its complex disciplines on domestic policies, will be a major challenge for the WTO. It will be equally important, however, for political leaders to maintain the courageous stance that ultimately allowed them to sign the Final Act, and to win domestic legitimacy for freer trade in agriculture. This will entail carefully crafted adjustment policies for affected farmers and their communities, as permitted by the Agreement on Agriculture. It should also involve, however, a vigorous public defence of

the justification for liberalizing agricultural trade, including a clear explanation of the gains to domestic and global economic welfare. Disappointingly, some governments have instead responded to the farm lobbies' predictable criticisms by pretending that little has changed.⁹³ The extent to which the Agreement realizes its promise, however, will be significantly affected by the capacity of governments to obtain public support for liberalization, thereby permitting specific commitments to liberalization that eventually exceed the rather modest minimum reductions required by the Agreement itself. Some trade diplomats and policy analysts place great hopes on the new institutional framework of the WTO as a means of sustaining and intensifying the liberalization commitments of the Uruguay Round.⁹⁴ Ultimately, however, the full potential of the Agreement will only be realized if citizens view the Uruguay Round liberalization of trade in agriculture not as a damage-control exercise or as a concession to the unreasonable demands of others, but rather as a promising new beginning. The Doha Round of negotiations on agriculture will provide a critical test of this hope.⁹⁵

Despite the lofty words of the Declaration, the Doha Round has floundered badly in its initial stages, culminating in a breakdown of talks at a key ministerial meeting in Cancun, Mexico in September 2003. This breakdown was largely attributable to a seemingly intractable disagreement between developed and developing countries on the pace and form of further agricultural liberalization.⁹⁶ However, negotiations may have been revived by a July 2004 'framework agreement' known as the Doha Work Programme.⁹⁷ The main achievement of this agreement is a seven-page 'Framework for Establishing Modalities in Agriculture', representing a preliminary consensus among Members on the next stage of agricultural reform. The Framework reaffirms the Declaration's commitment to 'substantial' reductions in domestic support, specifying an immediate 20% cut in such subsidies upon the conclusion of the Doha Round. Higher levels of domestic support are to be targeted for the deepest cuts. Significantly, the Framework calls for the 'elimination' of export subsidies. This represents a substantial change in position from the Declaration, which aimed only at the 'reduction of, with a view to phasing out' export subsidies. Other forms of export support such as export credits and state trading enterprises are also targeted for elimination. The Framework also promises 'substantial overall tariff reductions', with the deepest cuts reserved for products with the highest tariffs. However, the Framework also makes allowances for certain products to be treated as 'sensitive' and presumably subjected to less drastic cuts. In addition, the Framework reaffirms that special and differential treatment for developing countries will be integral to negotiations, states that lesser commitments will be required of developing countries, and promises flexible treatment with regard to products designated as 'special' by developing countries.

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Trade in services

INTRODUCTION

In the developed countries, services in the 1980s and 90s accounted for 50% to 60% of GNP¹ and in North America in particular are at present the largest source of new jobs in the economy.² At the same time, trade in services is thought to account for only about 20% to 25% of world trade.³ As comparative advantage in the production of many manufactured goods has shifted to the newly industrializing countries (NICs), the developed industrial countries have become increasingly concerned with enhancement of trading opportunities in services, particularly in areas such as financial services, insurance, telecommunications, transportation, computing and professional services (e.g. architecture, engineering, law).

The pre-Uruguay Round GATT framework applies only to trade in goods, reflecting traditional assumptions that services are not easily tradeable. These assumptions have come into question for a variety of reasons. First of all, because of technological developments, it is possible to effect many services transactions without physical proximity between the provider and consumer of the service.⁴ For example, many international banking or insurance transactions can be accomplished through electronic data transfers. Second, in almost all countries through most of the post-war period, many important service industries had been highly regulated, or maintained as state monopolies (telecommunications, transportation). The regulatory reform trend during the 1970s and 1980s resulted in a removal or loosening of prior substantial limits on domestic competition in these industries,⁵ thereby focusing new attention on the possibilities of international competition. It is of significance that regulatory reform in a wide range of countries has led to (at least partial) liberalization of markets in service industries such as telecommunications and transportation that themselves provide the means to bring together providers and users of many *other* services; for example, in many countries, online computer services have become both more feasible and less expensive as a result of regulatory reform in telecommunications.⁶ Third, many services have traditionally been viewed as functions integral to the production of goods, e.g. storage of customer or other data or engineering designs. The ‘splintering’⁷ of services from goods, and the increasing use of external contracting to obtain service inputs into the production of goods (or, indeed, inputs into other services), have created new explicit markets. The logic of external contracting for services within a domestic economy (i.e. that better contract terms can be had outside the firm) seems equally applicable to external contracting with foreigners. Conversely, the globalization of production functions within the multinational corporation (discussed in Chapter 14 on trade and investment) can be extended to include international *intra*-firm trade in service inputs into production *either* of goods *or* of other services. Sauvant notes the example of an American insurance

company that processes claims in Ireland: 'Insurance claims collected in the United States are shipped daily by air to Ireland, where they are processed. The claim information is then sent through transnational computer communication systems back to the United States, where checks are printed and explanations of benefits are mailed out.'⁸

In light of these various developments, all of which create increased potential for international trade in services, the reduction or elimination of barriers to services trade became a major priority of a number of developed countries in the Uruguay Round of GATT negotiations.

In this chapter we will consider the characteristics of traded services and the nature of the barriers to such trade. We will then examine provisions related to trade in services in a range of international agreements, including the Canada-US Free Trade Agreement (FTA), the North American Free Trade Agreement (NAFTA), the OECD Code on Invisibles and, most importantly, the Uruguay Round General Agreement on Trade in Services (GATS). The chapter will conclude with a consideration of the issues in trade in services in two sectors of particular importance to the global economy—financial services and telecommunications. Here, a major focus will be on the sector-specific provisions of the FTA, NAFTA and GATS, as well as the future prospects for negotiation of further commitments to liberalization within the GATS/WTO framework.

THE NATURE OF SERVICES

There is a wide range of economic literature that attempts to define the nature of services, the intrinsic differences between goods and services, and how these differences affect (if at all) the application of the neo-classical theory of comparative advantage to trade in services.⁹ At the level of general principle, there is no reason why the logic of gains from specialization and trade should not apply to services. Nevertheless, the factors that determine comparative advantage in services may often be rather different from those that determine comparative advantage with respect to goods. For instance, 'natural' factor endowments such as land and minerals will be of less importance than in the case of many goods, while 'man-made' factors such as knowledge and skill will be of paramount importance.¹⁰ Nevertheless, one should be wary of exaggerating these differences—for example, countries with beautiful scenery may have an advantage in the export of tourist services.

Traditionally, economists have attempted to define services largely by contrast with goods. Therefore, definitions have emphasized the intangibility or invisibility of services, their supposedly non-durable or transitory character, or the notion that, unlike with goods, consumption and production occurs simultaneously.¹¹ It is, however, possible to find exceptions to each of these definitions. For example, is there anything intangible or invisible about an architect's drawing or a design for an integrated circuit? With respect to transitoriness, as Nicolaides notes, 'a lecture, or occasionally a bank transaction, is longer than the lifetime of an ice-cream'.¹² Also, with respect to some services (e.g. most television programmes), consumption and production are *not* simultaneous. Understandably, given these kinds of anomalies, none of these definitions has attracted any kind of consensus within the economic literature. It has sometimes been argued that services that are inputs in the production of *traded goods* should not be viewed as traded

at all. The *real* trade transaction, it is claimed, occurs when the good itself, in which various service inputs are embodied, crosses national boundaries. This view was taken by the United States when it first sought to place the issue of services on the Uruguay Round agenda. The United States argued that the negotiations should be limited to trade in non-factor services, i.e. services that could themselves be viewed as finished products, such as financial services, thereby excluding services that could be viewed solely as inputs into production (e.g. construction crews).¹³ This distinction rather transparently served US self-interest: liberalization would occur with respect to knowledge- and technology-intensive services in which the USA had a comparative advantage, but would not occur with respect to labour-intensive services in which developing countries might have an advantage over the United States.¹⁴

It is not difficult to appreciate the artificiality of the distinction between services as final products and services as inputs. Most of the services often described as final products are also important inputs into the production, marketing and distribution of goods, including financial services that provide the capital required for production. At the same time, since *goods* that are primarily inputs into the production of other goods are governed by trade rules on goods, it seems illogical that services that are inputs into the production of goods (or indeed other services) would not also be governed by trade rules that apply to services.

A particular conceptual difficulty exists with respect to services that are embodied in goods as a *medium* for the delivery of the service. Literature and recorded music, for instance, could plausibly be considered as services that are embodied in or transmitted to the user through goods. However, trade in these services has been traditionally conceptualized as trade in the goods which embody them. Would it be more appropriate to subject the trade in question to rules on services?

These various definitional quagmires are largely avoidable, however, if instead of attempting an abstract definition, one looks to the purpose of creating trade rules on services in the first place. The purpose is to reduce or eliminate barriers to trade that are not caught by existing rules, since those rules have been designed largely with a view to liberalizing trade in goods. From the perspective of trade law and policy, what is most important is to be able to identify a set of barriers that should be reduced or removed to facilitate trade in services. Of course, the nature of these barriers arises from certain identifiable characteristics shared by a significant number of service industries (such as a high degree of domestic regulatory control or the importance of free movement of capital and labour to trading opportunities), but some non-service industries may also possess some of these characteristics. For this very reason, the knowledge of which traits of service industries are important from the point of view of trade liberalization may not generate a satisfactory abstract or conceptual definition of services, i.e. a definition that rigorously delineates goods from services in an essentialist manner.

BARRIERS TO TRADE IN SERVICES

Many barriers to trade in services relate to the modes of supply characteristic of service industries. Thus, in many cases, a commercial presence may be necessary or highly desirable in order to provide services in another country—thus the liberalization of

foreign direct investment is directly related to the liberalization of trade in services. Another way in which services are traded between providers of one country and consumers of another is through movement of people. Here, immigration restrictions that prevent temporary entry for purposes of providing a service, as well as restrictive licensing and certification requirements, may constitute barriers to trade in services. Services may also be traded through the movement of data and money across borders (insurance and accounting are examples)—thus, exchange and capital movement controls, as well as the regulation or restriction of transboundary data flows, may constitute barriers to trade in services. In other cases, trade in services occurs through access of the provider and/or consumer to a network, either international or domestic or both—the terms of access or interconnection with such networks may constitute barriers to trade in services. Where the network is owned and operated by a dominant market player and/or former monopolist, competition policy issues become intertwined with the removal of barriers to trade in services (as is the case with telecommunications services).

The very fact that barriers to trade in services are so heterogeneous and difficult to quantify makes a comprehensive approach to their discipline extremely difficult to conceptualize. Some would clearly be caught by a National Treatment obligation, but many others would not. As well, and perhaps more fundamentally, many of the barriers (particularly those that are not discriminatory or directly targeted at foreign providers) relate to fundamental domestic regulatory choices (such as between regulated monopoly or competition in a particular sector) or quality regulation, for instance requirements for the training and certification of professionals that allow for limited recognition of foreign credentials but do not directly discriminate on the basis of the nationality of the *provider* as opposed to the source of her training.

Ultimately, removal of these barriers would require harmonization of domestic regulatory regimes or (as in the European Union blueprint for liberalization of financial services) home country regulation, whereby a service provider is given the right to enter a foreign market provided it complies with its home country's regulatory requirements. In the case of professional services, the equivalent to home country regulation is mutual recognition of qualifications or licences, whether in accounting, engineering, law or architecture (law is perhaps the most problematic of all these cases, since a country-specific knowledge base may often be seen as a legitimate precondition for professional competence).

Many advocates of liberalization of trade in services see the argument for free trade internationally as linked to the purported benefits of deregulation domestically.¹⁵ Yet whether strict or liberal regulation (and these terms arguably conceal a much more subtle set of instrument choices)¹⁶ maximizes *domestic* welfare depends on complex judgments about market failures, and the costs and benefits of a particular regulatory approach in light of the risk preferences of one's own citizens. Three important and related observations follow from this insight. First of all, the global gains from liberalization of trade in services should be conceptually separated from gains or losses to domestic welfare that may be entailed by the regulatory changes required to produce a level playing field to sustain liberalization. If we assume a beginning point where the regulatory choices of each Member State represent a social optimum that maximizes domestic welfare within that state, then any changes in regulation needed to sustain liberalization in trade are likely to reduce domestic welfare—the global gains from trade

that are yielded by liberalization must be then traded off against domestic welfare losses. Of course, if some countries' domestic regulatory regimes are suboptimal from the perspective of domestic welfare, then liberalization may yield gains in excess of those from liberal trade itself.

On the other hand, in the absence of a high but level playing field, free trade in services may lead to spillovers that distort the global allocation of resources. For example, where lax regulation of a bank in one country results in failure of financial institutions or prejudice to depositors in another that have placed large deposits in that bank, significant costs will be incurred by the public authorities in that other country. The possibility of free trade in services allows countries to shift beyond their own borders some of the negative welfare effects of their regulatory approaches, thus driving a wedge between domestic and global welfare. Thus, in the absence of agreed minimum regulatory standards, free trade in services may actually result in a net reduction in aggregate global economic welfare—i.e. the gains from free trade are more than outweighed by the reduction in global welfare due to the opportunities for externalizing the costs of domestic regulatory approaches abroad that are created by liberalization.

However, the existence of such spillovers has already led to considerable regulatory cooperation in a number of highly significant service sectors. The world's leading financial powers have accepted guidelines for capital adequacy of banks under their regulatory control (the Cooke Committee guidelines, negotiated under the auspices of the Bank for International Settlements in Basel (BIS), although the Asian crisis showed the need to go much further in these respects);¹⁷ cooperation between domestic securities regulators has become increasingly effective in containing contagion effects where instability or regulatory failure in one market undermines market confidence elsewhere;¹⁸ and in telecommunications and aviation, coordination of a wide variety of domestic regulatory policies that have transboundary impacts occurs through a variety of bodies, including the International Telecommunications Union (ITU) and the International Civil Aviation Organization (ICAO).

It would be wrong to suggest that any of these fora or processes is leading or can lead in the foreseeable future to a genuinely level playing field, or to a resolution of all important conflicts over differences in domestic regulatory philosophy or regulatory interests. At the same time, the evidence does indicate that as markets in service sectors have become increasingly globalized, cooperative mechanisms have emerged to manage regulatory spillovers and constrain 'beggar-thy-neighbour' regulatory competition.

INTERNATIONAL AGREEMENTS FOR THE LIBERALIZATION OF TRADE IN SERVICES

The Canada-US Free Trade Agreement

Article 1402.1 of the Canada-US FTA states a basic National Treatment obligation with respect to services: 'Each Party shall accord to persons of the other Party treatment no less favourable than that accorded in like circumstances to its persons.' This general obligation applies to a wide range of measures, including the right of establishment, access to domestic distribution systems, and generally any measure related to 'the

production, distribution, sale, marketing and delivery of a covered service'. The National Treatment obligation applies to a limited number of sectors listed in an Annex to these provisions. The sectors range from construction to insurance to public relations.

The general National Treatment obligation is followed by a limitations clause, which permits deviation from National Treatment, where 'the difference in treatment' is 'no greater than that necessary for prudential, fiduciary, health and safety, or consumer protection reasons' (Article 1402(3)(a)). Such deviations must be 'equivalent in effect to the treatment accorded by the Party to its persons for such reasons'. Suppose, for instance, a Canadian province was to require American construction service providers to post a bond to assure that funds were available to pay occupational health and safety or workers' compensation claims, but did not demand the same of local firms. The argument would first of all be made that the differential treatment of Americans is due to the fact that they are unlikely to have valuable assets in the jurisdiction that can be readily seized or attached in case of non-payment of these claims. Equivalence in effect would be established by showing that this required bond has much the same *regulatory impact* on American operators as provisions permitting seizure and attachment in the case of local providers. On the other hand, if it turned out that local laws did not provide means of securing judgment against local firms for such payments, the American firm could argue that the regulatory impact was not, indeed, equivalent in effect. Finally, prior notification of differential treatment must be provided to the other Party, and the Party imposing the differential treatment must bear the burden of justifying it.

The National Treatment obligation in the FTA is subject to grandfathering, i.e. it does not apply to existing measures, or to continuation, 'prompt renewal' or amendment of existing measures. In the case of amendment, however, the effect must not be to *decrease* conformity with National Treatment. Obviously, the distinction between an amendment and a new measure is one that has no self-evident legal meaning. New comprehensive legislation would almost certainly be considered in the nature of a new measure, but the case of alterations that are more than caretaking amendments but less than a basic policy overhaul would be more difficult to classify.

The grandfathering provision may reflect in part expectations arising from the tendency towards deregulation and regulatory reform that was among the most prominent policy trends in both the United States and Canada—as well as in many other countries—during the late 1980s.¹⁹ As these dynamics led to liberalizing reforms in both countries, the new measures, presumably more conducive to free trade in themselves, would then be caught by the FTA, which would prohibit a future retreat to more restrictive approaches.

It should be noted that the National Treatment obligation in the FTA is not accompanied by a Most Favoured Nation (MFN) obligation. Therefore, a Party to the FTA is free to treat services provided by a third country more favourably or less favourably than those provided by the other FTA partner, where this treatment is also superior to that provided to its own nationals. Also, there is a provision that serves the same function as do rules of origin in the case of trade in goods. Hence, Article 1406.1 permits the other Party to deny the benefits of the National Treatment obligation with respect to services where it can be established that 'the covered service is indirectly provided by a person of a third country'. Clearly, this is a very rough rule of thumb—for instance, would a Japanese insurance company or architectural firm that provides services to the US market through a Toronto office where both Japanese and Canadian nationals

are employed be viewed as ‘a person of a third country’? Or what of a Canadian engineering company that supplied advice on a particular project to an American client, but on the basis of groundwork done by a multinational team of mining engineers?

In addition to the general National Treatment obligation, sectorally specific treatment is given to telecommunications and financial services (to be discussed in detail in the final part of this chapter). As well, there are provisions that mandate in some instances, and encourage in others, the development of common standards in various professional disciplines, e.g. architecture—enabling mutual recognition of some professional qualifications and facilitating movement of some service providers (but not labour in general) across the Canada-US border.

The North American Free Trade Agreement

The NAFTA takes an approach to liberalization of trade in services that is similar to that of the Canada-US FTA. However, one significant difference is that, unlike the FTA, the NAFTA contains an MFN obligation that applies with respect to both Parties and non-Parties (Article 1203). A second significant difference is that both the National Treatment (Article 1202) and MFN obligations in NAFTA are not limited to specific service sectors but are applicable to services generally.²⁰ Instead, a ‘negative list’ approach is adopted, whereby reservations are noted with respect to particular service sectors or particular measures within certain sectors to which a Party does not want these obligations to apply. The only service industries excluded altogether from coverage by the Services Chapter of NAFTA are those ‘associated with energy and basic petrochemical goods and air services’. However, the reservations noted by Canada, the United States and particularly by Mexico in Annexes to the NAFTA apply to a wide range of measures in various service industries. Very extensive reservations apply for one or more of the NAFTA Parties with respect to transportation (especially maritime shipping) and some professional services (especially law). In addition, further Annexes are to contain reservations with respect to measures of sub-national governments. These lists may well be quite lengthy, as in both Canada and the United States provincial and state governments (respectively) are deeply involved in the regulation of many services, particularly professional services.

A NAFTA Chapter 20 Panel found the USA in violation, *inter alia*, of its National Treatment and MFN obligations under the Services Chapter of NAFTA due to a blanket ban on Mexican trucks in the United States (USA-98–2008–01 *Cross-Border Services and Investment in the Trucking Sector*, Report of the Panel, February 6, 2001), the United States sought to justify the ban as necessary for safety reasons, given inadequate regulatory standards for trucking safety in Mexico. However, the Panel found that these concerns could be met by a case by case examination of the safety record of individual Mexican trucking firms seeking access to United States (and indeed there had been already some limited exceptions from the ban that operated in this manner).

In contrast to the FTA, existing services measures are not grandfathered in the NAFTA, although there is to be a two-year delay with respect to state and provincial measures to allow these governments adequate time to elaborate satisfactory lists of reservations (Article 1206). As in the FTA, the communications and financial services

sectors are dealt with in separate, sectorally specific Chapters (Chapters 13 and 14), to be discussed in the final part of this chapter.

In addition to the National Treatment and MFN obligations, which address direct and facially discriminatory barriers to trade in services, the NAFTA provides a framework for removal of other classes of barriers. For instance, with respect to direct but facially neutral barriers—defined in the NAFTA text as ‘non-discriminatory measures relating to the cross-boundary provision of a service’ (Article 1208)—Parties are invited to list specific commitments in Annex VI of the NAFTA (to date, very few such commitments have been made). As well, the NAFTA Parties are to engage in further negotiations with respect to temporary licensing of engineers on the basis of mutual recognition of professional credentials. These negotiations are to take place within a year of the entry into force of the NAFTA itself (Annex 1210 (Professional Services) Section C).

The OECD Invisibles Code

The Invisibles Code²¹ requires OECD Members to eliminate between each other ‘restrictions on current invisible operations’ (Article 1). The expression ‘current invisible operations’ refers to a wide variety of transboundary service transactions, listed in Annex A of the Code. These include, *inter alia*, many forms of technical assistance to businesses, including training, market research, and provision of plans and blueprints, construction services and maintenance services. As well, ‘current invisible operations’ includes transactions that *facilitate* transboundary services provision. Thus, transboundary movement of the salaries and wages of non-resident workers is included in the list in Annex A.

Members are permitted to lodge reservations and (in some circumstances, such as a domestic economic or financial crisis) derogations from the basic obligation to remove restrictions on current invisible operations, but must indicate their reasons for doing so. These reasons are periodically scrutinized by the Committee on Capital Movements and Invisibles Transactions. The Committee may recommend to a Member that it remove a reservation, but these recommendations do not have binding legal force. Reservations appear to be lodged most frequently with respect to audio-visual, maritime transport and insurance services.²²

The Invisibles Code contains a general limitation clause that allows Members to take measures that they consider necessary for reasons of public order, the protection of public health, morals and safety, or for reasons of domestic or international peace and security (Article 3).

The General Agreement on Trade in Services (Uruguay Round Final Act)

Background

It was largely due to the insistence of the United States that trade in services was placed on the Uruguay Round agenda.²³ This initiative generated much controversy and disagreement among other Contracting Parties, especially (but not exclusively) developing countries.²⁴ The reasons for this controversy can be traced to two

interconnected factors. First of all, a major motivation for the US initiative was the belief that unlike many basic manufacturing sectors where it was losing global markets as well as part of its domestic market to NIC competitors, service sectors remained a strength of the United States, especially sectors like financial services and telecommunications, considered to be highly knowledge- and technology-intensive. Some developing countries responded to this logic, and drew the conclusion that liberalized trade in services would result in their domestic providers being outcompeted by American firms. Moreover, most developing countries could see little benefit accruing to them through access to the services markets of other countries. It was argued that the comparative advantage that developed countries possessed with respect to services was due to their overall higher level of economic and technological development, and if liberalization of trade in services occurred under these conditions, developing-country providers would lose their domestic services markets before even having had a chance to acquire comparative advantage in service sectors. This was, in essence, a variant of the infant industry argument for protection that had often been invoked by developing countries in previous GATT negotiations with respect to trade in goods.

Some economists, the most prominent among them Jagdish Bhagwati, challenged the notion that developing countries possessed no comparative advantage in service sectors.²⁵ They noted that a range of developing countries (e.g. India) possessed significant numbers of highly trained professionals such as engineers and accountants who were typically paid far less than equivalent professionals in the developed industrial countries. Moreover, some services (such as construction) were labour-intensive, thereby potentially conferring a comparative advantage on developing countries with abundant supplies of skilled or semiskilled labour. Finally, the NICs, which had already acquired the capacity to manufacture medium- and some high-technology goods, could be expected to have some export potential with respect to related services, such as computer software.

In fact, these claims seem to be borne out by recent statistics. Between 1980 and 1987, a significant number of developing countries substantially increased the share of their total exports accounted for by services (including Egypt, Chile and the Philippines).²⁶ Moreover, in at least a dozen developing countries, in 1987 the percentage of total exports accounted for by services approached, equalled or even exceeded that of many developed countries.²⁷

More recently, the extent to which services such as call centres and customer support and data collection functions ('business services') are being provided by developing countries has in fact sparked a protectionist backlash in the USA. According to Mattoo and Wunsch, 'the exports [of "business services"] of countries like India, Israel, Dominica and Brazil have grown at rates above 20 percent per annum [between 1995 and 2000]. Moreover, many other developing countries—including Mauritius, Nicaragua, Barbados and China—have witnessed high rates of growth... What looks like a healthy job creation process in India and other developing countries may be seen as a "white collar job outflow" in the industrialized countries.'²⁸ Mattoo and Wunsch point to estimates that as many as 3.3 million jobs may be lost in the USA alone in this fashion over the next decade. Some states are proposing a prohibition on the use of offshore facilities in state procurement of such services; New Jersey is the first to actually put forward proposed legislation.

Although at the level of general principle the United States espoused the idea that negotiations on services should have a comprehensive scope, the US position on the definition of services themselves had the effect of focusing the negotiations on those sectors of most export interest to the United States and other developed countries (e.g. cross-border transactions in sectors such as telecommunications and financial services), while excluding liberalization of factor movements, especially labour,²⁹ where developing countries might often have a comparative advantage (e.g. ships' crews, construction gangs, etc.).

A second, important concern shared by many countries as well was the aggressive 'market access' approach to an accord on services that appeared to be taken by the United States. The United States appeared interested not only in the extension of the National Treatment obligation to services, but also in negotiating whatever changes in countries' domestic regulatory structures might be necessary to allow market access by foreigners. Since, as we discussed in 'Barriers to trade in services' (this chapter), many of the barriers to trade in services do indeed result from fundamental choices of regulatory instrument by individual countries (e.g. state monopolies, licensing or rate-setting), or from regulatory diversity itself, there was some substantive justification for a market access approach. However, the ultimate implications for domestic policy sovereignty would be profound. While all international trade obligations involve some surrender of domestic sovereignty, it was understandably far from clear to many Contracting Parties that the benefits of liberalization would outweigh the costs of substantially constraining or altering their domestic regulatory approaches. Since the Reagan Administration was firmly persuaded that the domestic changes required to meet its market access demands (e.g. privatization and deregulation) would also be of considerable benefit to the countries adopting these changes, it did not see any profound conflict of domestic and global interests in trade in services. Indeed, a range of countries (including some developing nations) had embarked unilaterally on ambitious programmes of deregulation and privatization, and it could be argued that a GATT services agreement would be one means of attaining some reciprocal trade benefit from these policy shifts. Nevertheless, contrary to crude 'free market' rhetoric, deregulation and privatization entail complex transitional issues and formidable challenges of regulatory redesign.³⁰ It is not surprising, therefore, that even countries with short- or long-term intentions of liberalizing domestic competition in key service sectors did not want their room to manoeuvre fundamentally constrained or pre-empted by a multilateral market access agreement.³¹ As well, negotiated reciprocal market access could easily turn into a market-sharing or managed trade arrangement, in tension with the general principles and philosophy of the GATT. This would be especially true if the position of some American experts were adopted³² and these market access commitments were negotiated on a discriminatory non-MFN basis.

As the negotiations evolved, insistence on a non-MFN approach became an important means of the US backtracking from its original 'open borders' rhetoric, as many US providers became increasingly worried about having to compete with foreigners in their own market. Where domestic US service providers were opposed to more competition at home, it would always be possible to insist that commitments in the area in question should be negotiated on a reciprocal basis, on the grounds that other countries were not prepared to open up their markets sufficiently to justify free access for foreign producers

to the US market. The large degree of indeterminacy in assessing how much other countries' specific commitments to liberalization were worth in terms of reciprocal access to one's own markets actually permitted a wide scope to the United States for justifying on reciprocity grounds its increasing refusal to make broad multilateral commitments to liberalize access to its own markets.

The negotiations, despite numerous impasses, were brought to at least a partial resolution (i.e. agreement on a framework with negotiations in some sectors to continue) on the basis of a number of carefully negotiated compromises. First of all, it was agreed that liberalization of trade in services would be negotiated under the 'umbrella' of the Uruguay Round, but with a view to the conclusion of an accord that would be legally separate from the GATT itself, i.e. a General Agreement on Trade in Services (GATS). Since agreement was reached on the institutional framework for a World Trade Organization (WTO), it was possible to maintain GATS (as well as the Agreement on TRIPs) as separate from GATT, but to place GATS nevertheless within the overarching framework of the WTO. With respect to the debate over MFN, however, the United States insisted to the very end on being able to exclude certain sectors almost entirely (e.g. maritime services) from the general framework of the GATS, and also on being able to negotiate on a reciprocal basis market access commitments with specific countries, which would be excluded from MFN treatment. With respect to financial services (to be discussed in the final section of this chapter), it was necessary to provide a special accommodation for the United States with respect to MFN exemptions in order to allow the round to close at the mid-December deadline.

Understanding the GATS

The GATS is a highly complex accord. The GATS contains an MFN obligation that applies to services generally, subject to reservations taken by individual Members within some narrow exceptions. However, National Treatment and most other disciplines (including a prohibition on quantitative restrictions of various kinds, known as 'market access') apply only where Members have made specific commitments to such coverage in the schedules—these commitments may be either general in scope with respect to a given mode of delivery for a service (e.g. local business presence) or they may apply to specific sectors; commitments for a mode of delivery also may contain certain qualifications on National Treatment and 'market access'. Thus, in a very real sense, the schedules of specific commitments constitute the pith and substance of the GATS.

Parts I and II of the GATS provide a set of general rules and principles with respect to liberalization of trade in services. Here, the GATS may be said to apply or adapt some of the key concepts and principles of the GATT to trade in services. Parts III and IV provide a framework for the negotiation of specific market access commitments to be bound in the schedules of individual Members. Part V contains provisions concerning dispute settlement and enforcement of obligations. Part VI deals with a variety of definitional issues in the application of the GATS. There follows a series of Annexes on exemption from MFN treatment, movement of persons, financial services, telecommunications and air transport services. In addition, there is a series of eight Decisions concerning various aspects of implementation and interpretation of the GATS (ranging from financial services to dispute settlement).

The following discussion covers all of these various provisions and instruments, except those specifically addressed to the financial services and telecommunications sectors, which will be dealt with in the final part of this chapter.

Part I

The definitions in Part I evoke a very broad view of the meaning of trade in services, without thereby attempting to define services themselves. Along these lines, the GATS is to apply not only to 'supply of a service...from the territory of one Member into the territory of any other party' (I.2(a)), but also to such 'supply' 'in the territory of one Member to the service consumer of any other Member' (I.2(b)) and through 'the presence of service providing entities of one Party in the territory of any other Party' (I.2(c)), as well as 'by natural persons of one Party in the territory of any other party' (I.2(d)). Clearly, I.2(c) directly bears upon the treatment of foreign investment, including the right of establishment, and I.2(d) on the right to enter a state of which one is not a national. What kind of measure would involve a restriction on the supply of a service on the territory of one Party to the consumer of another may at first glance seem obscure. An example might be a requirement that nationals of country A engage in certain banking or securities transactions only within country A and not in other Contracting Parties. Here, what is being restricted is not the flow of other Contracting Parties' services into A but access of A's customers to services offered by providers of other Contracting Parties.

Article I.2(d), which refers to supply of services 'through presence of natural persons of a Member in the territory of any other Member', would seem to imply that the scope of the GATS extends to include liberalization of movement of persons. However, this is not an area where, pursuant to Parts III and IV of GATS, Members are under any obligation to negotiate specific commitments. This is reinforced by the Annex on Movement of Natural Persons Supplying Services under the Agreement, which states that 'In accordance with Parts III and IV of the Agreement, Members *may* negotiate specific commitments with respect to movement of natural persons' (emphasis added). The Annex also states that the GATS does not apply in respect of 'measures affecting natural persons seeking access to the employment market of a Member, nor shall it apply to measures regarding citizenship, residence or employment on a permanent basis' (Article 2). However, a limited concession to the concern of developing countries that the GATS extend to movement of people is to be found in the Decision on Movement of Natural Persons, which provides that negotiations on movement of persons are to continue beyond the Uruguay Round through the establishment of a 'negotiating group on movement of natural persons'. The negotiating group is to conclude negotiations within six months of the entry into force of the Agreement establishing the WTO and to present a final report to the Council on Trade in Services at that time, when any commitments that result from the negotiations will be inscribed in Members' individual schedules.³³

Article I.3 sets out the entities to which GATS strictures on services will apply. This includes not only three levels of government (described as 'central', 'regional' and 'local') but also 'non-governmental bodies in the exercise of powers delegated' by these three levels of government. This last inclusion represents an important departure from typical GATT practice of only seeking to bind governmental entities, whether directly in the case of Members' central governments or indirectly in the case of sub-national

governments. The departure reflects the fact that in some countries, various professional services are often self-regulating in whole or in part; legal services, accounting, architecture and some health services are typical examples. A rather different kind of example would be the Canadian Radio and Television Commission—a public body created pursuant to statute but explicitly intended to exercise public authority independent from the government of the day. An important question will become whether a formal or functional definition of delegated powers is to be employed in the interpretation of this subsection. Some self-regulating bodies (e.g. the committee that promulgates the City rules that apply to London securities houses) do not exercise directly delegated powers, but could be said to perform a function that in many other Contracting Parties would be given to a government agency (in this case a securities commission like the US SEC). The formal perspective would be more in keeping with the GATT tradition of relating disciplines only to direct government action, but could result in an arbitrary asymmetry of obligations, with Members that choose a self-regulating approach to certain sectors being subject to less discipline than those that adopt more direct regulatory instruments, or at least structure self-regulation as explicitly delegated regulatory power.

In any case, *Members* (i.e. states) remain responsible for the compliance of these non-governmental entities with GATT provisions. One view of such an obligation, that would go hand in hand with a functional view of delegated powers, is that a positive obligation is imposed on governments to curb the practices of these entities that violate the GATS. The notion that the GATS—as a liberalizing agreement—could involve an obligation to regulate may seem, at first, odd. However, it should be noted that numerous provisions of the Agreement on TRIPs impose requirements of this kind with respect to protection of intellectual property rights.

Part II

MFN treatment

Article II:1 requires that MFN treatment be accorded ‘immediately and unconditionally to services and service providers of any other country’. Article II:2 however, allows a Member to maintain exemptions to MFN treatment, provided that the Member lists the exempted measure in the Annex on Article II Exemptions, and provided that the conditions listed in that Annex are complied with. The conditions include: that exemptions granted for more than five years shall be reviewed by the Council for Trade in Services to determine ‘whether the conditions which created the need for the exemptions still prevail’ (Annex: Articles 3, 4(a)); and that exemptions should not last for more than ten years and must be subject to negotiation in subsequent rounds of multilateral negotiations.

These provisions reflect a compromise between American insistence that, at least in many key sectors, the USA should not be required to open up its markets to countries not prepared to provide an adequate equivalent degree of market access, and the concerns of many other Members that the GATS does not evolve into a tangled web of bilateral sectoral deals, i.e. into a regime of sectoral-managed trade at odds with basic GATT principles of rules-based multilateral liberalization. In essence, the USA and other

countries that so wish are permitted to continue to pursue liberalization arrangements based on reciprocity, but the justification for refusing to extend these arrangements to other Members on an unconditional MFN basis is subject to ongoing scrutiny within the framework of the WTO.

Article II:3 exempts from the MFN requirement 'advantages' conferred on 'adjacent countries in order to facilitate exchanges limited to contiguous frontier zones of services that are both locally produced and consumed'. Part II contains a range of substantive obligations that are binding on all Members. Some of these obligations apply to trade in services generally, while others apply only where a Member has made specific commitments to market access in its schedule. Article III:1 requires prompt publication of 'all regulations of general application, which pertain to or affect the operation' of GATS, and Article III:3 requires, at a minimum, annual reporting to the Council for Trade in Services of any new measures 'which significantly affect trade in services' covered by specific commitments in a Member's schedule. Article VI:1 provides that in sectors where specific commitments are undertaken, each Member shall ensure that all measures of general application affecting trade in services are administered in a 'reasonable, objective and impartial manner', and Article VI:2 requires that administrative and/or judicial review of decisions that affect trade in services be available, subject to any constraints that may arise due to a Member's constitution or the nature of its legal system.

Among the most important substantive provisions of Part II is the framework for scrutiny of technical barriers to trade in services set out in Articles VI:4–5. The Council for Trade in Services is to develop a set of disciplines on these barriers (including 'qualification requirements and procedures, technical standards and licensing requirements') so as to ensure that these measures do not 'constitute unnecessary barriers to trade in services'. This work is to occur under 'appropriate bodies' established by the Council. The resultant disciplines will ensure that measures such as qualification requirements and technical standards are, *inter alia*: '(a) based on objective and transparent criteria, such as competence and the ability to supply the service; (b) not more burdensome than necessary to ensure the quality of the service; (c) in the case of licensing procedures, not in themselves a restriction on the supply of the service' (Article VI:4). The Decision Concerning Professional Services, which is part of the Uruguay Round Final Act, provides that 'the work programme foreseen in Article V, paragraph 4...should be put into effect immediately'. For these purposes, a working party is to be established, which is to give priority to the elaboration of multilateral disciplines with respect to regulation of the accounting profession (Article VI:5(a) of GATS makes the criteria in Article VI:4 immediately and directly³⁴ applicable to domestic measures in a sector where a Member has already made specific commitments in its schedule, at least where there is a possibility that the measures in question may nullify or impair specific market access commitments in a Member's schedule).

Article VII is aimed at the multilateralization of existing arrangements for recognition of educational and other credentials in the licensing or certification of service providers. Whether such recognition is afforded to particular countries unilaterally or on the basis of negotiated reciprocity (i.e. mutual recognition), other Members must be given the opportunity of demonstrating that credentials, licensing or certification in their country are also worthy of recognition. Moreover, 'a member shall not accord recognition in a

manner which would constitute a means of discrimination between countries in the application of its standards or criteria for the authorization, licensing or certification of service suppliers, or a disguised restriction on trade in services' (Article VII:3).

Articles VIII and IX concern monopolies and restrictive business practices. Article VIII requires that Members ensure that monopoly service suppliers act in a manner that is not 'inconsistent' with the Article II MFN obligation, or with specific commitments in the Member's schedule. Moreover, Members are required to prevent 'abuse' of monopoly position, where a domestic monopolist is competing in the supply of a service over which it does not have monopoly rights (Article VIII:2). An obvious example would be that of a telecommunications concern that has a monopoly over local service but competes with respect to long-distance and other services. Article IX provides for mandatory consultations where a service provider is believed to be restricting competition through business practices other than those described in Article VIII.

Part II of the GATS contains safeguards provisions and a set of general exemptions to GATS obligations. Article X of GATS provides that a permanent safeguards provision shall be negotiated within a three-year period. In the interim, Members are free to modify or withdraw specific commitments under the GATS provided that the Member justifies before the GATT Council that its measures are urgently needed and must be taken before the end of the three-year period contemplated for negotiation of a permanent safeguard instrument. There is an additional provision that permits the reimposition of restrictions on trade in services that would otherwise be inconsistent with a Member's specific commitments, where necessary to address serious balance of payments difficulties or other 'external financial difficulties' (Article XII). Such restrictions must, *inter alia*, be applied on a non-discriminatory basis and be consistent with the International Monetary Fund (IMF) Articles of Agreement.

Article XIII exempts government procurement from the MFN and National Treatment³⁵ obligations of the GATS, subject to a requirement that negotiations on government procurement of services take place within two years of the establishment of the WTO. Articles XIV and XIVbis contain general exceptions to GATS obligations, modelled respectively on Articles XX and XXI of the GATT. Article XIV exempts from GATS discipline measures 'necessary to protect public morals or to maintain public order' as well as 'human, animal or plant life or health', provided these are not 'a means of arbitrary or unjustifiable discrimination between countries where like conditions prevail, or a disguised restriction on trade in services'. In addition to these exceptions, virtually identical to some of those in Article XX of the GATT, exceptions are also provided that reflect particular concerns with respect to service sectors, for example privacy concerns with respect to transborder data flow (Article XIV(c)(iii)). As well, Article XIV(d) exempts from the National Treatment obligation differential tax measures for foreign service providers, where these special measures are necessary, for example, to counter tax avoidance or evasion. Article XIVbis provides an exception for measures taken for the 'protection of essential security interests', and is for all relevant purposes virtually identical to Article XXI of the GATT. Finally, Article XV requires Members to enter into negotiations with a view to multilateral disciplines on subsidies that affect trade in services, as well as on the issue of the countervailability of subsidies to service providers. Currently, only subsidies on goods are countervailable under domestic trade remedy laws of the major trading states, and the GATT provisions on subsidies can be

taken to authorize countervailing duty actions only with respect to trade in goods. Subject to the future negotiations contemplated by Article XV, GATS may be said to prohibit the imposition of countervailing duties inasmuch as these would violate the general MFN obligation in Article II of GATS. Article XV also provides that a Member that deems itself adversely affected by the subsidy of another Member may request consultations with the other Member. Such requests for consultations must be given sympathetic consideration.

Parts III and IV

Parts III and IV of the GATS apply with respect to specific market access commitments provided by Members in their schedules.

Scheduling of specific commitments

The methodology for scheduling of specific commitments is based on the four modes of supply identified in Part I of the GATS: cross-border supply, consumption abroad, commercial presence and temporary entry of natural persons. With respect to each of these modes of supply, Parties have made either horizontal commitments (across all sectors) or specific commitments (with respect to a particular sector) or none (in which case the Member lists itself as 'unbound' with respect to that mode of supply). Either horizontal or specific commitments with respect to each mode of supply may be subject to conditions and limitations on market access or conditions and qualifications on National Treatment. Market access refers to the obligations with respect to elimination of quantitative restrictions in Article XVI(2). Specific commitments have been scheduled based upon a classification of activities developed by the GATT Secretariat and based on the United Nations Central Product Classification (CPC). Nevertheless, there is no legal obligation that Members use this list. Each country's schedule can be accessed through the WTO website, which contains a useful guide as to how to read a schedule (<http://www.wto.org/>).

It is difficult to estimate what degree of liberalization has actually been achieved by the specific commitments bound in the Uruguay Round. Hoekman³⁶ has attempted to measure these results in terms of the number of commitments bound, the number of sectors covered by each Member, and the extent to which restrictions have been placed on market access and National Treatment. With respect to the number of commitments bound, the results are summarized in Table 12.1. With respect to sectoral coverage, weighted by the economic importance of the sector and the degree of restrictiveness (which determine together the liberalizing value of commitments in a given sector), Hoekman's findings are shown in Table 12.2. With respect to the magnitude of commitments where no conditions or qualifications are listed with respect to market access and/or National Treatment, Hoekman remarks: 'The figure for high income countries is 25 percent, for low- and middle-income countries 7 percent. These numbers vividly illustrate how far away GATS members are from attaining free trade in services, and the magnitude of the task that remains.'³⁷ Sauve suggests:

Virtually all the commitments scheduled under the GATS—including by OECD countries—represent a binding of the *status quo* rather than a rollback of existing restrictions to trade and investment in services. Such a regulatory freeze, which in many cases involves important qualifications and limitations (suggesting that some Members may, in fact, have offered less than the *status quo*) in effect establishes the liberalization frontier which successive rounds of negotiations will have as a central objective to push back [footnote omitted].³⁸

Table 12.1 GATS members: number of commitments scheduled

<i>Developing countries</i>		
Algeria	4 New Caledonia	24
Antigua and Barbuda	68 Nicaragua	196
Antilles (the Netherlands)	144 Niger	20
Argentina	208 Nigeria	96
Aruba	140 Pakistan	108
Bahrain	16 Paraguay	36
Bangladesh	4 Peru	96
Barbados	24 Philippines	160
Belize	8 Poland	212
Benin	44 Romania	176
Bolivia	24 St Lucia	32
Brazil	156 St Vincent and the Grenadines	32
Burkina Faso	8 Senegal	104
Cameroon	12 Slovak Republic	308
Chile	140 South Africa	288
China	196 Sri Lanka	8
Colombia	164 Suriname	16
Congo	16 Swaziland	36
Costa Rica	52 Tanzania	4
Côte d'Ivoire	56 Thailand	260
Cuba	120 Trinidad and Tobago	68
Czech Republic	304 Tunisia	52
Dominica	20 Turkey	276
Dominican Republic	264 Uganda	8
Egypt	104 Uruguay	96
El Salvador	92 Venezuela	156
Fiji Islands	4 Zambia	64
Gabon	44 Zimbabwe	72

Ghana	10	
Grenada	20	<i>High-income countries</i>
Guatemala	40	Australia 360
Guyana	72	Austria 412
Honduras	64	Brunei 76
Hungary	336	Canada 352
India	132	Cyprus 36
Indonesia	140	European Union 392
Jamaica	128	Finland 328
Kenya	84	Hong Kong 200
Korea	311	Iceland 372
Macao	76	Israel 180
Madagascar	8	Japan 408
Malaysia	256	Kuwait 176
Malta	28	Liechtenstein 312
Mauritius	43	New Zealand 276
Mexico	252	Norway 360
Morocco	144	Singapore 232
Mozambique	48	Sweden 320
Myanmar	12	Switzerland 400
Namibia	12	United States 384

Note

The maximum number of commitments is 620–155 activities multiplied by 4 modes of supply.

Table 12.2 Sectoral coverage of specific commitments (%)

	<i>High-income countries</i>	<i>Low- and middle-income countries</i>	<i>Large developing nations</i>
<i>Market access</i>			
Unweighted average count (sectors—modes listed as a share of maximum possible)	47.3	16.2	38.6
Average coverage (sectors—modes listed as a share of	35.9	10.3	22.9

maximum possible, weighted by openness or binding factors)			
Coverage/count (average coverage as a share of the average count)	75.9	63.6	59.3
No restrictions as a share of total offer (unweighted count)	57.3	45.5	38.7
No restrictions as a share of maximum possible	27.1	7.3	14.9
<i>National Treatment</i>			
Unweighted average count (sectors—modes listed as a share of maximum possible)	47.3	16.2	38.8
Average coverage (sectors—modes listed as a share of maximum possible, weighted by openness or binding factors)	37.2	11.2	25.5
Coverage/count (average coverage as a share of average count)	78.6	69.1	66.1
No restrictions as a share of total offer (unweighted	65.1	58.0	52.3

count)			
No restrictions as a share of maximum possible	30.8	9.4	20.2
<i>Memo item</i>			
No restrictions on market access and National Treatment as a share of maximum possible	24.8	6.9	14.3

Source: Authors' calculations based on WTO and World Bank data.

Article XVI:1 reaffirms the application of the MFN principle to specific commitments. A footnote to this Article also specifies that where a Member makes a particular market access commitment, and where 'cross-border movement of capital is an essential part of the service itself, the Member is thereby committed to liberalizing the movement of capital. Article XVI:2 prohibits the imposition of quantitative restrictions on trade in services with respect to those sectors where a Member has made specific commitments. The prohibited quantitative restrictions include limitations on the number of service providers, on the total value of service transactions, and limitations on the participation of foreign capital, in terms of a percentage limit either on foreign shareholding or on the total value of foreign investment, either in the aggregate or by a single entity.

Article XVII contains a National Treatment obligation with respect to sectors listed in a Member's schedule. 'Formally different treatment' of foreign suppliers may be consistent with the National Treatment obligation—provided of course that such formally different treatment nevertheless is 'no less favourable' in effect. However, this is very much a double-edged sword—for 'formally identical treatment' may be deemed to *violate* the National Treatment obligation where the measure in question nevertheless 'modifies the conditions of competition in favour of domestic service suppliers'. This approach to National Treatment, which goes beyond a ban on intentionally discriminatory measures, reflects the view that equal treatment implies adjustment of domestic regulatory regimes so that foreign suppliers have *substantively* equal competitive opportunities. Article XVIII states explicitly that Members may negotiate and bind within their schedules additional commitments beyond those that Articles XVI and XVII require with respect to any sector listed in a Member's schedule of specific commitments. Thus, a ban on quantitative restrictions (Article XVI) and National Treatment (Article XVII) may be said to constitute the *minimum required content* of liberalization commitments with respect to any specific sector contained in a Member's schedule. However, it is anticipated that additional commitments to particular regulatory changes (e.g. 'qualifications, standards or licensing matters') will also occur with respect to those sectors on a Member's schedule.

Members may lodge reservations with respect to Market Access and National Treatment. As noted by the WTO Secretariat,

A Member may wish to maintain measures which are inconsistent with *both* Articles XVI and XVII. Article XX:2 stipulates that such measures shall be inscribed in the column relating to Article XVI on market access. Thus, while there may be no limitation entered in the national treatment column, there may exist a discriminatory measure inconsistent with national treatment inscribed in the market access column. However, in accordance with Article XX:2, any discriminatory measure scheduled in the market access column is also to be regarded as scheduled under Article XVII and subject to the provisions of that Article. When measures inconsistent with both Articles XVI and XVII are inscribed in the column relating to Article XVI (as provided for in Article XX:2), Members could indicate that this is the case (e.g. by stating ‘also limits national treatment’ in the market access column).³⁹

Further negotiations

Article XIX commits Members to enter into ‘successive rounds of negotiations...with a view to achieving a progressively higher level of liberalization’. Liberalization is to occur ‘on a mutually advantageous basis’ and should secure ‘an overall balance of rights and obligations’. It is made explicit that what is involved is not merely the discipline of measures that discriminate against foreign suppliers directly or intentionally, but more generally ‘the reduction or elimination’ of measures which have ‘*adverse effects* on trade in services’. This legitimizes the notion that Members should be prepared to put on the bargaining table *any* domestic regulatory measure that has the effect of limiting market access. The far-reaching implications of this provision for domestic policy sovereignty are somewhat balanced by the statement in Article XIX:2 that ‘the process of liberalization shall take place with due respect for national policy objectives and the level of development of individual Members, both overall and in individual sectors’.

Developing countries

Article XIX:2 further specifies that ‘there shall be appropriate flexibility for individual developing countries 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 it conditions aimed at achieving the objectives referred to in Article IV, which include, *inter alia*, the strengthening of developing countries’ capacity in service sectors as well as liberalization in service sectors of export interest to these countries. Article XIX must be read in conjunction with the delicate compromise concerning the MFN obligation in Article II and in the Annex on Article II Exemptions. As discussed above, in light of US refusal to proceed with certain sectoral negotiations on an MFN basis, it was necessary to allow for certain exemptions from MFN treatment for specific sectoral commitments. However, as also noted above, these exemptions will be subject to ongoing scrutiny by

the Council for Trade in Services, which will ‘examine whether the conditions which created the need for the exemptions still prevail’ (Annex on Article II Exemptions). Arguably, Article XIX provides some significant guidelines to the Council in its examination of whether an exemption from MFN treatment is needed. Article XIX:2 may be said to set reasonable expectations with respect to the pace and extent of liberalization, particularly for developing countries. If, on the whole, the specific commitments of such countries are consistent with these reasonable expectations, an exemption from MFN treatment in the schedule of a developed country should not be justifiable on the basis that developing countries have not sufficiently opened up their own markets to allow for, in the words of Article XIX:1, ‘an overall balance of rights and obligations’.

Withdrawal or modification of commitments

Article XXI provides that a Member may permanently withdraw or alter a specific commitment in its schedule at any time after three years following the entry into force of the Agreement. This is subject to a requirement of three months’ advance notice, and to prior negotiation of a ‘compensatory adjustment’ where necessary. Such compensatory adjustments are to be made on an MFN basis, and are aimed at maintaining ‘a general level of mutually advantageous commitments not less favourable to trade than that provided for in schedules of specific commitments prior to such negotiations’ (Article XXI:2(a)). This provision makes it clear that modification or withdrawal of specific commitments by a particular country or countries is not to be used as a pretext for a broader move by other countries to narrow the scope of MFN-based liberalization. Where negotiations on compensation fail, binding arbitration under WTO auspices shall decide what compensatory adjustment, if any, is required.

The provisions of Article XXI clearly go beyond the traditional GATT ‘safeguards’ concept of temporary reneging on commitments. However, it should be emphasized that much of what Members will be binding in their schedules will consist of specific domestic regulations or regulatory changes. As technology, as well as social and economic conditions, evolve, it is essential that Members have some scope for adjusting their domestic regulatory frameworks.

Dispute settlement and institutions

Part V contains provisions that relate to the institutional framework of the Services Agreement, and more specifically, to dispute settlement. The Council for Trade in Services is to have a very broad mandate for implementing the Agreement. It ‘shall carry out such functions as may be assigned to it to facilitate the operation of [the] Agreement and further its objective’. The Council, and normally any subordinate body of the Council, is to be open to participation by all Members. This makes it clear that failure to provide a given level of specific liberalization commitments will not exclude any Member from participation in the decision-making of the Council (including decision-making about where exceptions to MFN treatment are justifiable). With respect to dispute settlement, the normal WTO procedures apply to GATS (these are outlined in the Understanding on Rules and Procedures Governing the Settlement of Disputes, which builds on Articles XXII and XXIII of the GATT). One difference, however, is that with

respect to GATS, the Dispute Settlement Body (DSB) may only authorize suspension of concessions where 'it considers the circumstances are serious enough to justify such action' (Article XXIII:2). Moreover, it is only concessions under GATS that may be suspended—retaliation may not be authorized in the form of suspension of concessions under any other Agreement in the WTO. By virtue of Article XXIII:3, the concept of non-violation nullification or impairment is extended to GATS. The Decision on Certain Dispute Settlement Procedures for the General Agreement on Trade in Services provides that a special roster of panellists is to be established for purposes of settlement of disputes under GATS. These panellists are to have 'experience in issues related to the General Agreement on Trade in Services and/or trade in services, including associated regulatory matters' (Article 3). Moreover, 'panels for disputes regarding sectoral matters shall have the necessary expertise relevant to the specific service sectors which the dispute concerns' (Article 4).

Rules of origin

Part VI represents a very basic attempt to state rules of origin for services. Article XXVII specifies that a Member may deny the benefit of the Agreement where it establishes that the 'service is supplied from the territory of a non-Member' or to a corporation that is not a 'service supplier' of another Member. Neither of these rules permits of straightforward application. With respect to the first, the concept of 'territory' is very difficult to apply in the case of multinational service provision. Take, for instance, the case of a multinational law firm that provides legal services to nationals of a GATS Member with respect to a business deal that involves a non-Member (e.g. Russia). Some of the work may be done in the firm's Moscow office, but many of the client contacts and even the negotiations may take place on the territory of GATS Members. How, then, can one decide whether the service in question is being provided from the territory of a non-Member? In the case of rules of origin for trade in goods, this is dealt with by specifying a threshold percentage of the value of the good that must be accounted for by economic activity within a Member country. With respect to the second rule, it depends upon the determination of corporate nationality, a very difficult issue in many service sectors where trade in services is dominated by multinational enterprises that have no unambiguous national identity (unless one invokes purely formal criteria such as the place of incorporation of the parent company, the head office location, etc.).

Dispute settlement jurisprudence on the GATS

The GATS has been judicially considered in only four dispute settlement cases: *Canada—Periodicals*, *EC—Bananas*, *Canada—Autos* and most recently in *US—Gambling*. (The recent *Telmex* ruling deals with the WTO Telecommunications Agreement and will be discussed below under 'Telecommunications'.)

In *Canada—Periodicals*,⁴⁰ the Appellate Body (AB) addressed the relationship between the GATT and the scope of the GATS. Canada claimed that its differential treatment of imported magazines based on, *inter alia*, advertising content fell outside of GATT because advertising was a service. The AB rejected this argument, holding that 'The entry into force of the GATS, as Annex 1B of the *WTO Agreement*, does not

diminish the scope of application of the GATT 1994' (p. 19). Thus, the US complaint about the effect of Canada's measures on the competitive relationship between 'like' *magazines* (i.e. goods) could proceed under the GATT.

A similar approach was taken by the AB in *EC—Bananas*,⁴¹ holding that the same measure could affect trade in both goods and services, and thus both GATT and GATS would apply simultaneously to that measure. The AB noted:

However, while the same measure could be scrutinized under both agreements, the specific aspects of that measure examined under each agreement could be different. Under the GATT 1994, the focus is on how the measure affects the goods involved. Under the GATS, the focus is on how the measure affects the supply of the service or the service suppliers involved. Whether a certain measure affecting the supply of a service related to a particular good is scrutinized under the GATT 1994 or the GATS, or both, is a matter that can only be determined on a case-by-case basis.

(p. 120)

In *Bananas*, the AB considered a number of the provisions of GATS. First of all, it opined on the legal effect of a WTO Member choosing a particular (recommended but not required) classification scheme to schedule specific commitments in GATS. The AB held that when a Member uses a classification system, in this case CPC, 'any breakdown of the sector should be based on the CPC. Consequently, any legal definition of the scope of the EC's commitment in wholesale services should be based on the CPC description of the sector and the activities it covers'. Thus, a Member could not invent its own sub-classification or differentiation of activities within a sector as defined by the classification methodology it chooses, in order to differentiate its legal commitments as between those different activities.

Citing the rules on retroactivity in Article 28 of the Vienna Convention on the Law of Treaties, the AB in *Bananas* rejected the EC argument that GATS did not apply since the EC measures originated prior to the GATS coming into force; the AB held that it was enough that the measures had *continued* to exist subsequent to the entry into force of the GATS (paras 235–7).

The AB held that the MFN obligation in the GATS (Article 11:1) covered both *de jure* and *de facto* discrimination; it also found the panel to be in error in attempting to understand the MFN obligation in GATS on the basis of similar wording and its meaning in the National Treatment provision of the GATS ('no less favourable treatment')—the more appropriate analogy was to the jurisprudence on MFN in the GATT (paras 231–4). With respect to National Treatment in the GATS (Article XVII), the AB elaborated a four-step test to determine whether a measure violated Article XVII. First, the complainant must show that the defendant has undertaken a commitment in the relevant sector and mode of supply; second, the defendant's measure must affect the supply of services in that sector and/or mode of supply; third, the measure must apply to foreign and domestic 'like' services and/or service suppliers; and fourth, the measure must be shown to accord less favourable treatment to the foreign service/service supplier than to the 'like' domestic service/service supplier. The AB did not provide a methodology for

determining ‘likeness’, but did reject an overall ‘aims and effects’ approach to GATS Article XVII, which would focus on whether the intent or purpose of the distinction in question was discrimination against foreign services/service suppliers. With respect to ‘no less favourable treatment’, the AB again did not set forth a methodology, but simply deferred to the factual finding of the panel that the foreign suppliers in question had been placed largely in a regulatory category that provided fewer rights or benefits than was the case for the ‘like’ domestic service suppliers.

In *Canada—Autos*, the AB returned to the issue of the scope of application of GATS in relation to GATT. Here the measure at issue was a scheme that provided duty-free access to certain automobiles depending on whether the manufacturer met certain criteria, including the operation of production facilities in Canada. The panel concluded that this scheme *de facto* discriminated against manufacturers of certain nationalities because their global production structure was such as to make manufacture in Canada unlikely or unfeasible, thus violating Article I of the GATT. However, the panel went on to conclude that, in so doing, the scheme must also discriminate against *wholesalers* of vehicles from manufacturers that did not meet the criteria for duty-free importation into Canada, and thus run afoul of GATS II:1. The AB reversed the panel, holding that one cannot simply *assume* that a measure that has a discriminatory effect on a good from a particular exporting WTO Member will have a discriminatory effect on the distributors of the good. Instead, one must actually undertake a factual inquiry concerning the nature of the market with respect to wholesaling services. The AB went on to stipulate a methodology for determining whether a given measure violates the MFN obligation in the GATS.

In *Gambling (United States—Measures Affecting the Cross-Border Supply of Gambling and Betting Services WT/DS285/R*, November 10 2004), Antigua challenged a variety of US state and federal laws and regulatory actions, which it claimed amounted to a “complete prohibition” on the cross-border provision of gambling by Antiguan suppliers; the measures in question mostly addressed remote gambling, e.g. through the Internet. Antigua argued that these measures constituted a violation of the U.S. market access commitments under Article XVI of GATS, and also of the National Treatment obligation (Article XVII GATS) and certain provisions of Article VI (Domestic Regulation).

Since all of these obligations apply only where a sector is scheduled by the WTO Member in question, the threshold issue was whether the USA had scheduled gambling services. There was no such heading in the US schedule, and the USA strenuously argued it had never intended that as sensitive an activity as gambling be covered in its GATS commitments. Antigua claimed that gambling services were included within the heading in the US schedule for ‘other recreational services’ or alternatively ‘entertainment services.’ Adverting to the 1993 Scheduling Guidelines which employ the CPC (Central Product Classification) system, the panel came to the conclusion that since in these Guidelines ‘gambling and betting services’ is a sub-classification of ‘other recreational services,’ the US must be presumed to have scheduled gambling when it scheduled other recreational services, even though (1) the Scheduling Guidelines are facilitative and not normative or mandatory; and (2) the US had *not* indicated in its schedule that it was following the CPC. The panel elevated the Guidelines to a primary source of treaty interpretation under Vienna Convention on the Law of Treaties Article 31 as the ‘context’ of GATS schedules, despite the Guidelines themselves indicating that Members may use

them on a voluntary and selective basis, and that they may not affect any rights and obligations under the treaty itself.

The panel went on to find that the USA was in violation of Article XVI (Market Access) since its measures were in the nature of a prohibition, which amounted to a “quota” of zero; the USA had claimed that its measures were qualitative in nature, not quantitative in that they targeted one kind of gambling—remote or long distance gambling—rather than limiting the number of service suppliers or the quantity of gambling services that could be supplied. The panel does not appear to have considered carefully or even understood the nature of the US argument here. On the other hand, certain state laws that addressed the prohibition to the individual gambler as opposed to those supplying gambling services were found not to violate Article XVI.

Antigua also argued that the USA had violated Article VI.1 and VI.3 of the GATS in failing to provide a transparent and non-discriminatory authorization procedure for Antiguan suppliers of gambling services. The panel rejected this argument, holding that VI.1 and VI.3 were obligations of a procedural nature, and would only apply if the US had set up a requirement of authorization as a condition for the supply of such services, which it clearly had not, having apparently instead chosen to ban the services altogether.

On judicial economy grounds, the panel declined to adjudicate Antigua’s claim of a National Treatment violation.

The United States sought to justify its measures as *inter alia* necessary for ‘public morals’ and ‘public order’ reasons, in accordance with the exceptions in GATS XIV(a). the Panel found that the US concerns of money laundering, organized crime, and protection of minors fell within the ‘public morals’ and/or ‘public order’ rubrics of XIV(a), and the Panel took a broad and deferential view of ‘public morals’ viewing this language as giving the regulating Member wide scope to define the content of public morals based on the beliefs of the nation or community as they relate to general or common interests. However, the panel found that the United States had not shown its measures were ‘necessary,’ since it had not made an effort to resolve its concerns through the less trade restrictive alternative of regulatory cooperation with the Antiguan authorities. Some observers are troubled by the notion that a WTO Member could be required to pursue a policy course that depends for its effectiveness on the voluntary cooperation of other states; however, as Pauwelyn suggests, it is arguable that all the panel was requiring of the USA was that it enter into exploratory talks with Antigua; if such discussions were not satisfactory in addressing the legitimate concerns of the USA, then on the panel’s reasoning it would be entitled to take unilateral action along the lines of the measures in question. (Joost Pauwelyn, ‘Condemnation of U.S. Ban on Internet Gambling Pits Free Trade against Moral Values.’ *ASIL Insight*, November 2004).

On appeal, the Appellate Body of the WTO corrected the cavalier approach of the panel to interpreting schedules, and provided a structured approach to interpretation based on the Vienna Convention; however, applying this approach to the facts, the AB came to the same overall conclusion as the panel, namely that the US had in fact made commitments in its schedule that applied to gambling. The Appellate Body upheld the panel’s finding that a prohibitive regulation could nevertheless fall within the meaning of a quantitative market access restriction under Article XVI of GATS. This conclusion raises difficult and vexing issues about the relationship of Article XVI to Article XVII, National Treatment in GATS as well as to Article VI, Domestic Regulation. It is

regrettable that the AB upheld the panel's conclusion without a thorough analysis of the context, which includes these other provisions that address regulatory measures that affect trade in services. However, there will be opportunity in future cases to clarify these matters. Reversing the panel, the Appellate Body held that most of the US measures were justified under the public morals and public order exceptions in GATS Article XIV; the AB found that the panel erred in concluding that the United States could not justify its measure as necessary for these objectives without having first attempted to solve its concerns through consultations with Antigua—consultations could not be considered an reasonably available alternative measure to achieve the United States' goal. At the same time the Appellate Body found that the United States had not shown that one of the laws was consistent with the requirements of the chapeau of Article XIV that the measure not be applied in such a manner as to constitute arbitrary or unjustified discrimination. In general, the approach of the AB to Article XIV displays sensitivity to domestic regulatory concerns and to the real world options available to governments to address their objectives. It may have implications for the interpretation of analogous exceptions in Article XX of the GATT.

Services and the Doha/Millennium Round of WTO negotiations

As noted above, Article XIX of the GATS 'builds in' a requirement of future negotiations on services trade liberalization, in particular the expansion of sectoral commitments. In addition, various other provisions of GATS mandate future negotiations on rules, namely in the areas of domestic regulation, safeguards (Emergency Safeguard Measures, or ESMs), government procurement and subsidies. Because of this 'built-in agenda', the services negotiations, strictly speaking, are not dependent on the Doha Mandate. Nevertheless, the Doha Declaration itself (para. 15) affirms the modalities for GATS negotiations decided by the WTO Services Council on 28 March 2001.

Modalities

This document⁴² establishes a request/offer approach to the negotiation of further sectoral-specific commitments. On this approach, within a fixed time frame, individual WTO Members are to submit initial requests, or 'wish lists', of commitments they want their trading partners to make, followed by the submission of initial *offers*, what each country is prepared to commit *to* in each sector. These requests and offers then become the basis for bargaining. The modalities document stipulates that no sector may be *a priori* excluded from bargaining, nor any particular mode of supply; at the same time, the document establishes the principle that 'The process of liberalization shall take place with due respect for national policy objectives, the level of development and the size of economies of individual Members, both overall and in individual sectors. Due consideration should be given to the needs of small and medium-sized service suppliers, particularly those of developing countries' (para. 3).

A critical yet under-appreciated issue is the relationship between the negotiations on specific commitments and those on rules that deal with various domestic policies, such as subsidies and 'domestic regulation' (e.g. licensing requirements). It is hard to imagine that what specific commitments Members would be prepared to make—or indeed would

insist on asking for from their trading partners in the WTO—would not depend on the shape of the rules concerning domestic policies that will apply to those sectors under the GATS. The modalities document attempts to deal with this issue by stipulating that ‘Members shall aim to complete negotiations under Articles VI:4, XIII and XV prior to the conclusion of negotiations on specific commitments’ (para. 7). However, both sets of negotiations are well behind the various deadlines and timetables set within the GATS itself, as well as by various decisions of the Services Council. In fact, in the climate that existed at the time this book went to press (early 2005), it appeared as though it would be almost impossible to impose any kind of deadline discipline on the talks on all these issues, without risking failure. As well, it is notable that paragraph 7 of the modalities document, while referring to the prior completion of negotiations on ‘domestic regulation’, does not mention ESMs. As discussed in the chapter of this book on safeguards with respect to trade in goods (Chapter 10; see particularly the economic analysis of safeguards by Alan Sykes that we discuss), one would expect that the extent of Members’ offers in individual sectors would be in part a function of the possibilities for temporarily reneging on those commitments in certain sensitive situations. It would thus seem undesirable to negotiate specific commitments under a veil of ignorance concerning the existence and nature of a safeguards clause.

Domestic regulation

Hugely important issues of regulatory autonomy and democratic legitimacy are at stake in the negotiations on domestic regulation.⁴³ The policy issues obviously differ enormously from sector to sector—water utilities, healthcare, accountancy and legal services, to give a few examples, raise very different questions about the balance between regulatory autonomy and market openness. Yet the WTO Secretariat has apparently taken the position that disciplines on domestic regulation should apply across the board, to all sectors. Thus, discussions have focused extensively on the idea of a ‘necessity’ test, which would be applied to all domestic regulations within the meaning of Article VI:4 of GATS, regardless of sector (some delegations, most notably Japan, have proposed, however, different versions of the test depending upon which generic category of domestic regulation is at issue (residency requirements, licensing procedures, etc.)). There are a number of anomalies in this approach, judged against the existing structure of GATS. First of all, National Treatment disciplines, which apply to discriminatory measures, *only* apply to sectors where commitments have been bound; thus, on the basis of the Secretariat interpretation, one would have the curious situation that more general disciplines would apply to non-discriminatory domestic regulations than to discriminatory ones. Second, while Members would be able to make reservations to protect discriminatory measures in their schedules, they would not be able to do so with respect to non-discriminatory measures, to which the ‘necessity’ test would apply across the board. Moreover, the ‘necessity’ test proposed would be very different from that in Article XX of the GATT, which presupposes a violation of some rule (such as National Treatment), and would apply regardless of whether some other provision of GATS had been violated. One of the issues here is whether to introduce a notion of proportionality to a ‘necessity’ test, as is proposed by the European Commission. Depending on how it is articulated in legal language, ‘proportionality’ can either enhance or reduce the flexibility

of domestic regulators. In the *Korea—Beef case* (see the discussion of Article XX of the GATT in the chapter of this book on domestic health, safety and technical standards, Chapter 7), the AB suggested that the concept of ‘necessary’ in Article XX of the GATT provided (1) that any measure indispensable to achieving a given policy objective was justified, and (2) that even measures that were not absolutely indispensable might be justified, where the trade-restrictive effect of the measure was not out of all proportion to the regulatory benefit. This latter concept of proportionality provides an additional margin of discretion to domestic regulators, all the more important in services sectors (such as water and electricity) where there are very complex and often untested choices of regulatory instruments, and a clear least restrictive alternative may not be easy to discern. However, another idea of proportionality is that of an *additional* hurdle to be superimposed on the requirement of showing that the policy instrument is the least restrictive alternative. On this understanding, even a least trade-restrictive measure would be impermissible if the WTO dispute settlement organs were to find that the regulatory benefits were not great enough to justify the level of trade-restrictiveness in question. Such an approach would put the dispute settlement organs in the position of second-guessing very complex trade-offs, and weighing free trade against other values in an open-ended fashion. Given our analysis of the problem of domestic regulation with respect to trade in goods (see Chapter 7), it will not be surprising that we see this version of proportionality as raising significant legitimacy issues.⁴⁴ In responding to concerns about domestic regulatory autonomy, given the sweep of GATS and possible disciplines on domestic regulation, the GATT Secretariat has placed emphasis on the so-called ‘right to regulate’ in GATS.⁴⁵ Thus, the preamble of the GATS recognizes ‘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’. However, this ‘right to regulate’ is subject to any specific limitations or disciplines as exist or may be negotiated; thus, the ‘right to regulate’ begs the critical question of how little or much the exercise of this right will be constrained or qualified by any particular set of GATS disciplines. The language in the preamble to GATS does not illuminate that question at all. The Secretariat also places emphasis on the exception in Article I of the GATS for services ‘supplied in the exercise of governmental authority’. However, to be excluded from GATS disciplines, such services must be ‘supplied neither on a commercial basis, nor in competition with one or more service suppliers’. These criteria would not apply to most public services that are provided in mixed economies, where there is usually some combination of public and private provision (for example healthcare in almost all developed countries, with Canada still being an exception), and some competition between providers in some segments of the market (government post offices vs. private delivery firms). To gain protection from the ‘public authority’ exception, a WTO Member would practically have to operate an old Soviet-style command economy, at least with respect to particular public services.⁴⁶

Emergency Safeguard Measures

According to Article X of the GATS, the negotiations on ESMs were to be completed by 1998, but at the time this book went to press, in early 2005, these negotiations remained deadlocked. Some developed countries (most notably the United States) maintain that

there is no need for any safeguards in the GATS, because the needed flexibility is supplied by the control of individual WTO Members over the commitments they schedule in individual sectors, as well as the possibility of filing reservations to those commitments; developing countries, in general, seek the flexibility of safeguards. Some (developed) countries also question whether the safeguards concept can be applied to the services area; given for example the complex nature of 'imports', one could not simply transfer the concept of a surge of imports, and of injury, from the goods to the services context. We do not believe these objections to safeguards in GATS carry much weight. First of all, *ex ante* limitations on commitments do not perform the same function as safeguards; safeguards necessarily adjust obligations *ex post* and temporarily, given some unanticipated social and economic consequences from the implementation of GATS commitments. If anything, the case for a mechanism to perform this function in GATS is even stronger than in GATT: specific commitments and other GATS disciplines have the effect of locking in particular approaches to regulatory reform and privatization. However, recent history has shown that such initiatives, particularly in network industries with public goods dimensions, can often produce critical and unanticipated consequences, which require regulatory adjustment or fine-tuning. One need only think of the introduction of competition in the electricity sector (which has both goods and services dimensions) in California. A GATS safeguards mechanism would allow the temporary suspension of GATS commitments where such unexpected circumstances arise, in whole or in part due to the implementation of pre-competitive policies required by GATS, including specific commitments. A Member invoking the safeguard would have to show why, in the short term, a deviation from GATS commitments was necessary in order to address the serious social and economic circumstances in question. In the manner of Article XX of the GATT, or the non-exhaustive list of legitimate objectives in the Technical Barriers to Trade Agreement, a GATS safeguards clause might provide an inventory of the kind of serious social and economic consequences that would justify safeguards relief. Finally, in addition to being conceptually misguided, it is arguable that the behaviour of certain WTO Members in attempting to block any safeguards proposal violates the requirement of good faith in the implementation of Article X of the GATS, which requires not only negotiations but the implementation of 'results' of those negotiations. The reference to 'results' suggests that blocking the notion of safeguards altogether violates the public international law obligation of good faith in respect of Article X.

Subsidies

Negotiations on subsidies have barely begun even to wrestle with the fundamental conceptual issues such as defining subsidization in the services context. Given that, if anything, the services area is more likely than with goods to be characterized by mixed private/public provision, issues concerning 'networks' and public goods, and oligopolistic competition, the difficulties we discuss in Chapter 9 about drawing a line between efficient, legitimate subsidies and those that are illegitimately trade-distortive apply here even more. Significantly, few WTO Members have provided any data on the current provision of state aids to services sectors, information that is a precondition to understanding how subsidies affect trade in services, and thus how one should approach

the challenge of disciplining them. According to the International Centre for Trade and Sustainable Development (writing just before the Cancun Ministerial in September 2003), 'no substantive debate has yet taken place on issues such as the definition of subsidies in the pursuit of public policy objectives, the need for [special and differential treatment] for developing countries or the appropriateness of a countervailing mechanism'.⁴⁷ An approach to subsidies disciplines that would avoid the vexatious definitional and conceptual issues entailed in distinguishing 'legitimate' from bad or trade-distorting subsidies would be to take the approach in the Agreement on Agriculture, and establish a mechanism for standstill and gradual reduction of aggregate subsidization in certain sectors, subject to a 'green box' of state aids that would be explicitly excluded from such commitments, perhaps regional development, environmental measures, healthcare and education. These various possibilities were discussed at a Geneva roundtable on services subsidies in March 2003.⁴⁸

Credit for autonomous liberalization and other matters of concern to developing countries

Many developing countries have already introduced competition in services sectors outside the normal GATS negotiating framework, whether in consequence of IMF/World Bank structural adjustment programmes or as a precondition to WTO accession, or simply due to a domestic regulatory reform programme. The issue of how credit can be provided to reflect these pre-existing liberalization moves has now been resolved in the GATS negotiations, as of March 2003. The criteria for assessing the value of autonomous liberalization measures (ALMs) include: sectoral coverage; liberalizing nature of the measure concerned; date of entry into force and duration; share of the trading partner in the total trade in the sector autonomously liberalized by the liberalizing Member; importance and impact of the autonomous liberalization measures with respect to the liberalizing Member's economy; market potential in the liberalizing Member for the trading partner; and opportunities for the expansion of foreign participation in the sector after the introduction of the measure. In addition, to receive credit, an ALM must be compatible with the MFN principle; have been undertaken since the previous GATS negotiations; and be applicable to any or all service sectors.⁴⁹ These modalities place no obligation on a WTO Member to provide another Member with credit for autonomous liberalization; rather, they are meant to facilitate bilateral bargaining and trade-offs on the basis of the requests and offers.

It has been stressed by activists, human rights organs of the United Nations (see Chapter 17 on trade, labour and human rights) and developing-country governments themselves that services trade liberalization may have complex effects on diverse human interests in developing countries, including the right to health and to clean water, to give examples from two sectors that are the subject of GATS negotiations, and that developing countries lack the capacity to assess *ex ante* potential costs and benefits of particular liberalization proposals; they are being pressured to put forth offers without this necessary prior analytical work. In response, there are some joint efforts by the WTO and the World Bank to provide technical assistance and guidelines for assessing the potential effects of liberalization in various sectors in developing countries. It is notable that these efforts lag far behind the pressure for developing countries to make their offers. It is to be

recalled that Article XIX:3 of the GATS mandates a comprehensive assessment of trade in services both generally and sectorally as a precondition for new negotiations, evaluating liberalization against the objectives of GATS. However, this work was not done prior to the adoption of the modalities document in March 2001.⁵⁰

A particular concern of many developing countries is the liberalization of Mode 4 services provision, i.e. the movement of persons into the consumer country for purposes of the delivery of services. This is an area where many developed countries have been unprepared to make bold liberalization commitments, because of the issues raised for immigration policy (see Chapter 19 on the movement of people). Chuadhuri, Mattoo and Self outline a possible approach to Mode 4 liberalization which emphasizes liberalizing movement of people within firms and for performance of specific contracts; the authors speculate that these kinds of mobility do not raise or should not raise fears of opening a gateway to permanent migration.⁵¹

FINANCIAL SERVICES

The OECD Code on Liberalization of Capital Movements

The Capital Movements Code⁵² requires OECD Members to 'progressively abolish between one another, restrictions on movements of capital to the extent necessary for effective economic cooperation' (Article 1(a)). Annex D establishes a list of capital movements to which the Code applies. This includes a very wide range of transactions required for the transboundary supply of financial services, including banking, insurance and securities. Members may lodge reservations and (in some circumstances) derogations with respect to the general obligation of progressive removal of restrictions. There is an MFN obligation with respect to domestic regulation that affects providers of financial services from other Member countries as well as an MFN obligation with respect to other OECD Members. However, the Code also encourages, without requiring, Members to extend the advantages of the liberalizing provisions of the Code to non-Members.

The European Union

Liberalization of trade in services within the European Union is stated as an objective in the Treaty of Rome, and is a major aspect of the Europe 1992 programme, reflected in the Single European Act (1986).⁵³ In the financial services sector,⁵⁴ the approach of the Union to liberalization of trade is based on the closely related principles of mutual recognition, home-country rule and minimum regulatory harmonization.⁵⁵ Mutual recognition entails the granting of market access to an institution from another EU Member State, based on the institution's compliance with regulatory requirements in its home country. The related principle of home-country rule stipulates that the regulatory authorities in the home country retain responsibility for prudential supervision of the institution even where what is involved is activities in other EU states. Hence, market access is not granted on terms of compliance with the (non-discriminatory) regulation of the 'importing' country (as with National Treatment) but on condition that the entity meet relevant regulatory requirements in its own country.⁵⁶ Unlike National Treatment-based

approaches, mutual recognition and home-country rule, taken together, imply not only the elimination of direct and facially discriminatory barriers to service provision by foreigners, but also the removal of those indirect and facially neutral barriers that exist where the foreign providers face costs in adapting products or operations so as to meet the distinctive regulatory requirements of the importing or host state.

However, since mutual recognition and home-country rule necessarily entail reliance on another state's regulators and regulations to protect one's own citizens, an essential *quid pro quo* is a set of minimum standards sufficient to provide even the country with the strictest regulatory requirements the needed confidence in the regulatory regimes of the others. This is reflected in the third principle, minimum regulatory harmonization.

The minimum standards to which EU Member States' regulatory regimes must conform are set out in the 1989 Second Banking Directive.⁵⁷ As Kim notes, these standards cover a very wide range of regulatory requirements, including 'initial capital requirements, disclosure of a credit institution's major shareholders, limitations on the size of participation in nonfinancial undertakings, standard solvency ratios, and permissible activities'.⁵⁸ 'Minimum' regulatory harmonization thus entails, in fact, a very significant degree of harmonization.

It is important to note that the European Union has a strong, permanent institutional structure that allows for ongoing consultation and cooperation among the regulators of the various Member States, and for further harmonization. This allows for ongoing adjustment of common minimum standards in response to experience with liberalized trade in financial services, and allows adaptation of harmonized requirements to changes in the industry, such as the introduction of new products and the changing interrelationship between banking and other financial services. It may be difficult to extend the EU approach to bilateral or regional contexts where this kind of common institutional framework does not exist. As well, unless the minimum common standards are in fact set quite high, the EU approach may lead to 'unfair trade' complaints from domestic institutions who must now compete with foreign providers who have lower regulatory costs because their home country's regulatory standards are laxer. In such a situation, an EU-style approach could create downward pressures on the regulatory standards of the stricter countries. Where, however, it is the stricter countries that have the bargaining power to ensure that the common minimum standards remain high, or are moved upward, the end result may in fact be a higher standard. It should be noted that, within the European Union, the two major powers, France and Germany, have what are generally considered relatively strict, rather conservative approaches to regulation of financial services (in comparison, say, to Italy or the UK). This may give an important clue as to why liberalization of trade in financial services has not led to downwards harmonization.

The Canada-US FTA

The Canada-US FTA takes a National Treatment approach to liberalization of trade in financial services between the Parties. The failure to move to an approach based on regulatory harmonization or mutual recognition reflects significant asymmetries in domestic regulatory approaches in Canada and the United States prior to the FTA, especially with respect to banking.⁵⁹ In Canada, there are strict entry requirements for the

banking sector, but once a bank is chartered or licensed, it can engage in banking business, as well as in securities business, throughout the country. The United States regime was at that time characterized by ease of entry into the banking business, but prohibition, at the time, under the then Glass-Steagall Act, of bank participation in the securities business, as well as limits on interstate banking. Prior to the FTA, Canadian banks had already obtained important exemptions from the limits on interstate banking in domestic US regulation. Canadian banking laws prohibit concentrated ownership of banks—no one shareholder may own more than 10% of a Canadian chartered bank. In addition, strict limits are also imposed on foreign ownership—the aggregate of foreign-held shares in a chartered bank may not exceed 25%. Given these limitations, a foreign-owned bank wishing access to the Canadian market must establish itself as a ‘Schedule II’ bank, with limited powers to engage in branch banking, and also limitations on assets. The aggregate assets of foreign ‘Schedule IF banks may not constitute more than 16% of the total assets of the Canadian banking system.

Under Article 1703 of the FTA, the United States is exempt from the main limitations imposed on foreign ‘Schedule IF banks in Canadian banking regulation, and from discriminatory treatment under federal laws that apply with respect to non-bank financial institutions such as trust companies (except the 10% limit on a single shareholder’s stake). However, since most regulation in the non-bank financial sector in Canada is provincial, the commitments are of less significance than with respect to banking. Canada also makes a general commitment to go beyond National Treatment and to ‘liberalize further the rules governing its markets’ (Article 1703.4).

While US institutions thus gain considerably enhanced access to the Canadian market, Canadian institutions do not gain a comparable increase in access to the US market. Canadian banks do preserve some of their *existing* rights and privileges under US law, such as exemptions from restrictions on interstate branching (1702.2) and the right to deal in government securities (1702.1). As well, Canadian institutions are promised National Treatment with respect to future changes to domestic US regulation, including the Glass—Steagall Act (1702.3). However, unlike Canada, which commits itself to liberalize further its domestic regulatory regime for financial institutions, the United States itself makes no such commitment. Instead, the preservation of Canada’s *existing* access to the US market is premised on further Canadian *unilateral* liberalization of regulations (1702.4). In the FTA, the USA may thus be said to have succeeded in achieving a one-sided agreement on financial services—obtaining considerably greater market access in Canada, while yielding no immediate effective increase in access to its own markets. This success in the bilateral context may be one underlying reason why the United States, as will be discussed below, was so resistant to accepting a genuine multilateral approach to liberalization of trade in financial services within the GATS.

NAFTA

Unlike the FTA, the NAFTA contains general MFN (Article 1406) and National Treatment (1405) obligations with respect to financial services, as well as a Right of Establishment. The Right of Establishment is, however, recognized only as a ‘principle’ and this principle is subject to requirements that separate financial institutions deliver

separate services (1403.2(a)), thereby protecting the provisions of the then US Glass-Steagall Act from scrutiny under NAFTA. As well, although the Right of Establishment includes the right to 'expand geographically' within the territory of another Party (1403.2(b)), compliance with the principle of a Right of Establishment is only to be subject to review by the NAFTA Parties once the United States has chosen of its own accord to lift domestic restrictions on interstate banking activity by foreign institutions (1403.3).

The National Treatment obligation in Article 1405 is based not upon the notion of facially non-discriminatory treatment, but rather upon the notion of 'equal competitive opportunities' (Article 1405.5–7). This provides considerable scope for claims that neutral domestic regulation nevertheless does not create a level playing field for competition.

Article 1407.1 provides that 'each Party shall permit a financial institution of another Party to provide any new financial service of a type similar to those services that the Party permits its own financial institutions, in like circumstances, to provide under domestic law', subject to any non-discriminatory domestic regulatory control over 'the institutional and juridical form through which the service shall be provided'. Article 1407.2 provides for the free transboundary flow of data between NAFTA Parties in connection with the provision of financial services. Significantly, this is not subject to any obligations with respect to the protection of personal privacy or commercial confidentiality Pursuant to Article 1408, Parties may make reservations with respect to their adhesion to the Right of Establishment, National Treatment, MFN and other obligations set out in Articles 1403–7. Mexico, in particular, filed a complex schedule for phasing in these obligations over the six-year period from 1994–2000, as well as a safeguard provision which applies between 2000 and 2007 (Annex VII(B)-Mexico). The schedule entailed an expanding set of limits on the aggregate market share of foreign institutions (whether from NAFTA Parties or non-Parties), as well as the individual market share of any one foreign institution. Separate limits apply with respect to each individual part of the financial services sector (banking, securities, insurance, etc.). For example, aggregate limits on banks increased from 8–15% from 1994 to 2000, and may be frozen at 25% between 2000 and 2007 under the safeguard provision. It should be noted that the safeguard provision applies only with respect to aggregate limits on market share; individual firm limits were phased out completely by the year 2000.⁶⁰

Article 1410 exempts from the obligations contained in the NAFTA chapter on financial services 'reasonable measures [taken] for prudential reasons'. These will include measures taken to protect investors and other market participants, as well as for purposes of maintaining the 'safety, soundness, integrity or financial responsibility' of financial institutions, or to ensure 'the integrity and stability of a Party's financial system'. There are special provisions with respect to dispute settlement concerning the NAFTA financial services chapter. Members of dispute panels are to be chosen from a special roster of individuals with expertise in 'financial services law or practice, which may include the regulation of financial institutions' (Article 1414.3(a)).

The Uruguay Round Services Agreement (GATS)

The GATS contains two Annexes on financial services as well as an Understanding on Commitments in Financial Services and a Decision on Financial Services. These various instruments reflect the incompleteness of the negotiations on financial services at the closure of the Uruguay Round in December 1993, as well as a compromise between different views as to how the negotiations should be completed. The United States took the view, during the final period of negotiations leading up to the December deadline, that other countries had not offered sufficient sectoral liberalization commitments in financial services to justify US adherence to a multilateral, MFN-based framework. The United States therefore stated its intent to take an MFN exemption with respect to its own commitments under a GATS agreement on financial services, and to proceed with bilateral and regional negotiations on liberalization of trade in financial services.⁶¹ This would, in effect, amount to an opting out of the multilateral track towards liberalization. Through a mechanism described in more detail below, a compromise was reached whereby the United States would suspend its MFN exemption for a six-month period after the coming into force of the Final Act in 1995, during which period a further attempt would be made at multilateral negotiation of liberalization commitments within the GATS/WTO framework. If this attempt succeeded, the USA would permanently withdraw its MFN exception. If these further negotiations resulted in an impasse, the USA would be free to reinstate the exception and proceed along bilateral and regional lines.

The Annex on Financial Services does not contain any specific liberalization commitments with respect to trade in financial services, but rather concerns the application of the GATS to the financial services sector. Article 2.1, for example, provides an exemption from GATS strictures of measures taken ‘for prudential reasons, including for the protection of investors, depositors, policy holders or persons to whom a fiduciary duty is owed by a financial service supplier, or to ensure the integrity and stability of the financial system’. This is, however, subject to the requirement that any such non-conforming measures not be used to circumvent GATS obligations. Article 3 permits either unilateral or mutual recognition of other countries’ ‘prudential measures’. This limited exception to the MFN principle is subject to the requirement that, where recognition is accorded through a negotiated agreement or arrangement, a Member must provide an opportunity for other Members to accede to the agreement, or to negotiate a comparable deal (Article 3.2).

In Article 5.1 of the Annex, the financial services sector is defined very broadly as including ‘any service of a financial nature offered by a financial service supplier of a member’. This is followed by a lengthy list of services that fall within this general definition. The list includes a comprehensive range of insurance services, ‘traditional’ banking activities such as deposit-taking and lending, as well as underwriting of securities and trading in virtually every existing form of security or negotiable instrument. In addition, consulting and brokering services connected with these transactions are included within the ambit of financial services. As is suggested by the wide-ranging character of this summary of the list, the clear intent of Article 5.1 is to include as many activities as possible under the rubric of financial services.

The Second Annex on Financial Services allows Members a period of six months following the entry into force of the Agreement Establishing the WTO within which to 'improve, modify or withdraw' any specific commitments in their schedules with respect to financial services, and also to finalize any MFN exemptions in their schedules. The Decision on Financial Services stipulates that, until the expiration of this six-month period, Members shall suspend the *application* of any MFN exemption already filed in their schedules. These provisions were required in order to implement the crucial compromise discussed above, whereby the United States agreed to extend provisionally its participation in multilateral negotiations on financial services, without prejudice to its right to proceed on a bilateral or regional basis if the negotiations were not to succeed within the agreed time period.

The Understanding on Commitments in Financial Services outlines a framework for liberalization of trade in financial services which provides an alternative to that set out for services generally in Part III of the GATS. Members are free to choose to schedule specific commitments in the financial sector either in accordance with Part III or in accordance with the Understanding. The Understanding sets out a series of specific commitments that some, but not all, Members have inscribed in their individual schedules, *and which gain legal force not from their inclusion in the Understanding but from their presence in the schedules*. This contrasts with the approach in Part III of the GATS, where Members are *legally bound* to inscribe certain basic commitments within their schedules.

The commitments contained in the Understanding, taken together, represent a very extensive degree of liberalization. Members are obligated to list in their schedules monopoly rights with respect to financial services provision and to 'endeavour to eliminate them or reduce their scope' (Article 1). Both National Treatment and MFN obligations are to apply to government procurement of financial services (Article 2). Market access is to be conferred on non-resident suppliers on a National Treatment basis in the areas of marine, commercial aviation and space travel insurance (e.g. of satellites), as well as with respect to financial data processing and transmission. A Right of Establishment is provided in Articles 5 and 6, including a right to establish a commercial presence in the territory of another Member through acquisition of an existing enterprise. There is also a right of temporary entry for certain classes of personnel from the financial services providers of other Members, including senior management, specialists in financial services operations and certain other technical specialists (e.g. computer services personnel) (Article 9). Article 10 of the Understanding entails a commitment to 'endeavour to remove' a wide range of *non-discriminatory* regulatory measures which are deemed to have an adverse effect on the market access of financial services suppliers from another Member. A notable instance is that of 'non-discriminatory measures that limit the expansion of the activities of financial services suppliers into the entire territory of the Member', which would apply to limits on interstate branching in US domestic banking law. It is to be noted that the language 'endeavour to remove' stops short of formal legal commitment actually to eliminate the measures in question. Furthermore, as an alternative to endeavouring to remove a measure, a Member may instead endeavour to limit its adverse effects on other Members (for example by not applying the measure to service providers of other Members or applying it in a different manner). Finally, the Understanding requires that providers of other Members be given access, on a National

Treatment basis, to 'payment and clearing systems operated by public entities, and to official funding and refinancing facilities available in the normal course of ordinary business', with the exception of 'lender of last resort' facilities. As well, the providers of other Members must be able to join any 'self-regulatory body, securities or futures exchange or market, [or] clearing agency' in a Member's territory, on the same terms as the Member's own financial services providers. This applies whenever joining any such body or institution is a requirement for providing financial services in the Member's territory on a National Treatment basis (Article 11.2).

Negotiations on commitments in financial services were in fact concluded in 1995, although one month after the six-month period referred to in the Decision. Although 29 countries improved their schedule of commitments or reduced the scope of their MFN exemptions, the United States was dissatisfied with the results, and in the end chose to take a very broad MFN exemption for itself. In light of this outcome, it was decided to label the result of these negotiations an 'interim agreement', with further negotiations envisaged in 1997. These were concluded on 12 December 1997, agreement having been reached on an additional set of improved commitments. These were such that the USA was finally able to withdraw its broad MFN exemption. These commitments were incorporated and bound in the Fifth Protocol of the GATS, and entered into force in 1999. The schedules of Members can be accessed on the WTO website (<http://www.wto.org/>).

The WTO Secretariat summarizes the achievements of the 1997 negotiations with respect to specific commitments as follows:

The new commitments contain *inter alia* significant improvements allowing commercial presence of foreign financial service suppliers by eliminating or relaxing limitations on foreign ownership of local financial institutions, limitations on the juridical form of commercial presence (branches, subsidiaries, agencies, representative offices, etc.) and limitations on the expansion of existing operations. Important progress was also made in 'grandfathering' existing branches and subsidiaries of foreign financial institutions that are wholly- or majority-owned by foreigners. Improvements were made in all of the three major financial service sectors—banking, securities and insurance, as well as in other services such as asset management and provision and transfer of financial information.⁶²

The WTO has also published a country-by-country summary of the specific commitments agreed in December 1997.⁶³ A total of 102 WTO Members had made specific commitments on financial commitments by the time the Fifth Protocol came into force in 1999.⁶⁴

A 1997 study by the WTO Secretariat identified the importance of appropriate domestic policies and regulations, if financial services liberalization is to be undertaken in a manner consistent with financial market stability, including stability-oriented monetary policies, sound fiscal and exchange rate policies, and measures related to the prudential regulation and supervision of financial institutions.⁶⁵ The Asian financial markets crisis, which evolved in 1997 and was a direct product of financial market

openness in these countries, illustrates the salience of such insights. In September 1997, the Basle Committee on Banking Supervision of the BIS released the Basle Core Principles for Effective Banking Supervision: these 25 principles bear upon, *inter alia*, licensing, prudential regulations and requirements, methods of ongoing bank supervision, and cross-border banking. The cross-border banking principles include the notion that banking supervisors must practice supervision over all aspects of the worldwide operations of their internationally active banking organizations, including contact and information exchange with host-country supervisory authorities. In the wake of the Asian crisis, a number of ambitious proposals have developed for international surveillance of, and guidelines or rules on, the regulatory oversight of financial institutions.⁶⁶ At a meeting of G-8 Finance Ministers in early May 1998, Canadian Finance Minister Paul Martin Jr put forth a plan for the creation of an international body for financial surveillance, which would, *inter alia*, 'provide a mechanism for peer review of financial sector regulatory and supervisory regimes' and 'form part of the crisis response team in responding to Asian-style crises'. The Basle Core Principles would inform the body's surveillance of financial sector regulation in Member countries.⁶⁷

Financial services are part of the GATS 2000 services negotiations, now integrated into the Doha/Millennium Round. Early in the GATS negotiations, several WTO Members, including Canada, the EC and Japan, submitted proposals that included suggestions for areas where further liberalization of financial services needed to be negotiated. Sauve and Steinfatt summarize these proposals:

A priority area for all six appears to be mode 3 of GATS, which deals with commercial presence or establishment-related trade in services. Indeed the proposals demonstrate broad consensus on the need to further liberalize quantitative measures impairing investment in the three financial services subsectors (banking, securities, and insurance). The measures most often mentioned in this regard include constraints on foreign ownership, foreign equity participation, the legal form of establishment, and the number of service suppliers... Only half of the proposals underscore the need to reduce restrictions on the ability of residents or firms from one territory to purchase services in another territory (GATS mode 2). With respect to cross-border trade (mode 1), some WTO members have identified specific subsectors within banking and insurance that they consider ripe for liberalization... For example, the European Union and

Other business services

Advertising	X	XX	XXXXXX	XX
Market research and opinion polling	XX	XX	XXXXXX	XX
Management consulting services	XX	XXX	XXXXXX	XX
Services related to management consulting	XX	XXX	XXXXXX	X
Technical testing and analysis services	X	XXX	X XX	
Advisory and consulting services relating to agriculture, hunting and forestry	X (forestry, logging)	XX	XXX	XX
Services incidental/related to energy distribution	X			X (for gas only) X
Advisory and consulting services relating to fishing	XX	X	X X	X
Advisory and consulting services relating to mining	XX	X	X X	XX
Geological, geophysical and other scientific prospecting services, including those related to mining	X			
Services incidental to manufacturing		X	X X	
Toll services—oil and basic metals	X			
Placement and supply services of personnel	XX	XX	X XX	X
Investigation services	XX	X	X	X
Security services	XX	X	X	X
Related scientific and technical consulting services	XX	XX	XX X	X

Sector-specific offers	Countries												
	Australia	Canada	Chile	EC	Iceland	India	Japan	Liechtenstein	New Zealand	Norway	Slovenia	Turkey	US
Surveying services related to land						X							
Maintenance and repair of equipment (not including maritime vessels, aircraft or other transport equipment)				X	X	X	X		X		X		X
Maintenance and repair of personal and household goods		X											
Building-cleaning services	X	X		X	X	X	X	X	X	X			X
Photographic services	X			X	X	X	X	X	X	X	X		X
Packaging services		X		X	X	X	X		X				X
Printing and publishing				X	X	X	X		X				
Convention services	X			X	X	X			X	X			X
Translation services	X			X		X			X				
Interior design services	X			X					X	X			
Specialty design services						X							
Mailing list compilation and mailing services	X					X							
Collection agency services				X					X				
Telephone answering services						X							
Exhibition management services										X			
Duplicating services	X					X							
Credit reporting services									X				

Communication services

Postal and courier services		X		X		X		X	X	X	X	X
Telecommunications services	X	X	X	X	X	X	X	X	X	X	X	X
Audio-visual services						X		X				
General construction work for buildings	X	X		X	X			X	X	X	X	X

(excluding insurance)														
Securities market			X										X	
Health services and social services														
Hospital services				X	X	X					X	X	X	
Other human health services	X			X							X		X	
Social services														
Tourism and travel-related services														
Hotels, restaurants and catering	X	X	X	X	X	X	X	X	X	X	X	X	X	X
Travel agencies and tour operators services (including tour managers)	X	X	X	X	X	X	X	X	X	X	X	X	X	X
Tourist guide services	X			X	X		X	X	X	X		X (plus mountain guide services)	X	
Recreational, cultural and sporting services (other than audio-visual services)														
Entertainment services (including theatre, live bands and circus services)										X	X	X		X
News and press agency services										X	X	X	X	X
Libraries, archives, museums and other cultural services											X	X		X
Sporting and other recreational services										X	X	X	X	X
Transport services														
Maritime transport services										X	X	X	X	X
Air transport services										X	X	X	X	X
Rail transport services										X	X	X	X	X
Road transport services										X	X	X	X	X
Services auxiliary to all modes of transport										X	X	X	X	X
Other transport services										X	X	X	X	X
Other services not included elsewhere														
Hairdressing services											X			
Cosmetic treatment, manicure and pedicure services											X			
Other beauty treatment services											X			
Services related to the sale of equipment or to the assignment of a patent											X			

the United States, with strong backing from the International Chamber of Commerce (ICC) propose the elimination of barriers that impede cross-border trade in financial information and advisory services; marine, aviation, and transport (so-called MAT) insurance; reinsurance and retrocession; and services auxiliary to the provision of insurance.⁶⁸

On the other hand, recent empirical economic research now confirms (as suggested above) a significant positive correlation between financial instability in developing economies and the depth of GATS financial services commitments: according to Valckx, who performed an econometric study of financial, banking and currency crises in the period 1997–99, ‘liberal commitments may be associated with greater vulnerability to currency and banking crises’.⁶⁹

TELECOMMUNICATIONS

The Canada-US FTA

The FTA provides for the liberalization of trade only with respect to what are termed in the Agreement as enhanced telecommunications services. The relevant provisions are contained in an Annex to the services chapter of the FTA (Chapter 14), entitled ‘Computer Services and Telecommunications-Network-Based Enhanced Services’. Each Party is required to maintain the existing access to the basic telecommunications network that it currently provides to the other Party (Article 4). Moreover, where a Party maintains a monopoly over basic services, it must ensure that the monopoly does not abuse its power to compete unfairly in the area of enhanced services. This means, *inter alia*, that a Party’s monopoly must provide access to its basic network on terms that do not discriminate against enhanced service suppliers of the other Party (Article 5).

As Globerman *et al.* observe, the significance of these provisions for liberalization of trade in telecommunications services depends on how ‘basic’ services are defined in contrast to ‘enhanced’ services.⁷⁰ The definitions in the Annex itself are of limited assistance. Basic telecommunications transport service ‘means any service as defined and classified by measure of the regulator having jurisdiction that is limited to the offering of transmission capacity for the movement of information’. Enhanced service is defined as ‘any service offering over the basic telecommunications transport network that is more than a basic telecommunications transport service as defined and classified by the regulator having jurisdiction’. It seems clear enough that local and long-distance telephone services fall within the ‘basic’ category, and indeed, at the time the FTA was negotiated, these were largely subject to monopoly provision in Canada. With respect to many other services, however, it is unclear whether they should be viewed as offering ‘transmission capacity for the movement of information’ or as providing something more. For example, there are services that store or transform information, and thus from one perspective can be viewed as ‘enhanced’, but which do so primarily to *facilitate* its movement or transmission, rather than—as with computer services—to provide new or additional information (Store and Forward Telex and Pager Services are two examples).

NAFTA

Chapter 13 of NAFTA is devoted to telecommunications, and embodies a rather more extensive set of obligations than the FTA.

Article 1302 requires that a Party provide 'persons of another Party' access to its basic telecommunications network 'for the conduct of their business, on reasonable and non-discriminatory terms'. This refers to private communications and data networks maintained by firms for their internal use, and to the kind of enhanced services covered by the FTA. It does not imply a right to sell or resell telecommunications capacity itself. Thus Article 1301.3(c) states that nothing in Chapter 13 prevents a Party 'from prohibiting persons operating private networks from using their networks to provide public telecommunications transport networks or services to third persons'. Article 1302 contains a series of rather technical provisions that define many of the elements of the right of access to the basic network (for example the right to attach one's own equipment to the basic network). The right of access may be limited where necessary, *inter alia*, to protect the privacy of basic network subscribers or to protect the technical integrity of the public telecommunications network (Articles 5–6).

Unlike the FTA, which refers to enhanced services, the NAFTA uses the expression 'enhanced and value-added services'. This expression is defined with some precision in Article 1310 as including services that 'act on' aspects of a customer's information, provide 'additional, different, or restructured information', or 'involve customer interaction with stored information'. This is a very explicit and broad definition, which clearly encompasses most services beyond the basic local and long-distance telephone service. There is a correspondingly narrow definition of public telecommunications transport service as a service 'required by a Party, explicitly or in effect, to be offered to the public generally...that typically involves the real-time transmission of customer-supplied information between two or more points without *any* end-to-end change in the form or content of the customer's information'.

It should be noted that, unlike the FTA, the NAFTA confers on enhanced service providers something more than a right to non-discriminatory access to the public telecommunications network. Enhanced and value-added service suppliers are also to be exempt from requirements that they cost-justify their rates or that they provide enhanced services to the public generally (Article 1303.2(a)(b)). Finally, the NAFTA requires that the Parties 'consult with a view to determining the feasibility of further liberalizing trade in all telecommunications services, including public telecommunications transport networks and services' (Article 1309.2).

The Uruguay Round Services Agreement (GATS)

The GATS contains an Annex on Telecommunications, which is very similar in its substantive provisions and terminology to Chapter 13 of NAFTA. Thus, the Annex establishes a right of access for persons of another Party to a Party's public telecommunications transport networks and services on 'non-discriminatory and reasonable terms' (Article 5.1). However, the extent to which this right may be used by persons of a non-Party to supply telecommunications services to others (including, presumably, what are referred to in the NAFTA as enhanced and value-added services)

will depend on the specific commitments inscribed in the schedules of individual Members (Article 2.3.1).

In addition to the GATS Annex on Telecommunications, the Uruguay Round Final Act also contains the Decision on Negotiations on Basic Telecommunications. This Decision entails the conduct of future negotiations 'on a voluntary basis with a view to the progressive liberalization of trade in telecommunications transport networks and services within the framework of the General Agreement on Trade in Services' (Article 1). These negotiations are to be 'comprehensive in scope, with no basic telecommunications excluded *a priori*'. Although the negotiations are to be open to all Members, initially only 12 countries announced their intention to participate. Significantly, all of these are developed countries, except Mexico (which is obligated by NAFTA to undertake 'consultations' of a similar nature in the NAFTA framework). The Decision provides for the establishment of a Negotiating Group on Basic Telecommunications, which must conclude its negotiations and make a final report by 30 April 1996.

Pursuant to the Decision, 69 countries eventually participated in the Negotiations on Basic Telecommunications. However, on the 30 April 1996 deadline, the United States walked out of the talks, dissatisfied with other countries' liberalization offers, and particularly concerned with respect to the treatment of satellite services and lack of discipline on anti-competitive practices.⁷¹ The WTO Secretariat intervened and successfully proposed an extension of the deadline into early 1997. One issue that threatened the extended talks was the asymmetry between accounting pricing for telecommunication services to other countries provided from the United States and the international rates for accounting and settlement, which reflected inflated and unreal cost structures. Under these circumstances, if a USA carrier wished to provide service to the USA from another country, it would typically have to price the service based on the international accounting and settlement practices; however, a foreign carrier could enter the USA and use the resale market to provide international service to its home country at low US rates. Ultimately, a unilateral US regulatory solution was achieved—a foreign carrier could only enter the US resale market to provide service to its home country if that carrier accepted a price cap on the accounting rates for US carriers providing such service.

Finally, in mid-February 1997, the negotiations reached a successful conclusion. In general, the United States was sufficiently satisfied with the offers of other countries that it was prepared to make MFN commitments in most areas; however, Canada's insistence on continued protection for Teleglobe, its satellite provider, coupled with Canadian refusal to lift foreign investment restrictions in the telecoms sector, may have contributed to a decision by the United States to take an MFN exception with respect to digital-audio satellite services.⁷² Because of the nature of basic telecommunications, the most important commitments relate to market access (e.g. the number of service suppliers allowed), National Treatment with respect to operations (e.g. licensing and the conditions for service provision attached to licences or otherwise legally mandated) and foreign investment (obviously related to the local presence required to compete in most, although not all, sectors of the basic telecoms market, for example as a primary longdistance carrier for residential users).

Commitments achieved in the February deal in these and other areas are bound in Member's schedules, and constitute the Fourth Protocol to the GATS, which entered into force in January 1998. Bronckers and Larouche summarize the commitments as follows:

[Sixty-one countries made] commitments to liberalize the provision of voice telephony to some extent. Two countries only liberalize voice services to closed user groups [footnote omitted]. International voice services are liberalized in forty-two schedules (fifty-six countries), national long distance services in thirty-seven schedules (forty-one countries), and local services in forty-one schedules (fifty-five countries). A large number of commitments (for twenty-five countries), however, are phased-in beyond the entry into force of the Fourth Protocol... Forty-nine schedules (sixty-three countries) include commitments on data transmission services, forty-one schedules (fifty-five countries) on leased lines, forty-six schedules (sixty countries) on cellular/mobile telephony services, forty-five schedules (fifty-nine countries) on other types of mobile services (personal communication service (PCS), mobile data, paging), thirty-seven schedules (fifty-one countries) on mobile satellite services or transport capacity and thirty-six schedules (fifty countries) on fixed-satellite services or transport capacity...forty-two...contain a commitment to permit foreign ownership or control of all telecommunications services and facilities.⁷³

In addition to these commitments, all but two countries (Ecuador and Tunisia) committed to follow the regulatory principles in a Reference Paper negotiated simultaneously with the other commitments. The Reference Paper requires the Members committed to it to establish 'appropriate measures' to prevent anti-competitive practices by major suppliers, which include 'cross-subsidization', 'using information obtained from competitors with anticompetitive results' and 'not making available to other services suppliers on a timely basis technical information about essential facilities and commercially relevant information which are necessary for them to provide services' (1.1, 1.2). Interconnection with a major supplier must be provided, *inter alia*, on a non-discriminatory basis (i.e. on as favourable terms as those provided for the major carrier's own like services and those non-affiliated or subsidiary suppliers) and in a timely fashion and on terms that are, *inter alia*, 'transparent' and 'reasonable' (2.2). There are a number of other provisions that relate to transparency and the existence of independent regulation (including dispute settlement by independent domestic regulatory tribunals with respect to interconnection).

Telecommunications services have been the subject of one high-profile WTO dispute, the *Telmex* case. In the *Telmex* case (*Mexico—Measures Affecting Telecommunications Services* (WT/DS204/R), Report of the Panel, April 2, 2004), the United States challenged Mexican regulations that required long distance carriers serving customers outside Mexico calling into Mexico to purchase call interconnection services from licensed concessionaires based on prices negotiated by the largest such concessionaire, the former telecommunications monopoly Telmex. The United States argued that these practices violated provisions of the Reference Paper on Telecommunications to which

Mexico was bound as well as obligations in the Annex to the Agreement on Basic Telecommunications and the provisions on market access in Article XIV of the GATS.

The main provisions of the Reference Paper at issue were Sections 2.1 and 2.2. Section 2 of the Reference Paper, as incorporated in Mexico's GATS schedule under "additional commitments," governs "Interconnection." In this regard, Section 2.1 states: "This section applies, on the basis of the specific commitments undertaken, to linking with suppliers providing public telecommunications transport networks or services in order to allow the users of one supplier to communicate with users of another supplier and the access services provided by another supplier. Section 2.2 then requires that "[interconnection with a major supplier will be ensured at any technically feasible point in the network." Under Section 2.2(b), such "interconnection" is to be provided in a timely fashion, on terms, conditions (including technical standards and specifications) and *cost-oriented* rates that are transparent, reasonable, having regard to economic feasibility,...

Since the strictures of the Reference Paper only apply where a WTO Member has made specific commitments with respect to basic telecommunications, the panel had first to consider the nature and extent of Mexico's specific commitments. The USA noted that Mexico had made specific commitments with respect to the supply of telecommunications services of this kind to the Mexican market through cross-border delivery (Mode 1). Mexico by contrast argued that in fact the US telecommunications operators in question were not supplying long distance services *in the Mexican market*; they were only supplying US consumers in the US market; the calls were simply "handed off" at the border for completion by Mexican suppliers. The panel appears to have misinterpreted Mexico's argument as one that was based on the idea that the US supplier must somehow have a presence or operate within Mexico in order for Mexico's commitments to apply; the panel correctly noted that the 'cross border' mode of supply does not presuppose any such presence. Where the panel went wrong was in not considering the fact that the American operators were only selling to customers in the USA—they were simply not supplying services to Mexicans. It was the US customer who was purchasing the service of long distance; the Mexicans picking up the phone were merely a third party in a contractual transaction between a US buyer and a US seller. Thus the real question was whether any service was actually being supplied here to the Mexican market: the most cogent answer is 'no.' As Nevin and Weiler put it, '...it appears that the panel ends up reading in the reference paper a commitment with respect to the *export* of services out of Mexico and it is not clear whether GATS was meant to impose a discipline beyond the imports of services (considering that services are typically supplied in more diverse modes than goods).'⁷⁴

The entire premise of the panel's application of the Reference Paper and other GATS provisions may thus be erroneous. This being said, the panel went on to find that the interconnection rates of Telmex were not cost-based, simply because *other kinds* of interconnection *prices* were lower in comparable circumstances, according to evidence adduced by the USA. The panel noted: '(§ 7.187): "The United States uses four methods to show that Telmex does not charge cost-oriented rates to United States suppliers of the services at issue. First, it presents evidence that the same network elements used to interconnect United States suppliers, when used for domestic interconnection, cost on average 75% less. Second, it presents evidence that grey market rates for a variety of

international routes to Mexico are far lower than the rates charged by Telmex. Third, it presents evidence that wholesale rates to terminate calls between various countries with competitive long-distance operators is much lower than the rates charged by Telmex. Fourth, the United States presents evidence that the financial arrangements related to “proportionate return” procedures among Mexican operators pursuant to the ILD Rules show that Telmex’s rates are above cost.” “The panel never bothered to consider the actual costs of Telmex, given its responsibilities as a network operator for Mexico. As Ellen Gould suggests, in a trenchant critique of the panel ruling,

Mexico also tried to claim that the “reasonable”, “cost-oriented” rates required by the Reference Paper allowed recovery of the costs of meeting universal service obligations. According to the USA: “Cost-oriented pricing, as that term is used in Section 2 of the Reference Paper, does not permit Mexico so-called ‘flexibility’ to implement the national goals that Mexico identified in its submission.” The panel agreed with the USA, with the result that foreign companies connecting to Mexican telecommunications infrastructure are freed from having to contribute to meeting Mexico’s social policy objectives.⁷⁵

On the basis of the extent of the difference between Telmex’s interconnection rates, and the lack of price competition for these services, the panel went on to find as well that Mexico had denied US operators interconnection on ‘reasonable terms and conditions,’ as required by 2.2(b) of the Reference Paper. The panel further found that the Mexican regulations by *mandating* the fixing of interconnection prices through a dominant supplier, Telmex, violated Para. 1.1 of the Reference Paper, which reads: ‘Appropriate measures shall be maintained for the purpose of preventing suppliers who, alone or together, are a major supplier from engaging in or continuing anticompetitive practices.’ It is notable that the panel, in determining the meaning of ‘anticompetitive practices’ took an extremely broad view that, at the limit these could include any ‘actions that lessen rivalry or competition in the market.’ (para. 7.230.) At the same time, the panel found that the language ‘major supplier’ and the pricing-related examples in 1.2 of the Reference Paper lent support to the notion that price-fixing was a prohibited ‘anti-competitive practice’ within the meaning of 1.1.

Similar considerations as those that entered into the panel’s findings of violations of the Reference Paper led the panel to find that Mexico had, *inter alia*, also violated 5(a) of the Annex, which provides that ‘Each Member shall ensure that any service supplier of any other Member is accorded access to and use of public telecommunications transport networks and services on reasonable and non-discriminatory terms and conditions, for the supply of a service included in its Schedule.’ Here the panel also made the interpretative leap of finding that this obligation to provide access included access that would permit a foreign service supplier to supply not its customers in the other Member’s jurisdiction (here, Mexico) but also in its home market (the United States). Mexico sought to rely on the limitation on Annex obligations contained in 5(g) of the Annex, which reads ‘Notwithstanding the preceding paragraphs of this section, a developing country Member may, consistent with its level of development, place reasonable conditions on access to and use of public telecommunications transport networks and services necessary to

strengthen its domestic telecommunications infrastructure and service capacity and to increase its participation in international trade in telecommunications services.’ Remarkably and without textual foundation, the panel read that provision as only applicable where the conditions in question were explicitly indicated in the Member’s schedule.

The state of play in the negotiations on telecommunications commitments in the current Doha/Millennium Round of WTO negotiations is summarized by Hodge:

The negotiations cover all aspects of the telecoms sector, including fixed line public networks, mobile networks and the full range of value-added network services (VANS) such as Internet and virtual private networks. Liberalisation of trade in these sub-sectors involves removing entry barriers into the market (market access) and any discriminatory practices against foreign operators (national treatment). It applies to all forms of operations—whether it is a commercial presence in the host country or offering a cross-border service such as international voice or data traffic. Liberalisation does not include privatisation (public companies can continue to exist in a competitive environment) and does not eliminate ability to regulate the industry in a fair and impartial manner... It is evident that there is strong interest in pursuing the liberalisation of the sector by both developed and middle-income countries. The reason for this is threefold: First, to gain market access for their telecoms firms that are seeking to make-up for domestic market share losses in the face of liberalisation at home and to seek further growth opportunities. Second, competition in foreign markets will bring down settlement rates for international calls made domestically, benefiting the home consumers. Thirdly, competition in foreign markets will lower the operating costs and competitiveness of multinationals operating in these markets. As most industrial countries have fully liberalised their telecoms sector and middle-income countries are already far down that path, there are no domestic reform limits that are holding back requests. These countries are generally asking for full liberalisation and the adoption of the Telecoms Reference Paper as their opening move in the negotiations. There have also been numerous negotiating proposals seeking to broaden the scope of negotiations by updating the service listing (Switzerland, Australia, Norway) or negotiating an e-commerce cluster (USA, Chile); and strengthening the Reference Paper by enhancing the regulatory independence provision (Australia), ensuring competitive mechanisms for allocating limited licences (Switzerland) and limiting the licence/universal service fees (Japan, EU).⁷⁶

As of early 2005, when this book went to print, WTO Members had included telecommunications commitments in their initial offers (see Table 12.3 above).

CONCLUSION

Given the highly diverse nature of the barriers to trade in services, and the interconnection of many of these barriers with a wide range of complex domestic regulations and policies, liberalization of trade in services is not achievable through the general multilateral rules and negotiated removal of border measures that have characterized the GATT's approach to liberalization of trade in goods. While some barriers are caught by a National Treatment obligation, many others can only be addressed through commitments either to remove or alter non-discriminatory domestic regulations, or to international regulatory harmonization (at least with respect to minimum standards or qualifications).

The attempt to insert a process for negotiation of specific commitments to regulatory change within a multilateral rule-based institutional and legal framework has been less than entirely successful—as witnessed by the severe tensions between different Members concerning the place of the MFN principle in this process. This has led to an incomplete result, disappointing to those who had expected more significant commitments to market access. There is a significant possibility that liberalization will in future be pursued further either through the elaboration of bilateral or regional accords that already deal with services (NAFTA and the OECD Codes, for instance), or through negotiations within the WTO framework on a basis which is, in fact, not genuinely universal or multilateral. The danger is that a set of liberalization commitments may emerge that closes off major markets for services from countries unwilling or unable to make particular kinds of commitments to deregulation of their own service industries. Of course, a convergence of approaches to regulation and deregulation among an increasingly wide range of countries would significantly attenuate this problem, and make a multilateral approach more feasible and attractive.

Such a convergence is arguably occurring, at least among a significant number of both developed and developing countries,⁷⁵ although not at a pace always satisfying those seeking the fullest possible liberalization. It is important nonetheless to recognize that, in theory and perhaps also in practice in at least some areas, important trade-offs may still exist between the gains from liberalized trade in services on the one hand and, on the other, the resultant sacrifice in regulatory diversity and innovation. Finally, if the initial, quite limited bargains within the WTO on services are to be sustained over the long term, it will be quite important that the WTO deliver on the promise of becoming a genuine supranational organization, capable of facilitating ongoing negotiation and adjustment of commitments with respect to trade in services, in light of technological and other changes that affect the covered sectors and that present new or renewed regulatory challenges.

13

Trade-related intellectual property (TRIPs)

INTRODUCTION

In the 1980s and 1990s, a number of the most economically advanced industrialized nations, including the United States and some members of the European Union, have faced increasing competition in manufactured exports from newly industrializing countries (NICs) in Asia and Latin America. This increasing competition has focused attention on domestic policies of these nations that may adversely or (as is often claimed) even unfairly disadvantage American or European trading interests. It is in this manner that the issue of intellectual property rights has become a prominent item on the trade agenda, as reflected in the extensive provisions on intellectual property in both the Uruguay Round Final Act and the North American Free Trade Agreement.

Two main concerns have dominated developed-country demands. The first is that many developing countries, including some NICs, had often afforded a shorter period of patent protection (and in some cases more narrowly defined protection) to products such as pharmaceuticals than do the United States and most European countries. The result was that domestic imitations of these products often dominated developing-country markets, with a resultant loss of potential foreign sales by the original North American or European producer who financed the innovation in the first place. In addition, the patent-granting process and the enforcement of patent protection in many developing countries has been viewed as lacking in transparency and legal security and certainty. The second concern was the tolerance of some developing-country governments (and lack of vigilance in some other states as well) with respect to the production and sale of pirate sound recordings and videos, as well as the 'theft' or appropriation of trademarks and symbols (like 'Rolex' or 'Pierre Cardin') and their attachment to cheap imitations that have no relationship to the original producer's own manufactures.

American business interests estimated losses in the billions of dollars annually from these kinds of supposed inadequacies in intellectual property protection, primarily in developing countries. From a trade theory perspective, however, it is far from clear that all countries should be required to maintain the same level of intellectual property protection. Patent protection constitutes a form of monopoly rent to the innovator. This provides incentives for innovation, but also may entail at least short-term consumer welfare losses and may discourage diffusion of technology through imitation and adaptation by competitors, which themselves constitute valuable economic activities. The level of intellectual property protection each country decides to afford will thus be rationally related to whether its comparative advantage resides more in innovation or imitation and adaptation of innovations made elsewhere, and the relative weight it gives to the interests of consumers (including its own producers who are consumers of inputs), imitators and innovators.

Two kinds of justification for the protection of intellectual property dominate the debate on TRIPs. The first centres on fairness or compensatory justice concerns, and the second on arguments about the relationship between protection of intellectual property and domestic and global economic welfare. The use of inventions or creative works of others without their permission is often labelled as piracy or theft. Of course, unless the act in question is defined in those terms in the positive law of the country concerned, or in international law, such a characterization merely states a normative conclusion that inventors and creators *should* have a proprietary entitlement to the fruits of their labour. One (Lockean) line of argument to support this view is that persons are naturally owners of the fruits of their own labour, and that the taking of these fruits represents an attack on the autonomy—or even the integrity—of the person.¹ Pushed to its limits, this view would point to a perspective that suggests that taxation—or any non-voluntary appropriation by society of some of the value of an individual's labour—is expropriation. While we cannot here explore all the theoretical difficulties with such an understanding of property,² it is worth mentioning one problem that presents particular complications with respect to intellectual property. Society provides the context in which creative activity takes place—few inventions or works of art or literature spring fully grown from the inventor's head. They usually depend on education within society, and build on the work of many others. There is thus a limit to the extent that creators can declare the work totally their own, and exclude any claim by society on some of that value.

In fact, despite the rhetoric of natural rights or proprietary entitlements that is often invoked to argue for strengthened protection of intellectual property, the debate centres around whether protection should be limited, say, to 15 years for patents or extended to 20 or 25 years. It is hard to imagine a natural right that miraculously disappears after 20 or 25 years! Once we have established that the issue is actually the *level* of compensation to which a creator is entitled, then it is clear that at least implicitly the creator's claims are being balanced against other social interests.

A complete absence of compensation, or a social expropriation of all the benefit of an individual's creativity, would, essentially, amount to slavery (with the one significant difference being that the inventor or creator could presumably choose not to invent or create, whereas the slave must work for another's benefit). Proprietary entitlements over one's creative product are, however, not the only form in which such compensation may be provided. For instance, in many countries, a large percentage of inventors or creators work in government laboratories and universities, and even literary and artistic activity is subsidized by the state. Invention and creation may be regarded as a salaried occupation like any other.

Once we view the relevant normative concern as that of compensation, a wide variety of factors may well enter into the determination of what a fair level of intellectual property protection would be. Just as inadequate compensation for valuable inventions may constitute exploitation, so could profiteering on the monopoly control over, for instance, the formula for some life-saving drug.³

The economic argument for the protection of intellectual property rights is relatively straightforward—unless invention or creation is compensated at its full social value, there will be suboptimal incentives to undertake it. Central to this insight is the 'free-rider' problem—an individual or firm will be much less likely to make an investment if someone else (the free rider) can capture or appropriate at little or no cost a significant

part of the economic returns from the investment in question. However, as is widely recognized in the economic literature,⁴ this must be weighed against the economic effects of creating a monopoly on knowledge, namely higher-cost products and the exclusion from the market of competitors who may be able to imitate or adapt the invention in such a way that its social value is increased.

To take a simple example, let us suppose that currently in a given country, 15 years of patent protection is extended to the development of new widget technologies. If protection is extended to 20 years, incentives for innovation are increased, and some new valuable widget technologies that otherwise might go undeveloped and unexploited would come into being. However, lower-cost products based on competitors' imitations or adaptations of existing widget technologies will take longer to get to market. Extending protection from 15 to 20 years will *only* make sense if the welfare gain from the added incentive to innovation outweighs the welfare loss from deterring competition with respect to imitations of the technology. In the abstract, we cannot tell which is more important to a given country—cheaper widgets from existing technologies or more new widget technologies.

Before we introduce the implications of this basic insight for trade, it is important to note that rarely will a single level of protection for all technologies or sectors maximize domestic welfare. After all, the trade-off between the economic benefits of innovation and imitation will vary quite considerably depending, say, upon whether we are dealing with computer technologies or pharmaceuticals. Recent work in economics on patent protection suggests the possibility that very strict protection could result in wasteful outlays on research and development (R&D)—due to the 'winner takes all' nature of such protection, firms may compete to be the first past the post with a patent in hand. This 'patent racing' argument points to the social efficiency in some contexts, of treating R&D as a public good.⁵ It should be noted that the gains from imitation and the corresponding losses from increased patent protection may be of two kinds—first, higher costs to consumers from the monopoly position that the patent confers on the holder, and second, the loss with respect to imitation industries, where revenues and employment will decline. Landes and Posner identify, besides patent races, other kinds of strategic behaviour that may be inefficient: defensive patenting and patent suppression. Defensive patenting occurs where an inventor who would otherwise not seek to cover her fixed costs through patent protection but who eventually wants to make use of the invention herself takes out a patent to prevent someone else from patenting it and thereby being able to charge her a license fee to use the invention. In her case, the monopoly rents are an unnecessary social cost, as the innovation would have occurred anyway. Second, firms may take out patents to keep others from developing a certain technology, for instance a competitor who might have a competitive advantage in exploiting the technology, given its existing production methods.⁶

Furthermore, the overall trade-offs between innovation and imitation may well differ from country to country. A country where innovation is not a major source of economic activity and growth is likely to choose, on balance, a less stringent intellectual property regime than would a country whose economy is highly dependent on innovation. From this perspective, there is nothing suspect or unreasonable with the preference of many developing countries for a relatively lax system of intellectual property rights. These countries have much to gain, in terms of consumer welfare, from countenancing cheap

domestic imitations of innovations made elsewhere, and perhaps little to lose if they are not at a stage of development that makes domestic research and development an important ingredient in domestic welfare. From the point of view of at least some developing countries, then, an agreement on TRIPs that raised intellectual property protection to developed-country levels could rightly be seen as a welfare-reducing or Pareto-inferior bargain.

Several arguments have nevertheless been advanced to show that such a bargain could be in the long-term self-interest of developing countries. The first is that these countries, like all others, benefit from innovation which occurs outside their own borders, and that the increased incentives to inventors due to increased global revenues from their innovations will yield greater amounts of innovation, and therefore new benefits in which developing countries will share. Often, industry estimates of 'foregone' revenues from sub-standard intellectual property protection in developing countries assume that if proper protection were afforded, a quantity of original products would be consumed equal to that of the imitations now being purchased. This, as is widely noted in more recent economic literature,⁷ may be quite misleading—since original products (i.e. patent as opposed to generic drugs) would likely be much more expensive, one could expect a considerable decline in demand. Deardorff questions whether the marginal benefit of extra protection, in terms of products that would not have been invented but for the additional incentive from higher monopoly rents in developing countries, is likely to outweigh the reduction in consumer welfare due to higher prices.⁸ It is also possible that the optimal level of innovation has already been achieved or exceeded, in which case further protection of intellectual property might actually result in, or even intensify, a misallocation of productive resources to research and development. At the margin, would welfare be increased more by an extra dollar being spent on innovation or on applications of existing inventions and technologies?

Another line of argument is that developing countries will attract greater amounts of foreign investment and technology transfers if foreigners believe that products, processes and trade secrets will be adequately protected. Empirical evidence that this is the case is, however, sketchy and anecdotal.⁹ In addition, the appropriate response might be to negotiate specific guarantees with investors, rather than increasing intellectual property protection across the board.¹⁰

TRADE THEORY AND INTELLECTUAL PROPERTY RIGHTS

In terms of neo-classical trade theory, whether a particular country will want stronger or weaker intellectual property protection will depend on whether its comparative advantage lies more in innovation or in the imitation and adaptation of others' innovations. This is simply an extension of the argument concerning the allocation of resources domestically between imitation and innovation. More precisely still, a rational country would have different levels of protection for different industries, representing different trade-offs between innovation and imitation in each industry, depending upon where its comparative advantage lies.

The United States has traditionally been a country with a significant comparative advantage in innovation, reflected in the fact that a higher percentage of its exports

contain domestically generated technologies than those of any other country, far exceeding even Japan.¹¹ Under these circumstances, a high level of protection for intellectual property rights within the United States would seem to be well justified. From the perspective of the *national* interest of countries that have a comparative advantage that lies more in imitative than innovative activity, however, a lower level of protection would likely be optimal. This argument, it should be stressed, does not apply only to developing countries. Much of Japan's dramatic economic growth in the 1960s and 1970s can be accounted for by its success at imitation and adaptation of innovations developed elsewhere, aided by a strategic use of intellectual property protection to stimulate imitation in some sectors and industries and innovation in others.¹² The strength of Canadian multinational enterprises has been linked to their capacity to find and adapt technology from elsewhere.¹³ In sum, it is far from clear that increased intellectual property protection would benefit even developed countries with a strong advantage in imitation.

The conclusion that stronger intellectual property protection may benefit some countries but not others suggests a fundamental difference between the theoretical case for trade liberalization, as we developed it in Chapter 1, and the case for mandating high levels of intellectual property protection throughout the world. In the former instance, the neoclassical theory of trade suggests that further liberalization will, with certain defined exceptions, be *always* beneficial *both* to the domestic economic welfare of the liberalizing state and to *global* economic welfare (defined in terms of global allocative efficiency and/or the aggregate of the domestic welfare of all member states).

With respect to intellectual property protection, however, the case cannot be stated in these terms, for a requirement of strengthened protection, in at least some sectors, could increase economic welfare in some countries, while reducing it in others. Mandated stronger protection for intellectual property rights is not necessarily, therefore, Pareto-superior and must be justified instead as a fair bargain or trade-off between the competing or conflicting economic interests of different states.

In addition, it is highly questionable whether increased protection is even Kaldor-Hicks efficient, i.e. whether the gains to economic welfare to countries who benefit from stricter protection outweigh the losses to those countries who lose by it. In a seminal and provocative article, Allan Deardorff has argued that global aggregate welfare may well be maximized if certain countries *are exempted completely* from requirements for intellectual property protection. The reason is that, with respect to these poorer countries, the marginal increased rents to the patent-holder are unlikely to be substantial enough to constitute significant incentives to further innovation. However, the losses to developing countries from being forced out of imitation or buying imitations from elsewhere would probably be more substantial.¹⁴ Additionally, if the effect of increased protection is to shift productive resources from an activity in which a country has a comparative advantage (imitation) to that in which it has less comparative advantage (innovation), then global allocative efficiency would be reduced by increased protection.

Deardorff's basic insight has been developed independently by Maskus as a formal model of the global welfare effects of intellectual property (IP) protection. His empirical studies using this model, which are based upon United States International Trade Commission data with respect to impacts of lower IP protection in other countries, yielded the result that 'static global welfare would suffer from the extension of IP

protection by information-importing countries' under most assumptions about elasticities of supply and demand.¹⁵ Only under highly speculative dynamic assumptions (i.e. that increased protection would create enough incentives for technology transfer to, and new R&D within, developing countries to *create* a comparative advantage in innovation) could global welfare be predicted to rise. Work by Grossman and Helpman also suggests that global welfare may be reduced by higher levels of intellectual property protection in developing countries, since the effect may be to slow the process whereby products invented in the North come to be imitated and manufactured in the South at lower cost (i.e. more efficiently).¹⁶

THE PRE-URUGUAY ROUND INTERNATIONAL LEGAL FRAMEWORK

Having considered the case for strengthening of intellectual property rights from a number of perspectives, we now canvass the existing international rules on this subject. The international legal and institutional framework for cooperation in the protection of intellectual property rights that has emerged over the last 100 years, as we shall see, falls short of elaborating a set of universal, harmonized standards for intellectual property rights. Yet from the fairness and domestic and global welfare perspectives discussed above, the case for such harmonization is, as we have seen, far from compelling. At the same time, the existing framework reflects long-standing recognition by a wide range of states that intellectual property rights are a legitimate subject of international legal discipline.

The GATT

By virtue of Article XX of the General Agreement, intellectual property has been largely excluded from the ambit of GATT. Article XX states a number of exceptions to the basic obligations of the GATT with respect to trade, and these include 'measures...necessary to secure compliance with laws or regulations which are not inconsistent with the provisions of this Agreement, including those related to...the protection of patents, trade-marks and copyrights, and the prevention of deceptive practices' (Article XX(d)). However, this exception, like all the others in Article XX, is subject to the following qualification: such measures must not be 'applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade'.

Students of the GATT have long been divided as to whether the meaning of this qualification is that the principle of National Treatment as defined in Article III nevertheless applies to Article XX exemptions, or whether the intent is to define an alternative, weaker, National Treatment standard applicable only to the matters listed in Article XX (the standard would be weaker because of the qualifying words, 'between countries where the same conditions prevail', which imply a 'similarly situated' test).¹⁷ To some extent, this issue has been resolved in favour of the latter view in a GATT panel decision on the GATT-consistency of Section 337 of the US Tariff Act.¹⁸ In that case, the panel held that, in some circumstances, an Article XX(d) exception might be claimed for

measures that, but for the exception, would be in violation of the Article III National Treatment obligation. This, of course, would be impossible if Article XX(d) itself were to imply the same National Treatment standard as Article III.

The Paris Convention

The Paris Convention¹⁹ is the principal instrument of international law with respect to protection of patents and trademarks, described within the Convention by the general label 'industrial property'. The Convention was established in 1883 and has 98 signatories whose countries represented (in 1985) 88% of world trade in goods.²⁰

The cornerstone of the Convention is the National Treatment principle, expressed in Article 11(1), which provides that 'Nationals of any country of the Union shall, as regards the protection of industrial property, enjoy in all the other countries of the Union the advantages that their respective laws now grant, or may hereafter grant to nationals.'

In addition to the same substantive protections, Article 11(1) also provides that nationals of other members of the Union shall have 'the same legal remedy against any infringement of their rights, provided that the conditions and formalities imposed upon nationals are complied with'. One important aspect of these obligations is that they apply to legal instruments defined as 'industrial property' in Article 1(2) including patents, trademarks, industrial designs and trade names. Thus, for instance, it is unclear whether the National Treatment obligation would apply to new *sui generis* forms of intellectual property rights. In light of efforts by the United States to negotiate bilaterally with some countries special agreements for protection of the intellectual property of its nationals, it is also important to note that, on its face, the National Treatment obligation of the Paris Convention does not include a Most Favoured Nation (MFN) requirement.²¹ In addition to the National Treatment obligation, the Convention sets some minimum standards with respect to both patent and trademark protection. A priority registration system is created whereby if a patent is filed in one Member country, nothing which occurs within a 12-month period that runs from the first filing will affect the right to a patent in other Member countries (e.g. exploitation or use of the invention within that 12-month period in a country where a patent has not yet been filed). The provision for trademarks is identical, except that the period is six months (Articles 4A–4B).

With respect to trademarks and trade names, there is a further set of much more rigorous obligations. Other countries are *required* to accept a trademark for registration and to protect it fully, once the mark has been properly registered according to the laws of the country of origin, subject to certain exceptions, e.g. where third-party rights are violated or where the marks are 'contrary to morality or public order' (Article 6). In addition, Member States are obliged to seize, upon importation, all goods 'unlawfully bearing' a trademark or trade name entitled to legal protection in the importing country (Article 9).

National Treatment clearly prohibits one kind of national strategy for intellectual property that, as suggested above, may in fact be domestic welfare-maximizing for certain kinds of countries, e.g. extending generous intellectual property protection to domestic innovators (to provide an incentive for domestic innovation) while providing minimal protection to foreigners (so as to maximize consumer welfare and provide

incentives for imitation and adaptation of foreign innovations). However, indirect pursuit of such a strategy is possible within a literal reading of the Convention.

For instance, as Lesser suggests, 'a member state may offer no patent protection for certain product groups, provided that the absence of protection applies equally to nationals and non-nationals'.²² This permits very significant *de facto* discrimination against foreigners to occur through selection of product groups. Countries can (and do) exempt from protection products in whose innovation they themselves have no comparative advantage (e.g. pharmaceuticals in the case of many developing countries). *A fortiori*, a country would have little or no interest in protecting intellectual property rights in products of which it is solely an imitator and intends to remain so—here the national interest is above all consumer welfare, i.e. sourcing the product as cheaply as possible.

At what point differential protection for particular products, industries or technologies becomes a *de facto* violation of National Treatment is of course very difficult to determine. Such differential treatment need not have a discriminatory intent; even assuming a country did not trade at all, it might well provide varying levels of protection depending upon the trade-offs between the benefits of encouraging innovation and those of encouraging imitation that existed in a particular sector. Here, the National Treatment principle itself, if it is to be effectively implemented, may point to some international minimum standards, i.e. to some kind of determination in international rules as to which balances between innovation and imitation are legitimate domestic policies and which constitute unfair trade practices.

An additional difficulty that arises with respect to National Treatment concerns rules or procedures that pertain to the granting and enforcement of intellectual property rights. Some legal systems place a premium on the exercise of administrative discretion in the determination of what intellectual property rights, if any, to grant to a particular innovation. Borrus notes with respect to Japan, for example, that

The exercise of discretion is enabled mightily by a lack of transparency in decision-making. The JPO (Japanese Patent Office) rarely documents its reasoning...when using the system to disadvantage foreign filings JPO examiners have been known to fail to communicate in a penetrable way. The resulting speculative interpretation of the examiner's intent leads to misinterpretation and instant justification for hindering or rejecting foreign filings.²³

With respect to these kinds of complaints, it is very difficult to know whether, in fact, discrimination against foreigners is actually occurring, or whether they simply find it burdensome working within a different legal and political environment. Despite the fact that foreigners may incur special costs in seeking intellectual property protection in another Member State (such as translation, or the hiring of local lawyers or patent experts able to guide them through the system), the Paris Convention clearly states that to avail themselves of National Treatment, foreigners must 'observe the formalities and conditions imposed upon nationals' (Article 2(1)).

Related complaints concern the enforcement of intellectual property rights. Particularly with respect to developing countries, Primo Braga notes: 'Problems often

mentioned include: the slowness of the enforcement process; discrimination against foreigners; biased court decisions; inadequate civil and or criminal remedies; and corruption.²⁴ Not surprisingly, much of the evidence of these difficulties is anecdotal. It is probably true that foreigners are in some sense discriminated against in legal systems characterized by corruption and bias, inasmuch as locals are likely to have access to 'back channels' that foreigners lack. Yet these are symptoms of broader social and political issues that may be difficult to address in the rather specific context of international rules on intellectual property rights. As well, in some cases, foreigners may incorrectly assume that outcomes that appear unfamiliar, anomalous or unfavourable are the product of discrimination or improper dealing. Even if they are based on ignorance of law and institutions in other countries, such assumptions contribute powerfully to the notion that the National Treatment principle, as elaborated in the Paris Convention, is inadequate to discipline discriminatory practices.

The Berne Convention

The Berne Convention,²⁵ established in 1885, sets certain minimum standards with respect to authors' rights, and also contains a National Treatment and an MFN obligation.²⁶ In general, the required minimum length of protection is the author's life plus 50 years (Article 7(1)). During this period, authors (or their estate) 'enjoy the exclusive right of authorizing' any reproduction or communication of the works they have created (Articles 9–14). These minimum standards are subject to certain limitations or exceptions, such as for quotation and utilization of works in other publications or works (e.g. TV broadcasts). These are exceptions not only to the minimum standard itself, but also to the National Treatment and MFN obligations; hence the Convention contemplates 'special agreements' on these matters between particular Member States of the Berne Union (Article 9(2)).

The Convention also contains special provisions applicable to developing countries, permitting them to substitute compulsory licensing for the minimum standards of the Convention. The (perhaps somewhat 'imperialistic') reasoning is that the dissemination of literary and artistic works from abroad is crucial to the development needs of these countries, and would often not be possible if the works had to be purchased as imports from the developed world, or reproduced on the basis of the kinds of royalties or fees that might be demanded in return for authorization by an author holding a copyright. The compulsory licensing provisions only apply where, after five years (or in certain cases three or seven years), the work has not been disseminated by the owner of the right of reproduction 'at a price reasonably related to that normally charged in the country for comparable works' (Appendix, Article III(2)). Thus the authors/owners retain the option of asserting their rights, if they are prepared to authorize reproduction at a price that is comparable to normal prices in the developing country in question. Moreover, for compulsory licensing to apply, the intent must be to disseminate the work 'for use in connection with systematic instructional activities' (Article III(2)(a)).

The language of the Convention clearly suggests an intent to cover virtually every kind of creative work.²⁷ However, with respect to certain kinds of scientific work or industrial and architectural design, the question arises of whether patent rather than copyright protection is more appropriate. This question has become of considerable

importance as countries grapple with the appropriate means of protecting creative rights in computer software.²⁸

The Berne Convention currently has more than 75 signatories. It is noteworthy that the United States only joined the Convention in 1988, having previously chosen to rely upon unilateral measures and bilateral reciprocity-based treaties to protect copyright.²⁹

The World Intellectual Property Organization (WIPO)

WIPO was established in 1967³⁰ to administer multilateral agreements on intellectual property rights, including the Paris and Berne Conventions, and since 1974 has had the status of a specialized agency of the United Nations. WIPO does not embody a formal court-like mechanism for the resolution of disputes under these agreements, but regularly produces studies and reports on issues that arise in their implementation. As well, WIPO has been active in assisting developing countries in establishing their own systems of intellectual property protection, and has provided financial aid and technical advice for this purpose. At the outset of the Uruguay Round, it was the position of most developing countries that WIPO, not GATT, was the appropriate forum for evolving stronger international rules on the protection of intellectual property rights. This position was undoubtedly influenced by the perception that developing countries have traditionally had more influence in the UN system than in the GATT. It could also be defended on the basis that WIPO's accumulated expertise and experience in the intellectual property field make it a more appropriate forum for negotiations on TRIPs.³¹

After the Uruguay Round TRIPs Agreement, WIPO has moved to revitalize its central role in the internationalization of intellectual property protection. New treaty instruments were negotiated and adopted under WIPO on matters such as copyright and neighbouring rights, performance rights, and the harmonization of trademark law procedures and formalities. WIPO also adopted a dispute settlement mechanism. There is a cooperation agreement between WIPO and the WTO, providing for exchange of information and documents, but with little in the way of a formal legal structure for interaction of the two organizations on TRIPs matters.

Under its 2000 'Patent Agenda', WIPO is now sponsoring negotiations on a draft Substantive Patent Law Treaty. The aim here appears to be to go beyond the minimum standards in TRIPs and create a harmonized global patent regime. The risk to developing countries in this exercise are explained by Musugu and Dutfield: 'Harmonization as proposed in the SPLT is likely to result in TRIPs-Plus standards for developing countries. While most of the proposed standards will benefit international industries, they will make it more difficult for developing countries to adapt their patent laws to local conditions and needs including...their critical public health and other needs. Such a result will undermine the achievements in Doha on public health and elsewhere on the issues in intellectual property and development.' (S.F.Musungu and G.Dutfield, 'Multilateral agreements in a TRIPs-plus world: The World Intellectual Property Organization', Quaker United Nations office, Geneva, 2003, pp. 11–12; this document also contains an excellent description of the organization structure and history of WIPO). Musungu and Dutfield point, for example, to a draft provision on patentability that would require that all states parties make eligible for patentability any invention that 'can be made or used for exploitation in any field of [commercial economic] activity.' This would go far

beyond the Uruguay Round TRIPs Agreement, which as we explain below, allow exceptions from patentability for various public policy and ethical reasons.

Other international agreements

Besides the Paris and Berne Conventions, a number of other international agreements exist with respect to other forms of intellectual property rights, including the Rome Convention³² (performers' rights), the International Convention for the Protection of New Varieties of Plants (UPOV) (plant breeders' rights)³³ and most recently (1989) the Washington Treaty (integrated circuits).³⁴ Although this last agreement addresses an increasingly important form of intellectual property, its significance is greatly circumscribed by the fact that the United States, Japan and the EU (i.e. the world's leading producers of these devices) have refused to sign the Treaty, apparently preferring to negotiate reciprocal accords among themselves rather than accept the general National Treatment approach embodied in the Treaty.³⁵

The UPOV treaty is quite controversial: as we explain below in our discussion of the Uruguay Round TRIPs Agreement, with respect to plant varieties, WTO Members have a choice of providing patent protection or a *sui generis* alternative form of intellectual property protection, which is not specified in TRIPs. In many developing countries farmers have traditionally engaged in exchanging, reusing and selling seeds, in usually in connection with small, subsistence agriculture, and have produced various new varieties of seeds through these small-scale economic activities. Under UPOV, in order to continue with such traditional activities if they must pay royalties to commercial breeders, in cases where the commercial breeder has obtained protection for a particular seed variety pursuant to UPOV (See South Asia Watch on Trade, Economics and Environment, 'UPOV: Faulty Agreement and Coercive Practices,' Policy Brief #5, 2003, Katmandu, Nepal.)

In addition, agreements exist to facilitate cooperation between countries in the administration of patent laws (e.g. the Patent Cooperation Treaty) and trademark law (the Madrid Agreement and Protocol). These agreements vary considerably in importance and in the number of countries that are signatories.³⁶

AGGRESSIVE UNILATERALISM: US TRADE REMEDY LAW AND THE EU NEW TRADE POLICY INSTRUMENT

US trade remedy law has long provided for unilateral retaliatory trade action against foreign products, based upon violations of intellectual property norms by the producing countries. Section 337 of the US Tariff Act of 1930 as amended applies to products imported into the United States, where the products in question have been produced in such a way as to violate intellectual property rights that American individuals or firms hold under domestic US law. There is no requirement of injury to the American producer, and a positive finding results in the complete exclusion of the product from the United States, unless the American holder of intellectual property rights and the foreign producer enter into a voluntary settlement (usually a licensing agreement). Conceptually, Section 337 can be considered either as a means of extra-territorial enforcement of domestic

American intellectual property or—more consistent with the overall framework of American trade law—as a counter to an unfair advantage acquired by a foreign producer in competition with domestic American producers for the American market. However, the remedy provided by Section 337, a ban on the imports in question rather than a duty aimed at neutralizing the supposed unfair advantage, comports more with the former interpretation than the latter. Nevertheless, the scope of Section 337 is limited to products imported in the United States, and does nothing to discourage use of American innovations in violation of domestic US law with respect to home-market sales or exports to third countries.

Where a developing country is determined to have ‘weak’ intellectual property protection, tariff concessions extended to it under the Generalized System of Preferences (GSP) can be withdrawn, which has apparently occurred in the case of Korea, Mexico, Brazil and Thailand. There is no requirement to prove injury to a particular American industry. Nor need it be shown that the intellectual property laws of the country concerned discriminate against American or other foreign holders of intellectual property rights or otherwise fail to meet international norms as set out, for example, in the Berne or Paris Conventions. It should be noted that these provisions apply *only* to countries within the GSP; clearly, a discriminatory withdrawal of other tariff concessions provided to a WTO Member would violate the MFN obligation of GATT and/or specific tariff bindings under the Agreement.

Broader in sweep still is the so-called Special 301 provision of the Omnibus Trade and Competitiveness Act of 1988, which provides that trade sanctions may be taken against countries named as engaging in ‘unfair’ trade practices.³⁷ Such sanctions would likely be contrary to the GATT MFN principle. To date, however, Special 301 has been used as a weapon to extract from named countries specific policy changes desired by US interests, or (it is also sometimes claimed) more sympathy for American positions in the round negotiations, including on intellectual property.³⁸ The countries named to date under Special 301 have included Japan, Brazil and India. The aggressively extra-territorial dimension of Special 301 is highlighted by the fact that it does not refer to any set of norms or principles in order to define adequate intellectual property protection among US trade partners—the implicit assumption being that any level of protection inferior to that provided by US law is an unfair trade practice. While Special 301 has been used as a weapon to convince developed countries that their interests lie in a multilateral solution to intellectual property disputes at the WTO (see below), Drahos and Braithwaite note:

Perhaps the most stunning achievement of the 301 system has been its continued growth and use in the period after the creation of the WTO. There were intimations that the creation of a WTO dispute resolution system would see the US ease off on aggressive unilateralism. But if anything, 301 has acquired a more machine-like efficiency in the post-TRIPs period... The Clinton Administration...strengthened 301 by introducing immediate action plans for foreign countries on intellectual property rights as well as out-of-cycle 301 reviews, pushing developing countries into accelerating their implementation of TRIPs.³⁹

Section 337 of the Tariff Act has come under challenge in the GATT. A GATT panel held in 1989 that the Section violated the GATT National Treatment obligation, since it entailed a method of enforcement, through the office of the United States International Trade Commission, that provided weaker procedural protection to foreigners than that accorded to American firms and individuals accused of violating American intellectual property laws.⁴⁰ While (as mentioned earlier in this chapter) Article XX(d) provides, under certain circumstances, exception from GATT strictures for measures 'necessary' to the enforcement of domestic intellectual property laws, the panel found that measures provided in Section 337 were not 'necessary' in this sense, since other countries had found it possible to enforce adequately their intellectual property laws against foreign nationals by subjecting the foreigner to the same legal processes as applied to domestic actors.

A further provision of US law, contained in the Process Patents Amendment Act of 1988, may also be vulnerable to challenge under GATT rules: the provision makes importers or retailers who bring products made in violation of US intellectual property laws into domestic US commerce liable to civil suit by the US holders of the violated intellectual property rights.⁴¹ Since importers and retailers will often not have the knowledge to determine whether a particular product has been made in contravention of intellectual property rights, the result is arguably a 'chilling' effect where buyers simply avoid products from countries with reputations for poor intellectual property protection, in order to obviate the risk of civil liability. In the result, arguably, the National Treatment principle of the GATT is violated since it is only to imported products that the risk of such liability is attached.

An instructive contrast with the American law is to be found in the approach of the EU. In 1984, the Union created what is called 'the new trade policy instrument'. The instrument allows the Union to engage in trade retaliation⁴² against 'illicit commercial practices' of non-Union countries that affect EU economic interests. 'Illicit commercial practices' are defined as violations of 'international law or generally accepted rules'.⁴³ According to the European Commission Green Paper on copyright, 'in the field of intellectual property, and copyright in particular, the instrument could conceivably play a significant role in the future, particularly as regards countries which practise a policy of more or less active connivance in the pirating of goods and services developed elsewhere'.⁴⁴ In the intellectual property area, the instrument would be used primarily against countries in violation of existing treaty obligations, under both the Paris and the Berne Conventions. However, Brueckmann notes that pursuant to Article 113 of the Treaty of Rome, which gives the Union jurisdiction over a common commercial policy, bilateral action has also been taken (in particular against Korea) along the lines of the US Tariff Act, i.e. suspension of GSP concessions.⁴⁵ The background of this action was, however, rather unusual. Korea had agreed, as part of a negotiated settlement of action under Section 301 of the Tariff Act, to provide intellectual property protection for US innovations but did not extend such protection to other countries. The EU claimed at least as favourable treatment, hence—although from one perspective unilateralist—the Union's action countered a discriminatory arrangement arguably in violation of provisions of the Berne Convention requiring equally favourable treatment for all foreigners.

INTELLECTUAL PROPERTY PROVISIONS IN TRADE AGREEMENTS

The Canada-US Free Trade Agreement (FTA)

Apart from a general commitment of the Parties to ‘cooperate in the Uruguay Round of multilateral trade negotiations and in other international forums to improve the protection of intellectual property’ (Article 2004), the only provisions on intellectual property rights in the FTA concern retransmission of broadcasts. This reflects a long-standing complaint of American broadcasters that Canadian cable companies rebroadcast their programming without any compensation, and moreover often remove the original advertising and replace it with advertising purchased from the Canadian cable company. Article 2006 of the FTA provides for a scheme whereby the holder of the programme copyright must be compensated for any retransmission. Furthermore, in the case of retransmission of pay-TV programmes—i.e. those ‘signals not intended in the original transmission for free, over-the-air receptions by the general public’—such retransmission must be with the permission of the original copyright-holder. Finally, retransmission in altered form or non-simultaneous retransmission shall only be allowed where permitted by the original copyright-holder. This last provision reflects the complaint that where Canadian viewers are capable of receiving the American signal directly (the case for a large part of the population), Canadian cable companies are in direct competition with the American broadcasters for audience and hence for advertising. There is thus a danger that Canadian cable companies will rebroadcast at a time or in a format more congenial to Canadian viewers, and therefore take away audiences from the original transmission.

The Uruguay Round and intellectual property rights

Background

Not surprisingly, it was the United States that spearheaded the movement to have intellectual property rights included as an integral part of the Uruguay Round negotiations. The overall American goal was clear from the outset: to obtain a set of international rules that ensure that American innovators’ intellectual property rights are as extensive and as effectively enforced abroad as in the United States itself. In general, Japan and the European Union were supportive of the American approach, although at first they required some prodding from high-technology industries and other domestic interests that stood to benefit from high international standards for IP protection.

Developing countries, however, generally opposed the negotiation of intellectual property rights within the GATT, arguing that WIPO was the more appropriate forum for these discussions. Underlying this concern about the institutional appropriateness of the GATT was, however, a more fundamental substantive concern that the American objectives, particularly with respect to patent protection and the curbing of compulsory licensing, were contrary to the economic interest of developing countries. As suggested by our analysis earlier in this chapter, this concern has a sound basis in economic theory.

The globalization of the American standard of patent protection was far from the only objective of the United States in the Uruguay Round negotiations. The United States, like

some other developed countries, was also concerned that existing international obligations under the Berne and Paris Conventions were not enforced adequately by many developing countries, and that WIPO did not provide a credible institutional framework for settlement of disputes under these agreements.⁴⁶ These were particularly acute concerns with respect to the Berne Convention, whose provisions the United States saw routinely ignored in a number of developing countries where piracy of American creative works was rampant. In the case of the Paris Convention, the United States had a related concern—the supposed difficulty that American patent-holders encountered in attempting to enforce their rights in foreign legal systems. Unlike the case with copyright, where the focus was on the lack of effective criminal or regulatory sanctions for piracy, in the patent context the emphasis was on the supposed lack of expeditious due process in the civil courts of other countries. This last concern, it should be noted, extended beyond the case of developing countries and encompassed complaints about several aspects of the patent registration and enforcement process in Japan. Developing countries, in particular, bristled at the notion that their domestic legal systems, and the level of scarce administrative and enforcement resources allocated to those systems, should have to pass muster according to American standards. There was considerable merit in the developing-country position. Operating a truly effective patent system is a costly enterprise, given the high demand for patent registration, and the substantial component of technical expertise required to make such a system work properly.⁴⁷ As well, the problems of administration of justice complained of by the United States were often arguably of a general nature (slow courts, lack of written reasons for decisions,⁴⁸ and corruption) and not attributable either to an intention to disregard the intellectual property rights of foreigners or to a reckless disregard for these rights. Perhaps, however, a ‘win-win’ or Pareto-optimal solution to this difference of perspectives would be to link expectations for improvements in patent registration, administration and enforcement in developing countries to the provision of technical assistance and funding to those countries so as to enable these improvements to be made.

A further dimension of the American position in the Uruguay Round negotiations was to ensure that developed-country approaches to the provision of intellectual property protection to new, technology-based forms of innovation would set the international standard. In the biotechnology field, for instance, US industrial and scientific interests were concerned that, as these technologies took on increasing economic importance, they be fully protected by intellectual property rights.⁴⁹ For many countries, however, the patenting of life itself raises not only economic but also important ethical issues.⁵⁰ The Biodiversity Convention, concluded at the Rio Environmental Summit, acknowledges the legitimacy of a country extending intellectual property protection at least to the genetic material of plants, but also states that individual countries have the sovereign right to determine on what terms and conditions private interests should have access to biological resources.⁵¹

The Uruguay Round Final Act

Despite these basic differences of perspective between the United States and some other developed countries, and most of the developing world, the Uruguay Round was successful in producing a comprehensive agreement on TRIPs. The TRIPs Agreement in

the Uruguay Round Final Act represents a complex balance between conflicting national perspectives and interests with respect to the protection of intellectual property rights.

The Agreement consists of seven parts: (1) a statement of general principles and of the interaction of the Agreement with the Paris and Berne Conventions; (2) substantive norms with respect to the protection of the various forms of intellectual property; (3) obligations with respect to the domestic enforcement of intellectual property rights; (4) obligations with respect to the facilitation in domestic legal systems of the acquisition and maintenance of intellectual property rights; (5) dispute settlement; (6) transitional arrangements; and (7) a WTO-based institutional framework for TRIPs.

General principles of intellectual property protection

Part I of the TRIPs Agreement sets out both National Treatment (Article 3) and MFN obligations (Article 4) with respect to intellectual property rights. The National Treatment obligation is subject to the exceptions that already exist in the Paris, Berne and Rome Conventions and the Washington Treaty. The MFN obligation does not apply with respect to rights and privileges conferred on a reciprocal basis to certain GATT Members through bilateral or multilateral agreements in force prior to the Uruguay Round TRIPs Agreement. An example would be the bilateral accords for microchip (semi-conductor) protection in force between the USA, the EU and Japan. However, to be exempted from the MFN requirement, these agreements must not operate so as to 'constitute an arbitrary or unjustifiable discrimination against other Members' (Article 4(d)). Similarly, where WIPO strikes new multilateral agreements with respect to 'the acquisition or maintenance of intellectual property rights', the National Treatment and MFN obligations in the GATT Agreement will not apply (Article 5). This allows for the evolution of 'mutual recognition'-type regimes for the filing and registration of claims for intellectual property protection.

Part I also contains a statement of principles, which acknowledges that a balance of legitimate (potentially competing interests) must be struck in determining the appropriate level and kind of intellectual property protection guaranteed by the GATT. According to Article 7, the protection and enforcement of intellectual property rights should contribute to the promotion of technological innovation and to the transfer and dissemination of technology, to the mutual advantage of producers and users of technological knowledge and in a manner conducive to social and economic welfare, and to a balance of rights and obligations.

Moreover, Article 8 states that 'appropriate measures, provided that they are consistent with the provisions of this Agreement, may be needed to prevent the abuse of intellectual property rights by right holders through the resort to practices which unreasonably restrain trade or adversely affect the international transfer of technology'.

A broad, purposive interpretation of Article 7 and Article 8 taken together would permit GATT Members considerable scope to impose competition policy- or investment policy-related measures on foreign patent-holders, provided the level of intellectual property protection itself conforms to that provided in the TRIPs Agreement. It remains an open question whether, for instance, a foreign patent-holder who refused to comply with policy measures aimed at facilitating technology transfer or preventing anti-competitive abuse of patent protection could be legally denied the level of protection

specified in the TRIPs Agreement. In other words, are domestic policy measures that condition the granting of rights under the TRIPs Agreement on compliance with the kinds of measures contemplated in Articles 7 and 8 'consistent' with the TRIPs Agreement? A further interpretive issue is whether Articles 7 and 8 could be used as a 'shield' by developing or other countries against unilateral US action in response to policies in conformity with the Uruguay Round TRIPs Agreement but nonetheless considered 'unfair' by US trade authorities. Thus, arguably, in the presence of such unilateral action, a WTO Member could make a complaint in the WTO TRIPs dispute settlement forum that the United States was in violation of Article 7 and/or Article 8 in prejudicing its ability to implement the kinds of intellectual property-related domestic policies contemplated in these provisions. This would reinforce a more general complaint that unilateral action violated other GATT provisions, such as Articles II, III or XI of the General Agreement itself (which would likely be the case if the action in question consisted in trade sanctions or discriminatory treatment of the Member's products under domestic US law (see the discussion of the Section 337 GATT panel above)).

Standards concerning the availability, scope and use of intellectual property rights

COPYRIGHT

The basic obligations and rights contained in the Berne Convention⁵² are incorporated into the TRIPs Agreement (Article 9). With respect to computer software, the Agreement clearly specifies that 'computer programs, whether in source or object code', shall be protected as 'literary works' under the Berne Convention (Article 10). This entrenches an approach to software protection long favoured by the United States, and increasingly deployed in the developed world (despite initial interest by the EC and Japan in the development of a *sui generis* form of protection).⁵³ However, the extent of required copyright protection for software may be significantly affected by the general proviso in Article 9(2) that 'copyright protection shall extend to expressions and not to ideas, procedures, methods of operation or mathematical concepts as such'. Arguably, given this proviso, copyright will protect the originality of a computer program as a whole, but will not extend to preventing use of ideas, functions, etc. in the development of new programs. Clearly, interpreting such a distinction on a case-by-case basis may involve quite difficult technical judgments.

With respect to databases, if these merit the status of 'intellectual creations' by virtue of the 'selection or arrangement' of their contents, they are to be afforded copyright protection. However, this does not create any entitlement to the protection of the underlying data or material out of which the database was generated. Moreover, where a pre-existing copyright exists with respect to the data or material itself, any protection of the database as an intellectual protection 'shall be without prejudice' to the subsisting copyright on the material (Article 10(2)). With respect to rental of films and computer programs, authors are to be provided with 'the right to authorize or to prohibit the commercial rental to the public of originals or copies of their copyright works' (Article 11). In the case of films, however, a Member may exempt itself from this requirement, provided that rentals have not resulted in widespread violation of authors' rights through copying.

Article 12 establishes that the minimum term for copyright protection is 50 years from the initial date of authorized publication, or alternately, 50 years from the making of the work.

TRADEMARKS

Article 16.1 of the Agreement states that

the owner of a registered trademark shall have the exclusive right to prevent all third parties not having his consent from using in the course of trade identical or similar signs for goods or services which are identical or similar to those in respect of which the trademark is registered where such use would result in a likelihood of confusion.

There is a requirement that all 'signs' with sufficient distinctiveness be accepted for registration by the Parties. This is, however, subject to the right of Parties to deny registration on other grounds (i.e. other than lack of distinctiveness), provided that those grounds are consistent with the provisions of the Paris Convention. It should be recalled that the Paris Convention explicitly permits refusal to register, where the trademark is 'contrary to morality or public order' (Article VI),⁵⁴ where it is 'of such a nature as to deceive the public' or where the mark's use would constitute unfair competition.⁵⁵ A further exemption—specific to the TRIPs Agreement—applies to 'fair use of descriptive terms'. Thus, where a trademark becomes a common expression applied generically to a particular process or product (e.g. nylon), Parties may allow for its use by others without permission of the owner of the mark, 'provided that such exceptions take account of the legitimate interests of the owner of the trademark and of third parties'. Parties are permitted to provide for revocation of a registered trademark after an uninterrupted period of three years of non-use, unless non-use can be shown to be due to certain kinds of obstacles presented to the holder, e.g. import restrictions on the goods in question or other 'government requirements' that may impede their use in the country concerned (Article 19).

An extensive set of provisions with respect to sound performances and recordings places positive obligations on states to provide to performers the right to prevent unauthorized recording of their performances, unauthorized reproduction of authorized recordings, or unauthorized broadcasting of any performance or recording, whether itself authorized or not. However, only 'broadcasts by wireless means' are included, which may indicate an intention to exclude cable rebroadcasts.⁵⁶ With respect to sound performances and recordings, the exemptions and limitations contained in the Rome Convention⁵⁷ are incorporated into the Agreement.

PATENTS

The provisions with respect to patents reflect the largest modification of the existing international regime, in that a substantive standard of protection is required of all Members. That standard is 20 years from the filing date. Protection applies to both product and process patents. With respect to process patents, however, the obligation to protect from unauthorized use extends only to products 'obtained directly' from the patented process. This means that Members are not required to protect the rights of

patent-holders where a process they own is merely the basis for production, i.e. where significant alteration or innovation in a patented process is at issue as opposed to direct use (Article 28.1).

Furthermore, patent rights must be 'enjoyable without discrimination as to the place of invention, the field of technology and whether products are imported or locally produced' (Article 27(1)). At the same time, the Agreement acknowledges the concern of developing countries, and some developed countries, to protect the scope for legitimate domestic tradeoffs of social and economic interests in the determination of patent rights. For instance, Members are permitted to exclude from patentability 'plants and animals other than microorganisms, and essentially biological processes for the production of plants or animals other than non-biological and microbiological processes', subject to providing some protection for plant varieties, either through patenting or a *sui generis* system (Article 27(3)(b)). However, this provision is to be reviewed every four years after the establishment of the WTO, and during this time the USA can be expected to exercise pressure (perhaps through unilateral trade instruments) for the inclusion of a requirement of patentability of life within the Agreement on TRIPs.

Most importantly, from the perspective of those countries with concerns about negative social and economic consequences from high levels of patent protection, the Agreement permits *compulsory licensing* during the period of required patent protection, provided certain conditions are fulfilled (Article 31). The proposed user must first have attempted to obtain explicit authorization for use from the patent holder on 'reasonable commercial terms' and have been refused. Once this condition is met, compulsory licensing is permitted. However, such licensing must be non-exclusive (i.e. anyone who applies must be granted a licence on similar terms and conditions); production under licensing must be intended primarily for the internal market of the licensing Party; and 'adequate remuneration' must be paid to the patent-holder, taking into account the 'economic value' of the patent (Article 31(j)).

An important issue arises as to the role of WTO dispute settlement panels in considering whether compulsory licensing provisions of Members' domestic laws meet these various criteria. Many interpretations might be advanced as to the kind of methodology required to determine, for instance, 'reasonable commercial terms' and 'adequate remuneration'. In our view, some degree of deference is warranted to legitimate efforts by domestic policy-makers to incorporate these conceptions in the detail of their laws, balancing the competing policy interests at stake. Thus, it is not up to the panel to develop its own methodology that represents the ideal implementation of these requirements and judge domestic law accordingly. Rather, where the approach of a Member has been developed in an open policy process, in which all stakeholders could participate, and does not reflect an attempt to embed discrimination against other Members in its methodology, the main concern of the panel should be simply whether the methodology reflects adequately the various, diverse principles and public purposes reflected in the TRIPs Agreement itself. This is consistent with Article 1.1 of the Agreement, which states in part: 'Members shall be free to determine the appropriate *method* of implementing the provisions of this Agreement within their own legal system and practice' (emphasis added).

In interpreting the expressions 'reasonable commercial terms' and 'adequate remuneration', account should be taken not only of the claim of the patent-holder to just

compensation, but also of the various social and economic interests stated in Part I of the Agreement on TRIPs, including the 'transfer and dissemination of technology to the mutual advantage of producers and users of technological knowledge and in a manner conducive to social and economic welfare' (Article 7). In addition, the need 'to prevent abuse of intellectual property rights' (Article 8) should also be considered in interpreting the conditions of compulsory licensing in Article 31.

OTHER FORMS OF INTELLECTUAL PROPERTY

In addition to these three main types of intellectual property rights, the Agreement also contains provisions on industrial designs, geographical indications for wines and spirits, integrated circuits and protection of trade secrets. In the case of industrial designs, Members are required to provide a minimum of ten years' protection to 'independently created industrial designs that are new or original', subject to the right of Members, if they so choose, to protect other designs (Articles 25, 26(3)). Furthermore, 'members may provide that such protection shall not extend to designs dictated essentially by technical or functional considerations' (Article 25). This last provision reflects a significant lobbying effort by US insurance companies, consumer groups and replacement-parts manufacturers, all of whom sought language on industrial designs that would not allow automobile manufacturers to protect the design of car parts, thereby threatening the 'generic' replacement parts and potentially raising the costs of replacement parts.⁵⁸

The provisions on geographical indications, and particularly those that apply to wines and spirits, address long-standing European concerns about the use of labels to describe imitation products with no direct connection to the geographical area denoted by the label. The main operative provision, Article 23(1), requires each Member to 'provide the legal means for interested parties to prevent use of a geographical indication identifying wines for wines not originating in the place indicated by the geographical indication in question, ...even where the true origin of the goods is indicated or the geographical indication is used in translation or accompanied by expressions such as "kind", "type", "style", "imitations" or the like'. This obligation applies identically to spirits. However, exceptions are provided with respect to geographical appellations in use for at least ten years preceding the conclusion of the Uruguay Round negotiations (Article 24(4)). In the case of geographical indications for products other than wines and spirits, protection need only be provided by Members against use of geographical indication 'which misleads the public as to the geographical origin of the good' (Article 22(2)(a)).

With respect to lay-out designs (topographies) of integrated circuits, the required protection is more extensive than that provided in the Washington Treaty, to which, it will be recalled, most developed countries had refused to adhere. Hence, the term of protection is ten years as opposed to eight in the Washington Treaty, and compulsory licensing or governmental use can only occur under the same conditions as those set out for compulsory licensing in the TRIPs Agreement provisions on patents (Articles 38, 37(2)). It is significant that among the main reasons that the United States and Japan refused to sign the Washington Treaty was their opposition to the Treaty's provisions on compulsory licensing.⁵⁹ However, the applicable provisions on compulsory licensing in the TRIPs Agreement are, in the end, very similar to those contained in the Washington Treaty. This reflects at least some compromise with the concerns of developing countries.⁶⁰

*Enforcement, dispute settlement and institutional design***ENFORCEMENT**

There is a wide range of obligations to provide other Members with access to appropriate mechanisms to enforce intellectual property rights. These provisions constitute a largely unprecedented degree of control by an international regime over domestic civil and administrative procedures. It is required that enforcement procedures ‘not be unnecessarily complicated or costly, or entail unreasonable time-limits or unwarranted delays’ (Article 41.2); decisions are ‘preferably’ to be in writing and to contain reasons; and a right of judicial review is to be provided in the case of administrative decisions, at least with respect to matters of law. These quite far-reaching obligations are balanced by the qualification that they create no ‘obligation with respect to the distribution of resources as between enforcement of intellectual property rights and the enforcement of laws in general’ (Article 41.5).

With respect to remedies, the TRIPs Agreement requires that ‘judicial authorities’ be empowered to issue injunctions (Article 44(1)); award damages and legal costs to successful right-holders (Article 45); and dispose of goods tainted by infringements of intellectual property rights ‘outside the ordinary channels of commerce’ (Article 46). In addition, the judicial authorities are to be authorized to grant interim or provisional injunctions, including in *ex parte* proceedings, ‘where any delay is likely to cause irreparable harm to the right holder’ (Article 50(3)).

These requirements would seem, at first glance, to be a massive intrusion into domestic legal systems, and especially the balance that those systems strike between the rights of defendants and those of plaintiffs. In some systems, for instance, there may be constitutional limitations on the capacity of courts to grant relief without hearing the other Party, even for certain kinds of interim relief. However, it is to be noted that where any of the remedies is ‘inconsistent with domestic law’, the domestic law is to prevail, subject to a requirement that ‘declaratory judgments and adequate compensation’ be available (Article 44(2)). It should also be noted that while the Agreement provides that judicial authorities be authorized to grant certain classes of remedies, the use of these remedies is not *mandated* by the GATT. Judicial authorities are, therefore, free to use their discretion to grant or deny a particular remedy, and to weigh plaintiffs’ and defendants’ rights in the exercise of that discretion.

A final important obligation with respect to enforcement relates to counterfeit or pirated goods. Rights-holders are to have access to a procedure whereby customs authorities suspend ‘the release into free circulation’ of such goods, for example by seizure or by turning them back (Article 51). This is subject to the right of the importer that such suspension be promptly removed except where a judicial or administrative determination is made that, in fact, the goods are counterfeit. Moreover, Members who have eliminated border customs inspection between themselves are not obligated to provide such a procedure (e.g. the case of the European Union).

MONITORING AND DISPUTE SETTLEMENT

A twofold approach to monitoring and dispute settlement is set out in the TRIPs Agreement. First of all, a new institution is to be created, the Council for Trade-Related Aspects of Intellectual Property Rights (the TRIPs Council), charged with the monitoring

of domestic compliance with the Agreement. Members are obliged to notify the Council of their domestic laws and regulations with respect to intellectual property protection (Article 63(2)). The Council may also provide a forum for consultations on intellectual property issues, and is 'to provide any assistance requested by [Members] in the context of dispute settlement procedures' (Article 68). This might include, for example, a kind of mediation or the provision of advisory opinions concerning Members' interpretations of the Agreement. Nevertheless, no special dispute settlement process is established in connection with the Council; instead, the general GATT procedures are to apply (Article 64).

With respect to settlement of disputes under the TRIPs Agreement, the provisions in Articles XXII and XXIII of the GATT are to apply, subject to suspension of the operation of dispute settlement under Articles XIII:1(b) and XXIII:1(c) of the GATT for the period of five years. This refers to complaints of non-violation nullification or impairment, which are to be referred to the TRIPs Council and the Ministerial Conference during the five-year period.

Developing countries

As discussed in an earlier section of this chapter, one of the main aims of the United States in placing TRIPs on the Uruguay Round agenda was to address what it considered ineffective protection of intellectual property rights in developing countries. It is not surprising, therefore, that developing countries do not enjoy many special exemptions from these obligations. They are entitled to a one-year delay with respect to implementing most of the obligations of the Agreement and a further four-year delay upon application to the Council. The further four-year delay does not apply, however, to the general requirements of National Treatment and MFN treatment in Part I. A further five-year delay applies, where a particular area of technology is currently unprotectable under the domestic law of a developing country. This reflects the fact that extension of protection may result in loss of entire industries in some developing countries (e.g. pharmaceuticals), with attendant adjustment costs.⁶¹ Finally, *least-developed* countries are exempted entirely from the Agreement for ten years.

Jurisprudence under the TRIPs Agreement

The first dispute settlement case under the TRIPs Agreement concerned issues of transition and implementation. In the *India—Patents* case (Appellate Body Report, *India—Patent Protection for Pharmaceutical and Agricultural Chemical Products*, WT/DS50/AB/R, adopted 16 January 1998), the USA and the EC both challenged India's implementation of the so-called 'mail box' condition attached to the right of an additional five-year transition period for implementing TRIPs obligations where the area of technology was previously unprotectable. The 'mail box' rule provides that the developing country exercising its right to delay implementation must create a means of ensuring the legal security of patent applications in the interim period of delay, so as to protect priority; thus, by notifying the developing country during the transition period, a patent applicant should be able to ensure that no subsequent claimant will be able to assert the same patent, even though the applicant's actual rights to exclusivity will not

begin until the end of the transition period. India had failed to secure a legislative change in order to introduce this kind of priority filing system, and instead resorted to administrative instructions to the national patent office. Passing judgment on the functioning of internal Indian law, the panel found that administrative instructions did not afford adequate legal security to a patent applicant. The panel does not appear to have engaged in a very thorough inquiry into the constitutional and administrative law of India, but rather to have relied to a great extent on assertions by the USA. The panel paid scant attention to Article 1.1 of TRIPs, which states that 'Members shall be free to determine the appropriate method of implementing the provisions of this Agreement within their own legal system and practice.' The Appellate Body (AB) upheld the panel, engaging in its own review of Indian law, again without the benefit of expert opinion on the functioning of the Indian legal system. One would have thought that, in light of Article 1.1, the burden of proof would be squarely on the complainant to show, based upon expert evidence, that Indian's chosen method of implementing the 'mail box' rule was not legally effective within India. Instead, the panel and AB rulings imply that it was up to India to show the effectiveness of non-legislative means.

The *Canada—Term of Protection* case (Appellate Body Report, *Canada—Term of Patent Protection*, WT/DS114/R, adopted 7 April 2000) addressed a quite different transitional issue, namely whether Canada was required to extend the minimum 20-year patent protection period in TRIPs in respect of patents that were granted for a shorter term *before* TRIPs came into effect. Canada argued that to do so would be to violate the basic principle of non-retroactivity of treaty obligations. Noting that Article 70.2 of TRIPs states explicitly that the Agreement 'gives rise to obligations in respect of all subject matter existing' and protected at the date TRIPs itself came into force, the AB rejected Canada's argument and upheld the panel ruling that Canada was required to extend these patents to 20 years. The AB also relied upon Article 28 of the Vienna Convention on the Law of Treaties and the Commentary thereon, which deal with the non-retroactivity principle: the text of Article 28, along with the elucidation in the Commentary, confirmed that treaty rights and obligations normally extend to situations that began before the treaty came into force, provided they are *continuing*. Thus, Canada would not be required, say, to provide extra years of patent protection where the patent expired the day before the TRIPs Agreement came into force but, if the patent was still in existence on the day on which TRIPs came into force, it would have to be extended so as to afford the mandated minimum of 20 years' protection.

In the *Canada—Generic Medicines* case (Panel Report, *Canada—Patent Protection of Pharmaceutical Products*, WT/DS170/AB/R, adopted 12 October 2000), a Canadian provision that allowed competing generic manufacturers to test patented products before the required period of protection expired was upheld as consistent with the TRIPs Agreement. The companion measure, however, that permitted manufacture and storage ('stockpiling') of patented products before the expiration of the patent, so they can be available for sale immediately upon expiration of the patent, was struck down. Both Canadian measures were aimed at achieving Canada's long-standing policy goal of providing relatively low-cost medications to consumers as soon as possible, consistent with its basic legal obligation under the WTO Agreement to provide 20 years of patent protection. Early working exceptions of this kind, which facilitate entry onto the market

immediately upon expiration of the 20-year period of mandated patent protection, have been recognized internationally as one means of achieving these social goals.

The TRIPs Agreement provides that patent rights extend to the ability to prohibit the non-authorized manufacture and use of a patented product (Article 28(1)(a)), and on the other hand the decision of Members to limit the required period of 'protection' from a patent to 20 years (Article 33). The 'protection' that a patent-holder receives from a patent is, fundamentally, the protection against competition, i.e. a right to monopoly rents. If it were necessary to prohibit manufacture and use of a patented product by a competitor for the full 20-year term, the result would be that the stream of monopoly rents to the patent-holder would extend beyond the 20-year period to the time after the patent had expired that it took the competitor to engage in testing for regulatory approval and manufacture for the market.

In defending its measures, Canada relied on the Article 30 exception in the TRIPs Agreement. This provision states that 'Members may provide limited exceptions to the exclusive rights conferred by a patent, provided that such exceptions do not unreasonably conflict with a normal exploitation of the patent and do not unreasonably prejudice the legitimate interests of the rights holder, taking account of the legitimate interests of third parties.' From this language, the panel understood Article 30 as containing three *separate* stipulations, all of which must be met in order for an exception to be taken under Article 30: that the exception be limited; that it not unreasonably conflict with a normal exploitation of the patent; and that it not unreasonably prejudice the legitimate interests of the rights-holder, taking account of the legitimate interests of third parties.

In applying this provision to the Canadian measures, the panel first of all considered, in the case of each measure, whether the exception was 'limited'. It found that the regulatory testing exception was limited, but not the stockpiling exception. However, it considered the meaning of the expression 'limited' solely from the perspective of the rights-holder, and without regard to the policy goals or purposes of the exception (para. 7.31). Even though dealing with an explicit 'exceptions' provision, comprehensible only if there are legitimate competing policy interests, the panel was only interested in how much the rights-holder might lose, not in how much society might gain, from a given exception. It never asked what scope the exception might require to achieve the social purposes at issue. It also failed to consider the scope indicated by the expression 'limited' in light of the protection of public health, an objective explicitly affirmed as legitimate in Article 8.1 of the TRIPs Agreement.

The panel concluded that the stockpiling exception was not 'limited', even though there was a time limit on the exception, which allowed it to be used only in the final six months before expiration of the patent, and only by those availing themselves of the testing exception. With respect to the six-month cap, the panel had to admit that this was some kind of limitation, as that was obvious (para. 7.37). However, the panel adopted the complainant's view that a narrower rather than broader meaning of 'limited' should be applied; 'limited' should be read to mean 'small'. The tenor of this reasoning is exactly contrary to the interpretive principles established by the AB in *Hormones*—according to the AB, the principle of *in dubio mitius* requires that where there are two plausible approaches to the interpretation of a treaty provision, the treaty interpreter adopt the interpretation that is less restrictive of the sovereignty of the state or states undertaking the obligation in question.

In justifying its decision to choose the narrower interpretation, the panel relied on the character of Article 30 as an ‘exception’: since the notion of an ‘exception’ itself suggests a limited right, when the word ‘limited’ is added, the exception must truly be intended to be narrow. The panel appears to have let assumptions about ‘exceptions’ themselves being by their nature grudging or confined influence its reading of the modifying adjective ‘limited’. Thus, it remarks: ‘The word “exception” by itself connotes a limited derogation, one that does not undercut the body of rules from which it is made. When a treaty uses the term “limited exception” the word must be given a meaning separate from the limitation implicit in the word exception itself. The term “limited exception” must therefore be read to connote a narrow exception—one which makes only a small diminution of the rights in question’ (para. 7.309).

The basic purpose of Article 7 of the TRIPs Agreement is *not* protection and enforcement of these private rights as such, but rather in a manner so as to achieve the *mutual* advantage of both producers and users and a *balance* of obligations and rights and contribute to social and economic welfare. To do justice to this purpose, the panel would, at a minimum, have had to consider the scope implied in the word ‘limited’ not only from the perspective of how much rights-holders’ interests were being curtailed, but also from the perspective of how limited the exception could be while affording sufficient scope to protect public health and the interests of consumers generally.

All this being said, it is something of a mystery as to how the panel could find the testing exception sufficiently narrow but not the stockpiling exception. In fact, the testing exception could actually curtail much more substantially rents that the patent-holder might receive after the end of the 20-year period than the stockpiling exception; the period of testing required as a preliminary for regulatory approval of pharmaceuticals in Canada was three years, much longer than the six-month period for stockpiling. But for the testing exception, the patent-holder might have three additional years past the 20-year period of protection to collect monopoly rents (as the competing generic manufacturer would have to wait until the end of the 20 years to begin testing for regulatory approval, thus having to delay an additional three years or so after that before the generic product would have regulatory approval and therefore be competing in the actual marketplace). By failing to consider properly the meaning of the word ‘limited’ in light of the object and purpose of the TRIPs Agreement, the panel was left without an analytical framework which would allow a principled distinction between exemptions that are limited within the meaning of Article 30 and those that are not; the panel as much as admitted that intuitive line-drawing was what it was doing.

The second condition for taking an exception under Article 30 is that the exception not ‘unreasonably conflict with a normal exploitation of the patent’. Here the Canadian argument was (sensibly enough) that, since neither the regulatory testing nor the stockpiling exception interfered with the stream of monopoly rents to the patent-holder during the 20-year minimum period of protection required by Article 33 of TRIPs, neither unreasonably conflicted with ‘normal exploitation’. Since the panel had already found that the stockpiling exception was not ‘limited’, it did not need to go on to consider whether that exception did not ‘unreasonably conflict with normal exploitation of the patent’, but rather only the regulatory testing exception. Nevertheless, the panel in dicta as it were drew a sharp distinction between the exceptions as far as ‘normal exploitation’

went, perhaps aware that the distinction it drew with respect to the first criterion of being 'limited' was conclusory, if not obscure.

In interpreting 'normal', the panel looked exclusively at the expectations of rightsholders as to the 'economic returns anticipated from a patent's grant of market exclusivity'. This again reflects its overall bias in viewing the TRIPs Agreement as having as its overarching goal the protection of the rights of innovators, not a balance of rights and obligations between different relevant social and economic interests. Patent-holders in general could anticipate that they would enjoy monopoly rents from the patent even beyond the 20-year period of protection, due to the ability to prevent manufacturing of the product from beginning before the end of that period, and the consequent delay until sufficient product is manufactured in getting the product to market. Thus, the monopoly rents obtained after the twenty-year period until the competitor is able to come to market with its stock constituted part of 'normal exploitation'.

If one were to examine the meaning of 'normal', however, from the perspective of those interests that dictated a *limit* on the period of protection required by TRIPs to 20 years, a quite different answer might result; these interests might well anticipate that in establishing a maximum of 20 years of required competition, the TRIPs Agreement allows Members to ensure that the significant social and economic benefits of a competitive marketplace begin to flow immediately following the expiry of the required 20-year period of monopoly. Recognition of the significance of the levels of protection in the TRIPs Agreement as a *maximum* required under WTO law is to be found in Article 1.1 of TRIPs, which explicitly states that Members shall not be 'obliged to implement in their law more extensive protection than is required by this Agreement, provided that such protection does not contravene the provisions of this Agreement'. This provision would be largely inutile or tautological unless there were some possibility that, in certain circumstances, the operation of dispositions of the TRIPs Agreement, *taken together*, could have the *effect* of conferring, overall, more extensive protection than that provided as a matter of law by each individual provision.

In explaining why the Canadian regulatory testing exception fit within the *panel's* notion of 'normal', while the stockpiling exception did not, the panel made the following observation:

Some of the basic rights granted to all patent owners, and routinely exercised by all patent holders, will typically produce a certain period of market exclusivity after the expiration of a patent. For example, the separate right to prevent 'making' the patented product during the term of the patent often prevents competitors from building an inventory needed to enter the market immediately upon expiration of a patent. There is nothing abnormal about the more or less brief period of market exclusivity after the patent has expired. The Panel considered that Canada was on firmer ground, however, in arguing that the additional period of *de facto* market exclusivity created by suing patent rights to preclude submissions for regulatory authorization should not be considered 'normal'. The additional period of market exclusivity in this situation is not a natural or normal consequence of enforcing patent rights. It is an unintended consequence of the conjunction of the patent laws with product regulatory

laws, where the combination of patent rights with the time demands of the regulatory process gives a greater than normal period of market exclusivity to the enforcement of certain patent rights.

(paras 7.56, 7.57)

This distinction is artificial, if not tendentious. The time required to build an inventory for sale subsequent to the expiry of the patent may well reflect the need to use production methods that respond to requirements for safety and quality in production, the *same* regulatory concerns that, ultimately, underlie a lengthy period of testing prior to regulatory approval. Moreover, the ability of producers to build inventory rapidly, *while ensuring quality and safety*, may well differ depending upon levels of economic development. In the Canadian case, the time needed was apparently around three weeks—but one could not assume the same for generic producers in developing countries, where (ironically) given the weak purchasing power of the vast majority of consumers, any delay in the marketing of generic products at lower cost might have significant health consequences, if not in certain cases deadly ones. It is significant in this respect that while most of the developed countries who intervened as third parties in the litigation, most notably the USA and Japan, viewed the stockpiling provision as different from the testing provision, and not justifiable under Article 30, the developing-country interveners (including Brazil, Ecuador, Cuba and Thailand) generally saw the two provisions as linked, and viewed *both* as acceptable under Article 30. Finally, by limiting those early working exceptions that are consistent with ‘normal exploitation’ to those connected with government requirements for regulatory approval, the panel in effect excluded the possibility of early working exceptions for purposes of scientific research. There may be important social gains from allowing such research activity during the period in which the rights-holder is enjoying monopoly rents from the patent.⁶² It is to be noted, however, that in discussing the meaning of ‘legitimate interests’, the third criterion for an Article 30 exception (discussed below), the panel cited scientific research as among those legitimate interests that might need to be balanced against those of the patent-holder. Perhaps the panel felt that in an appropriate case, even though a scientific research exception did interfere with ‘normal exploitation’ of the patent, it might nevertheless not do so *unreasonably*. Thus, although it will make justification of scientific research exceptions more difficult under TRIPs, the panel’s approach to the meaning of ‘normal exploitation’ may not exclude altogether the possibility of such exceptions being legal under TRIPs, given that Article 30 does permit interference with normal exploitation that is not ‘unreasonable’.

The third condition for taking an exception under Article 30 is that the exception ‘not unreasonably prejudice the legitimate interests of the patent owner, taking into account the legitimate interests of third parties’. In considering whether this criterion was met with respect to the regulatory testing exception, which had now passed the first two criteria, the panel once again displayed its myopic focus on the interests of the rights-holder. Here, this bias is even more dramatic, since the very language of the provision indicates the need to balance diverse social and economic interests. Thus, for the panel, the mention of ‘legitimate interests of the rights holder’ first indicates a ‘logical sequence’, a lexical priority as it were. One cannot even begin to consider what third-party interests might be without first of all ascertaining ‘the legitimacy and weight of the

patent owner's legitimate interests' (para. 7.60). This provides a route for avoidance of any kind of real balancing—one can silence competing social and economic interests entirely by starting off by defining the rights-holder's interests as so weighty or fundamental that other legitimate interests cannot possibly outweigh the prejudice to the rights-holder's interests.

The first step of the panel in determining what interests are 'legitimate' within the meaning of Article 30 should thus have been to consider whether there are interests recognized as legitimate in the TRIPs Agreement itself. These interests include, *inter alia*, 'the mutual advantage of producers and users of technological knowledge' (Article 7; emphasis added); 'public health and nutrition' (Article 8); and 'the public interest in sectors of vital importance to socio-economic and technological development' (Article 8). With respect to patents in particular, '*ordre public* or morality' (Article 27.2); 'human, animal or plant life or health' (Article 27.2); and avoidance of 'serious prejudice to the environment' (Article 27.2). All these interests are given legal weight in the TRIPs Agreement. Moreover, had it followed the practice of treaty interpretation required by the Vienna Convention, the panel, in considering the language 'mutual advantage of producers and users of technological knowledge', would have understood that the legitimate interests of the patent-holder are not to be considered prior to other interests, but inherently in relation to those other interests, in particular those of users of technological knowledge.

However, the damage done by the panel with respect to its application of the 'legitimate interests' criterion is rather limited. It came to the conclusion, based on various negotiating documents, including those related to legal instruments other than the TRIPs Agreement, including the Berne Convention (on copyright!), that legitimate interests of the patent-holder did not, as the EC asserted, mean the legal rights of the patent-holder as defined in Article 28 of the TRIPs Agreement, but had some kind of broader meaning, however ill defined. The panel knew what the patent-holder's legitimate interests were *not*, even if it lacked clarity on what they were—and since they were not what the EC said they were, it was able to avoid actually examining the balance between these and other legitimate interests, by simply viewing the EC as not having proven the first step of its legal argument.

The EC, however, made a second claim about 'legitimate interests'. This was the claim that, in fact, patent-holders themselves enjoy less than 20 years' effective protection, because of the regulatory approval requirements *they* are subject to. According to the EC, being able to obtain monopoly rents during the period after 20 years during which marketing of the generic product is delayed due to regulatory approval merely compensates for the original delay to which the patented product is subject for regulatory approval purposes. Here, in order to determine whether the interest of the patent-holder in compensation for its own loss of monopoly rents during the 20-year period due to regulatory approval delays was 'legitimate', the panel examined how this problem was treated in a number of jurisdictions in developed countries. It noted that some jurisdictions had increased the term of protection beyond 20 years, but others had not, in response to this concern about the effects on the patent-holder's exclusive rights due to regulatory approval delays (para. 7.78). The panel noted correctly that where governments had not extended the patent term for these reasons, 'these government decisions may represent either disagreement with the normative claim made by the EC in

this proceeding, or they may simply represent a conclusion that such claims are outweighed by other interests' (para. 7.80). Without any supporting reasoning, the panel simply agreed with Canada that the interest of the patent-holder was not 'legitimate' at all. It merely asserted that to be 'legitimate', an interest has to be 'compelling' and widely recognized (presumably in domestic legislation) (para. 7.82). This conclusion displays the violence that the panel's interpretive approach has done to the fundamental structure of Article 30—if the patent-holder's legitimate interest means a 'compelling' interest, how can it then ever *not* trump the other legitimate interests to be taken account of under Article 30? The notion of wide recognition should raise some red flags as well: if wide recognition by governments is substituted for recognition within the TRIPs Agreement itself (the correct approach to interpreting 'legitimate' on the basis of Article 31 of the Vienna Convention) as the criterion for legitimacy, what about interests recognized only, for instance, by developed countries as legitimate, not developing ones?

The TRIPs Agreement allows the interests of rights-holders of an economic nature to be taken into account as legitimate (and indeed in the earlier stages in its analysis, ironically, the panel itself viewed these as more than legitimate, but actually primary and paramount)—this is arguably even implicit in the description of intellectual property rights as 'private rights' in the preamble to the TRIPs Agreement. However, the extent to which such interests are recognized as legitimate is circumscribed by Article 7, which refers to 'mutual advantage' of rights-holders and users of technology. Thus, the economic interests of the rights-holders cannot be given a status as 'legitimate interests' that defeats the 'advantage' of users of technology. An appropriate interpretation of Article 30 in this case would have accepted the interests of the rights-holders as 'legitimate to an extent', but would have examined whether the Canadian exceptions caused 'unreasonable prejudice' to these interests, taking account of the 'legitimate interests of third parties'. Here, Canada argued that these third-party interests were above all the health interests of its citizens.

Perhaps most damaging of all to the legitimate balance of rights and obligations in the TRIPs Agreement is the panel's finding (despite the lack of a textual basis for any such limit) that exceptions under Article 30 cannot include exceptions to the non-discrimination provisions in Article 27.1 of the TRIPs Agreement. These non-discrimination provisions are very different from those found typically in other WTO treaties, which prohibit discrimination between domestic and foreign products and services. Article 27.1 of the TRIPs Agreement prohibits discrimination, *inter alia*, with respect to 'field of technology'.

The panel's reasoning on this issue is totally perverse—it claims that Article 27.1 limits the Article 30 exception, because there is nothing in Article 30 that says otherwise. But where there is no explicit qualification to an exception, one should assume that the exception applies generally to its explicit subject matter, which is, in this case, patent rights. Throughout the TRIPs Agreement, where the Parties wished to qualify a right or obligation in a particular provision by making it conditional on some *other* provision of the Agreement, they employed the formula that the right or obligation is 'subject to' that other provision. The panel suggests that 'It is quite plausible, as the EC argued, that the TRIPs Agreement would want to require governments to apply exceptions in a non-discriminatory manner, in order to ensure that governments do not succumb to domestic pressure to limit exceptions to areas where right holders tend to be foreign producers'

(para. 7.92). However, if the requirement with respect to non-discrimination on the basis of sector of technology were aimed at preventing this kind of discrimination against foreign producers, it would be superfluous—for Article 27.1 quite independently prohibits discrimination based on ‘whether products are imported or locally produced’.

In the *US—Copyright Act (‘Jukebox’ or ‘Music’)* case (Panel Report, *United States—Section 110(5) of the US Copyright Act*, WT/DS160/R, adopted 27 July 2000), the EC challenged US legislation that exempted certain restaurants, bars and shops from the requirement to pay royalties in respect of broadcasts of music that were played for the customers in the establishments in question. (This applied only to broadcasted music, not recordings.) It was not disputed by the United States that its law violated provisions of the Berne Convention as incorporated into TRIPs, mostly notably Article 11 bis, which dealt with broadcast rights. However, the United States sought to rely on the so-called ‘minor exceptions’ doctrine, which allowed exceptions to copyright protection where these had a minor effect on the rights-holder. The panel held that this doctrine was incorporated into the TRIPs Agreement along with the text itself of Berne. In coming to this conclusion, the panel did a very careful job of examining the sources of the ‘minor exceptions’ doctrine in Berne practice, one of the best examples of a panel using the rules of interpretation in the Vienna Convention on the Law of Treaties.

However, even once incorporated into TRIPs, the minor exceptions doctrine was subject to TRIPs Article 13, which reads: ‘Members shall confine limitations and exceptions to exclusive rights to certain special cases which do not conflict with a normal exploitation of the work and do not unreasonably prejudice the legitimate interests of the right holder.’ In applying this provision, the panel took the following approach: ‘We will look at the defined and limited scope of the exemptions at issue under the first condition [“certain special cases”], and focus on the degree of conflict with normal exploitation of works under the second condition. In relation to the third condition, we will examine the extent of prejudice caused to the legitimate interests of the right holder in the light of the information submitted by the parties’ (para. 6.99).

In applying these criteria to the US scheme, the panel distinguished between two kinds of exemptions provided under the US statute. The first, the ‘business exemption’, applied to a very large percentage of eating and drinking (about 70%) and retail (about 40%) establishments. The second, the ‘homestyle exemption’, applied to a more limited set of cases where the music was being broadcast by means of ‘a single receiving apparatus of a kind commonly used in private homes’, the case of small stores, corner bars, etc. with a single radio or standard TV set.

The panel found that the ‘business exemption’ was not ‘defined and limited’ in scope because of the large percentage of establishments to which it applied; it came to the opposite conclusion concerning the ‘homestyle exemption’, based on evidence that it could only be applied to 13–18% of establishments. Along similar lines, the panel found that the ‘business exemption’ conflicted with normal exploitation of the work, since considerable revenues might be foregone, whereas it did not in the case of the ‘homestyle exemption’, because this kind of situation (limited apparently to the broadcast of ‘dramatic musical’ works) was not a potential major source of royalties. Finally, in considering the extent of prejudice to the legitimate interests of the rights-holder, the panel yet again pointed to the large number of establishments that could be sources of royalties but for the exemption, and came to the conclusion that rights-holders were

forced to forego significant opportunities to participate in licensing arrangements that would provide royalties. It noted that the burden of proof was here on the USA to demonstrate the converse. With respect to the 'homestyle exemption', however, the panel held that there was no evidence that, even if given the opportunity, rights-holders would make the effort to collect from such establishments. Thus, the 'homestyle exemption' was consistent with TRIPs Article 13, whereas the 'business exemption' was not.

It will be evident that as applied in this case, there is considerable redundancy between the three criteria in TRIPs Article 13. The single issue seems to be the extent to which the rights-holder is being asked to forego rents that they would otherwise receive. Despite the urging of the United States, the panel does not seem to have taken into account the possibility that establishments playing broadcast music under the 'business exemption' would, if faced with the administrative and other costs of paying licensing fees, simply switch from broadcast to recorded music. Finally, the panel looked only to the effects on the rights-holders in assessing the 'unreasonableness' of the prejudice to legitimate interests; it might have assessed the unreasonableness taking into account the public policy interests that the *exemption* was intended to serve (in this case, admittedly, not likely of a compelling nature). This would be more consistent with the notion of 'balance' in Article 7 of TRIPs.

In the *Havana Club* case (Appellate Body Report, *United States—Section 211 Omnibus Appropriations Act of 1998*, WT/DS176/AB/R, adopted 1 February 2002), the EC challenged US legislation that denied legal protection to trademarks associated with businesses or property confiscated by the Castro regime, except where authorized by the original owner; an EC firm had obtained the 'Havana Club' mark from the Cuban government and, by virtue of the challenged legislation, could not protect its rights in the USA against a main competitor, Bacardi.

The EC appealed the panel's finding that the US legislation did not violate Article 6quinquies of the Paris Convention, incorporated into the TRIPs Agreement through TRIPs Article 2.1. This provision reads, in part: 'Every trademark duly registered in the country of origin shall be accepted for filing and protected *as is* in the other countries of the union, subject to the reservations indicated in this Article' (emphasis added). These reservations include situations where the trademark may 'be of such a nature as to infringe rights acquired by third parties in the country where protection is claimed'; where the mark 'is devoid of distinctive character' or has become essentially generic; and where the mark is 'contrary to morality or public order, and in particular, of such a nature as to deceive the public'.

Placing considerable emphasis on the expression 'as is' in the first paragraph of Article 6quinquies, the panel found that Article 6quinquies did not create a self-standing obligation to register a trademark, subject to a limited number of reservations or exceptions, but rather only required that if domestic law *otherwise* permitted registration of the mark, it must be registered 'as is', i.e. in exactly the form presented to the authority upon registration. Thus, Article 6quinquies did not derogate from a Member's general right under Paris Convention 6.1 to determine the conditions for the filing and registration of trademarks by its domestic legislation, except as regards the *form* of the mark. In consequence, the challenged US legislation did not violate Article 6quinquies, inasmuch as the restrictions it placed on registration were not related to the form of the mark. The grammar of Article 6quinquies is logically consistent with both the broader

meaning asserted by the EC ('You must register this trademark, and not only that, you have to register it as is unless one of the exceptions applies') and the narrower meaning discerned by the panel ('If your domestic law otherwise permits the registration of this trademark, you are obliged to register it in exactly the form in which it is presented, subject to the exceptions'). Thus, the AB rightly found that the 'ordinary meaning' of the words in Article 6quinquies was not sufficient to resolve the issue, and went on to explore the 'context' of Article 6quinquies. The AB then determined that the 'context' supported the narrower interpretation made by the panel.

The first contextual consideration that the AB adduced was Paris Convention Article 6.1, the general default rule of domestic sovereignty, which reads: 'The conditions for the filing and registration of trademarks shall be determined in each country of the Union by its domestic legislation.' The AB suggested that 'if Article 6quinquies A(1) were interpreted too broadly, the legislative discretion reserved for Members under Article 6(1) would be significantly undermined'. Some might criticize the AB here, since 6.1 explicitly limits the default rule of domestic sovereignty, by stating it is subject to the obligations in the Paris Convention itself, and therefore 6.1 merely begs the question of how narrow or broad those obligations might be, i.e. how much they cut into the default rule of domestic sovereignty. Yet such an alternative reading of 6.1 would reduce the provision to a triviality: 'You are permitted to do what is not prohibited to you.' That would simply restate what is already obvious, at least since the *Lotus* case, namely that the sovereignty of states is presumed to be unlimited, unless bounded by specific rules of law.

Thus, to give 6.1 an effective meaning, it must be interpreted as signalling that, in fact, such derogations from domestic sovereignty *as are provided for in the Paris Convention* will be narrow, bounded and clearly expressed.

Finally, the AB introduced an additional contextual consideration, namely an agreed interpretation of Article 6quinquies as it appeared in the original Paris Convention of 1883, which made clear that the provision in question only prohibits exclusion from registration based on the form of the mark, leaving Members free to deny registration based on other conditions or criteria in their domestic laws. However, this agreed interpretation was omitted in subsequent versions of the Paris Convention.

Much in the manner in which it sought to discern in Paris Convention 6quinquies a substantive right to trademark protection, the EC argued that TRIPs Article 15.1 provided not merely for negative harmonization (stating certain discrete grounds on which Members were not permitted to distinguish between trademarks as eligible or not eligible for protection), but rather states a right to have a trademark protected, unless the decision not to protect fell within one of the exceptions permitted by the Paris Convention.

TRIPs 15.1 states certain grounds on which a mark may *not* be denied eligibility for trademark protection. Namely, WTO Members may not exclude from eligibility for trademark protection a sign because of the kind of sign that it is—thus, whether the sign is constituted of words, letters, numerals, figurative elements, combinations of colours or a mix of any of the above, it shall nevertheless be eligible for registration. There thus seems to be some overlap between TRIPs 15.1 and Paris Convention 6quinquies, which requires that a trademark be registered as is. TRIPs 15.2 provides that 15.1 'shall not be understood to prevent a Member from denying registration of a trademark on other

grounds, provided that they do not derogate from the provisions of the Paris Convention (1967)'.

Unlike the case with Paris Convention 6quinquies, the ordinary meaning of the words in 15.1 excluded the interpretation being urged by the EC. As the AB noted (para. 155), Article 15.1 deals with the question of when a mark may be 'eligible' for or 'capable of receiving trademark protection. The EC's reading would in effect eliminate those words from the treaty text, such that 15.1 would say not when a mark must be *eligible* for protection, but rather when there is an obligation to provide the protection.

However, the AB went further, and sought support for its (obvious) reading of 15.1 from the 'context' of 15.2, which states that Members can nevertheless deny registration of a trademark on 'other grounds', provided that they do not derogate from the Paris Convention. As the AB pointed out, the reference to 'other grounds' suggests that all 15.1 does is to state *one* particular kind of grounds on which Members *cannot* refuse to consider a trademark eligible for registration and protection, namely what kind of signs or symbols it consists of. The AB further cited as 'context' for its interpretation TRIPs 15.4, which establishes that a trademark may not be denied registration simply because of the nature of the goods or services that it designates. As the AB noted, if, as the EC suggested, 15.1 constituted a general obligation to register and protect trademarks, rather than stating a single prohibited grounds for denying registration and protection, then 15.4 would be superfluous; there would be no need to state prohibited grounds one by one, since by virtue of 15.1 there is instead (on the EC theory) a general obligation to register and protect, subject to certain defined exceptions.

Even though this disposed of the EC's appeal on this issue, since no violation could be found (the US legislation in question having nothing to do with the kind of sign that composes the mark), the AB made a point of going on to consider and reject the EC's interpretation of 15.2. The EC's view of 15.2 was that it limited the legal right to refuse registration and protection to those situations explicitly stated as *exceptions* in the Paris Convention (or TRIPs itself). The AB, however, regarded 15.2 as an affirmation of the default rule of domestic sovereignty in Paris Convention 6.1. In other words, Members are free to determine the conditions of trademark registration and protection, subject to certain explicitly prohibited grounds, which they are forbidden to use to discriminate between trademarks with respect to eligibility for registration and protection.

Here, the AB made an explicit decision to jettison judicial economy, it would seem, in order to make clear as guidance for future panels the overall nature of TRIPs as far as trademarks are concerned; TRIPs is not an agreement for substantive harmonization, or mutual recognition, but merely reinforces or reaffirms the negative integration commitments of the Paris Convention.

The AB went on to reject the EC's claim that the US legislation violated Article 16.1 of TRIPs. Article 16.1 is similar to Paris Convention 6bis, in conferring a substantive right to exclude third parties from using the mark for identical or similar goods or services such that there is a likelihood of consumer confusion. Unlike Paris Convention 6bis, TRIPs 16.1 requires a presumption of likelihood of confusion where the sign being used is identical to the original mark.

There is, however, a crucial difference between Article 16.1 and Paris Convention 6bis. Paris Convention 6bis does not depend on the concept of ownership of the mark. Instead, it states that the mark 'must be considered by the competent authority of the

country of registration or use to be well known in that country as being already the mark of a person entitled to the benefits of the Convention'. Thus, *who* can exclude others from using a mark appears to depend on the decision of the authorities of the jurisdiction of initial registration and/or use.

By contrast, TRIPs 16.1, nor any other provision of TRIPs for that matter, defines *how*, or by *whom*, the question of ownership is to be determined. In the absence of any explicit provisions on these matters in either TRIPs or the Paris Convention, the panel had asked the Director-General of the International Bureau of WIPO for an expert opinion on whether the Paris Convention contained an *implicit* definition of 'ownership'. The Director-General answered in the negative.

The AB approved the panel's deference to this opinion from WIPO. Arguably, however, the absence of an implicit definition of ownership in the Paris Convention, as determined by the official experts of that legal regime, does not excuse the AB from attempting a contextual definition of ownership as it relates not to the obligations of the Paris Convention but to those in *TRIPs itself*. The EC pointed to a number of provisions of TRIPs that, contextually, seemed to suggest that the owner of a trademark, at least presumptively, was the undertaking that had originally used or registered the mark, and anyone who had legally acquired the mark from that original 'owner'.

The very nature of 16.1 is that of an obligation that rights established in one jurisdiction (the home jurisdiction) be *recognized* by the authorities of *other* WTO jurisdictions; thus, there is arguably no need to define ownership. Ownership and other preconditions for the establishment of a trademark are naturally governed, in the logic of a recognition provision, by the laws of the home country, absent any explicit minimum international standards. Viewed in this way, the conclusion that the AB draws from the silence on ownership in TRIPs is perverse—namely that the jurisdiction obliged to *recognize* a trademark right duly established in the home country gets to decide who is a bona fide owner of the right.

A recognition and enforcement regime such as that in 16.1 is of course appropriately subject to exceptions of a public policy nature; and in a case such as *Havana Club*, the United States could arguably invoke such an exception, if the decision of the host country to recognize a certain individual or entity as an owner violated the public policy of the United States. But that is quite another matter than inferring a general default rule that the country of recognition and enforcement, not the country where the rights are established in the first place, has full latitude to determine who is a trademark 'owner'.

In any case, the AB's holding that domestic sovereignty to restrict the ownership of trademarks remains essentially unconstrained by TRIPs is of no small importance. On the AB's logic, through ownership measures, a government can impose a wide range of responsibilities on an entity that wishes to have the status of 'owner' of a mark, including social responsibilities. If the US view of the Cuban revolution and the Castro regime is a legitimate basis on which to make a determination of who owns a trademark, then denying a mark, for example, to an entity that manufactures marked goods in sweatshops that violate internationally recognized labour standards might be equally legitimate, if not more so.

Moreover, one may ask if the analysis of 'ownership' by the AB in *Havana Club* might not have implications for the interpretation of TRIPs obligations in respect of *other* forms of intellectual property. Take the case of patents. Article 28.1 of TRIPs bestows

certain exclusive rights on the 'owner' of a patent. Article 27 of TRIPs lists *specific grounds* on which Members *may or may not* exclude patentability. But TRIPs says nothing about the determination of who is the 'owner' of a patent and is therefore entitled to the exclusive rights named in TRIPs 28.1. Of course, the National Treatment and MFN obligations in TRIPs would apply to determinations of ownership under domestic law.

As for the Paris Convention, as incorporated into TRIPs, it appears to have a similar default rule in favour of domestic sovereignty in respect of patents. Thus, Article 27.5 of the Berne Convention provides: 'any Contracting State is free to apply, when determining the patentability of an invention claimed in an international application, the criteria of its national law in respect of prior art and *other* conditions of patentability not constituting requirements as to the form and contents of applications'.

Thus, if WTO Members are free (subject to the National Treatment and MFN obligations of TRIPs) to determine the criteria or conditions for someone to be an 'owner' of a patent, this has major implications for the ability of developing countries, for instance, to ensure that patent protection does not conflict with their development needs. Technology transfer, acceptance of price controls, etc. could all be imposed as conditions for an entity to be recognized as an 'owner' of a patent, and thereby the beneficiary of the rights enumerated in TRIPs 28.1.

In addition to the key findings discussed above, the *Havana Club* AB also addressed National Treatment and MFN under TRIPs, finding a violation of both in the manner in which the US legislation afforded fewer legal rights to trademark-holders in certain countries outside the USA in particular circumstances. The AB also held that the Paris Convention provisions on trade names were incorporated into TRIPs, despite an explicit reference in TRIPs itself to trade names as a form of intellectual property protected by TRIPs.

The access to medicines debate

As discussed in an earlier section of this chapter, Article 31 of TRIPs provides the flexibility for WTO Members to compulsory-license patents, where certain conditions are met, including reasonable compensation to the rights-holder, and provided the licence only applies to the market of the WTO Member in question. Despite this flexibility, which is even greater where an emergency situation exists (some of the conditions are lifted), drug industry interests and some developed-country governments tried to intimidate developing countries who sought to use this flexibility to address the health crisis of HIV/AIDs. The TRIPs division of the WTO Secretariat appears to have largely collaborated in this undertaking, sending a message as to the strictness of TRIPs disciplines, and underemphasizing the flexibilities.

Despite the problem not being the TRIPs Treaty itself, the HIV/AIDs situation in South Africa led to the access to medicines issue contributing significantly to the legitimacy woes of the WTO, and became a tripwire issue for civil society, as well as human rights organs of the United Nations, which were beginning to address the human rights implications of WTO commitments. Drahos and Braithwaite provide a concise and thoughtful account of the South African controversy and its broader implications for the WTO TRIPs regime:

[South African legislation] specifically allowed the importation into South Africa of patented medicines that had been put onto another market with the consent of the patent holder. The idea was to encourage the importation of patented medicines from the cheapest market (parallel importation)... The response of the US officials was to turn the passage of the South African bill into a trade matter... Agencies of the US government..., with the assistance of officials from the European Commission (EC), began to pressure South Africa to change the bill. One of their arguments was that the South African government would be in breach of its obligations under the [TRIPs] Agreement... In March 2001, 39 pharmaceutical companies came to the Pretoria High Court armed with most of South Africa's intellectual property barristers and a barrage of arguments against the [South African law]. TRIPs surfaced again... In April 2001 the pharmaceutical companies withdrew from the litigation and the case settled. What had happened?... The international publicity [the] coalition of NGOs (including Médecins Sans Frontières and Oxfam) gave to the plight of South Africa was also accompanied by good public policy analysis, that at its core, raised a fundamental issue—could the world community continue to rely on a patent-based R&D system that contributed heavily to a situation in which only 10 percent of global health research investigates the causes of 90 percent of the world's disease burden? [footnote omitted]⁶³

One result of these developments was that patent-holding drug companies themselves began to make available to developing countries retroviral drugs at (relatively) affordable prices. Another result was the Doha Declaration on Access to Medicines, which made it clear that the TRIPs Agreement should not provide obstacles to the availability of essential medicines at affordable prices, at least in relation to certain critical diseases. In considering the Declaration's terms, it is important to remember that neither the parallel importation foreseen by the South African legislation nor the alternative of compulsory licensing itself is prohibited under TRIPs—the problem was not the Agreement but it being interpreted unreasonably, in a manner that allowed it to be used to bully developing countries with an HIV/AIDs crisis. It must also be asked why it would not be economically rational for a patent-holder to engage in price discrimination, charging a very low price which the market would bear in African countries, as long as that price was above marginal cost. Part of the answer may lie in the strategic desire of drug companies not to reveal, by such pricing, just how low their marginal costs actually were; this information could be used by large purchasers of medicines—governments or private health insurers—to bargain down the price of medicines in rich, developed countries. Hence, drug companies have been prepared in some instances to give away medicines to poor countries, rather than price them at marginal cost—and have presented this behaviour as 'charitable'. Another concern is that of arbitrage—the risk that medicines will be reimported into rich countries and sold on the unofficial market at low prices, thereby bringing down the price in those countries. However, it is very unclear how serious such effects could be, since the market in rich countries for medicines of this nature, not provided through the quality control and liability regime of healthcare

professionals, may be relatively small, and mostly consist of persons who would not otherwise have purchased the medicines at full price (e.g. the uninsured).

Article 4 of the Declaration on TRIPs Agreement and Public Health reads: 'we agree that the TRIPs Agreement does not and should not prevent Members from taking measures to protect public health. Accordingly, while reiterating our commitment to the TRIPs Agreement, we affirm that the Agreement can and should be interpreted and implemented in a manner supportive of WTO Members' right to protect public health, and in particular, to promote access to medicines for all.' Article 5 of the Declaration specifies some of the specific implications of this affirmation, 'including the right to grant compulsory licences and the freedom to determine what constitutes a national emergency or other circumstances of extreme urgency, it being understood that public health crises, including those relating to HIV/AIDS, tuberculosis, malaria and other epidemics, can represent a national emergency or other circumstances of extreme urgency'. Moreover, and this explicitly rejects the theory put forward in the South African controversy that TRIPs prohibited parallel importation, 'The effect of the provisions in the TRIPs Agreement that are relevant to the exhaustion of intellectual property rights is to leave each Member free to establish its own regime for such exhaustion without challenge, subject to the MFN and National Treatment provisions of Articles 3 and 4.'

In the debate over the usefulness of compulsory licensing as an instrument to ensure affordable access to essential medicines, it was widely put about that Article 31 of TRIPs did not cover a situation where a developing country wanted to grant a compulsory licence in respect of a drug it was importing, i.e. manufactured in another country. Thus, if an African country with no indigenous capacity wanted to import for its domestic market a generic from India, it could not, it was thought, use Article 31. Only *India* could grant a compulsory licence for the Indian domestic market, according to the terms of Article 31. This is true as far as it goes, but it ignores the Article 30 exception in TRIPs. There are good reasons to think that the granting of a compulsory licence could be extended to the market in another WTO Member country as an Article 30 exception, where that other WTO Member indicates that were it to possess its own manufacturing capacity, it would itself have granted such a licence for production of generics *domestically*. Such an exception does not conflict with normal exploitation of the patent, in the sense that the government of the importing state would be entitled to limit anyhow the patent-holder's right through compulsory licensing, and the only thing that prevents it from doing so is current lack of manufacturing capacity domestically. It would not fundamentally undermine the patent-holder's legitimate interests because, in the case of a poor country, the amount of revenue foregone would not be substantial, and in any case the country granting the licence (India) would still have to comply with various conditions (albeit mitigated by the emergency nature of the situation in the case of HIV/AIDS drugs). For these reasons, in our view, the problem of a poor country not having domestic manufacturing capacity could be solved within the four corners of TRIPs. However, especially in light of various interpretations issued by the industry and to some extent from within the WTO Secretariat, many developing countries wanted additional legal security on this point. Thus, Article 6 of the Declaration provides: 'We recognize that WTO Members with insufficient or no manufacturing capacities in the pharmaceutical sector could face difficulties in making effective use of compulsory

licensing under the TRIPs Agreement. We instruct the Council for TRIPs to find an expeditious solution to this problem and to report to the General Council before the end of 2002.'

In fact, the solution was not found until August 2003, less than a month before the Cancun Ministerial. The resulting agreement, as Correa explains, 'takes the form of an *interim* waiver, which allows countries producing patented products under compulsory license to export the products to eligible importing countries, provided that a compulsory license has also been granted in the importing country'.⁶⁴ According to Correa, however, this solution is not very practicable, given all the onerous conditions that must be fulfilled to take advantage of the waiver, including the requirement that the product for export be clearly distinguishable from the patented version in appearance ('shape, colouring, labelling and packaging'), and the provision of exact information about the quantities being produced and shipped, as well as imposing responsibility on the generic producer for proving the 'bio-equivalence' of the generic product and the possibility, if data are not disclosed by the patent-holder, that it would have to conduct its own toxicity and efficacy studies. In Correa's view, these various conditions entail such costs for generic manufacturers that the solution will be of no practical benefit to poor countries who lack their own manufacturing capacity. Moreover, whether a developing country does or does not have such capacity is not a matter of self-declaration, but is subject to challenge, if a developed WTO Member for instance questions the actual existence of incapacity.

We are somewhat less pessimistic than Correa, in particular because we believe that should these conditions be applied in a too onerous manner, there is the real possibility that the producing country and the importing country could successfully defend a TRIPs challenge through the combined invocation of Articles 30 and 31 of TRIPs. A ruling along these lines by the AB would not be an attractive prospect for drug industry interests and the governments that back them. At the same time, as Frederick Abbott (who did pioneering work on the access to medicines issue for Médecins Sans Frontières) notes, the underlying problem of powerful industrial interests and powerful governments teaming up to intimidate and threaten poor developing countries remains serious in the TRIPs area. Abbott believes that collective and institutional responses are the only things that can alter this power imbalance (for example new WTO rules against the use of such tactics, where a WTO Member is acting within the limits of the law). In our view, while he identifies a real problem, usually such threats have been accompanied by *interpretations* of the rules that would not stand up in dispute settlement at the AB, rather than being purely extra-legal (for example threats to withdraw from the negotiation of bilateral trade agreements, or to reduce foreign aid, or remove GSP preferences). Thus, it is important that the conduct of the WTO Secretariat in endorsing these kinds of interpretations be carefully reviewed, especially what it tells developing-country governments about the meaning of TRIPs in the context of technical assistance and training programmes. As well, the capacity of developing-country governments to effectively use the dispute settlement system needs to be enhanced (an issue we discuss in the dispute settlement chapter of this book, Chapter 4).

The North American Free Trade Agreement (NAFTA)

The provisions on intellectual property rights in the NAFTA are, in most important respects, largely identical to those in the Uruguay Round Agreement, discussed in detail in the previous section. Unlike the Uruguay Round Agreement, the NAFTA does not contain substantive provisions on performers' rights. Performers' rights would seem to be covered by the National Treatment obligation with respect to intellectual property rights. An exception to National Treatment is, however, that 'a Party may limit rights of performers of another Party in respect of secondary uses of sound recordings to those rights its nationals are accorded in the territory of such other Party' (Article 1703.1).

The NAFTA also contains a provision on the decoding of encrypted satellite signals that is not present in the Uruguay Round TRIPs Agreement. Under this provision, each Party would be required to make it a criminal offence to manufacture or sell any device used for the purpose of decoding encrypted satellite signals, and a civil offence to decode or improperly receive these signals. These provisions would appear to be primarily aimed at protecting the rights of pay-TV broadcasters. Finally, unlike the Uruguay Round TRIPs Agreement, the NAFTA does not contain any special provisions on dispute resolution with respect to intellectual property rights, suggesting that the general dispute resolution mechanism in the NAFTA will apply to disputes under the intellectual property provisions of the NAFTA.

The NAFTA represents a major victory for mostly US-based multinational pharmaceutical companies. Canada had a significantly shorter period of patent protection for Pharmaceuticals (ten years), after which compulsory licensing was provided under Canadian law.⁶⁵ The consequence was a wealth of low-cost generic drugs, with major cost savings to consumers, as well as to government programmes that provide free or subsidized medications to the elderly and the poor. In order to comply with NAFTA and a possible Uruguay Round Agreement on TRIPs, the Canadian government of the time changed the law to provide 20 years of patent protection to patent pharmaceutical producers. However, under the letter of both NAFTA and Uruguay Round Agreement on TRIPs, compulsory licensing is still permissible, provided reasonable compensation is offered to the patent-holder and some other conditions are met. This suggests that there was some kind of informal understanding between Canadian and American authorities that Canada's approach to pharmaceuticals must be dismantled if the spirit of NAFTA is to be respected. Perhaps also influential with the Canadian authorities was a massive, high-profile lobbying effort on the part of patent drug manufacturers stressing the amount of new R&D activity that would occur in Canada with the adoption of these changes. In any case, despite these major changes in the Canadian domestic regulatory regime to the advantage of American proprietary drug interests, Canada failed completely to win any insulation from US aggressive unilateralism, including actions under Section 337 of the Tariff Act.⁶⁶ At the time this book went to press (early 2005), the Canadian government was apparently considering the reintroduction of measures to provide for the compulsory licensing of pharmaceuticals, on terms consistent with NAFTA and Uruguay Round TRIPs Agreement.

POST-URUGUAY ROUND DEVELOPMENTS

Implementation of the WTO TRIPs Agreement

Perhaps more than any other trade agreement in history, the WTO TRIPs Agreement requires extensive changes to, and in the case of many countries additions to, domestic law and regulations. Pursuant to its mandate under the Agreement, the WTO TRIPs Council has established procedures for notification⁶⁷ and examination⁶⁸ of Members' domestic intellectual property laws and regulations. The review of national implementing legislation is now largely complete, with the exception of newly acceding Members and several Members who joined the review process late.⁶⁹ Pursuant to Article 67 of the TRIPs Agreement, which contains an obligation that developed-country Members provide technical assistance to developing countries with respect to the establishment and reform of intellectual property regimes, as well as enforcement issues, the TRIPs Council has received numerous notifications of their technical cooperation programmes from developed countries. The WTO Secretariat has also begun to provide technical assistance to developing countries, in some instances in cooperation with WIPO (such as joint workshops on institutional capacity and other issues for developing countries).

WIPO treaties on copyright and performance rights

The 1996 WIPO Copyright Treaty⁷⁰ has as its main thrust the updating of the Berne Convention in light of information technology and communications developments. Article 4 of the Treaty mirrors Article 10 of the TRIPs Agreement in establishing that computer programs are to be protected as literary works within the meaning of the Berne Convention. Article 11 confers on authors the right to control the dissemination of their works through electronic means such as the internet. The Treaty also requires Member States to establish effective legal remedies against tampering with encoded information that allows authors to track and control the making and distribution of digital copies of their works. At the WIPO diplomatic conference at which the Copyright Treaty was negotiated, an initiative was put forward to provide intellectual property rights protection with respect to data.⁷¹ This was rejected, although further examination of the issue of protecting databases (as opposed to 'raw' data) was agreed. The notion of proprietizing facts raises serious issues of individual freedom of expression, as well as the possibility of seriously undermining the civic, democratic and educational potential of the internet. Boyle notes that the proposed

right would have been effectively permanent and would not have been restrained by the traditional limitations of copyright law, such as fair use. This proposal, with its potentially devastating effects on research and free speech, and its offer of a potent new tool of private censorship, drew fire from the research establishment, civil liberties groups and even—embarrassingly for its proponents—the database industry it was designed to protect [footnote omitted].⁷²

The WIPO Performances and Phonograms Treaty⁷³ updates, in light of new (including digital) technologies, the Rome Convention provisions on copyright protection to be afforded with respect to performance of sound recordings, including those for broadcast. The Treaty also grants performers moral rights of attribution and integrity (Article 5.1). Rights to royalties for performance of recordings are, however, subject to a reciprocity provision; this provision is necessary because the United States only has very limited performance rights in its domestic law (i.e. for digital performances only) and other Member States could not accept a reservation by the USA to the Treaty provisions on these rights, unless they were free to derogate from these provisions in respect of the rights of American performers.⁷⁴ According to a study by the WTO Secretariat, the WIPO Copyright and Performances and Phonograms Treaties, taken together, 'will greatly facilitate the creation of a secure and predictable legal environment that will foster the development of electronic commerce involving on line distribution of protected materials'.⁷⁵

Emerging issues

There are several important emerging issues that will likely need to be addressed in the near future, either through dispute settlement under TRIPs or relevant WIPO conventions, or through the creation of new laws.

The persistence of unilateralist threats

One issue is the continuing use by the United States of unilateral trade action, particularly under Section 301 and Super 301, to deal with complaints about inadequate protection of intellectual property rights in developing countries, in some instances simultaneously with the pursuit of dispute settlement in the WTO. It is arguable that even if unilateral action does not violate any specific provision of the GATT or the TRIPs Agreement (as it would not for instance in the case of withdrawal of voluntary GSP preferences, as was recently done in the case of Honduras),⁷⁶ it may be in contravention of Article 23 of the WTO Dispute Settlement Understanding. Article 23 provides that Members 'shall have recourse to the rules and procedures of this Understanding' when they seek redress of violations of WTO Agreements. The Article further provides that a Member shall not 'make a determination that a violation has occurred, that benefits have been nullified or impaired or that the attainment of any objective of the covered agreements has been impeded' except through recourse to WTO dispute settlement. This would seem to preclude unilateral action without reference to WTO dispute settlement, where the subject matter is covered by the TRIPs Agreement.⁷⁷

Domain names

Another emerging issue of importance is the relationship between trademarks and domain names on the internet (a domain name constitutes an essential part of a web address). As a study by the WTO Secretariat notes,

[o]ne of the questions that has arisen is under what circumstances and under which jurisdiction(s) the use of a domain name that is identical to or similar to a trademark may constitute a trademark infringement, and what remedies should be available for the trademark holder. Further consideration is needed to determine whether the above mentioned problems call for adaptations to the international protection of trademarks.⁷⁸

Geographical indications

At the instigation of the EU in particular, the negotiating mandate in the Doha Declaration (para. 24.1) includes the expansion of TRIPs disciplines on geographical indications (GIs). Maskus notes:

Some developing countries see benefits to their producers from extending the scope of global GIs registration to food products (e.g. Basmati rice and Darjeeling tea) and cultural goods (e.g. carpets or textile designs from particular regions). Others are opposed, fearing that an extended system would foreclose the use of certain words by their own producers and raise costs to consumers. The United States, Australia, Chile, and other major 'new world' wine producers also oppose stronger GIs, arguing that reliance on certification marks, collective marks and consumer fraud statutes is sufficient for effective protection while providing flexible use of geographic terms... Although preparatory work for negotiations on GIs has proceeded within the TRIPs Council at the WTO for some time, no consensus has emerged [as of the summer of 2003].⁷⁹

These differences have spilled out into dispute settlement—in October 2003, the United States and Australia requested a panel to challenge EC legislation that allows foreign geographical indications to be registered in the EC only if the country of origin itself has EC-like protection for geographical indications. The US and Australia claim that this condition in the EC legislation violates, *inter alia*, the National Treatment and MFN provisions of the TRIPs Agreement.

The panel ruling (*European Communities—Protection of Trademarks and Geographical Indications for Agricultural Products and Foodstuffs and Geographical Indications for Agricultural Products and Foodstuffs*, WT/DS174/R, WT/DS290/R), which was released as this volume was going to press, found that this, and a few other aspects of the EC scheme, violated National Treatment in both the GATT and the TRIPs Agreement; many of the other claims against the EC in the dispute were either not dealt with on judicial economy grounds or dismissed.

Genetic resources, traditional knowledge and folklore

An additional issue arises from the interaction of the emerging international environmental law with respect to biodiversity and international intellectual property law. One dimension of this issue that is not yet explicitly addressed by international legal rules

is the use of patentable technology that exploits genetic resources found in nature in developing countries; there is a concern that these resources themselves be protected as intellectual property, so that the contribution of farmers and local communities to their conservation can be compensated. A report of the WTO Trade and Environment Committee appears to take the view that nothing in the TRIPs Agreement would prevent a Member from requiring that a user of these resources provide compensation for their use.⁸⁰ Thus, while a Member would normally have to grant a patent on an innovation based on use of genetic resources in nature, it could decide to restrict access to the resources themselves in its domestic law. The Doha Declaration provides that the TRIPs Council is to examine 'the relationship between the TRIPs Agreement and the Convention on Biological Diversity, the protection of traditional knowledge and folklore, and other relevant developments'.

The TRIPs Council has already received a proposal by a group of developing countries (including such major players in the WTO system as Brazil, India and Thailand) that TRIPs be amended to address the existing lack of provisions 'to prevent biopiracy (illegal access and use) or ensure prior informed consent and fair and equitable sharing of benefits. To this end, the group proposed several conditions to acquiring patent rights related to biological materials or traditional knowledge (TK), including requirements for patent applicants to disclose the source of origin of the biological resource and associated TK, and evidence of prior informed consent and benefit-sharing.'⁸¹

Recent literature notes the proliferation of fora in which these issues are considered, including the Food and Agriculture Organization of the United Nations (where in 2001 a treaty on plant genetic resources was negotiated), the Rio biodiversity regime, WIPO and the WTO itself.⁸² The key conceptual issue is whether a new, *sui generis* approach is required to prevent unauthorized and/or uncompensated appropriation of genetic resources, traditional knowledge or folklore, given the cultural and economic contexts at issue, or whether mainstream conceptions of property rights, including intellectual property, can be applied and adapted for these purposes. The strengths and limitations of intellectual property rights as a means of protecting traditional knowledge and folklore are set out in a balanced and lucid fashion in a recent joint study by UNCTAD and the International Centre for Trade and Sustainable Development.⁸³ The Plant Genetic Resources Treaty envisages a *sui generis* compensation mechanism through Material Transfer Agreements, which would involve payments from those commercializing plant genetic resources, to the benefit of farmers and indigenous populations in the countries where the resources are located. The Treaty contains a provision stipulating that 'recipients [of the genetic resources] shall not claim any intellectual property or other rights that limit the facilitated access to the plant genetic resources for food and agriculture, or their genetic parts and components, in the form received from the Multilateral System' (Article 12.3(d)). In this respect, it is important to recall that TRIPs, while not requiring WTO Members to make available patents of this nature (for life forms), also does not *prohibit* individual WTO Members from offering such patents.

TRIPs-plus: bilateral and regional agreements

A range of recent bilateral and regional trade agreements contain provisions that require intellectual property protection above that stipulated in TRIPs. Such agreements have

been used by developed countries to further increase protection beyond the TRIPs level, at a time when the debate at the WTO has focused on providing if anything greater flexibility to developing countries with respect to intellectual property obligations. A summary of TRIPs-plus obligations in such bilateral and regional agreements, current up to 2001, is provided in Table 13.1.

CONCLUSION

While trade theory provides little basis for mandating uniform standards of intellectual property protection across all countries, intellectual property rights is an issue that is here to stay on the international trade agenda. But so is the controversy surrounding the effects of TRIPs on developing countries, as is illustrated by the access to medicines controversy. The Uruguay Round TRIPs Agreement, while at the level of general principle promoting a

Table 13.1 TRIPs-plus obligations in bilateral and regional agreements

<i>Proponent (North)</i>	<i>Counterpart (South)</i>	<i>Type of agreement</i>	<i>Date</i>	<i>TRIPs-plus provisions</i>
<i>Africa and Middle East</i>				
EU	African, Caribbean and Pacific (ACP) states (Cotonou Agreement)	Trade	2000	Must patent biotech inventions
EU	Morocco	Trade	2000	Must join UPOV and Budapest by 2004
EU	Palestinian Authority	Trade	1997	Highest international standards
EU	South Africa	Trade	1999	Must patent biotech inventions; highest international standard; must undertake to go beyond TRIPs
EU	Tunisia	Trade	1998	Must join UPOV and

				Budapest by 2002; highest international standards
USA	Jordan	Trade	2000	Must implement and join UPOV within one year and partially implement Budapest; no exclusions for plants and animals from patent law
USA	Sub-Saharan Africa (African Growth and Opportunity Act)	Trade	2000	Trade benefits gauged on extent to which countries go beyond TRIPs
<i>Asia and Pacific</i>				
EU	ACP states (Cotonou Agreement)	Trade	2000	Must patent biotech inventions
EU	Bangladesh	Trade	2001	Must make best effort to join UPOV by 2006
Switzerland	Vietnam	IPR	1999	Must join UPOV by 2002
USA	Cambodia	Trade	1996	Must join UPOV
USA	Korea	IPR	1986	Must join Budapest
USA	Mongolia	Trade	1991	No exclusions for plants and animals from patent

USA	Singapore	Trade	Under negotiation	law See USA-Jordan above
USA	Sri Lanka	IPR	1991	No exclusions for plants and animals from patent law
<i>Proponent (North)</i>	<i>Counterpart (South)</i>	<i>Type of agreement</i>	<i>Date</i>	<i>TRIPs-plus provisions</i>
USA	Vietnam	Trade	2000	Must implement and make best effort to join UPOV; must provide patent protection on all forms of plants and animals that are not varieties as well as inventions that encompass more than one variety
<i>Latin America and Caribbean</i>				
EU	ACP states (Cotonou Agreement)	Trade	2000	Must patent biotech inventions
EU	Mexico	Trade	2000	Must join Budapest within three years; highest international standards
USA	Andean countries (Andean Trade Preference Act)	Trade	1991	Trade benefits gauged on extent to which

				countries go beyond TRIPs
USA	Caribbean countries (Caribbean Basin Trade Partnership Act)	Trade	2000	Trade benefits gauged on extent to which countries go beyond TRIPs
USA	Ecuador	IPR	1993	Must conform with UPOV if no patents on plant varieties
USA	Nicaragua	IPR	1998	Must join UPOV; no exclusions for plants and animals from patent law
USA USA and	Trinidad and Tobago Latin America	IPR	1994	Must implement and make best effort to join UPOV
Canada	(FTAA/ALCA)	Trade	Under negotiation	US negotiating position is no exclusions for plants and animals from patent law; actual negotiating text contains many proposals to implement UPOV

Source: ““TRIPs-plus” through the Back Door: How Bilateral Treaties Impose Much Stronger Rules for IPRs on Life than the WTO’, *Genetic Resources Action International*, Barcelona, 2001.

uniform approach, in fact allows for a balance to be struck between countries' legitimate interests in limiting intellectual property rights for consumer welfare and economic and social development reasons, and the interests of their trading partners in sustaining adequate incentives for innovation. Maintaining this balance through monitoring and dispute settlement will be a major challenge for the World Trade Organization.

14

Trade and investment

INTRODUCTION

The last decade of the twentieth century witnessed a dramatic increase in foreign direct investment (FDI), defined as ownership and (normally) control of a business or 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 ‘three forms: an infusion of new equity capital such as a new plant or joint venture; reinvested corporate earnings; and net borrowing through the parent company or affiliates’.² According to the United Nations Conference on Trade and Development (UNCTAD),

The global FDI stock, a measure of the investment underlying international production increased fourfold between 1982 and 1994; over the same period it doubled as a percentage of world gross domestic product 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 internationalization 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) the current boom is characterized 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.³

More recently, after a peak in FDI flows in 2000, global flows declined in 2001. The record high levels of FDI in 2000 declined sharply in 2001 for the first time in a decade by 51%. This was mainly the result of the weakening of the global economy, notably in the world’s three largest economies which all fell into recession, and consequent drop in the value of cross-border mergers and acquisitions (M&As). This decline in FDI flows followed rapid increases during the late 1990s. There was a similar pattern during the late 1980s and early 1990s, and in 1982–83. Thus, this is the third downward cycle in FDI, each punctuating a long upward trend in FDI every ten years or so.⁴ These swings reflect changes in several factors—business cycles, stock market sentiment and M&As. The decline in FDI was mainly concentrated in developed countries where it shrank by 59%,

compared to 14% in developing countries. Inflows to Central and Eastern Europe (CEE) remained stable. In 2001, world inflows of FDI were \$735 billion, of which \$503 billion went to developed economies, \$205 billion to developing economies and the remaining \$27 billion to the transition economies of CEE. The shares of developing countries and those of CEE in global FDI inflows reached 28% and 4% respectively in 2001, compared to an average of 18% and 2% in the preceding two years. The 48 less-developed countries (LDCs) remain marginal recipients, receiving only 2% of all FDI to developing countries and 0.5% of the global total. In 2001, the five largest FDI recipients attracted 62% of the total inflows to developing countries, while the corresponding figure for CEE was 74%. Among the top ten gainers in terms of absolute increases, eight were developing countries, led by Mexico, China and South Africa. Conversely, among the ten countries experiencing the steepest declines in FDI inflows, eight were developed countries (Belgium and Luxembourg, the United States and Germany reported the largest declines).

UNCTAD's most recent statistics, current as of January 2004,⁵ establish the following picture:

Global foreign direct investment (FDI) flows last year remained flat, at \$653 billion, according to UNCTAD estimates released today. The figure for 2002 was \$651 billion... This follows two previous consecutive declines—from \$824 billion in 2001 and \$1.4 trillion in 2000. The continuing low value and number of cross-border mergers and acquisitions (M&A)—the key driver of global FDI flows since the late 1980s—contributed heavily to the downturn [footnote omitted]. But UNCTAD is predicting that FDI flows will rebound this year, boosted by the improving global economy, higher corporate profitability, recovering M&A transactions and growing investor confidence.

FDI inflows to developed countries increased marginally, from \$460 billion in 2002 to \$467 billion in 2003—just two fifths of their peak level of \$1.1 trillion in 2000. FDI flows to the United States rose threefold. The largest decline occurred in the European Union (EU), notably in France and Germany. Flows to Japan were down as well. With global economic recovery gaining strength, the outlook for FDI inflows to developed countries in 2004 is promising, UNCTAD says. Led by the US, developed countries expect stronger economic growth in 2003 and 2004, with a positive impact on corporate investment. Further industry consolidation and an increase in M&A transactions will also boost FDI. The strong euro, while hurting export-oriented companies, favours investment in the US by EU firms.

FDI inflows to Africa last year rose by 30% to \$14 billion, up from \$11 billion in 2002. The rebound was due to a number of large investment projects in natural resources and an improving policy environment with the unfolding of the New Partnership for Africa's Development (NEPAD). The oil industry continues to account for the bulk of the increase in FDI flows to African countries. Africa's prospects for FDI inflows in 2004 are also positive, based on expected investment in the oil

sector. Privatization is likely to remain weak in the region, but some large deals may come off, particularly in electricity and telecommunications.

FDI flows to the Asia-Pacific region increased marginally, from \$95 billion in 2002 to \$99 billion in 2003. China (whose \$57 billion marked another record for that country), the Republic of Korea, Thailand, Viet Nam and oil-rich Azerbaijan all saw higher FDI flows. Strong domestic growth, the relocation of efficiency-seeking FDI to competitive locations in the region, higher global corporate spending and oil investment were the key factors behind the performance. Flows to the Pacific Islands, however, remained modest. In the aftermath of the Iraq war, flows to West Asia again slumped.

In the 1990s, many developing countries took a positive view of foreign investment and have since 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). However, the recent experience with investor protection provisions in the North American Free Trade Agreement (NAFTA) and some bilateral investment treaties (BITs) (allowing investors to sue host governments for 'expropriation' and other violations of investor protection norms) made many developing countries wary once again about the project of negotiating new investment provisions in the WTO; at Cancun, these developing countries essentially succeeded in having investment removed as a topic of negotiation in the Millennium (Doha) Round of WTO negotiations.

Ownership by foreigners has become of increasing concern in certain industrialized countries, particularly the United States, that traditionally complained about illiberal attitudes elsewhere towards foreign investment.⁶ As well, increased interest in foreign investment in Japan by nationals of other major industrialized countries, especially the United States, has focused attention on a range of domestic policies and practices in Japan (including competition policies that provide few constraints on domestic cross-ownership of enterprises) that supposedly create obstacles to foreigners wishing to acquire business assets there.⁷

The issue of foreign investment is closely linked to the role of multinational corporations in the global political economy. Some see such corporations as powers unto themselves, capable of buying or 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 haven and yet another's favourable rules on intellectual property, and perhaps creating a race to the bottom.⁸ Others view the multinational corporation as a logical and desirable extension of the inherent logic of comparative advantage, combining the benefits of organizing production within a single firm with the gains from free trade.⁹

Much of the contemporary 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 channelling 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 and most obviously, that foreign ownership is necessarily harmful to development; and second, that developing countries are powerless to

determine the way in which foreign firms exploit their productive resources.¹⁰ Also of significance are incentives to attract foreign investment, such as tax holidays or subsidies.¹¹ 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.¹²

As will be described in the next section, in a world completely free of restrictions on the movement of goods, services and capital, any measure that distorts the global allocation of productive resources would be world welfare-reducing from the perspective of neoclassical economic theory.¹³ 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 the foreign firm's output be exported.¹⁴ The investment provisions of the Uruguay Round Final Act would subject some investment measures with direct effects on trade to more explicit scrutiny against existing GATT norms. These are relatively modest disciplines on investment disincentives and incentives in comparison with those found in the NAFTA, which contains a National Treatment obligation with respect to investors and investments, as well as a general right to invest (right of establishment) subject to certain limitations and exceptions; the NAFTA also requires that expropriation be compensated at fair market value, and that investors be afforded the minimum standard of treatment in international law. Finally, the equivalent of a right to establishment is also entrenched in the OECD Code of Liberalisation of Capital Movements (1991), and a National Treatment obligation with respect to foreign investors is contained in the OECD 1976 Declaration on International Investment and Multinational Enterprises.

FOREIGN INVESTMENT AND TRADE THEORY

The theory of comparative advantage outlined in Chapter 1 shows the gains to both domestic *and* global economic welfare from specialization of each country in the production of those goods in which it has a comparative advantage. However, most goods—including Ricardo's classic examples of wine and cloth—can be understood as composites of other goods and services. It is unlikely that a country that has an overall comparative advantage in the production of a particular good also has a comparative advantage with respect to all the inputs required to produce the good in question. To return to Ricardo's example, England's comparative advantage in cloth may arise from the skill of its weavers, and in fact Portugal may have a comparative advantage in the production of wool or cotton; similarly, Portugal's comparative advantage in wine may arise from the quality of its grapes, and would not exclude English comparative advantage in the production of wine-making technology. In such a case, it may still make sense for Portugal to make wine and trade it for English-produced cloth, but it will also make sense for Portugal to export its cotton or wool to England and for England to export wine-making technology to Portugal. Such an outcome need not, of course, lead to any foreign investment. Wholly Portuguese companies may make wine with technology produced by wholly British companies. However, just as it may make sense to produce

domestically a good through internalizing different activities required for production within a given firm, rather than through contracts between discrete individuals or firms, so too could it make sense for Portuguese vineyard-owners to purchase wine technology from British producers, or for the British producers to buy Portuguese vineyards. According to the modern theory of the firm, production will be organized within a given firm where the agency costs of internal contracting between the firm's owners, agents and employees are lower than the costs of external contracting between independent producers or providers of each component or element required to make the final product.¹⁵ The rapid growth in intra-firm trade over the last few decades testifies to the economic logic of transboundary internal contracting.¹⁶

Increasingly, the production of complex goods may entail both cross-boundary internal and external contracting. For instance, many of the activities required to produce an automobile may be subsumed within a given auto-maker, which in turn will locate production facilities globally in order to maximize comparative advantage, but other important components will be obtained through external contracting with both domestic and foreign firms.¹⁷

Nicolaides suggests that there may be some archetypal cases where cross-boundary internal contracting will occur, rather than or in addition to external cross-boundary contracting (trade): the multinational company exists precisely because it is not easy to trade intangible assets in open markets. It is difficult, for example, to write contracts for experience and newly developed technology which is in the process of being adapted for commercial applications. Factors in favour of corporate integration are that production costs are reduced, information flows faster and actions of individual units are more effectively coordinated.¹⁸ Some of the reasons for engaging in foreign investment as opposed to or in addition to external contracting may be endemic to, or particularly salient to, the international context. For instance, the greater difficulty in enforcing external contracts across borders may lead to increased agency costs of contracting.¹⁹ As well, intellectual property and related laws in other countries may provide inadequate protection of firm-specific innovations or knowledge, leading to a reluctance to transfer these to domestic firms through arm's-length external contracts (e.g. licensing arrangements or direct sale of technology or processes).²⁰ This last factor is of paramount importance for Gilpin: 'Oligopolistic firms attempt to keep firm-specific advantages within the secure confines of the firm and out of the hands of rival firms through the establishment of "greenfield" plants or the acquisition of wholly owned foreign subsidiaries over which they have exclusive control.'²¹ This may explain the evidence, recently summarized by Maskus,²² of a weak or even negative correlation between FDI and technology transfer, especially in developing countries: firms choose the FDI model for their global business strategy when they want to *keep* not relinquish control over their know-how. This suggests (as will be discussed below) that if developing countries wish to use FDI as a strategy for indigenizing technological knowledge, they need to negotiate an explicit bargain for technology transfer with the foreign enterprises in question.

Dunning has analysed a vast literature on the theory of the multinational firm and the globalization of production, and has developed what he calls an 'eclectic' theory, which emphasizes a wide range of factors, including transportation and wage costs, greater suitability of internal contracting to the development and dissemination of firm-specific technology and processes, and hedging of the political risk of locating in a single country

in a volatile world environment.²³ In many respects, this pluralistic approach is quite consistent with contemporary views on the nature of comparative advantage in trade, which take into account a wide variety of factors that may determine the comparative advantage or disadvantage of a particular country, including dynamic factors that change with changes in governments' domestic policies, technologies, consumer preferences and other rapidly evolving domestic and international realities.

ECONOMIC RATIONALES FOR GOVERNMENT INCENTIVES AND DISINCENTIVES TO FOREIGN INVESTMENT

Do the combined insights of the neo-classical theory of free trade and the modern theory of the firm suggest that economic welfare could actually be increased by government incentives or disincentives with respect to foreign investment? In a world where (apart from background rules of contracting) government action does not influence the allocation of productive resources, markets themselves should generate optimal levels of foreign investment. In such a world, government intervention would, almost by definition, distort the allocation of productive resources, inasmuch as disincentives reduced the level of investment below the market optimum, or incentives increased the level above that optimum.

A number of important qualifications to this view have been proposed by trade scholars and merit serious examination.

For example, according to one prominent theory of industrial competitiveness—that of Michael Porter and his associates—much economic development is attributable to the creation of 'clusters' of industries in a given country or region. Clusters are groups of industries that are interdependent or complementary.²⁴ According to Porter, many industries develop in response to the needs of other industries within a particular region or country. Most firms form part of an industry cluster in their home base—they have developed over time a complex web of relationships with suppliers and customers, including suppliers who have incurred sunk costs in developing or adapting products and services to the needs of the particular firm. When a firm establishes operations abroad, it or its foreign subsidiary is likely to continue to source many inputs from the firm's 'home base', thus failing to help build a cluster in the host country. On this view, local content or sourcing requirements may have desirable domestic welfare effects, if they can effectively counter the 'home base' bias identified by Porter, and lead to the development of functioning clusters in the host country.

In addition, host-country local content requirements, or local hiring and manufacturing requirements, may offset the cumulative effects of subsidies or other governmental measures in the 'home base' of the investing firm. The pressures to source in the 'home base' may come less from the market than from government. These pressures may be informal, as well as formal. Formal pressures would include subsidies linked to job creation in the domestic economy and local content requirements in 'home base' government procurement contracts. More informally, the perception that a firm is a good local 'corporate citizen' may be viewed as important in effectively lobbying 'home base' governments on a wide variety of regulatory matters of concern to the firm, whether environmental standards, labour policies or taxation issues. Often, the treatment a firm

receives from its 'home base' government may be linked to the perception and reality that the firm really 'belongs' to that country.

Finally, it may make sense to impose special burdens or requirements on foreign firms where these firms are able to elude more general or neutral forms of redistributive regulation. For instance, multinational corporations, especially those characterized by high levels of intra-firm trade, may find it easy to manipulate transfer pricing²⁵ so as to avoid taxation on actual earnings in a foreign country. Many developing countries, in particular, do not have the sophistication in the design and enforcement of corporate tax regimes required to counter this kind of conduct effectively. As well, manipulation of transfer pricing may allow a multinational corporation to 'cheat' on tariff restrictions by significantly under-pricing imports of inputs. Seen as a response to this kind of behaviour, local content or sourcing requirements may be viewed as a substitute for ineffective tariff protection.

These various considerations do not, admittedly, add up to a decisive argument in favour of local content and related requirements, which may have negative consumer welfare and allocative efficiency effects within the host country. This does, however, weigh against any kind of general assumption that trade would be undistorted, or less distorted, in the absence of such requirements.

Investment and trade protection

There is a complex interaction between foreign investment and trade protection. First of all, foreign investment may occur as a means of jumping tariff walls or avoiding harassment of imports under the trade remedy laws of the host country (so-called 'cooperative protectionism'). If much of its comparative advantage is portable, consisting of know-how, processes and technology, a company may avoid border restrictions simply by manufacturing within the domestic market. Enhanced access to host-country markets generally ranks high among the factors that industries cite as reasons for foreign investment.²⁶

Protection-avoiding foreign investment has both opportunities and risks attached to it. One such opportunity is the strategic use of tariffs or, more likely, administered protection to encourage foreign investment. Where a tariff (or other form of trade protection) induces a foreign producer to relocate production facilities to the protecting state, new jobs in that state are created, and in fact there is a possibility of shifting some of the foreign firm's comparative advantage itself to the host country. For instance, when Honda or Toyota sets up production in Canada or the United States, it brings with it the processes, know-how and so forth that arguably constitute much of its comparative advantage.

It is important, however, to note that in one important sense, consumers in the protecting state will still be worse off than under conditions of liberal trade, because the foreign firm that does relocate will be able to price up to tariff or other trade barriers (e.g. voluntary export restraints (VERs)), thereby still charging consumers prices higher than would be the case without trade restrictions.

A simple example will illustrate this point. A and B are both foreign car manufacturers who have been exporting cars into C. A and B both produce a mid-sized car that would sell, in the absence of protection, for £6,000, and C's consumers do not distinguish

between the car produced by A and that produced by B. Assume that a tariff of 30% is imposed on imports and an elasticity of demand for this kind of car that results in two-thirds of the tariff being passed on to the consumer in higher prices. If A and B both export their cars to C, C's consumers will pay £7,200 per car. If A starts to produce the car in C and comes inside the tariff wall, it may be able to underprice B while still earning more than the non-tariff price per car. As long as consumers do not distinguish between A's car and B's, A will be able to outcompete B at any price below £7,200. The end result will be somewhat less of a consumer welfare loss than if both A and B's cars are imported and subject to tariffs, but consumers will still be somewhat worse off than they would be if there were no protection.

At the same time, because *some* of the rents of protection have been shifted from domestic firms to the foreign firm producing domestically, this may compensate in whole or in part for additional costs incurred in shifting some production to the importing country, including compliance with export performance, technology transfer or other requirements imposed by the host-country government. A disturbing implication, especially for consumer welfare, is that the higher the amount of protection, the more attractive the shift of production is, because the rents from protection that accrue to the domestically producing foreign firm are correspondingly higher.²⁷

The dynamic effects of foreign investment in protected markets

In reality, when foreign firms have come within a tariff wall, they have often found it to be something less than a safe haven. Domestic firms are apt to petition government for relief from the increased competition, frequently arguing that the foreign plants are little more than screwdriver operations aimed at circumventing tariffs or other border restrictions, and that they create less employment per car sold, for instance, than domestic firms, which source domestically to a greater degree and thus create jobs in a wider range of sectors that produce inputs. As a consequence, once inside the tariff wall, foreign firms may well find themselves confronted with new obstacles to exploitation of the domestic market. A prominent example of this has been the effort of the European Union to limit the market share of cars manufactured by Japanese producers within Europe, claiming that these are not really European automobiles.²⁸ Quite commonly, local content requirements are imposed upon the foreign firm.

At one level, such *ex post* adjustments of the 'bargain' between the protecting country and the foreign firm could be viewed as opportunism—once it has sunk substantial costs in the creation of factories or other production facilities, the foreign firm may have little choice but to stay. On the other hand, it is arguable that domestic welfare is improved by such measures—some of the rents from protection against competing foreign firms that accrue to the investing firm are clawed back in the form of boosted sales for domestic providers of inputs.

In theory, there are losses in allocative efficiency since otherwise uncompetitive manufacturers of inputs are being kept in business. However, in the case of inputs for some complex products, arguably the effect is to transfer comparative advantage to input providers as well. Where a firm is unhappy with the quality of domestic inputs but must use them to circumvent the tariff wall through foreign investment, it may still be in the

firm's interest to produce locally but also to work with domestic input providers on quality control, making their products genuinely competitive with imported inputs.

Alternatively (or additionally), the host country may find a way of increasing the rents from protection to compensate the investing firm for the costs of complying with new local content or local sourcing requirements. Quotas and VERs, because of their discriminatory potential, are a simple way of increasing such rents. In return for local content requirements, for instance, a foreign car manufacturer producing domestically could be offered larger quotas on models that it continues to produce offshore. Consumers will benefit from the increased quota (a larger supply will result in somewhat lower costs), but will of course not benefit as much as when quotas on all imported cars in a similar category or competing for the same market are increased or at the limit eliminated. Conversely the foreign firm with the increased quota benefits from greater sales, but at the same time loses fewer of the scarcity rents than it would if the supply of its foreign competitors' comparable products were also increased.

The dynamics of the relationship between trade protection and foreign investment described above have broader implications that should dampen the enthusiasm of advocates of strategic protection. First of all, a clear consequence is to reinforce the dominant position of the strongest firms in a given industry, thereby reducing global competition. In order to play the game, a firm must be large enough and have sufficient resources to expand production globally, investing large amounts of capital in new production facilities. Second, in the host country, a whole new set of jobs is created that, in effect, depends upon continued protection. If comparative advantage has genuinely been transferred to the host country, of course it may still make sense to continue production even after the removal, or reduction, of protection. But the closing of American branch plants in Canada, and their relocation to the United States, that has occurred in the wake of the Canada—US Free Trade Agreement (FTA) is a powerful reminder that jumping the tariff wall may remain a decisive consideration in a plant's continuing operation in the host country. Arguably, as well, this suggests that if protection is to be used to induce foreign investment, then it is important to attach conditions that actually assure a real transfer of comparative advantage (such as requirements for reinvestment and renewal of the plant, training of workers, and technology transfer).²⁹

NON-ECONOMIC RATIONALES AND EFFECTS OF INVESTMENT POLICIES: SOVEREIGNTY AND THE FOREIGN FIRM

The discussion so far has focused exclusively on economic and trade policy dimensions of foreign investment measures. Traditionally, however, many of the reasons for which states have imposed restrictions on foreign investment have been connected with political arguments about sovereignty. These arguments concern a wide range of specific harms that are believed to flow from ownership of a country's productive resources by foreigners. They include national security and defence considerations; the supposed difficulty of subjecting foreign or multinational firms to domestic jurisdiction; concerns that foreign investors or foreign firms will become a vehicle for inappropriate influence

by their home governments on politics and society within the host country; and concerns about the protection of cultural autonomy or distinctiveness.³⁰ We will briefly consider several of these preoccupations with the potential drawbacks of foreign investment.

Defence and national security

A traditional dictum of security policy, at least since Machiavelli,³¹ is that no state should rely on others to furnish the weapons needed for its own defence. Nevertheless, the global arms trade flourishes, and only a handful of relatively industrially advanced nations are capable of manufacturing sophisticated weapons systems in any quantity.

The concern about having one's own arms often extends to autarchy with respect to the inputs necessary to produce those arms, whether steel or computer chips. For instance, as Japan and some European countries have become world leaders in the development and manufacture of products and technologies considered to have critical defence applications, the United States has become increasingly concerned that it may be placing its vital security interests in the hands of foreigners. This concern has been deployed as a rationale for trade protection to sustain uncompetitive national industries considered vital to the security of the United States. It has also resulted in measures intended to control foreign ownership of productive assets in the USA. The United States has justified prohibitions or restrictions on foreign investment in many sectors on national security or related grounds (i.e. vital national interest). These sectors include air transportation, coastal shipping, commercial fisheries, communications, energy resources and real property.³²

In 1988, an amendment was added to the Omnibus Trade and Competitiveness Act (the Exon—Florio Amendment, named after the US legislators who proposed the bill) providing the President of the United States with the authority to block mergers or acquisitions involving foreign firms on grounds that US national security interests would be impaired by the resulting foreign ownership.³³ The Committee on Foreign Investment in the United States (CFIUS) (made up of representatives of various agencies in the US government, including the State Department, the Defense Department, the Commerce Department and the office of the United States Trade Representative) is given the authority to conduct investigations of mergers, acquisitions and takeovers that may threaten US national security. On the basis of these investigations, the Committee makes recommendations to the President as to whether national security interests justify blocking a transaction or altering its terms. Until recently, at least, there have been few investigations, and even fewer instances where the result has been presidential intervention in a transaction.³⁴ Nevertheless, the need to avert the threat of such intervention may, in a wider range of cases, lead to various Voluntary' undertakings by the potential investor, making the terms of the investment more favourable to American interests.³⁵ However, as Graham and Ebert note,³⁶ there is strong pressure in Congress to make investigation of proposed investments mandatory, at least with respect to some sectors. In the post-September 11 world, national security has become an even stronger priority and preoccupation of US policy.

A review of US trade and investment policies by the WTO Secretariat in January 2004 noted:

During 1988–2002, the CFIUS initiated investigations of 18 acquisitions; a total of 1,434 acquisitions were notified to the CFIUS [footnote omitted]. A recent study observes in this regard that the CFIUS has initiated investigations under only limited circumstances and that, as a matter of practice, it tries to avoid the use of investigations and presidential determinations [footnote omitted]. During this period, the President blocked an acquisition notified under the statute only once, in 1989, and no acquisition has been blocked or divested since then. In May 2001, the CFIUS concluded its review of the acquisition of the Silicon Valley Group Inc. by a Dutch semiconductor equipment manufacturer, ASM Lithography NV. The acquisition was approved but some concerns have been expressed about the length of time taken to complete the review process and the substantial restructuring of the proposed acquisition that was asked for as a condition for its approval [footnote omitted]. In the context of this Review, the authorities indicated that, in the wake of the 11 September attacks, issues relating to terrorism are given heightened consideration in the review of submissions under the Exon Florio provision.

(Trade Policy Review—The United States, Report by the Secretariat, WT/TPR/S/126, 17 December 2003, p. 29)

Does foreign ownership of strategically sensitive enterprises really jeopardize security? First of all, if in fact foreign producers do have a monopoly over products or processes that are vital to a country's security interests, the country in question is certainly better off having those products or processes developed within its borders. Dependency on imports is much riskier since a foreign government can, in effect, control the export of the needed materials. In a national emergency, by contrast, domestic production facilities (even though foreign-owned) could be commandeered by the government, or made directly subject to its orders.

What, however, of the case where there currently exist two suppliers of a given technology or product, one domestic and one foreign, and where the foreign supplier chooses to buy out the domestic supplier? Here, the acquisition may be motivated by the desire to obtain a monopoly, and in fact could result in *all* production, or much of it, being moved offshore. In such an instance, it may be quite justifiable to weigh carefully national security implications within any overall review of the impact of such an acquisition.

In addition, foreign firms in the defense sector are likely to have particularly close relationships with their home-country government—often reflected in the presence of former politicians and senior bureaucrats on their board of directors, government subsidies, procurement and research and development contracts, or partial government ownership. Where this is the case, some concern that foreign powers will be able to exercise influence or control over the firm's strategy, and have privileged access to its products or research, may be warranted. Again, however, this concern would be justified mainly where a merger or acquisition results in a monopoly in a particular product or process.

In the instances just discussed, national security concerns may in fact be warranted with respect to foreign investment. However, in the United States in particular, the national security argument has been extended far beyond the case of very sensitive defence industries to sectors that produce a wide variety of inputs into military products, or whose production facilities might, in wartime, need to be converted to military uses (steel, cars, civil aircraft). In most of these instances, a variety of producers, domestic and foreign, currently exist. Taken to its logical conclusion, the argument would end up justifying something close to complete autarchy, since there are few sectors of civilian production that do not contribute something of importance to the materiel needed, in the broadest sense, to sustain an all-out war effort.

Furthermore, blocking a foreign takeover or merger will itself far from guarantee either the continuation of a domestic source of supply for the products in question or protection against foreign influence. For example, where the merger or acquisition is required to rescue the domestic firm, or to ensure its continuing viability, the alternative may well be bankruptcy, with the result that the foreign firm becomes the monopolist anyway but produces abroad, and hence the source of supply becomes even more insecure. Hence, in a number of instances, one suspects that national security arguments against *foreign* acquisitions are disguised attempts to attract a government-supported bail-out at home, or more protection. Once the firm is considered a domestic producer vital to national security, the logical consequence is not just that foreigners should be prevented from acquiring it, but that its survival as a domestic firm should be guaranteed by the state.

Inadequate regulatory or political control over the foreign investor

The multinational firm is often described as a kind of power unto itself, able to slip through the normal control of national jurisdictions through the global diffusion of its activities. There are few inherent legal constraints on the application of domestic jurisdiction to the activities that multinational corporations engage in within a particular country; however, there may be significant practical constraints, where the bulk of the firm's assets and much of the information about its activities and decision-making are located abroad. Of course, while it is true that offshore activities and decisions of a foreign multinational may affect the regulatory interests of its host country, so may the foreign activities and interests of the host country's *own* firms. Thus, the problem concerns both inward and outward foreign investment.

In some sectors, the regulatory issues may be particularly acute. In the case of financial services, for instance, regulators may be concerned with the overall stability of an institution, the quality of its investments, etc. Ultimately, domestic deposit-holders are dependent upon the stability of the overall institution, including the soundness of its lending practices and other activities abroad. As is illustrated by the Bhopal disaster, regulatory issues may also arise where multinationals are engaged in high-risk activities in a host country, but where they retain elsewhere the assets necessary to satisfy potential liabilities for these risks, or information about the risks.

These kinds of regulatory issues may justify some kinds of differential treatment of foreign investors—the requirement to carry liability insurance, to maintain a minimum

level of assets within the host country, or to post a bond or a deposit to guarantee regulatory compliance.

Extraterritoriality

Another set of concerns about foreign investment may be considered the 'mirror image' of the concern about lack of domestic control of the foreign-owned company or subsidiary, that is the possibility that foreign ownership will result in the extraterritorial application of the laws and regulatory authority of the firm's home country to its activities in the host country.³⁷ Extraterritoriality has been a particular concern raised by the explicit extraterritorial sweep of a number of US regulatory regimes. One important example is export controls. The United States has sought to prevent foreign subsidiaries of American firms from exporting products to countries that are embargoed by US law, such as Cuba.³⁸ From the perspective of the law of the GATT, this can rightly be seen as an interference with the trade relations of another Contracting Party. However, export controls based upon national security considerations are explicitly exempted from normal GATT rules by Article XXI,³⁹ although it is highly questionable whether even Article XXI provides scope for a Contracting Party to interfere with exports and imports flowing between another Contracting Party and a third state.

It bears emphasis that extraterritoriality is not a problem that is limited to the context of foreign investment. Ownership by nationals is but one basis among many that the United States, for instance, uses as a grounds for exercising jurisdiction beyond its borders. For instance, US antitrust law is applied extraterritorially not just to American-owned companies, but to any activity that materially affects US commerce including, for example, participation of foreign-owned firms in cartels with US firms that restrict competition in the US market.⁴⁰

The most promising avenue for resolving problems of extraterritoriality is not restrictions on investment, but the evolution of multilateral processes to deal with particular cases of conflicting exercises of jurisdiction, and eventually to evolve a set of detailed principles or guidelines broadly consistent with international law norms on state sovereignty. In this regard, it should be noted that a 1991 Decision of the OECD Council allows any Member state of the OECD to refer to the Committee on International Investment 'any problem arising from the fact that multinational enterprises are made subject to conflicting requirements'.⁴¹ With respect to extraterritorial application of antitrust laws, the OECD has developed a separate process intended to address directly issues of restrictive business practices and the multinational enterprise.⁴² A number of approaches to inter-jurisdictional conflict have been suggested, including harmonization of domestic competition laws and designation of a lead jurisdiction for review of international mergers.⁴³

In addition to the matters discussed above, developing countries have traditionally had an additional (although often overlapping) range of concerns about foreign investment, which have been used to justify severe restrictions on the activity of foreign firms. These have included concerns that foreign investors often will deploy technologies that are inappropriate for exploitation of and development of local skills for best advantage, and that may aggravate or create balance of payments problems by heavy reliance on imported inputs in the production process; and that foreign investors will perpetuate

existing patterns of Southern dependency in exploiting cheap, unskilled labour in developing countries without transferring the skills and technologies required for economic development.⁴⁴

On balance, the recent empirical evidence seems to suggest that foreign direct investment has had a positive impact on growth and development in LDCs.⁴⁵ In addition, it appears that on a comparative basis, developing countries with relatively restrictive policies towards foreign investment have experienced much lower rates of economic growth over the last 30 years than those (e.g. Malaysia) with relatively open policies.⁴⁶ However, it may be that what distinguishes, at least in part, the countries with more open policies is that instead of placing general (and severe) restrictions on, for example, repatriation of earnings or the right of establishment as such, these countries negotiated specific agreements on issues like technology transfer and local employment with individual firms. Thus, instead of adopting either a generally negative stance towards FDI, or a completely open attitude, they proceeded in a more selective fashion to impose requirements or conditions on some foreign investors, where it was believed this would serve the interests of domestic economic development. This case-by-case approach, however, is more transaction-cost intensive and heightens the risk of corruption in the administration of foreign investment policies.

This being said, in the aftermath of the LDC debt crisis (which has resulted in the substantial reduction of new debt financing available to many developing countries), and given what many observers consider to be a world shortage of capital (considering, for instance, the substantial needs of the newly liberalizing countries in Central and Eastern Europe), many developing countries have adopted a much more liberal attitude towards foreign investment, and see the issue for governmental policy much more as that of attracting foreign investment rather than restricting or limiting it. This led *The Economist* magazine to remark, in a recent survey of multinationals, that

too many governments see foreign investment as a shortcut to prosperity, bringing in skills, capital and technology to push their countries rapidly from the 1950s to the 1990s... Those governments that rely too heavily on multinationals are likely to look for a foreign scapegoat when inflation heads for triple figures, unemployment fails to drop and demonstrators surround the ministry⁴⁷

The impact of the Mexican peso crisis of 1994–95 and the crisis in Asian capital markets in 1997 on FDI suggests that this prediction of *The Economist* was overly pessimistic. These crises involved massive outflows of *portfolio* equity investment, but neither crisis has led to a devastating impact on FDI flows or the FDI climate in the affected countries.

Foreign investment and cultural diversity

A persistent critique of multinational corporations is that they present a powerful threat to cultural diversity. Recently, Naomi Klein, in a best-selling book, has accused multinationals of creating a global 'brand' culture, which suppresses or drives out of the market local creativity and difference.⁴⁸ In a provocative and well-researched study, Yale law professor Amy Chua documents how economic dominance by minority cultures in a

wide range of developing countries has been perceived as a threat by the majority, leading to intensification of cultural conflict. While much of her focus is indigenous minorities (such as East Asians in Kenya), she extends her analysis to the effects of foreign ownership as well.⁴⁹ Chua makes the crucial point, to which we subscribe, that the presence of multinational corporations through foreign investment in developing countries need not have culturally pernicious effects—it depends on how those corporations *behave*. As she observes, in poor countries, multinationals that are good global corporate citizens can do a lot, using their wealth, to help regenerate or create local cultural institutions.⁵⁰ Shutting the door to foreign investment will not create the resources to preserve and enhance national and local culture: shaping how foreign investors behave, through both voluntary and regulatory approaches, is the better strategy.

ALTERNATIVE APPROACHES TO INTERNATIONAL DISCIPLINE OF FOREIGN INVESTMENT MEASURES

The pre-Uruguay GATT

Investment measures and the General Agreement: an overview

Our discussion in ‘Foreign investment and trade theory’ and ‘Economic rationales’ (this chapter) has emphasized the complexity of the relationship between foreign investment measures, liberal trade and protectionism. The dramatic expansion in foreign investment in recent years has depended heavily on liberal rules governing trade in goods, yet this expansion has also provided new opportunities and incentives to exploit the rents from protection, thus leading to new kinds of protectionist pressures. At the same time, the interdependencies created by the globalization of production have brought into being new interests that would lose enormously from a fundamental unravelling of the liberal trading order.

As a matter of law, only a few of the investment measures that can be deployed strategically along with trade protection arguably fall within the ambit of the GATT. The most clear-cut example is that of local content or sourcing requirements, which explicitly discriminate against imports and in favour of like domestic products, hence violating the National Treatment obligation of the GATT (Article III:4). Export requirements are a somewhat more complicated case. As will be discussed below, a GATT panel decision with respect to Canadian foreign investment measures held that export requirements did not *per se* violate any provision of the General Agreement. However, as we will argue, export requirements linked with a subsidy to the foreign investor may in some circumstances constitute an export subsidy, the only kind of subsidy explicitly banned in the General Agreement (Article XVI). Export requirements may also lead to dumping, inasmuch as they lead to the product being exported below cost or at a price lower than that which applies in the domestic market.

In addition to local content and export requirements, the law of the GATT may be violated by trade balancing requirements, which typically limit the value of what a foreign investor is allowed to import into the host country to the value of exports. Here,

two sets of provisions in the GATT are relevant. First of all, the limitation on imports might be considered, like a domestic sourcing requirement, as a form of discrimination against imported goods. However, it might be argued that this need not be the result, since with a trade balancing requirement (unlike a direct local sourcing requirement), a foreign firm wishing to import more inputs will be permitted to do so if this is balanced by an increase in exports of finished products (and, as we have just mentioned, *export* requirements are not as such illegal under GATT). A stronger case can be made that trade balancing restrictions violate the Article XI ban on quantitative restrictions, as they place (albeit variable) quantitative limits on imports (see for example the report of the panel in the *India-Autos* case). Because Article XI bans restrictions on exports as well as imports, a *prima facie* violation of Article XI might also occur where the host country places limits on the percentage or amount of production that the foreign firm can export, i.e. requiring that a portion of the production be set aside for the domestic market. Such a requirement might be imposed where, perhaps for technology transfer reasons, a country wishes domestic users to have access to what is being produced by the foreign firm. This requirement might go hand in hand with an additional provision that the percentage of production in question be made available to domestic users for local currency or at a lower than world-market price.

Additional investment measures that implicate GATT law are requirements that foreign investors reinvest a percentage of earnings within the host country and, conversely, limitations on the repatriation of profits in convertible currency. In the former communist countries (of which several were long-standing GATT Members), such requirements were commonplace, and they still exist today in many developing countries. Arguably, both reinvestment requirements and limitations on the repatriation of profits could constitute violations of Article XV of the GATT, which requires Contracting Parties to adhere to International Monetary Fund rules with respect to balance of payments and exchange arrangements. However, as has been discussed in detail in Chapter 4, these rules allow considerable scope for developing countries to restrict foreign exchange, including exchange of local earnings into foreign currency. In addition, it should be noted that trade balancing requirements or other investment measures that would otherwise be in violation of Article XI of the GATT may nevertheless be saved by Article XII, which permits some, mainly non-discriminatory, quantitative restrictions where necessary to address a balance of payments crisis. Although the drafters clearly had temporary measures in mind, Article XII has been used to sustain much longer-term restrictions. In addition, Article XVIII B:9 explicitly authorizes a broader range of quantitative restrictions—including discriminatory quantitative restrictions—where these are measures undertaken by developing countries to protect or enhance their balance of payments.

The *FIRA* Panel Decision

The *FIRA* Panel Decision⁵¹ represents the only case where foreign investment measures were the central focus of a panel prior to the WTO, and therefore deserves detailed analysis. At issue were various undertakings obtained from foreign investors pursuant to Canada's Foreign Investment Review Act. The Act established a governmental agency, the Foreign Investment Review Agency, to screen investment proposals by foreign

interests. The Agency was to review the proposals and either accept, reject or modify them. The essential criterion was whether the investment would be of significant benefit to Canada, significant benefit being defined to include increases in employment and exports, technology transfer, and advancement of 'national industrial and economic policies'. Under the Act, foreign investor applicants were able to make undertakings with respect to any aspect of the operation of their business in Canada, with a view to more favourable treatment of their application. Such undertakings were not, however, mandatory or a formal prerequisite for the success of an application. Once an investment application was approved, however, the undertakings were legally enforceable.

The United States argued that three kinds of undertakings violated provisions in the GATT: local content, local manufacturing and minimum export.

Local content and local manufacturing requirements

With respect to local content requirements, the main argument was that these undertakings violated Article III:4 of the General Agreement (National Treatment). Given that the undertakings were not formally *required* by the Canadian law, a threshold issue was whether they could be considered, for purposes of Article III, as 'laws, regulations, or requirements'. The United States argued that such undertakings could not be viewed as simply voluntary, since no firm would make them unless it would gain some advantage or avoid some penalty by doing so. The panel, however, sidestepped the issue of voluntariness, simply stating that 'private contractual obligations entered into by investors should not affect the rights which contracting parties, including contracting parties not involved in the dispute, possess under Article III:4'.

A second issue was raised by the Canadian argument that these undertakings merely constituted predictions of what foreign investors intended to do based upon commercial considerations.

The panel rejected this argument, pointing out that the specific content of some of the undertakings showed that firms were expected to act in a manner not consistent with commercial considerations or in explicitly discriminatory terms, for instance binding themselves always to purchase a Canadian product when available on similar terms to an import. The panel's approach seems justified in light of the economic analysis developed earlier in this chapter. Because the foreign firm producing domestically can capture rents from protection by pricing up to the tariff, there are good reasons to believe that commitments investors make about how much local sourcing they will undertake are not simply in the order of a prediction about how they will behave in future in accordance with market forces, but also reflect a 'price' investors are willing to pay to capture some of the rents of protection.

A further important issue raised by the economic effects of local content or local manufacturing undertakings is that of injury. The panel chose to sidestep this issue, noting that 'understanding GATT practice, a breach of a rule is presumed to have an adverse impact on other contracting parties' (para. 6.4). It is not obvious that foreign investors who make undertakings are worse off under a scheme for screening foreign investment than under circumstances where investment is unimpeded. As discussed earlier, the rents from protection that a foreign investor gains from coming within the tariff wall (i.e. from being able to price up to the tariff) may be substantial, and may more

than compensate for the costs of compliance with domestic content or other performance requirements. Also, such requirements may in some situations be balanced with explicit subsidies or other incentives to investment (such as tax holidays). There is clearly, however, a trade-related injury from local content and local manufacturing requirements that is borne by producers and suppliers of imported goods that would otherwise compete favourably with locally produced imports. These producers *may*, of course, include the foreign investor itself, or other firms from its 'home base' country—but they may be from other countries entirely.

Thus, it is incorrect to conceive of the debate over the trade effects of these measures as simply a conflict between host-country and home-country interests. Even though developed countries are more likely to be home than host countries, developing countries or other countries that are not major sources of foreign investment can still lose significantly from investment restrictions in the nature of local content requirements, if the result is discrimination against their exports.

Export performance requirements

The *FIRA* panel also considered the legality of export performance requirements under the GATT. The United States had argued that these requirements violated the obligation in Article XVII:1 of the GATT for certain enterprises to act 'in accordance with commercial considerations'. The panel found that this obligation only applied to state trading enterprises as defined in the general provisions of Article XVII, and therefore was not relevant to foreign investors. However, the panel also found that 'there is no provision in the General Agreement which forbids requirements to sell goods in foreign markets in preference to domestic markets. In particular, the General Agreement does not impose on contracting parties the obligation to prevent enterprises from dumping' (para. 5.18).

Here, the panel seems to have overlooked the spirit (although perhaps not the strict letter) of the prohibition of export subsidies in Article XVI:2B of the General Agreement. The panel's general position—that undertakings are not made gratuitously but in exchange for a benefit that flows from the host-country government to investor—would argue in favour of the view that in fact export undertakings are likely to be subsidized, at the very least by the rents from protection that the host government 'grants' to the investor in authorizing the investment. Article XVI:4B, furthermore, prohibits Contracting Parties from granting 'directly or indirectly any form of subsidy' on exports, at least where the result is a lower price for exports than the domestic price of the product.

The case for deeming export performance requirements as equivalent to an export subsidy is, of course, particularly strong where an investor is attracted to the host country by explicit financial incentives to establish operations there. However, at the same time, the GATT rules on subsidies do not refer explicitly to investment incentives as such. Some such incentives may constitute countervailable subsidies under the WTO Subsidies and Countervailing Measures Agreement, but only because domestic *products* are being subsidized, not because of the impact of such subsidies on the location decisions of foreign firms.

The evolution of the GATT rules: TRIMs and the Uruguay Round

Clearly, the GATT rules only extend to a relatively narrow range of investment measures with direct and immediately identifiable impacts on trade. In the Uruguay Round of GATT negotiations, the United States in particular sought a much more comprehensive GATT code on investment based upon the principle of free access to foreign markets. On this free access approach, the investment measures disciplined by the GATT would no longer be limited to measures such as local content requirements that discriminate against imported products, but would extend to a potentially wide range of domestic policies of Contracting Parties that create barriers to inbound foreign investment regardless of whether specific trade impacts are present. The free access approach, it should be noted, gains some normative weight from the allocative efficiency arguments for liberal investment policies explored in 'Foreign investment and trade theory' (earlier in this chapter). These imply that, in principle, almost any incentive or disincentive to investment can be regarded as a distortion of the optimal global allocation of productive resources. However, under real-world conditions of imperfect competition and tariff and other trade restrictions, important qualifications exist on these allocative efficiency arguments—qualifications explored earlier in this chapter. In addition, the free access approach provides no obvious means of weighing against allocative efficiency considerations the non-economic rationales for investment restrictions discussed above in 'Non-economic rationales' (this chapter).

Unlike the United States, most other Contracting Parties were sceptical of the free access approach, and saw the task of the Uruguay Round negotiations on trade-related investment measures (TRIMs) as that of developing more detailed and explicit rules with respect to measures that appear inconsistent with well-established GATT principles, such as National Treatment with respect to products. This suggests a cautious extension of the kind of analysis undertaken by the *FIRA* panel to a somewhat broader set of measures (such as trade balancing requirements or export performance requirements) that directly affect trade flows. A concrete example will elucidate how the much more comprehensive US view of what is trade-distorting conflicts with the more text-bound view of other Contracting Parties. The USA views technology transfer requirements as distorting trade, in that a possible result is to transfer to the host country the capacity to develop products and processes that it would otherwise have to import from the home country.⁵² Other countries question whether this impact is very well established: it might be the case, for instance that, absent such a transfer, some developing countries would not be able to afford such products and processes at all, and therefore that imports would be negligible.⁵³

The Uruguay Round Final Act reflects a rather subtle compromise between these differing perspectives.⁵⁴ On the one hand, there is a binding obligation not to apply any investment measures 'inconsistent with the provisions of Article III or Article XI of the General Agreement' (Article 2(1)). There is thus a clear reaffirmation of the principle that existing GATT provisions do apply to some investment policies. Moreover, an 'illustrative list' of such measures is provided, which includes local content, sourcing and some trade-balancing requirements (which violate National Treatment), and import and export restrictions (which violate the ban on quantitative restrictions, in Article XI of the General Agreement).

On the other hand, the illustrative list does not contain any of the measures with more indirect or questionable effects on trade for which US negotiators had been seeking explicit disciplines, such as technology transfer requirements. In addition, the existing exceptions with respect to Article XI that apply to developing countries are reaffirmed (Article 4). As well, developing countries were provided with transition periods (five years and seven years in the case of the least-developed countries) for elimination of TRIMs that offend Article III and/or Article XI (Article 5).

However, it should also be noted that the illustrative list is just that—the text leaves it open for GATT panels to find that measures not on the list violate the GATT, and in addition, the fact that no list of ‘green light’ or explicitly non-GATTable measures is provided means that no further protection is extended to Contracting Parties against unilateral retaliatory action by the United States on the basis of its market access approach. Indeed, additional legitimacy could well be conferred on the US approach in that the Final Act provides for a five-year review of the provisions on TRIMs, possibly with a view to including new provisions on ‘investment policy and competition policy’ (Article 9). The Final Act Agreement on Trade Related Investment Measures also calls for the creation of a Committee on TRIMs whose functions are, *inter alia*, to ‘monitor the operation and implementation of’ the Agreement. In the *Indonesian Autos* case (not appealed), the panel held that the TRIMs Agreement has ‘an autonomous legal existence’ from the GATT (para. 14.62). It also held that the Agreement could apply to performance requirements that were a condition for receipt of subsidies, even if the subsidy measures themselves might be covered by the Agreement on Subsidies and Countervailing Measures (paras 14.47–14.55). The panel further found that the local content requirements could be covered by the TRIMs Agreement, even if these requirements, or the advantages conditioned upon meeting them, were not targeted at foreign investors, but rather were generally applicable to enterprises, whether domestically or foreign-owned (para. 14.73).

In subsequent cases, the WTO dispute panels have largely avoided directly addressing claims under TRIMs, by choosing to consider the related claims of violation of National Treatment prior to examining alleged violations of TRIMs. In the *India—Autos* case,⁵⁵ this resulted in a finding of a National Treatment violation and the panel then declined to go further and consider the TRIMs allegations on grounds of ‘judicial economy’ (paras 7.151–7.161), an approach based to some extent on the very cursory discussion of TRIMs in the early *Bananas* case, where, however, the panel appeared to think it was considering the claims simultaneously.⁵⁶ In the *Canada—Autos* dispute,⁵⁷ the panel found that the particular measure complained of did not violate National Treatment Article III:4 of GATT, and therefore there could be no violation of the TRIMs Agreement (para. 10.150). In *Canada—Autos*, the panel also rejected an argument by Canada that a different aspect of its policies did *not* violate Article III:4, on the grounds that the measure in question was not in the TRIMs illustrative list of investment measures contrary to Article III:4—the panel simply noted that since the list was non-exhaustive, the fact that a particular measure was not on the list said nothing in itself about whether the measure could be a National Treatment violation (para. 10.89).

The view that it is appropriate to consider a claim of National Treatment violation prior to a claim of TRIMs violation appears at odds with the view of the Appellate Body in the recent *Sardines* case (discussed in Chapter 7 on domestic health, safety and other

technical standards) that claims under a more specific or specialized agreement ought to be considered prior to those under more general norms like National Treatment (a view also expressed in the early Appellate Body ruling in *Bananas*). In the *India—Autos* case, the panel made the rather puzzling comment that the TRIMs Agreement might not be considered more specific than GATT Article III:4 (para. 7.157). This seems bizarre—after all, what is the TRIMs Agreement if not an elaboration of Article III:4 as it applies to a specific subset of measures (investment measures, in this case)?

The Multilateral Agreement on Investment (MAI)⁵⁸

Background

As noted, negotiations on investment in the Uruguay Round failed to yield a result even approaching a comprehensive set of rules on foreign direct investment, the Uruguay Round TRIMs Agreement being little more than an affirmation and modest strengthening of the *status quo* of the 1947 GATT, particularly as interpreted in the *FIRA* panel ruling. This failure of the Uruguay Round (at least from the perspective of liberal trade) was often attributed to the recalcitrance of developing countries. Not long after the completion of the round, thinking in Western trade policy circles began to turn to alternative venues and mechanisms for achieving a set of comprehensive liberalizing commitments on investment. This thinking suggested that among an increasing number of countries, there was (in the words of one advocate) ‘a convergence of attitudes’⁵⁹ about the relationship of investment policy to the interests of the regulatory state, i.e. in the direction of economic liberalism. Among this expanding group of like-minded countries, it would be easier to achieve agreement on far-reaching investment rules, beginning with already developed countries and soon extending to newly industrializing countries, and then to others competing for foreign investment, which would not be able to afford not to go along. In 1995, thinking along these lines was reflected in an OECD Report to Ministers, which proposed the negotiation of a Multilateral Agreement on Investment within the OECD forum, but open to accession to non-OECD countries prepared to accept its strictures.⁶⁰ The timing and venue could partly be justified on the rather benign grounds that the existing OECD Liberalisation Codes (discussed earlier in this chapter) required renewal, and one could build from these existing instruments towards a comprehensive agreement. Various drafts were produced from 1996 through April 1997, all of them reflecting a general architecture (including National Treatment, Most Favoured Nation (MFN) and dispute settlement), but all of them also with gaps and alternative texts indicating important areas where consensus was elusive. We have chosen to base our analytical overview of the initiative on the last draft text, indicating its relationship to some of the earlier versions, and also where agreement remains elusive, and so the text is bracketed or alternative wording is presented, neither or none of which has yet attained a consensus. In early December 1998, the MAI negotiations were formally halted.

The draft Multilateral Agreement on Investment⁶¹ had at its core the principle that governments must not discriminate against, or among, foreign investors from countries that have signed the Agreement—the obligations of National Treatment and MFN respectively (Article III, 1–3). These obligations are subject to certain general exceptions,

as well as reservations to be filed by individual signatories, which are in turn governed by the principles of standstill and (possibly) rollback. Standstill signifies the notion that any measures reserved may not be more restrictive of investment than existing measures. Rollback connotes the idea that, over time, countries' reservations will be subject to an ongoing process of scrutiny, and (hopefully) negotiated removal.

The rules on performance requirements in the draft MAI were quite similar to those in NAFTA—minimum export, domestic content and domestic sourcing requirements are all prohibited (it will be recalled that these last two kinds of requirements were already found to violate the GATT by the *FIRA* panel, an approach reinforced by the illustrative list in the Uruguay Round TRIMs Agreement). More controversially, especially in light of the potential adoption of this text by developing countries, the draft MAI contained a prohibition on technology transfer requirements as well, except as a competition law remedy. Initially, it was intended that the MAI would also cover, in addition to requirements, investment *incentives*, which would have been a major advance over NAFTA. However, disagreement on how to do this proved intractable, with some Parties objecting to any meaningful disciplines. Therefore, the draft MAI text is silent on these measures.

In some areas, such as movement of key personnel, the MAI went appreciably beyond NAFTA in securing a liberal investment regime. In other areas, such as protection of investments against 'expropriation' and dispute settlement, there were important issues to be resolved, which, however, were already present in the NAFTA in a not dissimilar form. Finally, the interface between MAI obligations and legitimate domestic policies in areas such as environment and culture—and the relationship between liberal investment and labour rights—were not resolved.

By May 1997, agreement had been reached between the negotiators on many elements of the basic architecture of the MAI, including MFN and National Treatment. However, important differences of view between countries were surfacing with respect to the relationship of the MAI to environmental and labour standards and cultural policies.⁶² As well, considerable disagreement existed concerning whether and how investment incentives should be disciplined, the result being that incentives were simply not dealt with in the draft. At the same time, however, a vigorous public debate was beginning in OECD countries such as Canada, the United States and Australia concerning the impact of the MAI on the democratic regulatory state in general, and on environment, labour rights and cultural protection more specifically. Canadian activist groups were at the forefront of bringing the MAI negotiations into public view. In January 1997, when no public version of the negotiating text was available, Canadian activists obtained a confidential version, and began circulating it to like-minded groups, using the internet as an effective dissemination tool. In April 1997, accounts of the MAI began to appear in the popular press, and governments were placed on the defensive to justify their negotiating positions to the public at large.⁶³ Some of the groups in question had unsuccessfully challenged the Canada-US FTA and the NAFTA, often making grossly exaggerated and hypothetical claims about the damage likely to flow from these agreements to the welfare state. With the MAI, their approach was shrewder and more careful. They linked a more general critique of globalization driven by corporate interests with a highly plausible analysis of specific provisions of the draft MAI, or omissions from it, as well as a critique of the way it was negotiated. While many groups took

different and overlapping positions, the thrust of the overall attack is well expressed by Tony Clarke and Maude Barlow:

We do not wish to leave the impression that we reject the idea of a global investment treaty. We are well aware that transnational investment flows have been accelerating at a rapid pace and that there is a need to establish some global rules. But the basic premise on which the draft versions of the MAI have been crafted is, in our view, largely flawed and one-sided. It expands the rights and powers of transnational corporations without imposing any corresponding obligations. Instead, the draft treaty places obligations squarely on the shoulders of governments...Meanwhile the MAI says nothing about the rules that transnational corporations must follow to respect the economic, social, cultural, and environmental rights of citizens.⁶⁴

The secrecy surrounding the negotiations and the usual cloak-and-dagger behaviour by foreign ministries when faced by early enquiries about the course of the negotiations gave *prima facie* credence to a conspiratorial view of the whole undertaking. The fact, noted above, that the draft MAI did not contain an environmental or health and safety exception even comparable to that existing in the 1947 GATT lent credibility to the notion that only the interests of capital were reflected in the Agreement.

While activist groups were given credit or blamed (depending on the perspective of the observer) for 'killing' the MAI, informed sources close to the negotiations had been predicting failure long before a public debate on the draft MAI was provoked. As noted, the initiative to proceed with evolving investment rules in the OECD was based on the premise (often unstated) that developing countries had been the main obstacle to the achievement of a comprehensive TRIMs Agreement in the Uruguay Round, and that without them consensus would be much easier to reach. In fact, before public controversy became intense, differences of views among OECD countries about culture and labour rights were already surfacing. As well, concern about the Helms-Burton legislation led to a number of proposals concerning extraterritoriality and conflicting requirements, which would have surely met with total rejection by the United States. Furthermore, the removal of investment incentives from the coverage of the Agreement represented a major disappointment for some negotiating Parties. The MAI negotiations are, in fact, an illustration of the fallacy that agreement is likely to be easier when negotiations are limited to a smaller group of countries, with supposedly more comparable economic systems.

Of course, part of the MAI strategy—an essential part—was that developing countries would be invited to accede to the MAI, and that those who were seeking to attract FDI would find themselves unable to afford not to. However, the rapid growth in FDI, including and especially inflows to developing countries, cited earlier in this chapter shows that investor confidence is not dependent upon adhesion to this kind of agreement. Moreover, the notion of simply signing up these countries betrays a naïve view of the accession process, as is well illustrated by attempts to 'extend' NAFTA to other countries in Central and Latin America. In any agreement such as the MAI, any accession is likely to involve country-specific reservations, that will potentially change the balance of

concessions in the overall agreement. Also, the proposed accession of a country to this kind of agreement is unlikely to take place without affected economic and other interests raising issues about the commercial policy as well as environmental and labour rights performance of the country in question.

Another major difficulty with the MAI as a self-standing treaty, noted even by some of the more insightful and cautious supporters of global investment rules, such as Pierre Sauve and Ed Graham, is the relationship of such a treaty to overlapping existing multilateral rules as reflected in the GATT, and the WTO TRIMs, Services, and Intellectual Property Agreements. This raises serious issues concerning the respective jurisdiction of MAI and WTO (and perhaps NAFTA) dispute settlement bodies, in addition to substantive and temporal issues with respect to the applicability of provisions of the various Agreements and their interaction. Effort is made in the draft MAI text to be sensitive to these problems, but they are far from being resolved. In fact, at the outset, an MAI separate from multilateral rules would create considerable uncertainty.

Back to the WTO

The WTO Singapore Declaration in 1996 required the establishment of a WTO Working Group on the Relationship between Trade and Investment (WGTI). With the failure of the MAI talks at the end of 1998, the focus of those seeking multilateral rules on investment again shifted to the WTO. In addition to several Asian countries (e.g. South Korea), the EC provided a main impetus to insist that investment negotiations be part of the next round of WTO negotiations (along with competition policy). The Doha Declaration instructed the WGTI to consider and clarify seven issues: scope and definition; transparency; non-discrimination; modalities for pre-establishment based on a GATS-type positive list approach; development provisions; exceptions and balance of payments safeguards; and consultation and the settlement of disputes. A formal decision as to whether to launch negotiations based upon the preparatory work of the WGTI was supposed to be taken at the next WTO Ministerial. (The concept of 'pre-establishment' refers to conditions or constraints that an investment faces in entering the host country in the first place (for example a prohibition on foreign ownership in a certain sector, like telecommunications or water) in contrast to 'post-establishment' issues, which concern how the investment is treated once it has been permitted entry.)

The fact that the Doha Declaration fell short of a full commitment to negotiations reflected the concern of many developing countries that such an agreement might not be in their interests—especially if it prevented the use of investment incentives in industrial policy, and if it came with something akin to the investor state provisions that had generated such controversy in NAFTA, allowing damages awards against governments for actions such as changes in government regulation negatively affecting the value of an investor's property ('regulatory takings'). Some of the concerns of developing countries were articulated by an Indian trade policy analyst in the *Financial Times* in the lead-up to Cancun:

Many countries, such as Japan, South Korea, Taiwan and China, have registered higher growth without liberalizing their investment regimes. The existing frameworks of investment liberalization are highly biased in

favor of protecting foreign investors' rights. Countries enjoy correspondingly less freedom to adjust their investment policies to suit their development needs. Although the EU favors the adoption of a 'bottom up' approach to investment, which allows countries to select the sectors they wish to liberalize—along the lines of the General Agreement on Trade in Services—there is no guarantee that it would give member countries the policy freedom they need. As seen during the ongoing GATS negotiations, it puts added pressure on countries to make wider commitments over the years. Likewise, an agreement covering many but not all developing countries would also be problematic, as it would in effect compel outsiders to join later on.⁶⁵

It is not surprising that the WGTI discussions that took place after Doha and before Cancun generated little consensus. Writing on the eve of the Cancun meeting, in September 2003, Pierre Sauve and Maryse Robert noted:

Major controversies [exist] within the WGTI...such as the breadth of the definition of 'investment' and 'investors' and the (potentially far-reaching) implications thereof; the extent of transparency obligations, notably in respect of prior notification requirements; the degree and form of technical assistance required to help developing countries overcome a widely-perceived analytical deficit in this area; the operational modalities of development provisions...; the desirability of replicating a GATS-like approach to scheduling liberalization commitments...as well as the links between FDI and technology transfer.⁶⁶

At Cancun, the EC's insistence on the launching of investment negotiations and the equally adamant stance of a large group of developing countries that investment should be put on hold were a major factor, in the breakdown of the meeting; in the final hours, EC Trade Commissioner Pascal Lamy made the dramatic concession of accepting that both investment and competition be dropped from the Doha agenda, but this proved too late to reverse the negative dynamics of the meeting. In a letter to fellow trade Ministers in early 2004, United States Trade Representative Robert Zoellick expressed the US position that investment (and competition) should be removed from the Doha agenda. With neither the USA nor the EC now prepared to support negotiations in the face of developing-country resistance, investment is effectively off the table at the WTO for the foreseeable future.

The NAFTA

Articles 1102 and 1103 of NAFTA, respectively, establish National Treatment and MFN obligations with respect to investors *and* investments of other NAFTA Parties. National Treatment is required with respect to establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments. Thus, in effect, the National Treatment obligation embodies a right of establishment. These obligations may be subject to various reservations and exceptions, listed in various Annexes to the

NAFTA (especially Annexes I–III), and in the case of Mexico include measures related to the following sectors: transportation, telecommunications, petrochemicals, the postal service, professional services and social services. Canada and the United States, however, have also included reservations with respect to some of these sectors in Annex II, in some cases out of specific policy concerns and in others simply to preserve reciprocity or symmetry between the obligations of Mexico and its NAFTA partners.⁶⁷ Where not reserved, existing non-conforming measures must be eliminated within ten years. Article 1105 requires that investors be provided with the minimum standard of treatment under international law, including fair and equitable treatment and full protection and security.

In addition, there is a general provision in the introductory section of Chapter 11 stating that nothing in this chapter shall be construed to prevent a Party from providing a service or performing a function such as law enforcement, correctional services, income security or insurance, social welfare, public education, public training, or health and child care in a manner that is not inconsistent with this chapter (Article 1101.4). This reflects Canadian as well as Mexican concerns that some provisions of the investment chapter, particularly the right of establishment, could be interpreted as providing to private investors of other NAFTA partners a right to compete in areas that are characterized by complete or substantial public sector provision in Mexico and Canada, but where some or all delivery is provided by the private sector in the United States. One may question, however, the legal significance of this clause, since it protects only those measures that are *in any case* ‘not inconsistent’ with the provisions of Chapter 11, and thus does not override the application of Chapter 11 to public provision of essential services. In addition, on its terms, the clause only seems to apply to direct governmental provision: thus, once a government begins contracting out some of these functions, even to the non-profit sector, it might be required to permit a direct business presence in that sector by private interests in other NAFTA countries, on a National Treatment basis. The effect may be to deter governments from innovative experiments with delivery through non-governmental actors such as non-profit community groups, for fear of losing adequate scope for regulatory control or being required to allow competition on essentially commercial criteria.⁶⁸

The NAFTA prohibits various kinds of performance requirements, including minimum export, domestic content, domestic purchasing and technology transfer requirements (Article 1106(1)). The prohibition on technology transfer requirements is somewhat qualified by the fact that requirements for the domestic conduct of research and development and training of workers are explicitly permitted (1106(4)). The NAFTA does not discipline investment *incentives*. From an allocative efficiency perspective, it is just as undesirable to encourage a higher level of investment than would occur on the basis of market forces alone, as to discourage investment that would occur on the basis of such forces alone—thus, the failure to discipline incentives is a major defect of the NAFTA investment chapter. However, Article 1106(3) provides that some of the requirements listed in Article 1106(1) cannot be stipulated as *conditions* for the receipt of subsidies, which may discourage to some extent the use of investment incentives.

The NAFTA provides some protection for investors from non-NAFTA countries who already have substantial business activities in the territory of one of the NAFTA Parties. These investors from non-NAFTA Parties are to enjoy the full rights of NAFTA country investors if they choose to expand their activities into the territory of another NAFTA

Party (Article 1113.2). Thus, for example, a German-owned company operating in Canada that wishes to engage in business activities in the United States would be entitled to the same benefits of the NAFTA as a Canadian-owned company operating in the United States.

Article 1110 of NAFTA prohibits 'direct or indirect' expropriation of an investment unless certain criteria are met. These are that the expropriation be for a public purpose; undertaken on a non-discriminatory basis; in accordance with due process; and with payment of full compensation at market value. As Jon Johnson notes, the NAFTA lacks a definition of 'expropriation'.⁶⁹ The American view of the meaning of expropriation is deeply influenced by the 'regulatory takings' doctrine in US domestic law, under which, in some circumstances, changes in general laws and regulations that affect the value of property may be considered as 'expropriation', thus triggering some right of compensation, even if title to property is in fact not taken.⁷⁰ While as Johnson correctly notes, in interpreting this Article of NAFTA 'the relevant body of law is international law and not the domestic law of any Party',⁷¹ he also acknowledges that 'international jurisprudence on the subject of taking versus regulation is not nearly as well developed as Canadian or U.S. jurisprudence'.⁷² In 1997, a US investor challenged a Canadian environmental law banning the importation and inter-provincial transport of a gasoline additive which is a neurotoxin and also interferes with anti-pollution devices in automobiles (MMT), under Article 1110 of NAFTA. The investor, the Ethyl Corporation, which manufactures MMT, claimed that the ban amounted to an 'expropriation' and sought \$350 million in damages but eventually settled the case for a lower amount.⁷³

Ethyl was able to take the Canadian government to arbitration due to what is arguably the most innovative feature of the NAFTA investment provisions—the establishment of investor-state dispute settlement processes based on arbitration according to international arbitral rules, in particular those of the IC SID, the International Convention on the Settlement of Investment Disputes. The NAFTA Parties consent to submission to arbitration of investment disputes under Chapter 11, at the request of the private investor itself. This makes NAFTA the first comprehensive international trade treaty⁷⁴ to provide to private parties direct access to dispute settlement as of right.

Since *Ethyl*, there have been numerous claims and many decided cases under the NAFTA investor-state provisions. Considerable controversy has been generated concerning the risk that a government would be held liable for significant monetary damages on account of changes in legitimate public policies, such as environmental regulation. We now proceed to an analysis of this jurisprudence and its policy implications.⁷⁵

'Expropriation'

Perhaps the most serious area of controversy and even alarm is 'expropriation'. As noted, NAFTA requires full compensation even for takings in the public interest, and this includes direct and indirect expropriation as well as actions that are tantamount to expropriation.

In the *Pope and Talbot* case, the NAFTA tribunal rejected at the preliminary jurisdictional stage the claim of an investor who operated an integrated forest products company across the Canada-US border that the export quota regime established by

Canada as a settlement of the softwood lumber dispute between Canada and the USA (see Chapter 9 for a discussion of the underlying dispute) 'expropriated' its right of access to the US market. The tribunal held that deprivation of market access could in principle constitute 'expropriation' under the NAFTA, but also held that an expropriation must constitute a 'substantial deprivation' of the investor's property; in the tribunal's view, these temporary and partial restrictions on market access did not rise to the level of a 'substantial deprivation'. The *Metalclad* case, decided very shortly after the jurisdictional phase of *Pope and Talbot*, involved a claim by an American company that had invested many millions of dollars in the establishment of a waste treatment plant in Mexico. A local governmental authority declared the site of the facility a cactus reserve, thereby preventing its use for the purpose for which it was being built. The facts of the case established that there were no cacti present in the area in question; it is quite likely that the local authority acted for reasons having nothing to do with conservation, but connected to the company's refusal to pay bribes to local officials. Here, the tribunal found that the conduct in question amounted to an act 'tantamount to expropriation'. The panel held: 'Expropriation under NAFTA includes not only open, deliberate and acknowledged takings of property, such as outright seizure or formal or obligatory transfer of title in favour of the host government, but also covert or incidental interferences with the use of property, which has the effect of depriving the owner in whole or in significant part, of the use or reasonably-to-be-expected benefit of the property even if not necessarily to the obvious benefit of the host state' (para. 103). In *Metalclad*, the tribunal emphasized that the local authority's action prevented the investor from making any economic use at all of its property.

Taken together, *Pope and Talbot* and *Metalclad* suggest that an enormous range of government actions could constitute 'expropriation' or acts 'tantamount to expropriation', provided they have a serious enough impact on the investor's property. But it should also be borne in mind that in *Metalclad*, the actions of the authorities appeared to be intentionally targeted at putting Metalclad out of business, and they were also found to violate the minimum standard of treatment in international law (see below). In other words, the tribunal was faced with what seemed to be egregious and non-publicly interested conduct.

In a later case under a Mexico-Spain BIT, the arbitral tribunal considered this NAFTA jurisprudence. Interestingly, the tribunal in *Tecmed* suggested in dicta the possibility that if a government regulation had an impact on an investment that was not out of proportion to the legitimate regulatory purpose, the regulatory act might not be considered an 'expropriation' in the international law sense. This sort of reasoning may provide a way out from the uncomfortable result that looking at the issue of 'expropriation' *only* from the perspective of the seriousness of the effects on the investor could result in enormous host-state financial liability for compelling and essential public policy changes. As well, where the government is responding to new information about a health or environmental risk, there is an argument that the investor may not be entitled to any, or to very small, damages. The reason is that even in the absence of new regulation, the economic value of the investment would have to be discounted based on the potential for tort liability based on the newly discovered risks, as well as possible negative reactions of consumers and the possibility that the laws of other jurisdictions and international law would quite

independently constrain the enterprise's operations where it is creating significant hazards.

National Treatment'

In the *S.D. Myers* case, the investor operated a PCB waste disposal business, which involved the transport of such waste from Canada for processing in the USA. The Canadian government moved to prohibit the export of such waste, requiring its processing in Canada. In this case, there was material evidence that the actual motivation of the Canadian actions was the protection of the domestic industry, not the environment. The tribunal seemed to oscillate between a focus on discriminatory intent and an objective conception of whether the Canadian and American enterprises were in 'like circumstances', which the tribunal considered from the perspective of whether they competed in the same sector. This is close to the 'economic' approach to 'likeness' in GATT National Treatment cases (see Chapter 3).

In *Pope and Talbot*, the arbitral tribunal developed a two-step test for 'like circumstances'. The first step was to analyse whether the foreign investment and the domestic investment alleged to be receiving more favourable treatment were competing in the same marketplace; the second step was to consider whether, even though the two investments were competing in the same marketplace, the difference in treatment could be explained by some *bona fide* public policy. The tribunal's approach suggests that it may well be possible to find a violation of National Treatment where there is a difference in treatment of competing foreign and domestic enterprises even if there is no actual evidence of protectionist intent. A similar approach was followed by the tribunal in the later *Feldman* case, which found a violation of National Treatment because the investor had not received tax rebates that had been received by Mexican enterprises that the tribunal considered to be of the same character (a rather loose way of viewing the notion of enterprises being in competition), and the Mexican authorities had provided no valid explanation of the reasons for this different treatment. In fact, the *Feldman* tribunal seems to suggest that the evidentiary burden of proof may shift to the host government to show that the differential treatment has a *bona fide* explanation, once it is established that the enterprises are in competition.

This being said, the second step in National Treatment analysis, which appears to require only some kind of rational nexus between the difference in treatment and a *bona fide* public policy to find that the enterprises are not 'in like circumstances', seems to provide considerable insurance against governments becoming liable under National Treatment for legitimate regulation.

'Minimum standard of treatment', 'fair and equitable treatment' and 'full protection and security'

The notion that states are under an obligation to provide a certain standard of treatment to aliens within their territory has been part of customary international law at least since the nineteenth century. This treatment includes due process of law, administrative fairness and protection by local law against abusive treatment by private actors (such as the duty to provide reasonable police protection for a threatened alien's person and property).

In the *Pope and Talbot* case, the Canadian government argued that the minimum standard of treatment incorporated into NAFTA was based on the state of customary international law as it had evolved into the early twentieth century, not beyond, and would only cover acts or omissions that today would be regarded as egregious human rights violations, such as torturing or falsely imprisoning an alien, or maliciously failing to protect the alien from an armed mob.

The arbitral tribunal rejected this view, considering that customary international law might have evolved since that time, due to greater economic interdependence and other factors, and it held that the required standard of treatment extended to fairness as it is understood in the modern administrative state. The tribunal in a later case, *Loewen*, described as follows the conduct of the Canadian government that the *Pope and Talbot* tribunal found to run afoul of the minimum standard of treatment required by international law:

the Tribunal found that when the Investor instituted the claim in these proceedings, Canada's Softwood Lumber Division ('SLD') changed its previous relationship with the investor and the Investment from one of cooperation...to one of threats and misrepresentation. Figuring in this new attitude were assertions of non-existent policy reasons for forcing them to comply with very burdensome demands, for documents, refusals to provide them with promised information, threats of reductions and even termination of the Investment's export quotas, serious misrepresentations of fact in memoranda to the Minister concerning the Investor's and the Investment's actions and even suggestions of criminal investigation of the Investment's conduct.⁷⁶

The *Loewen* case itself concerned a Canadian funeral home company that had damages of \$425 million awarded against it, approximately \$420 million of which was punitive damages (i.e. the actual dispute concerned a \$5 million claim). This award occurred after the judge permitted xenophobic tactics and comments by counsel and witnesses for the plaintiffs. While barring the investor's claim on rather dubious technical grounds (the tribunal thought that *Loewen* had not properly exhausted local remedies in the USA), it held that *Loewen* would otherwise have had a valid claim that the minimum standard of treatment was violated: 'Neither State practice, the decisions of international tribunals nor the opinion of the commentators support the view that bad faith or malicious intention is an essential element of unfair or inequitable treatment or denial of justice amounting to a breach of international justice. Manifest injustice in the sense of a lack of due process leading to an outcome which offends a sense of judicial propriety is enough.'⁷⁷

In yet another recent case, *Mondev*, the arbitral tribunal stated the appropriate test as follows: 'clearly improper and discreditable [administrative or judicial action], with the result the investment has been subjected to unfair and inequitable treatment'.⁷⁸

The approach that tribunals have so far articulated with respect to 'minimum standard of treatment' creates little risk that ordinary legitimate government action, including judicial and administrative decision-making, can be impugned. To violate the minimum standard of treatment, the government's conduct must be improper to the extent that it would shock or surprise an impartial international tribunal (*Mondev*).

In 2001, the NAFTA Parties issued an agreed interpretation of Article 1105, aimed apparently at narrowing the ambit of minimum standard of treatment in international law. It reads:

- 1 Article 1105(1) prescribes the customary international law minimum standard of treatment of aliens as the minimum standard of treatment to be afforded to investments of investors of another Party.
- 2 The concepts of 'fair and equitable treatment' and 'full protection and security' do not require treatment in addition to or beyond that which is required by the customary international law minimum standard of treatment of aliens.
- 3 A determination that there has been a breach of another provision of the NAFTA, or of a separate international agreement, does not establish that there has been a breach of Article 1105(1).

This statement does not have much clear impact on interpretation, however, because customary international law is inherently evolutionary in nature, and it remains for the arbitral tribunals to define the ambit of custom: since treaty obligations are themselves one kind of evidence of custom that is widely invoked by tribunals, and since good faith observance of treaty obligations is itself part of the customary international law of state responsibility, treaty law will remain a relevant consideration in determining the customary international law minimum standard of treatment, despite the notion in the interpretation that on its own, a breach of another agreement does not establish a breach of NAFTA.

Thus, when the *Pope and Talbot* tribunal was invited to consider the interpretation at a late stage in the litigation (after already stating its views on minimum standard of treatment), the tribunal ventured that even if the statement was applicable (there was an issue of whether it went beyond the interpretive power of the Parties and therefore was invalid because not a formal amendment), the tribunal held that the interpretive statement in no way required a change in its analysis of minimum standard of treatment.

Beyond NAFTA: the Free Trade Agreement of the Americas (FTAA)

Controversy concerning investor protection in NAFTA has not deterred the negotiators for the FTAA from including comprehensive investor-state protections, including investor-state dispute settlement, in the draft investment chapter of the FTAA. The latest draft available at the time this book went to press, dated 21 November 2003, does not differ significantly from NAFTA. The minimum standard of treatment is defined in terms of customary international law, along the lines of the NAFTA Commission interpretive statement. Also, unlike NAFTA, the FTAA would allow an investor to choose domestic courts, as well as international arbitral facilities, as a forum for investor-state dispute settlement.

The codes of conduct approach: negotiating the rights and responsibilities of multinationals and sharing the costs and benefits of foreign investment

Another approach to international discipline of foreign investment measures is embodied in the various multilateral and bilateral codes of conduct that have been negotiated between states as well as between states and multinational firms themselves. The codes of conduct generally aim at striking an explicit balance between concerns of investors (compensation for expropriation, repatriation of earnings) and concerns of host countries about the conduct of foreign firms (whether corruption and bribery, avoidance of domestic regulatory and tax regimes, or unfair labour practices). In return for commitments of 'fair treatment' from the host country, the firm commits itself to behave there as a good corporate citizen. Reflective of this approach are the 1976 OECD Guidelines for Multinational Enterprises⁷⁹ and the United Nations Draft Code on Transnational Corporations, as well as Guidelines for Investment developed by international business groups such as the International Chamber of Commerce for inclusion in negotiated agreements between multinational enterprises and individual countries.⁸⁰

One attractive feature of the codes and guidelines is their inherently pluralistic character, involving an explicit balance of economic and a variety of political, ethical and social concerns in the regulation of foreign investment. Another, often cited advantage with respect to some codes and guidelines is that they result from a multilateral process where there is a relative equality of bargaining power between large and small countries, and between the developed and developing world. This is particularly true of instruments developed within the UN system, including the UN Draft Code on Transnational Corporations.

Often, however, the language of these instruments reflects a high level of generality and diplomatic vagueness. They therefore often provide very limited guidance for the resolution of specific disputes or conflicts. For instance, an obligation to abstain from bribery is specific enough, but what of the obligation on multinationals by the OECD Guidelines 'To take fully into account established general policy objectives of the Member States in which they operate'? How would one go about determining whether this vague obligation had been sufficiently complied with by a particular foreign investor? Despite their voluntary character, and the vagueness of many of their prescriptions, the Guidelines have been credited with improving channels of communication between multinational corporations and host-country governments (as well as local trade unions) in OECD countries. Implementation of the Guidelines is monitored by the OECD Committee on Investment and Multinational Enterprises (CIME), which, however, does not serve the function of settling specific disputes between multinationals and host governments. The CIME does issue 'clarifications' of the Guidelines, and these 'clarifications' are usually triggered by specific disputes which involve disagreement about the meaning of the Guidelines.⁸¹

In contrast to the Guidelines, two other OECD instruments contain strict substantive commitments by OECD Member States with respect to liberalization of investment measures. The OECD Code of Liberalisation of Capital Movements and the Code of

Liberalisation of Current Invisibles contain specific disciplines on measures that impede the flow of capital between OECD Member States.⁸² Cumulatively, these disciplines are viewed by the OECD as the equivalent of a right of establishment.⁸³ The Codes of Conduct are legally binding on OECD Members. A commitment to National Treatment of foreign investors is contained in Article II of the OECD Declaration on International Investment and Multinational Enterprises (1976). Unlike the Codes, the Declaration is not binding in international law. Subsequent Decisions of the OECD Council (which *are* binding) have, however, required that Member States lodge with the OECD any exceptions to National Treatment in their national policies. Such exceptions are to be examined by the CIME at regular intervals (at least once every three years) with a view to 'making suitable proposals designed to assist Members to withdraw their exceptions'.⁸⁴ In addition, any Member country 'which considers that its interests may be adversely affected by significant official incentives and disincentives to international direct investment' by another Member country may demand consultations in the CIME 'to examine the possibility of reducing such effects to a minimum'.⁸⁵ The National Treatment commitment in the Declaration is subject to 'needs [of Member states] to maintain public order, to protect their essential security interests and to fulfil commitments relating to international peace and security'.⁸⁶ Member States are, nevertheless, required, for transparency purposes, to notify to the OECD measures that may be justified on these terms.

In contrast to these OECD instruments, most multilateral investment codes, especially those concerned with investment relations between developed and developing countries, only become effective through explicit or implicit understandings between host countries and individual multinational corporations. This is the case, for example, with the UN Draft Code on Transnational Corporations. Here, all the inherent difficulties of inequality of bargaining power between developing and developed countries—supposedly redressed in part through multilaterally developed codes—return as countries and firms bargain as to what subset of rights and obligations will be adopted and complied with in these explicit or implicit bilateral understandings.⁸⁷ At the same time, some observers have noted that the codes of conduct have succeeded in influencing the settlement of some investment disputes through private litigation, due to the willingness of judges and arbitrators to invoke them as interpretive aids or sources of guidance on matters of international economic policy.⁸⁸

An attempt to remedy the problem of inequality of bargaining power, at least in part, is reflected in the Convention on the Settlement of Investment Disputes Between States and Nationals of Other States (IC SID).⁸⁹ The IC SID provides a vehicle by which host countries, home countries and multinationals can agree to submit investment disputes to third-party arbitration. The IC SID responds both to the concerns of developed-country foreign investors that they may not be fairly treated in the domestic legal processes of host countries and to the parallel concerns of the developing countries about investment disputes being adjudicated in, for example, American or British courts (as would often be provided in the choice of forum clause of an investment agreement, at the insistence of the developed-country investor). While a variety of bilateral investment treaties and agreements between host countries and multinationals provide for arbitration through the IC SID process, it has rarely been resorted to in order to resolve investment disputes, for reasons that are not entirely clear.⁹⁰ The IC SID's future may now, however, be

somewhat brighter by virtue of the incorporation of the IC SID arbitration process into the dispute resolution provisions of the NAFTA chapter on investment. Finally, inasmuch as principles in the codes end up being part of bilateral, reciprocal bargains that strike a balance of interests between investors and host countries, they present the same kind of danger as any managed trade, bilateral reciprocity-based approach to liberalization. The balance of interests struck may ignore effects of investment measures on third countries (e.g. import substitution effects), with a global welfare perspective being lost sight of entirely.

At the same time, these dangers may be somewhat attenuated through the development of general norms of international law with respect to compensation for the expropriation of the property of foreign nationals and extraterritoriality, as well as more specific regimes that deal with inter-jurisdictional dimensions of corporate taxation or antitrust policies. As discussed earlier in the chapter, these are matters that loom large in investment relations between states, but overlap with other international and domestic regimes not specific to the foreign investment context.

Bilateral investment treaties

Over the last two decades there has been an extraordinary proliferation of BITs: in the decade of the 1990s alone these are said to have increased in number from 470 to close to 2,000.⁹¹ Developing-country governments in particular have been using BITs as a device to attract foreign investment, by signalling a credible commitment to investor protection guarantees, such as those discussed above in the context of NAFTA. Such treaties often provide for dispute settlement through international arbitration, thus permitting the investor to enforce directly its rights under the treaty; once an investor wins an arbitral award, it may be enforced in the courts of those many countries that, either as signatories to, for example, the New York Convention, or by practice, recognize arbitral awards. An important feature of BITs is that they generally contain an MFN provision as do investment chapters of regional trade agreements like NAFTA. The result is that a country will find itself providing treatment to *all* its BIT or regional trade agreement partners based on the most generous rights it accords investors in *any* of its BITs or regional agreements.

Hallward-Driemeier⁹² claims that BITs are unlikely to be an effective means of attracting foreign direct investment, except where coupled with domestic institutional reforms, such as strengthening of property rights and judicial institutions.

CONCLUSION

Investment provisions in trade agreements remain controversial, even if they have become common, if not ubiquitous, in bilateral and regional free trade arrangements.⁹³ On the one hand, provisions such as the investor protection rights in NAFTA raise issues about domestic regulatory autonomy, as well as the balance of power, and of rights and responsibilities between multinational corporations and governments and social actors. On the other hand, the economic evidence suggests that FDI is only one factor that contributes to technology transfer in developing countries, and that commitments in trade

agreements may have only a modest impact on the kind of FDI that enhances the development prospects of developing countries.⁹⁴

The mainstream approach to multilateral investment liberalization has resulted in failure in the MAI, and has proven unacceptable as a basis for WTO negotiations, particularly to developing countries. Yet there is still a conceptual case for a multilateral regime—multilateralism could, in theory, work to mitigate power imbalances between corporations and governments, and between developed and developing countries, that plague much direct bargaining between states and firms, and also cast a shadow over bilateral and regional pacts between countries of vastly different levels of global economic and political power.

In our view, a successful multilateral alternative will have to link investor rights to investor responsibilities, through a binding code of conduct. It must also allow space for the kind of interventionist policies that credible economic analyses suggest may have supported rapid and real economic growth and development in economies such as South Korea.⁹⁵

15

Trade and developing countries

INTRODUCTION

In 1999, developing countries¹ accounted for 28.8% of world trade.² Although some developing countries were included within GATT from the outset,³ they had a marginal influence on the original Bretton Woods negotiations.⁴ By the 1960s, developing countries had come to predominate numerically in the GATT, and during the 1960s and 1970s their share of world trade, and particularly of exports, grew rapidly, although in this respect the performance of some developing countries was vastly superior to that of others.⁵ Indeed, there is substantial heterogeneity among developing countries including differences in size, levels of development, levels of indebtedness, composition of trade, degree of concentration of trading relationships, etc.⁶ Throughout this period, developing countries complained that their influence on the design and functioning of the GATT rules remained marginal, and increasingly pressed demands for more preferential treatment within GATT, as well as attempting to evolve other fora for the creation of rules on trade (particularly, UNCTAD—the United Nations Conference on Trade and Development) where they could wield greater influence.

While some developing countries continued through the 1970s to experience considerable growth, particularly those with more open or outward-oriented trade policies, the strategy that was adopted by most LDCs and the one that predominated in the development literature at the time—import substitution and protection of infant industries—generally yielded disappointing results.⁷ The conclusion most often drawn was that the rules of the game of international trade and finance were so heavily skewed to the disadvantage of the LDCs that a radically new strategy was necessary, based upon a fundamental redistribution of wealth and opportunities between North and South. Developed in UN fora such as UNCTAD, the strategy was termed the New International Economic Order (NIEO).⁸ While the NIEO remained at the level of ideology or at most the ‘soft law’ of UN resolutions, the developed countries did, at a practical level, respond to these pressures by granting further tariff preferences to developing countries on a non-reciprocal but also a non-binding basis (the Generalized System of Preferences (GSP)). At the same time, the availability of recycled petrodollars promised to give the strategy of protected, state-assisted rapid industrialization a new lease on life.

The further failure of this strategy, combined with the second oil shock and recession in the developed world (which produced high interest rates and low demand for developing-country exports), led to the debt crisis of the early 1980s. The rescheduling of loans to developing countries was premised upon the undertaking of domestic reforms, including price liberalization, movement towards convertible currency, and unilateral trade liberalization. Thus, many developing countries moved towards an outward-oriented, export-driven approach to development and growth.⁹ While these policy shifts

can be in part understood as imposed from the outside through institutions like the International Monetary Fund (IMF) as a price for cooperation by the North in solving the debt crisis, they also may reflect, or at least be reinforced by, the intellectual and political decline of Marxism, which in its Leninist/centralist and neo-Marxist variants was an important ideological source of resistance to economic liberalism.¹⁰

More recently, neo-liberal 'Washington Consensus' prescriptions for growth and development have been put into question, as IMF-backed or -mandated reforms, together with trade liberalization, have often failed to procure equitable growth in particular developing countries; economists such as Dani Rodrik and Joseph Stiglitz have emphasized that development cannot be reduced to a formula and that depending on the context and country, sometimes 'interventionist' policies or even forms of trade protection may work better than dogmatic 'liberalization.' (see especially, D.Rodrik, *The Global Governance of Trade as if Development Really Mattered*, United Nations Development Programme, 2001.) At the same time, many developing countries have questioned whether the Uruguay Round package of trade treaties was, overall, a good deal for them; policy flexibility was limited by agreements such as TRIPS, GATS, and the SCM Agreement, while (in part due to very generous phase in and safeguard arrangements) the liberalization of trade in agriculture and textiles did not deliver on the expectations of many developing countries. The conceptualization of the Doha Round as a 'development' round was a way of responding to such concerns about the 'imbalance' in the Uruguay Round result.

The treatment of developing countries in the GATT that emerged during the first few termed a 'Faustian bargain' between the North and the South.¹¹ On the one hand, decades after the General Agreement came into force reflects what Bela Balassa has aptly opined countries were granted significant exemptions from GATT disciplines, so as to allow them considerable scope to adopt import-substitution, infant-industry-protection strategies of development. Eventually, as well, developing countries were granted preferential tariff concessions or complete removal of tariffs on a non-binding basis, with respect particularly to raw materials. On the other hand, with respect to exports that could immediately figure in an export-led growth strategy, such as textiles, light manufactures and processed agricultural products, developed countries maintained extremely high trade barriers, including high tariff rates, and also in the case of textiles, quantitative restrictions under a special GATT-exempt arrangement that came to be known as the Multi-Fibre Arrangement (MFA). Thus, although it is fashionable to blame leftist theories of development economics and the influence of Soviet bloc central planning approaches for the protectionist follies of the developing world in this epoch, the treatment of developing countries in the Western-dominated global trading order made inward-oriented policies easy, while it set up obstacles to export-led growth. We now proceed to examine in some detail the nature of this treatment.

THE LEGAL AND INSTITUTIONAL FRAMEWORK FOR DEVELOPING-COUNTRY TRADE

The pre-Uruguay Round GATT

Article I

Article I, which establishes the MFN (Most Favoured Nation) principle, nevertheless allows for the *continuation* of preferential tariff rates—i.e. tariffs below the bound MFN rate negotiated within the framework of the GATT—between countries that shared a common sovereignty before the Second World War, and also between countries that formed part of the Ottoman Empire until the settlement at Versailles that ended the First World War. Under the first category, preferences given by (ex-colonial) powers such as Britain, France and Spain to their former colonies are permitted, and this would have included a substantial part of trade between developed and developing countries at the time the GATT was created. The margin of preference, however, cannot exceed that which existed between the MFN rates and the preferential rates in question at the time of entry into force of the GATT (1947). Thus, further preferential treatment has required an explicit GATT waiver from the MFN obligations of Article I.

Quantitative restrictions (Articles XI, XII, XIII, XVIII)

As discussed in earlier chapters, Article XI of the General Agreement contains a general prohibition on quantitative restrictions on imports and exports, subject to a range of exceptions. The balance of payments exceptions defined in Articles XII and XIII were not especially aimed at the needs of developing countries—at the beginning of the post-war era, very few of the *developed* countries possessed stable or even convertible currencies.¹² Nevertheless, Article XII does contemplate that a Contracting Party may assert an exception to Article XI on balance of payments grounds, where its balance of payments difficulties are due to ‘domestic policies directed towards the achievement and maintenance of full and productive employment or towards the development of economic resources’ (XII: 3(d)). This has the effect of immunizing a developing country from the claim that since its balance of payments crisis is induced or prolonged by its own illiberal or distortive domestic policies, the appropriate solution is to change those policies rather than to increase trade protection.

Article XVIII, in the form that emerged after the 1954–55 review of the General Agreement, contains much more explicit recognition for development-based exceptions from GATT strictures. Article XVIII begins with a lengthy preamble that states the agreement of the Contracting Parties that developing countries¹³

should enjoy additional facilities to enable them (a) to maintain sufficient flexibility in their tariff structure to be able to grant the tariff protection required for the establishment of a particular industry and (b) to apply quantitative restrictions for balance of payments purposes which take full

account of the continued high level of demand for imports likely to be generated by their programmes of economic development.

(XVIII:2)

This statement is notable for its incorporation within the terms of the GATT itself of the infant industry protection view of economic development—the notion that the goal of ‘establishment of a particular industry’ is an appropriate rationale for protection where pursued by a developing country.

The preamble to Article XVIII is followed by Sections A, B and C, which set out the specifics of the ‘additional facilities’ to be granted to developing countries. Section A provides that a developing country may, where it wishes ‘to promote the establishment of a particular industry’, reopen negotiations on bound tariffs with any Contracting Party ‘with which such concession was initially negotiated’ (A 7(a)). It is foreseen that the developing country would offer compensation for the withdrawal or modification of a concession, perhaps in the form of a reduction of tariffs on other products. If, despite an offer of adequate compensation, the developed Contracting Party or Parties in question refuse(s) to allow the concession to be withdrawn or modified, the developing country can apply to the GATT Council for the right to proceed unilaterally. Section B reiterates but also expands the balance of payments exceptions to Article XI strictures already contained in Article XII. For instance, developing countries may impose quantitative restrictions for balance of payments purposes on a discriminatory basis, i.e. ‘in such a way as to give priority to the importation of those products which are more essential in the light of its policy of economic development’ (XVIII(B):10).

Section C applies where a developing country ‘finds that governmental assistance is required to promote the establishment of a particular industry with a view to raising the standard of living of its people’ (XVIII(C):13). If the developing country is experiencing difficulties in the achievement of this goal, it may notify the GATT Council of the difficulties and any GATT-inconsistent measure with respect to imports that may be indicated. Upon notification, the GATT Council may, within 30 days, either request consultations with the developing country in question, or allow it to proceed with measures that would otherwise be in contravention of provisions of the General Agreement. There are two limits on this relief from GATT strictures: first, where the measures in question affect products for which there are already tariff bindings, the developing country must first consult with, and seek the consent of, the Contracting Party with whom the initial concession was negotiated; second, no deviation from Articles I, II and XIII of the General Agreement is permitted under Section C. Hence, whatever import-restricting measures are adopted pursuant to Section C must be implemented on a non-discriminatory basis.

In practice, as is described in detail by Hudec,¹⁴ Article XVIII provided a basis for the granting of sweeping exemptions from GATT strictures to many developing countries, usually with a view to import substitution and protection of infant industries. The GATT Council routinely accepted such deviations from the general provisions of the GATT, and without insisting on the consultation requirements and other formal criteria embodied in Article XVIII. The explanation for this laxity is to be found less in development theory than in the fact that developed countries simply did not feel threatened by infant industries in developing countries. These industries posed little threat to developed-

country dominance in the sectors concerned, in both home markets and third-country markets. In more recent years, there has been increased pressure for scrutiny of developing-country trade practices, in part because a number of the larger and relatively more prosperous developing countries have come to be seen as significant potential markets for developed-country exports, whether goods, services or technology. This has been reflected to a large extent in US pressure to include disciplines on services and intellectual property in the Uruguay Round (the implications for developing countries are discussed below), but also in demands that developing countries' Article XVIII exemptions be re-examined and eliminated wherever not justified, or no longer justified, by the wording of the GATT.¹⁵

Part IV

Part IV of the General Agreement, entitled 'Trade and Development', was added in 1965, in response to the increasingly insistent demands of developing countries as they emerged through UNCTAD, which had been formally established in 1964.¹⁶ Unlike Article XVIII, which had as its focus the relaxation of GATT strictures to enable developing countries to pursue inward-looking growth policies based on protection and promotion of infant industries, Part IV concerns the access of developing countries to developed-country markets, and therefore appears at least implicitly to endorse the theory of export-led growth. Hence, the preambular section of Part IV states (in part): 'the export earnings of the less-developed contracting parties can play a vital part in their economic development' (Part IV: Article XXXVI:1(b)).

Nevertheless, the persistence of the inward-looking approach is reflected in the statement that '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 countries' (Part IV: Article XXXVI:8). This principle of non-reciprocity, along with special dispensations for import substitution policies, are often referred to as 'special and differential status' for developing countries. The clear implication is that export-led growth is consistent with, and indeed should go hand in hand with, protection of developing countries' domestic markets—a mercantilist view in profound tension with the neo-classical perspective that protectionism which distorts domestic price mechanisms and insulates industries from international competition is likely to frustrate the development of viable export industries.¹⁷

A pervasive characteristic of the substantive provisions of Part IV is that they lack the clearly binding or obligatory character of most provisions of the General Agreement. Thus the developed countries 'shall to the fullest extent possible—that is, except when compelling reasons, which may include legal reasons, make it impossible—give effect' to commitments to reduce and eliminate trade barriers with respect to 'products currently or potentially of particular export interest to less-developed countries' (Part IV: Article XXXVII:1 (a)). In other instances, developed countries are 'to make every effort' to, *inter alia*, 'give active consideration to the adoption of other measures designed to provide greater scope for the development of imports from less-developed countries' (Part IV: Article XXXVII:3(b)). The only remedy specified in Part IV where developed countries are not living up to these loosely worded commitments is the possibility of a

developing country requesting consultations either with individual developed countries or in the GATT Council (Part IV: Article XXXVII:2).

Other GATT provisions

The Tokyo Round Codes

Serious tensions arose between developed and developing countries in the GATT due to the refusal of the United States to grant the benefit of the Tokyo Round GATT Subsidies and Antidumping Codes to countries that had not signed the Codes, which included most developing countries. In the 1960s, India had obtained a legal ruling from the GATT Secretariat that MFN applied to the Kennedy Round Antidumping Code, thereby obliging the United States to provide the benefits of the Code to non-signatories.¹⁸ In the Tokyo Round, the United States pressed for an explicit conditional MFN approach to the revised Antidumping Code and the new Subsidies Code. The resultant Codes, on their face, required that benefits only be extended to signatories. However, the Codes did provide some special treatment for developing countries. In the case of the Antidumping Code, this only amounted to a general provision (Article 13) requiring Parties to explore 'possibilities of constructive remedies provided for by this Code [i.e. price undertakings]' before 'applying antidumping duties where they would affect the essential interests of developing countries'. This supposed special consideration for developing countries has not been translated into concrete provisions in the domestic trade remedy law of major developed nations. In the case of the Subsidies Code, developing countries were exempted from the general ban on export subsidies, provided that these subsidies are not 'used in a manner which causes serious prejudice to the trade or production of another signatory' (Part III: Article 14(2)(3)). It was, however, an open legal question whether this exemption only applied to the export subsidies provisions of the Code (Article 9) itself, or whether it extended by implication to the restrictions on export subsidies in Article XVI of the General Agreement. The latter view seems to be more plausible, since the entire Subsidies Code could be seen as an elaboration and detailed application of the subsidies provisions of the General Agreement.

In addition, the Code stated that with respect to *any* subsidy granted by a developing-country signatory (i.e. either export or domestic), no action may be taken under the dispute resolution provisions of the Code, unless the subsidy had nullified or impaired a tariff concession 'or other obligations under the General Agreement' (Article 14(7)). Nullification and impairment was defined narrowly as displacement of imports into the subsidizing country or 'injury to domestic industry in the importing market of a signatory'. However, this provision was of little practical significance, since it only applied to subsidies actions under the multilateral dispute resolution process provided for in the Code, and did not constrain the unilateral application of countervailing duties.

Dispute settlement

The dispute settlement procedures of the GATT in the early post-war decades were rarely invoked either by or against developing countries. From 1947 to 1986, only 12.5% of GATT complaints were initiated by LDCs and LDCs were respondents in only 15% of

the cases.¹⁹ One reason for this state of affairs may have been the consequences (perceived or real) of power imbalances between developed and developing countries. The GATT enforcement mechanism is ultimately based on retaliation as the sanction of last resort—a sanction that most developing countries would be hard put to apply to developed countries. Since few developing countries represent, individually, major export markets for developed countries, withdrawal of concessions would not normally be a very powerful sanction. On the other hand, where developed countries wish to induce developing countries to comply with trade rules, they possess very effective leverage, including development aid and GSP preferences. In addition, because of the power imbalance, unilateral measures can often be applied to developing countries with relative impunity.

Significantly, as the number of developing-country Members in the WTO grew and they acquired greater political and economic power and influence, they tended to be increasingly involved in the WTO dispute settlement process. Developing countries filed 17% of GATT cases between 1980 and 1989, 32% between 1990 and 1994, and 33% between 1995 and 1998.²⁰ The increase in the percentage of cases filed against developing countries is even more dramatic—from 13% of cases between 1980 and 1994, to 39% of cases between 1995 and 1998.²¹

Busch and Reinhardt²² caution, however, that increased developing-country participation in the dispute settlement system does not necessarily mean that developing countries benefit more today than they did under the GATT dispute resolution system. Examining complaints filed between 1980 and 2000 inclusive, the authors found that the gap between developed and developing countries has increased in terms of their ability to win concessions from the respondent. They attribute this phenomenon to developed countries' relatively higher success in obtaining concessions prior to formal dispute settlement. Busch and Reinhardt find that developed and developing countries are equally likely to obtain a positive judgment and to secure compliance with judgments. They consequently suggest that developing countries need more assistance at the pre-dispute settlement stage.

The Generalized System of Preferences and the Lomé Convention

Despite the absence of self-contained and self-activating 'hard' legal obligations in Part IV, it set the scene for the granting of non-reciprocal trade preferences to developing countries through mechanisms outside the GATT. The two main mechanisms are the Generalized System of Preferences and the Lomé Convention. The GSP was initiated under the auspices of UNCTAD in 1968. The intent was to build on existing colonial preferences which (as discussed above) had been grandfathered in the GATT MFN requirement—no longer would only the ex-colonial powers grant such preferences and the ex-colonies be their only recipients (hence the expression 'generalized'). Each developed country would be free to grant or not grant such preferences as it chose. And the preferences are not 'bound' in the GATT—therefore they may be removed or modified at any time. A 'waiver'—pursuant to Article XXV of the GATT—was granted in 1971 to permit the derogation from Article 1 MFN obligations that would be needed to introduce new preferences. However, the GATT waiver did require that each Contracting Party's GSP programme benefit developing countries generally—a potential constraint

on open-ended discrimination between developing countries and the use of the GSP to strike bilateral side-deals with particular developing countries.²³ This waiver was replaced in 1979, two years before its expiry, by a decision of the Contracting Parties referred to as the Enabling Clause, which provided a permanent basis for the allowance of preferences to be granted to developing countries, although requiring a waiver to the MFN obligations imposed by Article I:1 of the GATT²⁴

In the case of the European Union, preferences have been embodied in the Lomé Convention, which first came into force in 1975 and has been renewed and revised several times since.²⁵ While containing non-reciprocal tariff preferences, these agreements also deal with a wide-ranging agenda for commercial cooperation between the EU and some 65 developing countries (almost all of them ex-colonies of Britain or France).²⁶ Since the preferences contained therein do not benefit all developing countries, it might be argued that, in principle, they do not conform with the terms of the GATT waiver. The Lomé Convention allows the EC to grant special preferences to certain African, Caribbean and Pacific (ACP) countries. This would ordinarily violate the MFN obligation of the GATT. However, the violation could be excused by virtue of a waiver granted by a decision of the Contracting Parties from the EC's Article I:1 obligations in December 1994. The waiver was granted 'to the extent necessary to permit the European Communities to provide preferential treatment for products originating in ACP states as required by the relevant provisions of the Fourth Lomé Convention, without being required to extend the same preferential treatment to like products of any other WTO member'.²⁷

A WTO Appellate Body decision 'dealt a severe blow to the European Union's system for regulating the import of bananas in a way that restricts access for Latin American bananas in favour of fruit from its Member States' former colonies'.²⁸ The complaint, initiated by a coalition of Latin American countries and the United States, alleged that the EU's regime for the import, sale and distribution of bananas was inconsistent with a number of GATT provisions, as well as the Import Licensing Agreement, the Agreement on Agriculture, the TRIMs Agreement and the GATS.²⁹ In May 1997, the panel ruled in favour of the coalition, finding aspects of the EU regime inconsistent with the GATT. The EU subsequently appealed the decision. The Appellate Body largely upheld the findings of the panel, but tightened 'the original ruling in...ways that strengthened the hand of the opponents of the EU regime'.³⁰ The Appellate Body found that the Lomé Waiver did not permit the EU to derogate from its obligations of non-discrimination in the administration of quantitative restrictions under Article XIII or to expand historical deviations from Article I (MFN) obligations. Thus, in the case of bananas at least, the Lomé Waiver had limited protective effect on the EU's preferential trading arrangements.

In the *EC-Tariff Preferences (GSP)* case, (*European Communities—Conditions for the Granting of Preferences to Developing Countries*, Report of the Panel (WT/DS246/R)), the panel ruled by a 2–1 majority that developed countries must provide identical GSP preferences to all developing countries, with very limited exceptions.³¹ The panel findings in *EC-Tariff Preferences* were based upon the panel majority's reading of both the MFN obligation in the GATT (Article I) and the Enabling Clause, which provides that a GSP scheme for developing countries may operate 'notwithstanding' MFN. In the case at hand, India had challenged a program by the EC, which provided an additional margin of preference (beyond that accorded all developing countries) to those recipients

with drug enforcement issues. However, India originally had also attacked preferences aimed at enhancing environmental and core labour rights performance in developing countries. Since the GSP programs of the EC and the US contain numerous conditions and limitations on GSP treatment, for a wide variety of purposes and motivations, the panel's ruling threatened to spell the end of GSP as we know it.

The Appellate Body modified considerably the panel's ruling, even though in the end it found that the particular design of preference program in the case of the EC drugs scheme violated the Enabling Clause (*European Communities—Conditions for the Granting of Tariff Preferences to Developing Countries*, WT/DS246/AB/R, Report of the Appellate Body). The AB upheld the panel's ruling that the notion of GSP as 'non-discriminatory', brought into the Enabling Clause through reference to earlier instruments relating to GSP, created a hard legal condition binding on donor countries, but it reversed the panel's finding that 'non-discriminatory' meant 'identical.' Instead, it created a complex test for 'non-discrimination', may or may not—depending on how it is applied in future cases—give donors significant scope to differentiate among different developing countries.

Overall, the wording of the legal instruments in question and their application in state practice suggests that that donor states never accepted that their ability to modify or withdraw GSP preferences would be subject to such a 'hard' legal constraint: non-discriminatory states at most an aspirational, soft-law norm.³² This threshold issue was never forthrightly raised by the EC in its written pleadings, and only obliquely raised by two Third Parties, the US and the Andean Group (admittedly less obliquely than the US).

The Appellate Body at least recognized the issue. The AB disposed of it by comparing the English with the French and Spanish texts of the Enabling Clause and observing: 'In our view the stronger, more obligatory language in both the French and Spanish texts... lends support to our view that only preferential tariff treatment that is "generalized, non-reciprocal and non-discriminatory" is covered under paragraph 2(a) of the Enabling Clause.' However, Article 33 of the Vienna Convention specifies a particular procedure where the ordinary meaning of one linguistic version of a treaty appears to be different from that of another, equally authentic linguistic version. The treaty interpreter must attempt to reconcile the difference by recourse to all the interpretative sources in Article 31 and 32 of the Vienna Convention; at the end of the day, what is to be decisive in the presence of ambiguity is the purpose and object of the treaty. Thus, in the recent *Lagrande* case (*Germany v. US*), the ICJ was faced with the issue of whether provisional measures of the Court were binding on the party to which they were directed: having found that English text of the ICJ Statute pointed to a lesser degree of obligatoriness than the French text, the ICJ did not stop there and simply choose the version that corresponded to its own intuition, but rather went on to consider the object and purpose of the treaty provision in question. In sum, the AB erred in viewing its comparison of the English with the Spanish and French texts of the Enabling Clause as the end rather than the beginning of an inquiry into the nature of the obligation of non-discrimination, which would inter alia have had to consider state practice and the object and purpose of the Enabling Clause.

If the AB's approach was legally incorrect, it was politically correct, however. Whatever the *lex lata*, to deny obligatory force to the notion of non-discrimination in the Enabling Clause in an explicit judicial ruling would be a provocation to developing

countries at a very difficult time in the history of their relationship to the multilateral trading system—this especially so since the structure of the drug preferences (where the European Commission invents out of whole cloth a list of beneficiaries of the program, but without any objective criteria) highlights the possibility of arbitrary conduct of donors towards beneficiaries, and therewith the need for some *kind* of legal discipline. This being said, the AB might have better reconciled law and politics, through at least attempting to support its view of the non-discrimination norm with the kind of teleological interpretation explicitly endorsed in cases of linguistic divergence by Vienna Convention 33.

Having discerned that non-discrimination is a hard law requirement of the Enabling Clause, the AB resorted to what it considered to be a general concept of non-discrimination, namely that those similarly situated should not be treated differently. The AB went on to apply this general concept of non-discrimination to the situation where different levels of preference are accorded to different developing countries. Since in this situation, different developing countries are being treated differently on the face of the scheme, the AB not illogically suggested that a non-discrimination requirement entails the donor being able to show that this differential treatment flows from the fact that the countries accorded more preferences are not in the relevant sense ‘similarly situated’ to those accorded lesser preferences.

There are several things that a donor country must now show in order to defend a GSP program that provides different levels of preferences to different developing countries: (1) that the different countries are not similarly situated, in the sense that the countries receiving the greater preferences have special development needs; (2) that tariff preferences are an effective means of addressing those special needs; (3) that all developing countries who have those special needs are offered the greater preferences; (4) that any conditions or performance requirements imposed on the eligible countries be objective, transparent and non-discriminatory. With respect to (1), the AB imported into 2(a) of the Enabling Clause, from which it carved the non-discrimination condition, a comparator for non-discrimination from 3(c) of the Clause, which requires that GSP respond positively to the development, trade and finance needs of the developing countries. The AB found that India had not properly pleaded a violation of 3(c) taken on its own, and therefore stressed that its interpretation of 3(c) was for purposes of giving context to the non-discrimination requirement in 2(a). In determining what needs are referred to in 3(c) for purposes of determining what developing countries are similarly situated, the AB suggested that the adjudicator should look for a benchmark of development needs in WTO treaties, but also in other multilateral instruments related to development. This implies a further role for non-WTO law (hard and soft) in articulating standards or benchmarks relevant to the application of WTO agreements. With respect to (2) we assume is that the AB has in mind a rational connection, and as it emphasized in the Shrimp/Turtle ruling, there would not be a requirement of empirical proof of effectiveness. With respect to (4), it is encouraging that the AB cited the conditions in the EC’s environmental and labour preferences as examples of objective and transparent criteria. This could be a message as well that it would be unwise for India to follow up its drugs claim with a challenge to those other preferences (that it had, at the very beginning included in its claim along with drugs, but then withdrawn).

A very important question is the relevance of the AB ruling for a different kind of GSP conditionality. In US and to some extent also EC GSP, there exists the feature that GSP may be withdrawn altogether if certain conditions are not met. In other words, a developing country must meet certain conditions (not country specific but in principle attainable by any developing country) in order to receive the level of preferences offered to *all* developing countries alike. The issue of discrimination arises for the AB when different *countries* are being treated differently; it is unclear that any issue of discrimination arises when the same level of tariff preferences is accorded to all developing countries, but they have to fulfill certain minimum conditions—objective, origin-neutral, transparent—in order to receive that general level of preferences. Thus, the AB stressed: ‘we do not rule on whether the Enabling Clause permits *ab initio* exclusions from GSP schemes of countries claiming developing country status, or the partial or total withdrawal of GSP benefits from certain developing countries under certain conditions.’ Even if such conditions, because imposed on all developing countries alike, do not violate the non-discrimination requirement of Article 2(a) of the Enabling Clause, given what the AB said about 3(c), the question will doubtless arise whether for example intellectual property conditionality would conform to the requirement of 3(c) that GSP respond positively to the individual development needs of developing countries. If 3(c) as the AB hinted, albeit in dicta, is about judging whether individual aspects of individual donor GSP schemes respond positively to the development needs of developing countries, then conditions that are about improving donor country market access (such as IP conditionality) are likely to fare poorly in WTO litigation; at the same time, conditions that can be linked to generally recognized conceptions of development and human rights (including core labour rights and environment, where related to biodiversity and sustainable development) will more likely be found consistent with 3(c). These are controversial matters, however, and one can imagine the sensitivities for instance if the AB were to delve into whether conditionality based on anti-terrorism measures was or was not in a particular instance consistent with 3(c).

In contrast to the European Union, the United States and other developed countries such as Canada and Australia have embodied trade preferences for developing countries in domestic customs legislation rather than in agreements with the developing countries themselves. Given the importance of the United States as a market for developing-country exports, the American GSP system has loomed large in debates about the desirability of the GSP approach to promoting export-led growth in developing countries. The United States initially opposed the granting of preferences to developing countries, but finally established its own GSP system in the mid-1970s.³³

The present version of this system is found in the Trade Act of 1974, as amended in 1984. The Act contains a number of provisions that open the door to discrimination between different developing countries, and to use of the threat of withdrawing GSP status as a political and economic weapon. For instance, the Act gives the US President authority to waive GSP status if the country in question fails to provide ‘reasonable access to its markets and to its commodities’ and if it does not afford ‘adequate and effective protection of intellectual property rights’.³⁴ In addition, the Act provides for ‘graduation’ of developing countries from GSP status once they reach a certain level of per capita GDP (US\$8,500 in 1984, indexed to a formula based on half the annual US growth rate).³⁵ This threshold is relatively high, but some of the most prosperous newly

industrializing countries (NICs) are now beginning to pass it.³⁶ As well, detailed rules exist for removal of preferences on particular products, even where a country does not meet the threshold for complete graduation. A preference will be removed when a developing country has become a major world exporter of a product—arguably a highly perverse approach that punishes the most successful LDC exporters (i.e. those who are most competitive in developed-country markets).³⁷ This partial graduation has occurred with respect to particular exports of more than a dozen LDCs.

Aside from the issue of graduation, and the obvious drawbacks of trade preferences that are non-binding and that can be used as political and commercial leverage by developed countries, there is a more general question to be raised about whether, in fact, the kinds of preferences actually granted have done much to assist export growth in the developing world. As Balassa suggests, the GSP itself excludes ‘product groups of principal interest to developing countries such as steel, textiles,³⁸ clothing, and shoes’.³⁹ In addition, trade remedy laws (countervail and antidumping) have frequently been used against developing countries, thereby clawing back much (and in some cases, all) of the benefits provided by tariff preferences—in past years, for instance, the number of antidumping cases initiated by the United States and the European Union against developing countries has often equalled or even exceeded the number of cases against developed-country exporters.⁴⁰ Thus, it is questionable exactly how beneficial the GSP actually is to developing countries.⁴¹

Furthermore, preferences do not appear to have responded adequately to developing countries’ concerns about ‘tariff escalation’. Tariff escalation denotes the tendency for developed countries to impose very low tariffs on imports of raw materials and much higher tariff rates on processed or finished products that are made from those raw materials. This practice makes it very easy for developing countries to export raw materials in an unprocessed state and much more difficult to export products that have a significant value-added component. The escalation effect occurs because while developed-country producers of the processed or finished products have access to raw materials at almost the same price as developing-country producers (due to the low tariffs on the raw materials), they also have a protected market against the developing-country producers by virtue of the significant tariff imposed on the processed or finished products in question. The end result is to discourage export-driven strategies of moving up the value chain from the extraction of raw materials to increasingly sophisticated processing industries. Balassa found that, even on the basis of GSP and Lomé preferences, effective protection afforded against higher value-added products from developing countries due to tariff escalation ranged from three to almost nine times the applicable nominal tariffs.⁴² More generally, as MFN tariff rates have fallen in successive rounds of GATT negotiations, the value of the GSP to developing countries has inevitably eroded. As well, GSP arrangements have often contained ‘safeguard’ provisions, allowing reimposition of higher tariffs or other import restrictions where a surge of developing-country imports threatens developed-country domestic producers.

The Multi-Fibre Arrangement

The MFA is an agreement between nine importing developed-country signatories (including the EU) and 31 exporting developing countries. It provides a framework for

voluntary export restraints (VERs), primarily quotas, limiting developing-country exports of textiles and clothing to the nine developed-country signatories. The MFA was formally established in 1974. It superseded two earlier agreements, the Short- and Long-term Arrangements, that applied to a far narrower range of developing-country exports.⁴³

The Short-term Arrangement on cotton textiles was in force from 1961 to 1962, and had been negotiated at the initiative of the Kennedy Administration. It was replaced in 1962 with the Long-term Arrangement Regarding International Trade in Cotton Textiles. It is important to note that these Arrangements did not initiate restrictive trade practices with respect to these sectors, which had existed since the end of the Second World War, particularly in the Western European countries.⁴⁴ Indeed, at the beginning, these Arrangements held the promise of an orderly codification of restrictions with a view to their eventual phase-out, as developed-country producers adjusted to new competitive realities through technological innovation and gradual labour shedding.⁴⁵

In the 1970s, however, competitive pressure from the NICs in particular became much more intense than had previously been experienced, and the MFA became a convenient vehicle to respond to these pressures through further restricting trade in these sectors with the use of special safeguards, VERs and quotas.⁴⁶ In addition, the incorporation of protectionism in a formal interstate agreement disguised to some extent the GATT-inconsistency of most of the measures in question, which were discriminatory quantitative restrictions, in violation of both Articles I and XI of the General Agreement. Jackson goes so far as to suggest that 'the countries who have accepted the textile or multifibre arrangements have arguably partially "waived" their GATT rights'.⁴⁷ In our view, this claim is highly suspect, because (as Jackson himself acknowledges) developing countries have accepted these arrangements only under the threat of even more restrictive GATT-inconsistent measures.

It is sometimes argued that developing countries are nevertheless protected by the MFA because the right to impose import restrictions is limited to cases where 'real risks of market disruption' exist in the import-restricting country (Article 4), and also because the MFA provides for gradual expansion of quotas, as well as exemptions for new entrants in the market and small suppliers. However, as Dao remarks, despite the existence of a monitoring mechanism (the Textiles Surveillance Body (TSB)), 'importing countries are reluctant to adhere to the Arrangement and often take additional restrictive measures beyond the Arrangement'.⁴⁸

The fundamental reality is that developing countries suffer very large losses from import restrictions imposed by developed countries in these sectors. It has been estimated that if *all* trade restrictions on LDC textile and clothing imports were lifted by the EU, Japan and the United States, the gains to LDCs 'would be no less than 50.8 per cent of total possible gains related to all trade'.⁴⁹ It has been further estimated that if all import restrictions were removed, developing-country textile exports would increase by about 50% and clothing exports by 128.9%.⁵⁰

The last extension of the MFA, which occurred in 1986, further sanctified the increasing restrictiveness of developing-country measures. Thus, coverage was extended to include new types of fibres and developed countries gained new rights to take unilateral measures against developing-country imports. Developing countries gained very little, save a statement that the final objective of the Parties was eventual submission

of trade in textiles to GATT strictures and some strengthening of the (in any case little-used and little-heeded) TSB.⁵¹

The Uruguay Round Final Act contains an ambitious plan for sweeping reform and the eventual phasing out of the MFA, which is described in detail in a later section of this chapter.

The United Nations Conference on Trade and Development

UNCTAD was founded in 1964 as a periodic conference of all UN members, with an ongoing institutional framework (the Secretariat). The intent was to establish a forum on trade where developing countries would find themselves less marginalized in the decision-making process than was thought to be the case with the GATT.⁵² Under the stewardship of Raoul Prebisch, an Argentinian economist, UNCTAD became a leading forum for the elaboration of the 'import substitution', protectionist view of economic development in the Third World.

According to Krueger,⁵³ this view of development was predicated on the following premises: first, developing-economies' production structures were heavily oriented towards primary commodity production and many observers attributed the low living standards in developing countries to dependence on primary commodity production and export. Second, if developing countries were to adopt policies of free trade, their comparative advantage would forever lie in primary commodity production. Third, both the global income and price elasticities of demand for primary commodities was low, so that expansion of primary commodity production would simply depress prices ('immiserizing growth'). Fourth, the labour force in developing countries, predominantly engaged in agricultural activities, had a marginal product of labour that was negligible, zero or even negative. Thus, it was explicitly or implicitly assumed that labour was a free good while capital was the scarce factor of production. Fifth, capital accumulation was crucial for growth and in early stages of development this occurs only with the importation of capital goods. Since it was expected that the demand for capital goods imports and imports of other products used in the production process would grow rapidly while foreign exchange earnings would not, it appeared that growth could follow only if domestic production of import-competing goods could expand rapidly. Sixth, there was very little response to price incentives in developing countries, especially in the agricultural sector: peasants were traditional in their behaviour and there were structural problems within the economy. Thus, most developing countries chose to maintain high fixed nominal exchange rates which reflected the perception that there was little response to prices and that maintaining such exchange rates taxed agricultural exports while simultaneously subsidizing capital goods imports.

At times, the developing countries appeared to be prepared to withdraw from GATT and to utilize UNCTAD as a forum for evolving an alternative legal order for world trade.⁵⁴ However, this threat never materialized, and instead UNCTAD became an instrument for applying pressure on developed countries to liberalize trade unilaterally with developing countries (while permitting developing countries themselves wide exemptions from GATT strictures in order to sustain import substitution-based growth policies, such as protection of infant industries). The main product of UNCTAD has been the non-law or at most 'soft law' of UN Resolutions. In the 1970s and early 1980s,

UNCTAD sought to develop a New International Economic Order, a grandiose project aimed at a fundamental restructuring of North—South relations. In fact, the NIEO was largely a recasting of the old demands for unilateral developed-country trade liberalization in a new ideological language—that of the moral imperative of redistribution of wealth from developed to developing countries.⁵⁵

The Global System of Trade Preferences

A much more concrete initiative of UNCTAD is the Global System of Trade Preferences (GSTP). Unlike the GSP, this is a system of preferences negotiated between, and applicable to, trade among developing countries themselves. It reflects UNCTAD's enthusiasm for the promotion of South-South trade as a response to supposed developed-country domination of the rules and terms of North-South trade. In fact, however, South-South trade continues to account for a very small percentage of world trade.⁵⁶

The GSTP developed from the 1971 GATT 'Protocol Relating to Trade Negotiations Among Developing Countries', which obtained an explicit Article XXV waiver to allow preferences in contravention of the Article I MFN requirement.⁵⁷ Despite official UNCTAD ideology that South-South preferences should reflect the relative economic development needs of the various developing countries, it appears that GATT-type reciprocity or trading of concessions on the basis of mutual self-interest has dominated negotiations on GSTP preferences.⁵⁸

With some exceptions, the GSTP provides for an MFN principle to apply with respect to concessions negotiated between the signatories. It appears, however, that the legal text of the GSTP permits the signatories, if they so desire, to confer the same preferences, or even more preferential treatment, on *non-signatories*, even where this may erode the value of concessions to signatories. This latitude was made necessary by the overlapping of the GSTP with various South-South regional trade agreements and customs unions.⁵⁹

The GSTP contains a provision that obligates signatories not to undermine concessions negotiated in the GSTP through the application of any charge or measure restricting commerce other than those existing prior thereto, with exceptions for countervailing and antidumping duties, border tax adjustments, and balance of payments measures (Article 10).

International Commodity Agreements and export earnings stabilization

Given the prominence of concerns about deteriorating terms of trade (particularly as related to primary commodities) in the traditional UNCTAD view of trade and development, it is not surprising that a major thrust of UNCTAD's work has been in the area of commodity price stabilization. Under the auspices of UNCTAD's Integrated Programme for Commodities, established in 1976, numerous International Commodity Agreements (ICAs) were struck, including ones for cocoa, coffee, copper, cotton and tin, among other commodities. These Agreements are in essence producers' cartels. Each producer country that is a member of the Agreement is assigned an export quota, with the global total of such quotas determined in such a way as to sustain world prices at a level acceptable to the Membership. Some of the ICAs also provide for Stabilization Funds

that purchase surplus production at times of oversupply with a view to selling when there are shortages.

The ICAs have not been particularly successful at sustaining commodity prices at the desired levels. The core difficulty is that which is endemic to many forms of cartelization: the tendency of individual members to ‘cheat’ on the supply constraints.⁶⁰ As well, a cartel can only function effectively if all or almost all the producers of the commodity in question are members, and this has not been the case with a number of the ICAs.⁶¹

In addition to ICAs, UNCTAD has also sought to establish a system of export earnings compensation, which would involve loans or grants to developing countries when their export earnings decline below a certain level due to supply and price fluctuations with respect to primary commodities. A limited facility for export earnings compensation, called the STAB EX, exists under the Lomé Convention but applies only to exports of a limited number of agricultural commodities to the EU.

The UNCTAD scheme involved the creation of a Common Fund that would apparently finance both the Stabilization Funds of individual ICAs (i.e. funds for purchase of buffer stocks or surpluses) as well as export earnings compensation. However, although first proposed in 1976, the Common Fund has yet to become a reality. The United States has consistently refused to participate, and a number of other developed countries (while agreed in principle on the idea) have failed to ratify the Agreement to create the Fund.⁶²

TRADE AND DEVELOPMENT: THEORY AND POLICY

Having reviewed the legal rules and institutions that apply to developing-country trade, we now proceed to examine the evolving theoretical and policy stances with respect to the relationship between trade and development that have influenced the evolution of these rules and institutions over the last 40 years.

The theory of comparative advantage and economic development: the limits of neo-classical theory

Despite the intense interest of their eighteenth- and nineteenth-century predecessors—particularly Smith, Hume and Mill—in the causes of wealth and poverty among nations, modern neo-classical trade economists have until recently not devoted a great deal of attention to articulating a rigorous theory of the linkage between trade and economic development.⁶³ As discussed in Chapter 1, neo-classical theory can explain why a country will experience welfare gains when it specializes in those products in which, given existing factor endowments, it possesses a comparative advantage. Comparative advantage is often taken to be *revealed* comparative advantage, leading to a static perspective that largely ignores the issue of how nations actually come to acquire comparative advantage in particular products in the first place. Today, of course, it is widely recognized that much more goes into the determination of comparative advantage than fixed, ‘natural’ factors like endowments of natural resources, and there is an

important and expanding economic literature on the causes of and constraints on economic growth and development.⁶⁴

Quite early in the post-war period, however, the creation of comparative advantage became a persistent concern of development theory and for a quite straightforward reason—the existing specialization of economic activity in developing countries seemed to provide no guarantee of generating sustained economic growth. On the basis of the example of the developed world (and the early experience of Soviet bloc industrialization), specialization in large-scale manufacturing industries was viewed as the key to growth. In addition, the existing specialization patterns of many developing countries could with justification be viewed as the historically contingent product of colonialism—developing countries served as ready sources of raw materials on the one hand, and as markets for the finished products of the colonial powers on the other. This suggested not only the artificiality of existing comparative advantage in developing countries, but also its foundation in fundamentally unjust power relationships.⁶⁵

Trade and development in the import substitution theories of the 1950s and 1960s

Although sometimes its intellectual success is blamed on the popularity of Marxist or neo-Marxist views of political economy, import substitution-based development theory rapidly gained acceptance as an orthodox policy prescription for developing countries even among the developed, ‘capitalist’ countries and among liberal policy analysts. The simple fact is that neo-classical liberal economists did not possess an alternative theory of growth and development, based on liberal trade, with which to launch an effective response.

Perhaps the one significant exception was Raymond Vernon’s ‘product cycle’ theory.⁶⁶ Vernon’s key argument is well summarized by Grossman and Helpman:

Most new goods...are developed in the industrialized North and manufactured there until their designs have been perfected and production techniques standardized. Then the innovating firms move the locus of production to the less developed South where wage rates and perhaps materials prices are lower. In a final stage of the product’s life, new and superior goods may impinge upon this market share and ultimately render it obsolete.⁶⁷

Vernon’s approach did provide a plausible strategy for developing countries to acquire comparative advantage in increasingly sophisticated manufactured products through foreign investment-based technology transfer. However, from the developing-country perspective, the theory had a number of unattractive features. First of all, it supposed, and accepted, that developing countries would never actually ‘catch up’ with the North, but would always remain a stage or two behind in the product cycle. Second, it was premised upon the acceptability of foreign ownership and investment, and was therefore susceptible to the critique that developing countries themselves (as opposed to foreign investors and multinational corporations) would realize few of the gains from their place in the product cycle, and would become subject to a new kind of economic colonialism.

In any event, the predominance of the import substitution view is reflected in the wide range of exemptions from GATT strictures afforded to developing countries, which we have outlined above, as well as the approaches and initiatives of UNCTAD. The many developing countries that adopted import substitution policies typically erected extremely high tariff and non-tariff barriers to imports, maintained artificially high exchange rates and stringent exchange controls, and in many cases domestic price controls (for instance, the prices of agricultural products were often controlled in order to contain the cost of living of industrial workers in the cities).⁶⁸

Dependency theory and the beginnings of a neo-classical response to import substitution approaches

It quickly became apparent that import substitution policies were producing disappointing, or even disastrous, results in many developing countries that had attempted them. According to Krueger,⁶⁹ once the easy opportunities for import substitution were largely exhausted, the new candidates normally had higher capital-to-labour ratios than the old, while many of the goods were items demanded by only the few in the upper income groups in poor countries. This meant that higher capital labour ratios required a higher rate of saving and investment to maintain the rate of economic growth, while for those industries with fixed costs and a minimum efficient scale of production, the cost disadvantages of producing in developing countries with small domestic markets were significant. Moreover, domestic import-substituting producers were provided with monopoly positions in the sheltered domestic market, and the incentives were such that few producers found it worthwhile to enter markets, particularly export markets, in which they were likely to face competition. Moreover, periodic balance of payments crises arose in reaction to overvalued exchange rates, increased indebtedness and the failure of export earnings to grow, leading to stop-go policy cycles.

These policy failures yielded two diametrically opposed responses in development theory. Many of those who advocated import substitution approaches turned to dependency theory to explain the continued failure to generate adequate economic growth in developing countries. According to dependency theory, these countries remained economically and socially backward due to complicity between the local power élites and the forces of developed-country capitalism. Early efforts at industrialization could easily be exploited by multinational corporations, who—with the support of corrupt and avaricious local élites—would build branch plant facilities in developing countries, but without contributing to development through significant technology transfer or training of local workforces.⁷⁰ The policy implications were a general continuation of import substitution policies but with a new emphasis on control of the multinational corporation, support for democratization movements, and guarantees that developed countries would not interfere with the sovereignty of developing nations.⁷¹

While many of those who had from the beginning supported import substitution approaches resorted to dependency theory to explain the early failure of these approaches, neo-classical trade economists began to reflect on the interesting fact that those few developing countries, mainly in East Asia, that had eschewed import substitution for outward-oriented strategies were experiencing high levels of economic growth.⁷² According to Balassa, the share of Korea, Singapore and Taiwan in total LDC-

manufactured exports increased from 6% in 1963 to 42% in 1984. Over the same period, per capita real incomes quadrupled in these three countries, while they increased at a much slower pace in inward-oriented LDCs such as India, Argentina and Mexico.⁷³

In reflecting on the empirical evidence of export-led growth, some neo-classical economists began to sketch a liberal alternative to import substitution-oriented development theory. The flavour of this alternative is captured by the following passage from an essay by Bela Belassa, one of the leading exponents of liberal development theory:

At the early stages of development, countries will generally benefit from specializing in natural resource products. In the process of industrialization, it will be advantageous to concentrate first on products utilizing mainly unskilled labour, with subsequent upgrading in the product composition of exports as the country accumulates physical and human capital.⁷⁴

The theory thus emphasizes how developing countries can move up the Value chain' beginning from a pre-existing comparative advantage in the least value-added exports (unprocessed raw materials). It thereby directly counters the claims of the import substitution-oriented theorists that absent the creation of protected industries by the state, developing countries will be fated to remain 'hewers of wood and drawers of water' under constantly deteriorating terms of trade.

A further focus of the liberal theory is the negative consequence for economic growth of 'the chaotic nature of differential incentives among diverse activities in IS (import substitution) regimes'.⁷⁵ The effect of this chaos is largely to destroy the market signals that would normally lead to efficient resource allocation. In addition, the pervasive government 'rigging' of economic activity diverts considerable resources to 'directly unproductive profit-seeking activities', i.e. rent-seeking, bribery of government officials, corruption, etc.⁷⁶ Finally, a liberal import policy can provide a substitute for domestic rivals which may be few or non-existent in many developing countries, thereby inducing competitive pressures to increase productivity.⁷⁷

The direct policy implications of the liberal theory of trade and development are the liberalization of *both* developed- and developing-country trade policies. Liberalization of the former gives developing countries new opportunities to achieve growth through export expansion, allowing these countries to move their exports up the 'value chain'. And liberalization of developing-country trade policies brings the gains from more efficient resource allocation that we have just described, with a corresponding increase in the competitiveness of developing-country products on world markets.

However attractive to proponents of liberal trade (such as ourselves), the theory and evidence of export-led growth still leave much to be explained and debated concerning the relationship between trade liberalization and development. It has been pointed out that those developing countries characterized by significant export-led growth did not simply replace import-restrictive policies with a *laissez-faire* approach. While reducing tariffs and other barriers to trade and reforming exchange rate regimes, these countries also initiated or activated a wide range of alternative government policies aimed at encouraging exports, including significant subsidies and loans to export-oriented

industries.⁷⁸ A study by the World Bank of growth in East Asian economies concluded that while targeted industrial policies (e.g. subsidies to specific firms) made little positive contribution to the so-called Asian economic miracle, more generally available export subsidies and other export incentives had a modest but significant impact on the extraordinary economic success of these countries.⁷⁹ Moreover, the economic difficulties experienced by a number of the East Asian economies in the late 1990s suggest that a number of firms may have over-expanded capacity through access to cheap debt capital provided in part by domestic financial institutions subject to weak capital market disciplines and excessive political interference in capital allocation decisions ('crony capitalism'). Thus, there remain unresolved questions as to the sustainability of the East Asian successes. In addition, there are further questions as to the generalizability of the East Asian experience to other contexts, such as whether the dynamic Asian economies display certain 'exceptionalist' institutional, social or cultural characteristics that explain in large part the success of the export-led model of development, including a relatively pragmatic, 'this-worldly' orientation in the mainstream culture; superior human resources (higher education levels among the general population); high savings rates; and a bureaucracy that is meritocratic and relatively 'autonomous' from patrimonial politics.

The LDC debt crisis

The debt crisis arguably marks a crucial watershed in the evolution of approaches to LDC economic development. Owing to the petrodollar surplus of the 1970s, major American, European and Japanese commercial banks found themselves with unprecedented amounts of money to lend on world markets. The banks became increasingly interested in lending to developing-country governments. They often presumed that since a sovereign could not go bankrupt, the very fact that the debtor was a government would provide adequate security for the loans. For developing-country governments, these loans represented an opportunity for another attempt at import substitution-based industrial development. The loans were particularly attractive since they offered the capital needed for industrialization, but without the strings attached to foreign direct investment or multinational corporate activities. Developing-country governments would have direct control of the money, and full rights to distribute or reinvest domestically the profits from successful investments. In the event, commercial banks lent to developing-country sovereigns an average of over US\$40 billion per year between 1977 and 1982.⁸⁰

By the early 1980s, a number of developing-country debtors were having increasing difficulty in paying off these loans. First of all, once again import substitution-based industrialization failed to yield high rates of growth. Second, the recession in the developed world had considerably dampened demand for developing-country exports, while at the same time leading to increased protection against those exports even where demand continued to be strong. At the same time, interest rates increased as the United States and other Western countries adopted an anti-inflationary monetary policy. Since the developing-country loans were based on floating rates, this meant that, just at a time when their foreign currency earnings from exports were declining, developing-country debtors were faced with very substantial increases in the cost of servicing their loans.⁸¹ Finally, in 1982, Mexico announced that it could not continue to pay its creditors according to schedule, and a number of other LDC debtors soon followed suit.⁸²

The initial response of the creditor nations was that of debt rescheduling. Repayment of loans would be stretched out over a much longer period, without any debt reduction. The debtors would be required to have the rescheduling backed by an IMF stand-by credit, which in turn would be conditional on domestic policy reforms to provide some assurance that the countries in question would attain the balance of payments stability required to repay on the rescheduled terms. The reforms in question included anti-inflationary policies, currency devaluation, and also liberalization of prices and (to some extent) foreign trade. Not only did some of the policy conditions of rescheduling cause severe human hardship in LDCs (for instance, rapid increases in food costs due to removal of price controls), but frequently, at the outset, the policy prescriptions were internally contradictory (for instance tight money policies to fight inflation alongside inflation-inducing currency devaluations and price liberalization), although eventually IMF officials paid greater attention to the interaction and sequencing of the various policy reforms.

During the 1970s, even despite the disappointing results from import substitution policies, many of these LDCs nevertheless continued to experience strong, albeit far from adequate, export growth, and increases in GDP. The effect of the debt crisis was to halt this growth almost entirely, as the debtor countries' foreign exchange earnings were eaten up by debt servicing requirements and they were unable to make investments in industrial production. In consequence, developing-country imports from the developed world declined significantly, further worsening the recession. This led to the fundamental recognition by the Reagan Administration of the dependency of world economic recovery on the renewal of growth in developing countries, and a sense of urgency to finding a solution to the LDC debt crisis that would permit such a renewal of growth.

The Baker Plan (named after the then US Treasury Secretary, James Baker) was the first such effort. Launched in 1985, it involved a proposal that commercial banks loan fresh money for investment in economic renewal to a select group of LDC debtors who were prepared to make major structural economic reforms, to be backed by structural adjustment lending by the World Bank and the IMF.⁸³ While it appears that some new loans were made pursuant to this Plan, the overall level of lending by commercial banks to LDC debtors actually declined from 1985 to 1987, and per capita income in debtor countries continued to fall.⁸⁴

While the Baker Plan did not provide for debt reduction, some LDC debtors were, towards the end of the 1980s, beginning to have some success with debt reduction, through repurchase of debt on the secondary market at discounted rates and also through debt/equity swaps. The swaps were most successful in the case of countries such as Chile and Mexico, who eventually were able to make credible commitments to provide an attractive climate for foreign investment to be purchased with debt. At the same time, in part due to pressure from domestic regulatory authorities, many developed-country creditor banks were increasing reserves on LDC loans, and their ability to do so lessened the sense of fear or panic that eventual debtor default could bring down the international financial system.

It was in this context that the United States proposed the Brady Plan in 1989. It would involve the commercial banks for the first time accepting debt reduction, but in return for a degree of backing for repayment of the remaining debt through various kinds of securities, with active participation in this backing by the US Treasury. After a somewhat

shaky beginning in Mexico, the Brady approach came to play an important role in debt restructuring in the Philippines, Venezuela, Uruguay, Costa Rica and Nigeria.⁸⁵ Mexico, Chile and the Philippines in particular recognized the potential for credible domestic policy reforms to induce significant influxes of capital, both foreign investment and (often more importantly) funds taken out of the country by its own nationals in order to avoid onerous taxation.

In 1999, a number of developed countries, the World Bank and the IMF endorsed an Enhanced Heavily Indebted Poor Countries Debt Relief Initiative that will provide substantial debt relief to 33 developing countries, subject to their meeting conditions relating to sound domestic macroeconomic, structural and social policies consistent with poverty reduction and sustained growth.

According to the IMF, 'To date, debt reduction packages have been approved for 27 countries, 23 of them in Africa, providing \$32 billion (net present value terms) in debt service relief over time.... For the 27 countries for whom packages have already been approved, debt service falling due between 1998 and 2004 on average has dropped by more than half in relation to both exports and government revenue.' (International Monetary Fund, 'Debt Relief Under the Heavily Indebted Poor Countries (HIPC) Initiative', Factsheet, March 2005.

Adjustment and sequencing

The lessons that have emerged from the debt crisis, along with the collapse of central planning in the Soviet bloc, and the general decline of Marxist-inspired development ideology, as well as the dramatic successes of more liberal trade policies in the Asian NICs, have led a variety of developing countries to move towards liberalization of their trade and related domestic policies even without the pressure of strict IMF conditionality. It has been estimated that since the mid-1980s, some 36 LDCs have undertaken significant trade policy reforms, and 17 of these have undertaken comprehensive reforms of distortionary policies, including exchange rate, price and wage policies.⁸⁶ Frequently, these reforms have been supported by lending facilities from the World Bank and the IMF.

Two issues that loomed large with respect to these reforms and continue to be the subject of discussion today are *adjustment* and *sequencing*. Lifting of trade restrictions can lead to the rapid decline of protected industries that would never have existed but for government intervention and isolation from global competitive forces. The result is often widespread labour dislocation, because of a lag before the positive growth effects of more liberal policies are felt. Moreover, because liberalization is unilateral, increased competition from abroad is not immediately offset by greater access for developing-country products in global markets. While they have undertaken very substantial lending to assist in the stabilization of the balance of payments during macroeconomic and related reforms, the international financial institutions have been very reluctant to engage in lending to facilitate labour adjustment. Worker adjustment is narrowly conceptualized as a distributional issue, and there is often suspicion that displaced workers may not be the most deserving beneficiaries of assistance. A World Bank paper suggests, for instance, that 'workers displaced from protected industries are not among the poorest groups in society'.⁸⁷ This is arguably a short-sighted view, as unemployment among

relatively advantaged segments of the population gluts the labour market in general and reduces consumer demand, therefore indirectly inflicting hardship on other, possibly less-advantaged segments of the population.⁸⁸ A further difficulty is that in some developing countries, particularly those with poor tax collection systems, tariff revenues may constitute an important source of revenue, and removal of tariffs therefore actually reduces the income stream which the government has at its disposal to fund labour adjustment programmes.

A second issue is that of sequencing: should import controls be removed before macroeconomic and other domestic reforms are already in place? There is a strong argument that until distortions in domestic prices and wages (inputs into production) are removed, and exchange rates become more realistic, it is unlikely that import competition will send the appropriate signals to domestic producers. It has been found that trade policy reforms can be effective when introduced either simultaneously with other reforms or shortly thereafter.⁸⁹ Although he primarily criticizes IMF pacing and sequencing of capital market liberalization, Stiglitz⁹⁰ also insists that trade liberalization in developing countries must be gradual and sequenced. He points to the success of developing economies in East Asia, which liberalized slowly, focusing on job and business creation and the need for capital to support it.

FUTURE POLICY OPTIONS

Unilateral trade liberalization

This option, which has just been described from the perspective of structural policy reform, has the obvious limitation that the adjustment process is not facilitated through any additional access to developed-country markets. However, in many developing countries, the costs of distortive policies to productivity and growth may have become so high as to justify not delaying liberalization until reciprocal trade liberalization can take place. Balassa suggests that in these instances, developing countries should proceed with liberalization, and that in eventual negotiations on the basis of reciprocity, they can credibly demand concessions for making liberalization that has already taken place binding and irreversible.⁹¹ This depends on the credibility of the implicit threat that such liberalization would be reversed in the future—the fact that many of the original protectionist policies are now seen as fundamentally pernicious to the developing countries themselves reduces the credibility of the threat considerably.

South-South trade liberalization

Despite the increasing activity with respect to South—South trading arrangements, and the implementation of the GSTP, South—South trade remains a very small percentage of global trade. However, in the wake of structural domestic reforms, particularly those directed towards currency convertibility, this may change somewhat. In the past, trade between developing countries rarely took place in convertible currency and therefore was less attractive than trade with developed countries. Moreover, a pattern is already discernible whereby the more developed LDCs, particularly the Asian NICs, relocate

some of the production processes for their exports to lesser-developed LDCs with lower wages and less skilled workforces.

Regional trading arrangements between developed and developing countries

This option is most clearly reflected in the North American Free Trade Agreement, encompassing Canada, the United States and Mexico, with possible future extension to other Latin American and Caribbean LDCs under a Free Trade Agreement of the Americas. Unlike multilateral liberalization, liberalization through a regional arrangement may bring with it adjustment and technical assistance from the more developed members of the grouping. On the other hand, there is the possibility that the developed country or countries in the grouping will exercise overwhelming power and influence over the way in which the arrangement is implemented.

Multilateral liberalization

The Uruguay Round provided a number of attractive trade-offs for (at least some) developing countries. On the one hand, many developing countries (particularly at the outset of the negotiations) were resistant to American demands that their domestic policies with respect to regulation of service industries, foreign investment and intellectual property become subjects of negotiation in the GATT. On the other hand, the prospect of substantial reduction in agricultural protection and the phasing out of a significant part of textiles and clothing protection offers the prospect of real gains for many developing countries. In previous chapters on trade in services, intellectual property and investment, we have discussed in greater detail the issues that these Uruguay Round agenda items raised for many LDCs. However, as we note in these chapters, the Uruguay Round Final Act reflects a number of compromises between developed-country demands and the concerns of developing countries. For instance, in the case of TRIPs, compulsory licensing of patented inventions is permitted subject to certain conditions being met, including compensation to the patent-holder. This reflects a significant compromise of the American view, shared to a large extent by the EU and Japan, that no compulsory licensing should be permitted within the 20-year period of required patent protection. In the case of TRIMs, the Final Act stops short of characterizing, for instance, technology transfer requirements as violations of trade rules, and leaves considerable scope for investment measures aimed at ensuring that foreign enterprises further the development goals of host countries—again, the United States in particular had pushed hard for a much more restrictive approach to investment measures. The following brief survey of the Final Act canvasses many of the specific references to developing countries as well as issues such as the MFA of direct, specific relevance to developing-country trade. It is intended to be illustrative, not exhaustive.⁹²

Manufactureds Trade Liberalization

Significant tariff reductions on manufactured imports were achieved in the Round. Developing countries actively participated in these negotiations and bindings on imported

industrial products rose from 13 to 61%. While developed countries' tariffs on imports from other developed countries were reduced by an average of 40%, tariffs on imports from developing countries were reduced by only 28%. Cuts by LDCs in protection of mechanized trade are estimated to increase real incomes in developing countries by between US\$60 and \$100 billion at 1992 prices, despite cautious commitments made by many developing countries.⁹³

Understanding on the Balance of Payments Provisions of the GATT

This Understanding, discussed in detail in Chapter 5, reflects concern by the United States and some other developed countries about insufficiently rigorous application of the conditions or criteria established in Articles XII and XVIII:B of the GATT to justify trade measures taken for balance of payments reasons. This mostly concerns, in contemporary circumstances, measures taken by developing countries.

Agreement on Agriculture

The Agreement allows developing countries the flexibility to implement their commitments to reduction of protection and domestic support over a ten-year period (Article 15; the normal implementation period for developed countries is six years). The least-developed-country Members are not required to make reduction commitments.

The existing system of agricultural support in developed countries is widely viewed as having depressed world prices for temperate zone agricultural commodities.⁹⁴ The effects on developing countries of the liberalization process set out in the Agreement on Agriculture are, therefore, mixed. As Winters suggests: 'Exporters of the temperate products whose prices are most affected by agricultural liberalisation—for example, Argentina and Thailand—have strong and direct interests in the dismantling of protection; their revenues and income would increase significantly. On the other hand chronic food importers—for example, Bangladesh—would undoubtedly suffer.'⁹⁵ The fact that developed-country liberalization of trade in agriculture may harm this latter group of countries is taken into account in the Decision on Measures Concerning the Possible Negative Effects of the Reform Programme on Least-Developed and Net Food-Importing Developing Countries.

The Decision commits Trade Ministers of GATT Members to review levels of food aid provided to developing countries to ensure that they are sufficient to meet the legitimate needs of developing countries during the reform programme (Article 3(i)); to increase the proportion of food aid provided to developing countries as aid or on concessional terms (Article 3(ii)); and to give 'full consideration' to developing-country requests for technical assistance to develop their domestic agricultural sectors (Article 3(iii)). As well, it is accepted that difficulties in financing imports of food on commercial terms may be a basis for assistance from international financial institutions (Article 5).

Agreement on the Application of Sanitary and Phytosanitary (SPS) Measures

The Agreement provides that Members agree to facilitate the provision of technical assistance to other Members, especially, but not only, to developing-country Members, either bilaterally or through the appropriate international organizations. Article 9 sets out the forms this technical assistance may take, including the areas of processing technologies, research and infrastructure, including the establishment of domestic regulatory bodies. The assistance granted may be in the form of advice, credits, donations and grants to allow recipients to adjust to and comply with the required level of SPS protection. In addition, where a developing-country Member must make substantial investments to meet the level of SPS requirements of an importing Member, the importing Member is requested to consider providing technical assistance that will enable the developing country to maintain and expand its market access opportunities for the product involved. In addition to this technical assistance provision, Article 10 of the SPS Agreement provides for special and differential treatment (S&DT) for developing-country Members, including longer time frames where possible as well as the granting of specific time-limited exceptions in whole or in part from the Agreement.

Agreement on Textiles and Clothing

Of major importance to many developing countries is the gradual liberalization of protection pursuant to the MFA, as provided for in the Uruguay Round Agreement on Textiles and Clothing.⁹⁶ Under the Agreement, all restrictions provided for in bilateral agreements and under the MFA are to be notified to the Textiles Monitoring Body (TMB), and removed according to a graduated schedule. Thus, upon entry into force of the Agreement, Members are to remove all MFA-based or bilaterally agreed restrictions on products accounting for at least 16% of the total volume of their imports in 1990 in the following product groups: tops and yarns, fabrics, made-up textile products, and clothing (a detailed Annex listing the individual product classes according to the Harmonized System of Classification is attached to the Agreement on Textiles and Clothing). With respect to restrictions that remain after this initial phase of liberalization, within three years, Members must remove restrictions on products accounting for a further 17% of the total volume of imports in 1990 terms. Removal of restrictions on products accounting for at least another 18% of import volume is required after seven years. All further restrictions are to be eliminated within ten years of the entry into force of the Agreement. During the transition period, quotas are to be expanded on imports that have not yet been completely derestricted.

It is to be emphasized that the above liberalization commitments apply only to restrictions imposed based upon the MFA or bilateral agreements outside the GATT legal framework. In the case of many of the products in question, the bound MFN tariff rates remain quite high, and are in themselves unaffected by these liberalization commitments. Tariff reductions achieved in the Uruguay Round, while substantial, will nevertheless leave in place tariffs on many textile and apparel items that are much higher than the average for industrial products generally.

It should be noted, as well, that special safeguard provisions apply with respect to the liberalization of MFA-based and bilaterally negotiated restrictions. A Member may take safeguard action when 'it is demonstrated that a particular product is being imported into its territory in such increased quantities as to cause serious damage, or actual threat thereof, to the domestic industry producing like and/or directly competitive products' (Article 6(2)). It is specified that 'serious damage or actual threat thereof must demonstrably be caused by such increased quantities in total imports [of the product in question] and not by such other factors as technological changes or changes in consumer preference'. Safeguard protection is to be temporary (a maximum of three years with no right of renewal) and must in any event cease when, pursuant to the liberalization commitments discussed above, all past MFA-based or bilaterally based restrictions are to have been removed from the product. The level of restraint under the safeguard 'shall be fixed at a level not lower than the actual level of exports or imports from the Member concerned during the twelve-month period terminating two months preceding' the request for safeguard protection (Article 6(8)). An importing Member seeking to take safeguard action must first attempt a voluntary agreement with the exporting Member before acting unilaterally. However, any such voluntary agreement must be reported to the TMB, which is to determine its consistency with the safeguard provisions of the Agreement on Textiles and Clothing. Finally, safeguards are to be applied on a Member-by-Member basis, rather than to all Members exporting the product in question. Therefore, a determination must be made that serious damage or threat thereof is attributable to *each* Member to whom safeguard action is to be applied (Article 6(4)).

Fearing serious damage to its domestic underwear industry, the United States relied on the Agreement on Textiles and Clothing to restrict Costa Rican imports of underwear. Costa Rica challenged this measure, alleging that it violated a number of provisions of the Agreement on Textiles and Clothing. In November 1996, a panel ruled largely in favour of Costa Rica, because, *inter alia*, the United States had not 'demonstrated that serious damage or actual threat thereof was caused by such imports to the United States' domestic industry'.⁹⁷ Costa Rica appealed, however, on a technical point regarding the legality of the retroactive application of apparel quotas. This appeal was allowed, thereby strengthening Costa Rica's victory. A similar case involved the consideration of US restrictions on imported wool shirts and blouses from India.⁹⁸ The primary issue was whether the TMB is required to endorse safeguard actions taken by Members. India argued that TMB endorsement was necessary, while the United States argued that there was no such requirement. Here the panel found a middle ground, ruling that 'members imposing safeguards are required to refer the matter to the TMB and then endeavour to accept'⁹⁹ the resulting recommendations of the TMB. Thus the US restrictions were found to be in violation of the Agreement. India appealed the ruling on a number of technical points regarding the burden of proof, the findings of the TMB and the panel's use of judicial economy.¹⁰⁰ The Appellate Body did not accept India's arguments and left the original panel decision intact.

Finally, Article 8 of the Agreement on Textiles and Clothing sets out the procedures for establishment and operation of the TMB. The TMB is to consist of a Chairman and ten Members. The membership 'shall be balanced and broadly representative of the Members and provide for rotation of its Members at appropriate intervals' (Article 8(1)). The membership of the TMB is to be selected by Members of the WTO designated by the

Council for Trade in Goods to serve on the TMB, voting in their personal capacity and not as representatives of their governments. The TMB is charged with a range of monitoring functions, including a major review of the liberalization process, to be conducted after the end of each of the stages (i.e. three, six and ten years).

Agreement on Technical Barriers to Trade

The Agreement stipulates that developing-country Members shall be provided, upon request, with technical assistance and advice from other Members in order to facilitate the process of standardizing technical requirements both through national standardizing bodies and through participation in international standardization exercises (Article 11(2), 11(4), 11(5)). Such assistance and advice is to occur on ‘mutually agreed terms and conditions’. Generally speaking, Article 12, although entitled Special and Differential Treatment of Developing Country Members, does not exempt developing countries from the obligations of the Technical Barriers Agreement with respect to harmonization, standardization or mutual recognition of technical requirements. Rather, most of the provisions of Article 12 merely require that various special needs of developing countries be taken into account in the interpretation and implementation of the Agreement. However, Article 12(4) seems to go further towards an actual modification (or at least a qualification) of substantive obligations, in stipulating that ‘developing country Members should not be expected to use international standards as a basis for their technical regulations or standards, including test methods, which are not appropriate to their development, financial and trade needs’.

Agreement on Implementation of Article VI of the GATT (Dumping)

Article 15 states that ‘special regard’ is to be given by developed-country Members to the ‘special situation’ of developing countries when considering the imposition of antidumping duties. Members are required to explore the possibility of constructive remedies (i.e. price undertakings) before imposing duties where these would ‘affect the essential interests of developing country members’. This provision is essentially identical to Article 13 of the Tokyo Round Dumping Code.

Agreement on Subsidies and Countervailing Measures

The ban on export subsidies in Article 3(1)(a) does not apply to least-developed-country Members, and will apply to other developing-country Members only after a transition period of eight years (Article 27(1)). The ban on subsidies ‘contingent...upon the use of domestic over imported goods’ shall not apply to developed countries in general for five years and to the less-developed countries for eight years (Article 27(2)). However, once a developing country has achieved ‘export competitiveness’ in a given product, it is required to phase out export subsidies over a period of two years (Article 27(4)), unless it is one of a listed group of least-developed countries, in which case the phase-out period is extended to eight years (Article 27(4)). ‘Export competitiveness’ is deemed to have been achieved where the exports of the developing country in question have reached at least 3.25% of world trade for two consecutive years (Article 27(5)). Finally, the Agreement

on Subsidies and Countervailing Measures contains special *de minimis* exemptions from counteravailability for developing countries. Thus a countervailing duty investigation is to be terminated when it is determined that a subsidy accounts for less than 2% of value on a per-unit basis or where the *volume* of subsidized imports accounts for less than 4% of the total imports of like products (unless imports of like products from developing countries, taken together, amount to more than 9% of total imports of like products into the importing country) (Article 27(9)).

Understanding on Rules and Procedures Governing the Settlement of Disputes

The Dispute Settlement Understanding contains several provisions that arguably seek to address long-standing complaints that developing countries have been marginalized or disadvantaged in the GATT dispute settlement process. Article 8(2) includes 'a sufficiently diverse background' as one of the criteria for composition of dispute panels, and—much more specifically—Article 8(10) stipulates that 'when a dispute is between a developing country Member and a developed country Member the panel shall, if the developing country Member so requests, include at least one panellist from a developing country Member'. Within the general time limits established by the Dispute Settlement Understanding, a panel examining a complaint against a developing-country Member is to 'accord sufficient time for the developing country Member to prepare and present its argumentation' (Article 12(10)). Furthermore, where a developing-country Member is party to a dispute, the panel must explicitly address in its report the applicability of any special GATT provisions with respect to developing countries, where these provisions have been invoked by the developing-country Member that is a party to the dispute (Article 12(10)).

In the case of least-developed-country Members, particular consideration is to be given to the 'special situation' of these Members throughout the dispute settlement process. Members are required to 'exercise due restraint' in making complaints against least-developed-country Members under the WTO dispute settlement procedures. A special role is contemplated for the Director-General of the WTO or the Chairman of the Dispute Settlement Body with respect to facilitating consultations in the event of a dispute involving a least-developed-country Member (Article 24(1), 24(2)). Finally, the Secretariat of the WTO is charged with the provision of legal advice and assistance to developing-country Members with respect to dispute settlement (Article 27(2)).

Decision on Measures in Favour of Least-developed Countries

The Decision reflects what remains of the non-reciprocal approach to trade liberalization with respect to developing countries, applied *only* to the least-developed countries 'as long as they remain in that category'. With respect to specific commitments and concessions as opposed to compliance with the general rules of the Final Act and its various Agreements, least-developed-country Members will 'only be required to undertake commitments and concessions to the extent consistent with their individual development, financial and trade needs, or their administrative and institutional capabilities' (Article 1). Thus MFN tariff and non-tariff concessions 'on products of

export interest to the least-developed countries may be implemented autonomously, in advance and without staging'—i.e. without being tied to reciprocal concessions from these countries.

The above survey of the provisions of the Final Act and related Agreements and Decisions that apply to developing countries clearly suggests that the overall approach is one of full integration of all but the least-developed countries into the GATT/WTO, with some special allowance made for special difficulties that developing countries may experience with respect to full integration, e.g. through longer phase-in periods for compliance with GATT/WTO obligations. Even with respect to the least-developed countries, 'special and differential treatment' falls far short of outright exemption from the main general rules of the GATT/WTO. Overall, the Uruguay Round outcome represents a wager by developing countries in favour of an approach to trade and development premised upon openness and export-led growth. Whether this wager will be won depends significantly on the will of developed countries to offer tariff concessions on products of export interest to developing countries. It also depends on the willingness to prevent (sometimes legitimate) concerns about 'fair trade'—e.g. labour and environmental standards—from releasing a new wave of protectionism against developing countries.¹⁰¹

The Doha Development Agenda

Overview

Despite continuing uncertainty as to the independent effect of international trade on growth and inequality, international trade liberalization is generally regarded by the international community as one essential element of development, but not the only essential element. Rodrik notes that dissatisfaction with the original Washington Consensus, which emphasized liberalization and privatization, led to the addition of new elements including legal and political reform, regulatory institutions, social safety nets and poverty reduction.¹⁰²

The current round of WTO negotiations, the Doha Round, has been promoted as the 'development round' and purports to address many of the concerns that developing countries have with the current WTO system. There are several key elements of the Doha Declaration¹⁰³ that relate to development, including the following. First, Members express continuing commitment to the principles of trade liberalization, and rejection of protectionism. Second, they assert that international trade 'can play a major role in the promotion of economic development and the alleviation of poverty' and commit to focusing the work programme on developing-country needs. This will involve enhanced market access, balanced rules, technical assistance and capacity-building programmes. Third, the Doha Declaration commits to addressing the marginalization of least-developed countries and to assisting in their meaningful integration and effective participation in the multilateral trading system. Fourth, Members indicate they would continue to work with Bretton Woods institutions, in view of the fact that trade alone cannot address the challenges associated with 'a rapidly changing international environment'. Fifth, Members confirm their responsibility to ensure effective participation of all Members in the WTO.

The Doha work programme is extensive. Several developing countries were not enthusiastic about certain issues on the negotiating agenda. Developing countries resisted incorporating electronic commerce and the four ‘Singapore issues’—trade and investment, trade and competition policy, transparency in government procurement, and trade facilitation (which recognizes ‘expediting the movement, release and clearance of goods’¹⁰⁴)—into the WTO agenda. In the meetings leading up to Doha, developing countries worried that they did not have sufficient resources to address such a broad agenda.¹⁰⁵ The following is a brief but not exhaustive survey and discussion of aspects of the work programme that are of particular importance to developing countries.

Market access

Implementation-related issues and concerns

The Doha Declaration calls for negotiation on outstanding implementation issues and adopts the Decision on Implementation-Related Issues and Concerns,¹⁰⁶ which raises Members’ general implementation concerns and those related to specific Agreements, specifically GATT 1994, Articles VI and VII, the Agreement on Agriculture, the Agreement on the Application of Sanitary and Phytosanitary Measures, the Agreement on Textiles and Clothing, the Agreement on Technical Barriers to Trade, the Agreement on Trade-Related Investment Measures, the Agreement on Rules of Origin, the Agreement on Subsidies and Countervailing Measures, and the Agreement on Trade-Related Aspects of International Property Rights. The Decision on Implementation-Related Issues and Concerns indicates that Members are ‘determined to take concrete action’ to address developing-country implementation concerns, including obstacles to implementation such as resource constraints.

According to Mukerji, Uruguay Round commitments to developing countries have not been satisfactorily met. Trade liberalization in areas of particular importance to developing countries, such as agriculture, textiles and clothing, has not kept pace with the general trend of liberalization. Instead, in these areas, tariffs remain high and non-tariff barriers are high and growing. Additionally, liberalization of trade in services has not addressed those sectors and modes of supply that could benefit developing countries.¹⁰⁷ Mukerji also points out that there are human and financial resource barriers to the effective participation of developing countries in the dispute settlement process.¹⁰⁸

*Agriculture*¹⁰⁹

The Doha Declaration commits to agriculture negotiations with a view to improving market access, reducing all forms of export subsidies with the aim of phasing them out, and reducing trade-distorting domestic support. Special and differential treatment for developing countries will be a component of these negotiations, to account for developing-country development and food security needs (para. 13). Members failed to meet the 31 March 2003 deadline specified in the Declaration for establishing ‘modalities on further commitments’. Among the contentious issues, according to the International Centre for Trade and Sustainable Development (ICTSD), is the matter of whether ‘with a view of phasing out’ indicates a commitment to eliminating export subsidies. It is also

unclear whether 'all forms of export subsidies' includes export credit schemes such as those used by the United States.¹¹⁰ A framework agreement enabling modalities for liberalizing agricultural trade reached in July 2004 suggests progress on these issues.

Non-agricultural products

WTO Members committed in the Doha Declaration to negotiations aimed at reducing or eliminating tariff and non-tariff barriers to non-agricultural products, with emphasis placed on products important to developing countries. There will be no *a priori* exclusions from product coverage, and negotiations will seek to address tariff peaks, tariff escalation and high tariffs. Flexibility for developing and least-developed countries will include less than full reciprocity in reduction commitments. Also, modalities for negotiation must include studies and capacity-building measures to help LDCs participate effectively in the negotiations (para. 16).

In May 2003, the Chair of the Non-Agricultural Market Access Negotiating Group circulated the first draft of modalities¹¹¹ to WTO Members. In addition to special and differential treatment and less than full reciprocity in reduction commitments, the draft modalities allow developing countries longer implementation periods for tariff reductions and the possibility of leaving up to 5% of tariffs unbound. Also, the modalities exempt LDCs from certain reductions required of other Members, but note that LDCs should still increase the level of their binding tariff commitments (para. 8). Although the draft modalities propose that developed Members 'who so decide' may remove tariff and quota barriers to LDC exports entering their markets, they impose no obligation that they do so (para. 9).

Services

The Doha Declaration indicates that negotiations on services will proceed based on the Guidelines and Procedures for the Negotiations.¹¹² The Guidelines indicate that individual developing- and least-developed-country Members will be treated flexibly, including with regard to 'opening fewer sectors', 'liberalizing fewer types of transactions' and 'progressively extending market access in line with their development situation'. Also, services negotiations are to proceed primarily on a request-offer basis (paras 11–12). The ICTSD notes that several developing-country concerns arise from the request-offer approach. Bilateral negotiations require considerable resources, lack transparency and involve unequal bargaining power. As of February 2003, most LDCs and less-advanced developing-country Members had not made bilateral negotiation requests.¹¹³

*Trade-related aspects of intellectual property rights*¹¹⁴

Whether or not the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs) has negatively impacted developing-country interests has been the topic of much discussion.¹¹⁵ Matsushita, Schoenbaum and Mavroidis¹¹⁶ identify five main criticisms of TRIPs relating to development. First, some commentators argue that TRIPs only benefits developed countries. Second, TRIPs does not currently protect the interests developing

countries have in their 'traditional knowledge and culture'. Third, TRIPs may conflict with the UN Convention on Biological Diversity,¹¹⁷ which protects the access of developing countries to their genetic resources. Fourth, food security may be threatened in developing countries by increasing the cost of seed and plant supplies. Fifth, TRIPs is a danger to public health in developing countries because it affects pharmaceutical cost and access.

The Doha Declaration takes steps to begin addressing two of these issues. It instructs the Council for TRIPs to study the relationship between TRIPs and the UN Convention, with development in mind (para. 19). It also stresses that TRIPs should be interpreted and implemented 'in a manner supportive of public health, by promoting both access to existing medicines and research and development into new medicines' (para. 17). At the Doha Ministerial, Members also adopted the Declaration on the TRIPs Agreement and Public Health.¹¹⁸ On 30 August 2003, the General Council agreed on a Decision to implement paragraph 6 of the Doha Declaration.¹¹⁹ The Decision is aimed particularly at a solution to the difficulties that WTO Members with insufficient or no manufacturing capacities in the pharmaceutical sector face in making use of compulsory licensing under the TRIPs Agreement. The Decision allows a waiver from the obligations set out in paragraphs (f) and (h) of Article 31 of the TRIPs Agreement in exceptional circumstances. The developing-country Member must notify the Council for TRIPs of its specific needs, the compulsory licensing must only be for the amount necessary to meet those needs, and the product produced under the licence must be clearly identified as such.

*Special and differential treatment*¹²⁰

While the general provisions of the Uruguay Round Final Act reflect developing-country concerns in a number of areas, the tendency was not to grant developing countries broad exceptions to compliance with GATT rules. In some instances, developing countries may be given a somewhat longer period of time to phase in domestic compliance with the new rules, but the Uruguay Round result reflects, in large measure, a rejection of the view that developing countries should not be required to make reciprocal commitments to trade liberalization.

In 2001, several developing countries¹²¹ proposed a Framework Agreement on Special and Differential Treatment.¹²² This proposal argues that the Uruguay Round resulted in a 'dramatic erosion of [special and differential] treatment' for three reasons:

- (i) It was assumed that the level of development had no relationship with the level of rights and obligations under the multilateral trading system;
- (ii) The same policies could be applicable for countries at various levels of development. It was thought that all that was required was the grant of short transition periods and technical assistance for developing countries; and
- (iii) Developing countries did not have the option to sign or otherwise [*sic*] on the various agreements because all of them, excepting four plurilateral agreements, were part of the Single Undertaking.¹²³

The countries note that although there are almost 145 special and differential treatment provisions in the Uruguay Round Agreements, few are legally enforceable because they

only involve a best-efforts promise (para. 9). The countries suggest adopting and applying a special and differential treatment agreement reflecting, first, the principle that trade liberalization is not an end in itself but a means to Member-country growth and development, and, second, that Members' different levels of development require different policy approaches (paras 10, 14). Among their specific suggestions is that such an agreement should make special and differential treatment mandatory and legally binding, and that developing countries should not be automatically bound to the Single Undertaking (para. 15).

Various commentators have been critical of the current S&DT system. For example, Olivares¹²⁴ emphasizes the 'soft law' nature of S&DT in the WTO Agreements, arguing that it discriminates against developing countries in the WTO dispute settlement system by making many S&DT provisions non-binding and unenforceable. Hoekman¹²⁵ supports abandonment of the traditional 'soft law' S&DT system, suggesting that a preferable development model would emphasize multilateral monitoring and surveillance, financial and technical assistance, and increased cooperation with trade and development agencies. Michalopoulos¹²⁶ sees a continuing, though reformed, role for special and differential treatment in the WTO. He draws two main conclusions regarding the current state of special and differential treatment. First, institutional and supply-side constraints in developing countries impede developing-country integration into international trade and the WTO system. He notes that despite uncertain causality between trade liberalization and development and the concern that liberalizing countries need short-term safety nets, commentators still agree that development requires market-oriented policies and systems and that government intervention should only be used in cases of market failure. Second, individual developing countries have different needs in terms of accessing international markets and integrating into the trading system. Michalopoulos's proposal is to institute a graduated system that targets the benefits of special and differential treatment to low-income developing countries and countries requiring assistance to integrate into the global trade system. He envisions several elements as a part of this scheme including, but not limited to, institutional capacity-building, legally binding commitments, more detailed differentiation of developing countries, and decreased emphasis on S&DT provisions allowing domestic market protection and export subsidization. The United Nations Development Programme (UNDP) also supports a graduated approach and suggests basing it on either comprehensive technological and human capability indicators, or Millennium Development Goals¹²⁷ committed to at the UN General Assembly in 2000.¹²⁸

The Doha Declaration makes note of the developing-country proposed Framework Agreement on Special and Differential Treatment and of the constraints faced by developing countries. The Declaration further agrees to review special and differential treatment provisions, and endorses the work programme set out in the Decision on Implementation-Related Issues and Concerns (para. 44). The programme set out in the Decision calls on the Committee on Trade and Development to identify mandatory S&DT provisions, to identify provisions that Members consider should be made mandatory, to consider how S&DT provisions could be made more effective, and to provide clear recommendations to the WTO General Council by July 2002. It also instructs the Committee to consider how S&DT might be incorporated into the WTO

rules (para. 12). Due to intractable differences of opinion between Members, the Committee missed the July 2002 deadline and an extended February 2003 deadline.

One difference between developing and developed countries is whether or not the S&DT mandate should be viewed as new negotiations that allow for new trade-offs. The latter hold this view, while the former see the mandate as allowing for the application of what was agreed to in previous negotiations by strengthening the language in the WTO Agreements. There is also disagreement between Members on whether the Committee should first address specific S&DT provisions, or overarching principles and objectives of S&DT. Developed countries would address overarching issues first, whereas most developing countries regard the Doha mandate as only referring to Agreement-specific provisions. Developing countries differ, however, as to whether they would be willing to entertain discussion of overarching issues after addressing Agreement-specific provisions. A third area of disagreement is that although Members agreed in principle on an S&DT 'monitoring mechanism', developing and developed countries have not come to an agreement on the role of that mechanism.¹²⁹

Least-developed countries

The Doha Declaration expresses commitment to the goal of duty-free, quota-free market access for LDC exports and indicates that Members will consider measures for increasing market access. It also acknowledges the concessions made by some WTO Members prior to the Third UN Conference on LDCs (LDC-III). The Declaration calls for continued work on LDC accessions to the WTO (para. 42).

The pre-LDC-III concessions to which the Declaration refers are commitments by certain developed countries to make their markets more accessible to LDC exports. Among these initiatives are the US African Growth and Opportunity Act (AGOA), the EU 'Everything But Arms' (EBA) initiative, and Canada's LDC Market Access Initiative. AGOA applies to designated sub-Saharan countries and extends the list of products under the US GSP from 4,600 under general GSP to more than 6,400 under AGOA GSP. Like the GSP, AGOA products are not subject to import duties. However, AGOA GSP extends almost two years beyond the expiration of general GSP, until September 2008.¹³⁰ EBA grants immediate duty-free imports from LDCs with certain exceptions: arms and munitions, fresh bananas, rice, and sugar. Duties for the latter three products will gradually decrease until they are eliminated, in 2006 for fresh bananas and 2009 for rice and sugar. Duty-free tariff quotas for rice and sugar will increase annually.¹³¹ Canada's LDC Market Access Initiative extends duty-free access to the Canadian market, excluding dairy, poultry and eggs, to 48 LDCs.¹³²

Critics argue that the impact of these initiatives is limited. Ianchovichina, Mattoo and Olarreaga¹³³ estimate that if the EU, the US, Canada and Japan fully opened their markets to a subset of 37 sub-Saharan countries, it would result in a 1.2%, \$1.8 billion increase in real incomes and a 14%, \$2.5 billion increase in non-oil exports. This would mainly be the product of access to the Japanese and EU agricultural markets. However, the initiatives described above keep a number of trade barriers intact. Rubens Ricupero,¹³⁴ Secretary-General of UNCTAD, specified five access barriers that exist despite trade preferences. First, developing countries cannot rely on access promises, partly because these can be changed unilaterally by the importing country. Second, importing countries

may impose non-trade-related conditions to preferential access, such as environmental and labour standards. Third, LDCs often do not have the capacity to meet importing-country rules of origin in the industrial sector, making rules of origin, according to Ricupero, ‘one of the main factors determining the current low utilization rate of available preferences’. Fourth, factors other than tariffs, notably sanitary and phytosanitary requirements, bar LDC exports. Fifth, despite expanded trade preference schemes, products of particular importance to LDCs are still not subject to preferences. These points indicate areas in which the EU, US and Canadian schemes might be improved in the future. As mentioned above, Canada’s GSP scheme excludes dairy, poultry and eggs. According to one estimate, the gains from non-oil exports under AGOA will be five times less—\$100–140 million, instead of \$0.54 billion—than they would have been but for the scheme’s strict rules of origin and certain coverage exclusions, mainly in textiles and footwear.¹³⁵ Brenton argues that EU rules of origin are also cumbersome, and limit the benefits LDCs can achieve under EBA.¹³⁶

The Doha Declaration also instructs the Sub-Committee for Least-Developed Countries to develop, for the first General Council meeting of 2002, a work programme for LDCs, which should consider the trade aspects of the Brussels Declaration and Programme of Action¹³⁷ adopted at LDC-III that are consistent with the WTO mandate (para. 42). The Sub-Committee adopted such a work programme in February 2003. The Work Programme for the Least Developed Countries¹³⁸ addresses seven systemic issues: market access for LDCs; trade-related technical assistance and capacity-building; diversification of LDC production and export bases; mainstreaming certain elements of the LDC-III Programme of Action into WTO work; LDC accession to the WTO; LDC participation in the multilateral trading system; and following up on WTO Ministerial Decisions and Declarations.

Finally, the Doha Declaration also endorses the Integrated Framework for Trade-Related Technical Assistance to Least-Developed Countries (IF) (para. 43). The IF was spearheaded by six institutions—the IMF, the International Trade Commission, UNCTAD, the UNDP, the World Bank and the WTO—to respond to the development needs of LDCs in an integrated manner. The main objectives of the IF are to mainstream trade into LDC development strategies and to help with trade-related technical assistance.¹³⁹ Criticisms of the IF have included conflicting mandates between institutions, poor organization, and suggestions by developing countries that money is better spent on infrastructure and direct aid than on technical assistance.¹⁴⁰

Technical cooperation and capacity-building

The Doha Declaration notes: ‘The delivery of WTO technical assistance shall be designed to assist developing and least-developed countries and low-income countries in transition to adjust to WTO rules and disciplines, implement obligations and exercise the rights of membership, including drawing on the benefits of an open, rules-based multilateral trading system. Priority shall also be accorded to small, vulnerable, and transition economies, as well as to Members and Observers without representation in Geneva.’ The Declaration also endorses the New Strategy for WTO Technical Cooperation for Capacity Building, Growth and Integration and instructs the Secretariat to support efforts to mainstream trade into national development and poverty reduction

plans (para. 38). It further instructs the Director-General 'to consult with the relevant agencies, bilateral donors and beneficiaries, to identify ways of enhancing and rationalizing the [IF] and the Joint Integrated Technical Assistance Programme (JITAP)'; instructs the Committee on Budget, Finance and Administration to formulate a plan for long-term funding of WTO technical assistance; and reaffirms various other technical cooperation commitments made in the Declaration (paras 39–41).

Technical cooperation and capacity-building in the WTO is narrowly focused on compliance and supplied on an issue-by-issue basis, primarily via workshops, briefings, seminars, documentation and technical missions.¹⁴¹ The UNDP criticizes the current WTO approach on four bases. First, despite being compliance-focused, not much has been done to assess the often high cost of compliance to WTO countries. Second, the process is donor-driven, which distorts priorities and deflects attention from the needs of individual developing countries. Third, developing countries must negotiate for technical assistance, which requires additional resources and makes developing countries vulnerable to political pressure in broader trade negotiations. Fourth, current provisions do not adequately differentiate between the needs of various developing countries and do not have sufficient resource support.¹⁴² Furthermore, there has been poor coordination between organizations including the World Bank and the IMF.¹⁴³ Doha promises to take steps to address some of these issues by working towards improvement of the IF and JITAP, and work on long-term funding.

'Development round' priorities

It is now widely accepted that successful development requires more than simply trade liberalization, but it is not the WTO's role to involve itself broadly with all aspects of development. Hoekman argues that the WTO should focus primarily on market access issues and not other development matters, which should be addressed elsewhere.¹⁴⁴ There are still significant gains to be made from continued liberalization. According to estimates, global world income would increase by \$60 billion per year with a 40% reduction in post-Uruguay Round agricultural tariffs and export subsidies; from this, developing countries would experience the largest percentage real income gains.¹⁴⁵ A 40% reduction in industrial product applied tariffs would increase global trade volume in excess of \$380 billion, with 75% of gains accruing to developing countries.¹⁴⁶ Notably, the Doha Declaration does not include textiles and clothing, roughly 8% of world manufacture trade, despite developing-country sentiment that developed countries were exploiting the Agreement on Textiles and Clothing to delay liberalization of products that are especially important to developing countries.¹⁴⁷

The UNDP¹⁴⁸ agrees that market access is an important element of development, but argues that 'policy space' and room for institutional development should take precedence and need to be reconciled with market access. The only demonstrated relationship between trade and growth is that countries liberalize as they grow, but successful institutions are a clear requirement for development. Therefore, the WTO should not limit the choices of developing countries in designing domestic policies, which a Single Undertaking tends to do. The system ought to allow for asymmetrical treatment of developing countries, according to their development needs, instead of focusing narrowly on trade liberalization. From this point of view, a Declaration on S&DT resulting from

the Doha Round of negotiations would be a positive development. In the Doha Ministerial Declaration, WTO Members agreed that all special and differential treatment provisions should be reviewed with a view to strengthening them and making them more effective and operational.¹⁴⁹ Thus far, all self-imposed negotiating deadlines for agreement on special and differential treatment for developing countries have been missed, and negotiations in most areas of the Doha Development Agenda (DDA)¹⁵⁰ are literally at a standstill.¹⁵¹ The latest ministerial meeting in Cancun collapsed after four days of mostly posturing and no progress.¹⁵² Although a number of previous Ministerial Conferences have also been less than successful, this failure is of grave concern due to the nature and magnitude of the gap between negotiating positions and the political nature of the divide between developed and developing nations.¹⁵³ Although this result is a disappointment for all WTO Members, it is most unfortunate for developing countries, who have the most to gain from this round of negotiations, as a successful outcome of the Doha Round could raise global income by more than \$500 billion a year by 2015, and over 60% of that gain would go to poor countries, freeing 144 million people from poverty.

The ultimate question of how to prioritize WTO reforms may be contextualized in terms of the broader debate on economic liberalization between gradualists and 'shock therapists'. Rapid reform advocates consider gradualism to be needlessly costly, in terms of both time and lost output. Gradualists, such as Stiglitz, tend to favour delayed privatization and emphasize the importance of market infrastructure, including competition, entrepreneurship, financial regulation, social capital and a strong legal system.¹⁵⁴ Unfortunately, the debate has yet to move away from the focus on numerous individual provisions to an overall change in the conception of S&DT as a means of facilitating the participation of developing countries in the multilateral trading system. The problem with reaching agreement on specific and practical S&DT, though, as described by one observer, is that 'developed countries don't know how to do that, and developing countries have not been able to focus on a specific shortlist that would address, via S&DT, the core problems faced by them'.¹⁵⁵ The traditional approach to S&DT has clearly not succeeded at improving their integration, and the need for special preferences has in fact increased. The limited success of the past five decades is clear evidence that the traditional approach needs reconsideration.

CONCLUSION

The empirical evidence to date suggests that liberal trade policies are more conducive to economic development than import substitution policies. However, at least three caveats are in order. First, liberal trade policies may be a necessary condition for economic development, but they are far from a sufficient condition. Domestic policies relating to investments in education, infrastructure and healthcare, and the quality of a country's political, legal and bureaucratic institutions clearly also matter. More generally, the quality of a country's institutional capital seems to be an important determinant of development.¹⁵⁶ While economic liberalization tends to advance the long-term process of political liberalization and democratization, some authoritarian political regimes have co-existed with market economies for long periods of time, in some cases pursuing predatory

and welfare-reducing policies towards their citizenry. Second, while it has become conventional wisdom among trade economists to be critical of the import substitution policies pursued by many developing countries in the post-war decades, it is important that this criticism be tempered with an acknowledgement that many developed countries also pursued such policies for extended periods of time earlier in their development, for example, the USA, Canada, Germany and arguably more recently Japan, raising questions as to whether these policies were equally mistaken, or whether the circumstances of these countries were different in some relevant respects from those of more recent developing countries. Third, there remain unresolved questions as to whether a state-promoted export-led growth strategy is a superior strategy for developing countries, given questions about the sustainability and generalizability of the East Asian experience and severe limits on institutional capacity in many developing countries. This might argue instead for agnosticism on the part of the state to any particular industrial or trade strategy, leaving sectoral judgments (other than reciprocal trade liberalization) to competitive private capital markets and instead focusing collective resources more sharply on developing general background endowments such as human capital, infrastructure, healthcare, law and order, and well-functioning public sector institutions. Multilateral and bilateral foreign aid policies might focus on a similar set of priorities.

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Trade and the environment

INTRODUCTION

In the last three decades, we have witnessed a remarkable increase in support for environmentalism among citizens throughout the world. Environmentalism is a very broad concept, extending from concern about traditional forms of pollution, such as emissions of dangerous substances into the air and the water, to the protection of endangered species and the aesthetic purity and integrity of natural landscapes. It has been increasingly recognized that environmental problems cross national boundaries, and that many of the most pressing challenges cannot be addressed adequately without international cooperation and international rules—saving the world's ozone layer from further damage is an obvious and important example.

The relationship between international trade and the environment has only recently attained a prominent place on the trade agenda, although it has been a concern of environmentalists for some time. Much of the debate on this issue has been highly emotive and polarized. Often, environmentalists tend to identify liberal trade with environmentally destructive unrestrained economic growth. Many free traders, on the other hand, are largely dismissive of the environmentalists' concerns as either disguised protectionism or irrational fanaticism.¹

The links between trade and environment are complex and multi-faceted. In this chapter, we attempt to clearly separate and define the issues, examine existing international trade law that affects environmental concerns, and explore prospects for reform.

In our view there are several crucial distinctions that must be made in order to clarify and better focus the debate. The first is between the use of trade restrictions to protect the domestic environment of the importing state and the use of such restrictions as a response to the environmental policies of *other* states. However, within this second category, several further distinctions must be drawn. Among the most important is between environmental and competitiveness aims of environmentally based trade restrictions.

Some international environmental treaties, such as the Convention on International Traffic in Endangered Species (CITES), use control of trade as a direct means of achieving an environmental purpose. Even where there is no such direct relationship between trade restrictions and environmental regulation, environmentalists may view trade restrictions as appropriate *sanctions* for non-compliance with international environmental standards, as a means of imposing such standards where there are none, or as a response to the failure of particular nations to engage in negotiations to develop or adopt such standards. Whether trade measures are an appropriate or effective means of achieving these ends raises a wide variety of normative and empirical issues. Environmentalists, in addition to this concern about international standards, are also

concerned about the so-called ‘race to the bottom’—the possibility that in response to the competitive advantage that is gained from lower environmental standards in some industries, a greater share of jobs and trade in those industries will shift to countries with lower domestic environmental standards. This, it is feared, will put downward pressure on environmental standards in countries that presently have higher levels of protection. Here, environmentalists are not necessarily seeking adoption by all countries of the same domestic environmental standards but are simply concerned that such standards continue to be sustainable in countries that have already decided to adopt them. Although some free traders are largely dismissive of the problem posed by the ‘race to the bottom’, our own view is that this problem is real but that there will usually be a better alternative response to increased competitive pressures than the lowering of environmental standards—including better instrument choices in environmental regulation that achieve the same or improved results while imposing lower costs on industrial production, investment in technologies that promise to reduce the cost of complying with higher environmental standards, and adoption of adjustment and exit-oriented measures that shift resources from sectors where comparative advantage continues to depend on lower environmental standards to those where it does not.

By contrast with environmentalists, ‘fair traders’ are concerned with the impact on trade, not on the environment as such, of other countries’ lower environmental standards. They consider it ‘unfair’ that a country can gain an advantage in trade from lower environmental standards. Unlike the claims of environmentalists, we view these claims of fair traders with great scepticism. First of all, the claims implicitly assume that the importing state’s environmental standards are optimal from both a domestic and a global perspective. But absent some defensible international norm or benchmark for environmental standards, this assumption merely reflects the bias of the importing country towards its own regulatory approach. Second, higher environmental standards may actually *confer* a competitive advantage in some sectors, where these standards may create incentives for the development of environmental technologies that can then be exported to other countries as their demand for environmental protection increases. Third, environmental standards and costs must be distinguished. ‘Fair traders’ are really concerned with differential costs to industry of environmental standards, yet even if standards *were* harmonized, different countries for technological, climatic, other geographical and demographic reasons could still face vastly different costs of meeting these harmonized standards. Here the arguments of fair traders exhibit the same kind of incoherence that is evident with respect to countervailing duty law, which we have discussed at length in Chapter 9. Briefly, for unfairness to have a normatively defensible meaning, it must entail the violation of some neutral, objective baseline for the balance of benefits and burdens that governments create for industries.

In this chapter, we review the existing trade law and jurisprudence that affects environmentally based trade measures, and attempt a clarification of the concepts and arguments at stake in the trade and environment debate. We pay particular attention to jurisprudence of the GATT and FTA/NAFTA that has applied a number of key legal norms and principles of international trade law in environmentally related contexts. As well, we consider the environmental provisions of the NAFTA, including the environmental side-agreement.²

DIFFERENT TYPES OF RATIONALES FOR ENVIRONMENTAL TRADE MEASURES

At the outset, it is crucial to draw a distinction between claims that trade measures should be used to attain a specific non-trade goal or vindicate a specific non-trade value, and arguments for a 'level' competitive playing field, evening the odds, or establishing 'fair' rules of the game that are internal to the trading system. The first kind of claim relates to measures such as the trade sanctions at issue in cases like *Tuna/Dolphin* and *Turtles*; the second produces demands for countervailing duty-type measures aimed at protecting domestic producers against the supposed advantage that foreigner producers possess due to lower environmental standards in their home countries.

Environmentally based trade sanctions

With respect to the first kind of claim, there are important and legitimate policy rationales for why countries may have to intervene with respect to the policies and practices of other countries that affect the environment. These are:

Externalities

In certain circumstances, a country may be able to externalize some of the environmental costs of economic activity within its borders to the nationals of other countries. The classic example is pollution which flows from country A into the territory of country B through common air or water bodies. These spillovers can be of major significance—for example, a significant portion of the acid rain that affects Canada can be attributed to emissions in the United States.

The global environmental commons

The commons may be defined as 'physical or biological systems that lie wholly or largely outside the jurisdiction of any of the individual members of society but that are valued resources for many members of society. International commons of current interest include Antarctica, the high seas, deep seabed minerals, the electromagnetic spectrum, the geostationary orbit, the stratospheric ozone layer, the global climate system and outer space.'³ Protection of endangered species might be added to this list. Where unconstrained and uncoordinated, exploitation of these physical and biological systems by nationals of each individual jurisdiction may produce what is widely referred to as the 'tragedy of the commons'.⁴

Shared natural resources

'Shared natural resources are physical or biological systems that extend into or across the jurisdictions of two or more members of international society. They may involve non-renewable resources (for example, pools of oil that underlie areas subject to the jurisdiction of adjacent or opposite states), renewable resources (for example, straddling stocks of fish or migratory stocks of wild animals), or complex ecosystems that transcend

the boundaries of national jurisdiction.⁵ Property rights to these shared resources cannot easily be assigned on a purely territorial basis, and therefore each sharing state has an interest in the practices and policies of each other sharing state with respect to these resources.

There is not much evidence on the effectiveness of environmental trade sanctions in particular to achieve these rationales; however, empirical work has been undertaken with a view to measuring the impact of economic sanctions more generally on state behaviour. To our knowledge, the most comprehensive work on this question remains the study by Hufbauer, Schott and Elliott,⁶ which examines 115 instances of the use of economic sanctions over a period of about 40 years. The authors conclude that these sanctions had an overall success rate of about 34% in achieving an alteration of the conduct of the targeted country in the desired direction.⁷ Not surprisingly, they found sanctions were more likely to succeed in changing behaviour where the policy changes in question were relatively modest, and where the sanctions-imposing country was larger and more powerful than the targeted country.⁸ Another important observation in this study is that sanctions are least likely to succeed against intransigent, hostile regimes as opposed to countries that are relatively friendly to the sanctions-imposing state.

Relative to many of the sanctions studied by Hufbauer, Schott and Elliott, most environmental trade sanctions would certainly count as aimed at only modest policy changes,⁹ in comparison with sanctions that seek to topple an entire regime, or the removal of a pervasive form of social ordering (e.g. apartheid in South Africa). Moreover, Hufbauer, Schott and Elliott's general observations on the importance of the relative size of the sanction-imposing and the targeted country, and about friends and enemies, seem consonant with recent evidence about the effectiveness of some environmental and labour rights sanctions. The threat of trade sanctions by the United States has, for instance, been credited with altering fishing practices that harmed endangered species in countries such as Japan, South Korea, Chile, Taiwan and Peru—all of which could be described as relatively 'friendly' states from the US point of view, and all (with the possible exception of Japan) significantly smaller and less powerful than the USA.¹⁰ By contrast, US threats to deny Most Favoured Nation status to China, made little impact in terms of human rights, including labour rights compliance.

Overall, the evidence suggests that trade sanctions are of limited but real effectiveness, and in this respect they are no different from other, more extreme forms of coercive action such as military force where the record of effectiveness is also extremely mixed (e.g. Lebanon, Bosnia, Somalia, Rwanda, Haiti and Vietnam). On the other hand, a systematic strategy of isolationism, appeasement or acquiescence would largely resign us to accept grotesque human rights abuses or indeed attempted genocide without external opposition.

An issue closely related to the effectiveness of economic sanctions is the relative desirability of sanctions as opposed to other instruments for influencing the behaviour of other countries and their producers. For instance, the GATT Secretariat advocated the use of financial inducements as an alternative means to sanctions for influencing countries to adopt higher environmental standards.¹¹ This proposal has the virtue of attaching a price to the invocation of such sanctions and thus providing some assurance that these higher standards are truly valued for their own sake in the country desiring the changes, especially in cases of ostensible *ad hoc* paternalism or altruism, while trade sanctions,

lacking such an explicit price (beyond price effects on consumers), may be easily subverted by protectionists. Chang argues, however, that subsidies, as opposed to sanctions, create a perverse incentive for foreign countries to engage in, or intensify, the offensive behaviour (or make credible threats to this effect) in order to maximize the payments being offered.¹²

A recent study of the effects of both carrots and sticks on political change in South Africa supports Chang's scepticism about carrots; it concludes that 'political strategies that rely on inducements rather than commands are limited in what they can accomplish'.¹³ Moreover, in cases of transboundary externalities, the global environmental commons, and shared natural resources (in contrast to exchanges of tariff concessions), a principle that victims (or their supporters) should always pay ('bribe') violators to achieve compliance would seem impossible to defend either ethically or politically. However, in some cases, financial assistance to enable poor Third World countries to meet higher environmental standards may be warranted on distributive justice grounds.

Another alternative¹⁴ to trade restrictions is environmental labelling (so-called ecolabelling), which allows individuals as consumers to express their moral preferences for environmental protection.¹⁵ Products that are produced in a manner that meets a given set of environmental standards would be entitled to bear a distinctive logo or statement that informs consumers of this fact. While labelling may enable individual consumers to avoid the moral 'taint' of consuming the product in question themselves, if most consumers have a preference for terminating production altogether (rather than merely reducing consumption and production) by changing a foreign country's domestic policies, then a collective action problem arises as in any approach to influencing behaviour that depends upon coordinating action among large numbers of agents. Unless she can be sure that most other consumers will do likewise, the individual consumer may well not consider it rational to avoid buying the product in question.¹⁶

In sum, neither financial inducements nor labelling programmes are self-evidently superior policy instruments to sanctions for influencing other countries' environmental practices. Each has its own drawbacks. However, it must be admitted that little concrete empirical evidence exists that would allow a rigorous comparison of these alternative instruments with sanctions. In addition, the greatest effectiveness might actually be achieved by a combination of more than one of these instruments. Again, in the absence of empirical work, it is difficult to make out a clear-cut case for excluding the use of trade sanctions as an instrument for influencing environmental policies.

Competitiveness-based environmental trade measures

Unlike the arguments for trade restrictions on environmental grounds that we have been discussing up to this point, which have a normative reference point external to the trading system itself, competitiveness-based 'fair trade' claims focus largely on the effects on domestic producers and workers of other countries' environmental policies and not *per se* on the effects of those policies on the environment and on workers elsewhere. Competitiveness claims are, in principle, indifferent to the improvement of environmental practices in other countries. Hence, in the case of competitiveness claims, trade measures that protect the domestic market or 'equalize' comparative advantage related to

environmental standards are a completely acceptable *substitute* for other countries raising their standards.

Competitiveness claims usually refer to one of two kinds of supposed unfairness (and, it is often argued as well, welfare losses) that stem from trade competition with countries that have lower environmental standards:

- 1 It is unfair (and/or inefficient) that our own firms and workers should bear the 'costs' of higher environmental standards through loss of market share to foreign producers who have lower costs due to laxer environmental standards in their own country.
- 2 It is unfair that downward pressure should be placed on our own environmental standards through trading with countries that have lower standards.

Both these arguments are, in our view, largely incoherent and in fact in tension with the basic theory of comparative advantage in trade. Assuming there is nothing wrongful with another country's environmental policies, then why should a cost advantage attributable to these divergent policies not be treated like any other cost advantage, i.e. as part and parcel of comparative advantage? In fact, even if all countries had the same level of environmental consciousness, or even the same general environmental standards, approaches to instrument choice as well as the choice of risks on which to concentrate would still differ widely, due to differing climatic and other geographical or demographic conditions. For these reasons, even in a world where all citizens shared the same environmental preferences, environmental laws and regulations would still be likely to differ substantially between countries and, even where they were the same, the costs to industry of complying with those laws and regulations would still likely differ substantially from country to country.

Precisely because the implicit benchmark of fairness is so illusory, i.e. a world where governmentally imposed environmental protection costs are completely equalized among producers of like products in all countries, trade measures based upon this kind of fairness claim are likely to be highly manipulable by protectionist interests. Since, of course, protectionists are really interested in obtaining trade protection, not in promoting environmental standards, the fact that the competitive fairness claim in question does not generate a viable and principled benchmark for alteration of other countries' policies is a strength not a weakness—for it virtually guarantees that justifications for protection will always be available, even if the targeted country improves its environmental standards.

As for the argument concerning downward pressure on one's own standards, shifting the competitiveness costs of these standards to workers in other countries seems distributively *perverse*. No matter how high an intrinsic or instrumentalist value we may wish to put on high environmental standards in our own country, there is simply an unsupportable leap of logic in the conclusion that someone else should be paying the price for them. First of all, workers in other countries do not even usually directly benefit from these higher standards, whereas workers in one's own country do. Second, most competitiveness-based fair trade claims are targeted against countries which are poorer than the trade-restricting country, often with lower *per capita* incomes, higher levels of unemployment and weaker social welfare nets (in some instances, the revenue from trading products may be essential to obtaining foreign exchange to buy essential goods such as medicines and foods). Moreover, we do not believe that, generally speaking, lowering environmental standards is an appropriate response to competitive pressures.

There is, in fact, a wide range of alternatives, such as better regulation which reduces compliance costs without lowering standards¹⁷ and investment in technologies that are likely to reduce the costs of compliance with environmental standards.

Of course, it is arguable (although there is not much hard empirical evidence on the matter) that governments and/or firms are in fact responding by lowering standards, rather than through these arguably superior policy alternatives. However, these suboptimal policy responses surely represent a political and social problem within countries that are lowering standards in response to competitive pressures. Again, it seems hardly fair that workers (or firms for that matter) in other countries should bear the burden of avoiding choices in another country that are ultimately attributable to a flawed policy process in that country.

A variation of the claim about the effect of competitiveness pressures on domestic environmental standards suggests the possibility of a form of beggar-thy-neighbour behaviour that may, admittedly, leave all countries worse off. This is the 'race to the bottom', whereby countries competitively lower their environmental standards in an effort to capture a relatively greater share of a fixed volume of trade or investment.¹⁸ Much like the beggar-thy-neighbour subsidies wars that characterized agricultural trade among Canada, the USA and the EU and other countries during the 1980s, it is not difficult, using the model of a Prisoner's Dilemma game, to show that competitive reduction in environmental standards will typically result in a negative sum outcome,¹⁹ as long as one assumes that before entering the race, each country's environmental standards represent an optimal domestic policy outcome for that country.

The 'race to the bottom' claim has a different normative basis from the other competitiveness-based claims discussed above. Those claims relate to the proper distribution of the competitiveness costs of maintaining higher environmental standards than one's trading partners. The normative basis for concern over the race to the bottom, by contrast, sounds in the language of efficiency: the race ends, literally, at the bottom, with each country adopting suboptimal domestic policies, but no country in the end capturing a larger share of the gains from trade.

Frequently, beggar-thy-neighbour regulatory competition is able to flourish much more easily where it is possible to reduce on a selective basis environmental standards to attract a particular investment or support a particular industry or firm. It is more difficult and more costly to engage in these activities where the formal statutory framework of environmental regulation must be altered across the board.

Accepting, however, that cooperation is the ultimate solution to the 'race to the bottom', a further difficult question remains as to the appropriateness of trade restrictions as a sanction to induce a cooperative outcome. Here, there is important further work to be done in applying the insights of game theory to beggar-thy-neighbour trade conflicts such as, for instance, the agricultural subsidies wars: did trade retaliation facilitate or frustrate a cooperative solution, i.e. the Uruguay Round Agreement on Agriculture? The role of unilateral sanctions in inducing rules-based, cooperative solutions to conflict is a complex one. Sophisticated advocates of unilateralism or aggressive reciprocity, such as Laura Tyson²⁰ and Carolyn Rhodes,²¹ argue for trade measures as a means of inducing a rules-based cooperative equilibrium, not as a long-term strategy of non-cooperative behaviour. The problem, as has been articulated by Bhagwati and others, is that these trade restrictions usually constitute deviations from *existing cooperative outcomes* (*pre-existing*

multilateral rules). Therefore, depending on one's standpoint, such restrictions may resemble cheating on an existing cooperative equilibrium, rather than inducement to create a new one. One response of the unilateralists and reciprocitarians might be that the 'race to the bottom' or 'beggar-thy-neighbour' conduct of one's trading partners has, in fact, already put in danger the pre-existing cooperative equilibrium, and that no return to a rules-based approach is possible unless new rules are adopted to deal with the 'race to the bottom'. However, free traders might well respond that an approach to inducing a new equilibrium based upon the use of technically illegal trade measures as a sanction to bring about negotiation of new rules is likely to undermine countries' overall confidence in the rule of law, and therefore actually to complicate the future prospects for rules-based solutions to trade conflict.

In the GATT, there is arguably already a kind of implicit response to this dilemma, to be found in the concept of non-violation nullification and impairment in Article XXIII. In some circumstances, a GATT panel may find that a Contracting Party's practices, even if not in technical violation of the General Agreement, nevertheless undermine reasonable expectations of another Party as to the benefit that it would receive from GATT concessions. In this situation, trade sanctions may ultimately be authorized, even if the targeted country did not engage in a technical violation of the GATT rules. Where a Contracting Party views the 'beggar-thy-neighbour' but technically GATT-legal conduct of another Party as undermining the existing cooperative equilibrium of GATT rules and concessions, it may seek GATT approval of ultimate recourse to unilateral trade measures through making a case that non-violation nullification or impairment has occurred. This procedure prevents each Party being judge in its own cause, and thereby obviates the consequent potentially negative implications for overall confidence in the rule of law. Through this means, trade sanctions, or the threat of sanctions, may be used as a legitimate instrument for inducing one's trading partners to bargain towards new or reformed rules to end a 'race to the bottom'. Thus, even where it could be shown that trade restrictions are appropriate as a means of inducing a cooperative solution, we do not see a justification for taking such measures outside the existing jurisprudential framework of the WTO, or for making the framework more amenable to unilateral actions in which Members are judges in their own cause as to whether the existing cooperative equilibrium has been undermined by purported 'beggar-thy-neighbour' conduct of other Members.

THE GATT

The General Agreement (especially Articles I, II and XI) prohibits border restrictions on the exportation and importation of goods, subject to specific exceptions. In addition, the GATT prohibits certain internal measures that discriminate against foreign imports (Article III). Clearly, the vast majority of domestic environmental policies fall into neither of these categories, and hence no potential or real conflict with the GATT is likely to emerge except in a relatively small number of cases.²² Nevertheless, the number and importance of these cases is growing as many Contracting Parties place increasing priority on protection of the environment. In the case of the FTA/NAFTA, the relevant provisions are closely similar or identical to those of the GATT, including the provisions

on National Treatment with respect to trade in goods and the prohibition of quantitative restrictions.

Article XX: a GATT environmental charter?

Given that many of the border measures connected with environmental goals are on their face violations of Article XI, much of the jurisprudence has centred on whether such measures can be saved by virtue of any of the exceptions listed in Article XX of the GATT. Article XX exempts certain classes of measures from the strictures of other GATT Articles, provided 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'. Among the classes of measures listed are those 'necessary to protect human, animal or plant life or health' (XX(b)), and those 'relating to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption' (XX(g)).

The word 'environment' is not mentioned explicitly in either paragraph. Commentators are divided on whether, nevertheless, these provisions were intended by the drafters to apply to the environment in the broadest sense (including moral and aesthetic concerns) or, alternatively, to a much narrower range of policy concerns. Shrybman, for instance, argues for the latter point of view.²³ It is possible to understand Article XX(b), for example, as intended to cover measures designed either to protect public health against diseases (e.g. from contaminated meat) or to protect animal or health life for commercial reasons (e.g. the economic consequences of crop pestilences). With respect to Article XX(g), its purpose might be to allow a country to protect 'exhaustible natural resources' such as minerals or petroleum that are considered as essential to its economic well-being. In a detailed analysis of the negotiations that produced the General Agreement, Charnovitz has shown, however, that the drafters had at least conservation goals in mind, as well as economic or public health and safety concerns. He argues that the drafters were aware of existing international conventions on conservation, and probably did not include a more explicit environmental exemption precisely because they thought that Article XX(b) and (g) would suffice for this purpose and the *Turtles* appeal to the Appellate Body found that Article XX(g) could encompass measures to protect living resources, in this case endangered species. This ruling was based on a consideration of developments in international environmental law and policy subsequent to the 1947 GATT, thus employing methods of treaty interpretation required under Article 31 of the Vienna Convention, as well as a reading of the preamble to the WTO Agreement.²⁴

Throughout much of the history of the GATT, the main issues raised by Article XX concerned the potential for protectionism to be disguised as measures taken for health and other goals stated in the Article. For example, phytosanitary measures with respect to livestock were often cited as indirect protectionist measures, as well as other technical barriers such as idiosyncratic product standards or inspection requirements. The explicit language of Article XX presupposes that it is possible to detect instances where measures are in fact 'disguised restrictions on trade'. In practice, this has proven far from straightforward in the presence of conflicting scientific evidence as to the non-

protectionist justification of particular measures, and also due to the fact that much of the claimed protectionism might be embedded in the manner in which a measure that did have a genuine non-protectionist basis was administered.

The WTO Agreement on Technical Barriers to Trade and the Sanitary and Phytosanitary Agreement attempt to address the task of distinguishing genuine non-protectionist measures from disguised trade protection through a multi-faceted approach, including the encouragement of the use of international standards. These Agreements are discussed in detail in Chapter 7, on health, safety and other technical standards. Significantly, the Agreement on Technical Barriers to Trade permits 'technical regulations and standards' which are 'for the protection of human health or safety, animal or plant life or health or the environment' (Article 2(2)). Here the addition of 'the environment' to language that otherwise duplicates the wording of Article XX(b) may suggest an explicit acknowledgement that the Article XX exemptions are to be interpreted broadly to include measures taken for environmental purposes.²⁵

The jurisprudence of the GATT (including interpretation of GATT provisions by Canada-US FTA panels)

In several GATT/WTO and FTA panel decisions during the 1980s and 1990s, and in one WTO Appellate Body decision, the consistency of environmental measures with Articles III and XI of the GATT was addressed, as well as the application of Article XX to the environment.

Herring and Salmon

The application of Article XX to trade-restricting measures to protect the restricting country's own environment was addressed in the *Herring and Salmon* case.²⁶ Here, the United States was the complainant, arguing that Canadian requirements that salmon and herring caught in Canadian waters be processed in Canada before export violated Article XI of the GATT. Among Canada's arguments in response was that these restrictions were an integral part of its overall scheme for management of West Coast fisheries resources, and therefore 'related to' the 'conservation of exhaustible natural resources' within the meaning of Article XX(g).²⁷ According to Canada, the export restrictions functioned in the following two ways to support its conservation scheme. First of all, the vulnerability of the species required an extremely accurate catch control system, and the only way of having precise data on the catch was to limit its destination to Canadian fish plants, which were subject to rigorous reporting requirements. Second, because of the cyclical nature of the catch for both species, making the unprocessed fish available exclusively to Canadian plants was the only means of balancing the conservation objective with the goal of sustaining a viable domestic fish processing industry. The implication of this latter claim was that unless Canadian fish plants were assured of the entire Canadian catch, the Canadian government would be faced with the choice of either accepting the demise of the industry or permitting over-fishing when the catch was good.

The United States replied that the Canadian requirements were 'neither necessary nor particularly useful' for the purpose of ensuring an accurate estimate of the Canadian catch, since in the case where unprocessed fish was exported to the United States, 'United

States authorities routinely provided to Canada, upon request and for use in the Canadian conservation programme, full data on United States landings of unprocessed fish'.²⁸ The United States also objected to the broad view of 'conservation' suggested by the notion that conservation measures included measures that balanced conservation goals with socioeconomic concerns such as the preservation of a domestic processing industry—in any case, Canada's domestic processing industry would have access to fish imports to make up any shortfall resulting from the combined impact of conservation measures and the cyclical nature of the industry.

Finally, the United States presented evidence that the Canadian government itself had described the export ban as a means of protecting Canadian jobs in its own official literature, and therefore that the measure should be viewed as a disguised restriction on trade.

The GATT panel interpreted the Article XX(g) requirement that measures be 'related to' conservation of exhaustible natural resources as meaning 'primarily aimed at' such conservation,²⁹ but it viewed this as weaker than the requirement of 'necessity' imposed by Article XX(b). Among the main factors that led the panel to find that the Canadian export ban was not 'primarily aimed' at conservation was that accurate statistical data could be collected without such a ban, as was done for other species that were subject to conservation measures but whose export in an unprocessed state was not banned. The panel thus adopted an objective test to determine primary intent, i.e. instead of examining the legislative history of the measure to determine whether its primary aim was protection of the domestic Canadian processing industry, it considered whether other means less restrictive of trade could equally serve the stated conservation purpose. An important clarification of the meaning of 'necessary' in Article XX(b) occurred in the non-environmental *Thai Cigarette* case.³⁰ In that case, the United States challenged a ban on imports of cigarettes into Thailand as a violation of Article XI of the GATT. Thailand defended the ban, under Article XX(b), as 'necessary' for the protection of public health. While no comparable ban existed on domestic Thai cigarettes, the Thai government claimed that American imports were more likely to induce women and young persons to take up smoking, because of sophisticated advertising directed at these groups. Thailand also argued that American cigarettes were somehow more addictive or more likely to be consumed in larger quantities than comparable Thai cigarettes, due to their chemical composition (this claim was largely unsupported, however, by scientific evidence). The panel ruled that an import ban would only be 'necessary' for public health reasons, within the meaning of Article XX(b), if alternative non-trade-restricting measures could not be used to achieve the public health objectives in question. The panel considered that restrictions or bans on advertising and labelling and content requirements that applied on a non-discriminatory basis to both domestic cigarettes and imports would be satisfactory alternatives to an import ban, and therefore the ban could not be justified under Article XX(b) as 'necessary' for reasons of public health. In coming to this decision, the panel simply ignored the possibility that the alternative measures might involve high regulatory and compliance costs, or might be impracticable to implement effectively in a developing country.

Salmon and Herring Landing Requirements

In the *Salmon and Herring Landing Requirements* case,³¹ an FTA panel considered the scope of the Article XX(g) exception with respect to measures ‘primarily aimed at conservation of an exhaustible natural resource’. In that case, the United States challenged provisions of a Canadian law requiring that salmon and herring caught on Canada’s West Coast to be landed and unloaded in Canada before processing. The landing requirement was imposed after Canada’s domestic *processing* requirement had been found in violation of Article XI by a GATT panel, as discussed above.³² Unlike the measure impugned in the earlier case, the landing requirement did not explicitly prohibit or restrict exports of the unprocessed fish. Nevertheless, its *effect* was to disadvantage American processors because, in the case of fish destined for US processing plants, they would have to be both landed and unloaded in Canada (due to the law) and then repacked, and unloaded again in the United States before processing. The United States claimed that the measure was, in effect, a restriction on ‘exportation or sale for export’ (i.e. of unprocessed Canadian fish to the United States) and therefore in violation of Article XI of the GATT. Canada argued that even if the landing requirements were in violation of Article XI, the Article XX(g) exception applied, because landing of the fish was necessary for accurate monitoring of the catch pursuant to Canadian conservation programmes. The panel found that other means less restrictive of trade existed to achieve Canada’s objectives of monitoring and compliance with its conservation schemes, including cooperation with US authorities and on-board inspection of catches and cargo, and that (at least implicitly) Canada had adopted more restrictive means for protectionist reasons. The panel was also prepared to accept that landing of part of the catch might be necessary for sampling in order to achieve Canadian monitoring and compliance objectives, but considered that a requirement that 100% of the catch be landed went farther than was reasonably necessary for these purposes. In consequence, conservation could not be considered the ‘primary purpose’ of the landing requirements and therefore Article XX(g) did not apply.

In our view, where a panel employs a least-restrictive-means test in its application of Article XX, it should do so in a manner that reflects sensitivity to the fact that environmental policy-makers have limited resources, and often operate under broad background constraints imposed by the political and legal system in their country. The availability of a hypothetically less restrictive means of achieving the same goals should not necessarily mean that the measures under scrutiny fail the least-restrictive-means test. The panel should be open to arguments that the hypothetical alternative is not truly available at a reasonable cost to the Contracting Party that has enacted the trade-restricting environmental measure. For instance, in some countries with weakly developed regulatory and legal systems, border controls may be among the few effective ways of addressing some environmental hazards, even if they seem a rather blunt or crude instrument from the perspective of ‘state of the art’ regulatory theory and practice. To return to the *Thai Cigarette* case, in the abstract, it would have undoubtedly been possible for the Thai government to have adopted some of the alternative, less trade-restricting means suggested by the panel, such as consumer warnings, public information campaigns and so forth. But this simply ignores the issue of whether the kinds of

sophisticated techniques of persuasion and psychological manipulation employed by Western cigarette manufacturers could be matched, at reasonable cost (or any cost), by the informational resources available to a developing-country government. In the environmental area, a more contextually sensitive application of the least-restrictive-means test would arguably require panels to draw upon evidence from the broader environmental policy community as to the available regulatory alternatives and their strengths and limitations in a given set of circumstances. Here again, the *Thai Cigarette* decision sets a bad precedent—the panel simply chose to ignore a report by the World Health Organization suggesting that the Thai government's approach was a reasonable instrument choice under the circumstances.

In its ruling in *Reformulated Gasoline*, discussed below, the WTO Appellate Body (AB) rejected the view that the apparently less stringent language of XX(g), referring to measures 'relating to' the conservation of exhaustible natural resources, should be interpreted in the same way as the expression 'necessary to' in Article XX(b), contrary to the approach taken by the FTA panel in *Salmon and Herring Landing Requirements*. Significantly, in *Reformulated Gasoline*, the AB breathed life into the criteria in the *chapeau* of Article XX as a means of preventing protectionist misuse of the exceptions in the Article—thus, the AB considered it an important dimension of any Article XX analysis to inquire into whether measures are 'a disguised restriction on international trade' or 'a means of arbitrary or unjustifiable discrimination between countries'. The meaning given by the AB to these provisions will be discussed later in this chapter; it is appropriate to note at this juncture that, to the extent that the *chapeau* provides a set of legal tests to weed out protectionist misuse, a more contextually sensitive and flexible interpretation of 'necessary' in XX(b) and, *a fortiori*, 'relating to' in XX(g) may be possible without major risk to the integrity of the multilateral trading order.

Lobsters

The *Lobsters* case raised a vexing issue, on which the GATT jurisprudence is far from clear: how to distinguish between border bans that are part of an internal regulatory scheme aimed at both domestic and imported products (permitted by GATT subject only to the Article III National Treatment obligation) and prohibitions or restrictions on imports within the meaning of Article XI (banned by GATT unless strictly justified under Article XX). In the *Lobsters* case,³³ a Canada-US FTA panel considered whether application of a domestic US minimum size requirement to imports of Canadian lobster should be considered as an Article XI prohibition on imports (i.e. the effect of the measure being the exclusion of all Canadian lobsters beneath a certain size) or as part of an internal regulatory scheme within the meaning of Article III.

The minimum size requirement, as it applied to American lobster, was unquestionably a reasonable conservation measure: the intent was to conserve the stock by ensuring that young lobster would not be taken before they could breed. However, because Canada has colder waters, its mature lobster are in general of smaller size, and accordingly Canada had a lower minimum size requirement, which arguably served in the Canadian context the conservation objective as well as did the higher American size requirement in the US context.

The evidence suggests that imposition of the same minimum size requirement on imports of Canadian lobster was largely in response to complaints by American fishermen that the domestic US requirement put them at a competitive disadvantage with Canadian fishermen. In its argument to the panel, however, the US government attempted to justify the application of its minimum size requirement to Canadian lobster as necessary to the enforcement of the requirement with respect to American lobster. Since lobsters do not carry passports, it would be costly to determine whether a given lobster was Canadian or American once it had entered the stream of commerce. This difficulty was entirely obviated through application of the size requirement to *all* lobster in the market, whether Canadian or American.

In considering whether to view the extension of the size requirement to Canadian lobster as the application at the border of an internal US regulation, or as a prohibition or restriction on imports within the meaning of Article XI, the majority panel judgment reviewed a variety of GATT panel decisions. The majority rejected the view that traderestricting impacts should be the decisive consideration in classifying a measure as an Article XI measure. This seems in direct contradiction with another FTA panel's ruling in the *Salmon and Herring Landing Requirement* case, where (as discussed above) the panel found that the measure in question, while not taking the legal form of a prohibition or restriction on exports or sale for export, had this effect, and should therefore be considered a *prima facie* violation of Article XI.³⁴ Nor did the *Lobster* panel consider it of paramount importance whether the measure was to be enforced at the border by customs officials or through internal inspections once the product entered the domestic stream of commerce. Instead, the panel's majority decision seems to rest upon its acceptance of the US position that the import ban was genuinely an integral part of an internal regulatory regime applicable to both foreign and domestic product. As pointed out in the vigorous dissenting judgment by one expert on the panel, this was precisely how Canada had characterized its landing requirement measure in the *Salmon and Herring Landing Requirement* case, i.e. as connected to the monitoring requirements of its internal conservation regime, and yet in *Salmon and Herring Landing Requirement*, the measures were nevertheless categorized as Article XI restrictions or prohibitions on exports.³⁵ In *Lobsters*, the panel did not go on to consider whether, in fact, the scheme violated Article III, since this issue had been excluded from its terms of reference.

Of course, even where the measures in question are classified as internal regulations under Article III, complex issues may be implicated in determining whether in fact foreign products are being treated equally. A particularly difficult issue is whether only facially discriminatory measures should be considered in violation of Article III, or whether measures with a 'disparate impact' on foreign producers also, in some circumstances, violate the National Treatment obligation. For instance, a country may impose on both domestic products and imports a requirement of environmentally safe (e.g. biodegradable) packaging, in circumstances where most domestic producers are already using such packaging. Foreign producers, unlike their domestic equivalents, would be required at considerable cost to change packaging methods and materials in order to sell their goods within one particular foreign market. The more specific and idiosyncratic the requirements, the more likely that any foreign producer who does not possess a large market share in the country concerned will simply find that the costs of adapting the product are prohibitive, and will effectively be excluded from the market.

Situations of this kind have led to considerable trade frictions within the European Union, despite the existence of institutional mechanisms for harmonization of national environmental standards.

The issue was addressed somewhat indirectly by a GATT panel considering the application of Article III to a variety of measures affecting the importation of beer into several Canadian provinces.³⁶ Among these measures was a tax on beer containers applied to both domestic and imported beer. However, the tax was refundable where a system of collection of the containers for rebottling and recycling was used. Such a system was readily available to domestic beer producers, as they were permitted to sell their beer through privately owned retail stores that had such a system in place. Imported beer, by contrast, could only be sold at provincial monopoly liquor outlets where no such system for return of containers was in place. As a result, the only way a foreign producer could comply with the conditions for refund of the tax was to set up its own independent system for collection, rebottling and recycling of beer containers, which would involve considerable if not prohibitive expense. Since the tax applied equally on its face to both domestic and imported beer, the US argument amounted to a claim that disparate impact of a facially neutral internal measure could constitute a violation of Article III. The panel found that the container tax as it applied to imported beer did not violate Article III. In significant part, its reasoning was that the disparate impact in question was really due to another, *explicitly* discriminatory practice that was in itself a violation of Article III, i.e. the effective prohibition of foreign beer producers from sale of their beer through private retail outlets.³⁷ At a minimum, this finding may be interpreted to mean that a mere disparate impact on imports does not render facially neutral internal environmental measures in contravention of the GATT.

Tuna/Dolphin I

In the *Tuna/Dolphin* case,³⁸ Mexico complained that an American embargo of its tuna exports violated, *inter alia*, Article XI of the GATT. The embargo was imposed because Mexico had failed to satisfy US authorities that its tuna was caught in a manner that did not risk the destruction of dolphins. The United States argued that because its restrictions on the manner in which tuna was caught applied to American tuna as well, the import ban should be treated as the enforcement of 'laws, regulations and requirements affecting (the) internal sale, offering for sale, purchase, transportation, distribution or use' of imported products within the meaning of Article III, and not as quantitative trade restrictions. Here, the United States relied specifically on an Interpretive Note annexed to Article III, which states that 'any internal law, regulation or requirement of the kind referred to in [Article III:1] which applies to an imported product and the like domestic product and is collected or enforced in the case of the imported product at the time or point of importation' nevertheless is to be treated as an internal measure within the meaning of Article III:1. As discussed earlier in this chapter, the view of Article III suggested by this Interpretive Note has led to considerable disagreement on whether a given measure should be classified as a restriction or prohibition on imports and exports within the meaning of Article XI, or as an internal measure merely enforced through a border ban (in which case the Article III National Treatment obligation alone would apply, and if non-discriminatory, the measure would be found to be GATT-consistent).

Here, the panel rejected the view that Article III rather than Article XI was applicable, on the grounds that what was being regulated was not the actual imported product (tuna) but the manner in which it had been produced, and that Article III concerned measures that applied to and affected the nature of products themselves. The panel suggested: 'Regulations governing the taking of dolphins incidental to the taking of tuna could not possibly affect tuna as a product.'³⁹ The panel thus went on to characterize the import ban as a quantitative restriction within the meaning of Article XI, the issue thus becoming whether either Article XX(b) or Article XX(g) could apply to exempt the ban from Article XI strictures. With respect to Article XX(b), the panel simply excluded the possibility that it could apply to the protection of animal life outside the jurisdiction of the Contracting Party taking the measure. Two grounds were provided for this interpretation, neither of which has any textual basis in the General Agreement itself. The first was that the drafting history of Article XX(b) suggested that the essential purpose was to permit sanitary measures to protect human, animal and plant health in the importing country. The second ground was that if the broader interpretation of Article XX(b) were accepted, each Contracting Party could unilaterally determine the life or health protection policies from which other Contracting Parties could not deviate without jeopardizing their legal rights under the General Agreement. The General Agreement would then no longer constitute a multilateral framework for trade among all Contracting Parties but would provide legal security only in respect of trade between a limited number of Contracting Parties with identical internal regulations.⁴⁰

Although this finding itself sufficed to make Article XX(b) inapplicable to the US import ban, the panel went out of its way to further narrow the Article's scope. The panel claimed that the language of 'necessity' in Article XX(b) meant the United States would have to show that it had exhausted all options less restrictive of trade before resorting to import restrictions. The panel noted that the possibility of international cooperation with respect to dolphin conservation was an option that the United States had not exhausted.

With respect to Article XX(g), the panel suggested that, like Article XX(b), it could only be invoked to justify measures aimed at protecting the trade-restricting state's own environment. The panel based this view, in part, on the notion that Article XX(g) requires that import restrictions be imposed in tandem with internal measures to control production or consumption of the resource. The panel noted: 'a country can effectively control the production or consumption of an exhaustible natural resource only to the extent that the production or consumption is under its jurisdiction'.

The panel also suggested that since, at a given moment, Mexico could not know how many dolphins had been killed by American fishermen, it could not know whether it was complying with American law, and therefore whether it could avoid an export ban. In the panel's view, 'a limitation on trade based on such unpredictable conditions could not be regarded as primarily aimed at conservation'.

The panel also considered a quite different American measure concerned with the protection of dolphins, the Dolphin Protection Consumer Information Act, which permitted producers to market tuna in the United States with a 'Dolphin-Safe' label, provided US authorities could be satisfied that the tuna were indeed caught in a manner that did not unnecessarily endanger the lives of dolphins. Mexico argued that this law violated Article I:1 of the GATT, the Most Favoured Nation provision, since documentary evidence on the manner in which tuna were harvested was only required

when the tuna came from the Eastern Tropical Pacific; thus, less than the full benefit of the label was conferred on tuna producers from countries such as Mexico that fished in the Eastern Tropical Pacific. The panel rejected this argument, finding that the requirement of documentation would apply equally to any country that wished to fish in the Eastern Tropical Pacific.

The *Tuna/Dolphin* decision was widely criticized by environmentalists, but vigorously defended by the GATT Secretariat⁴¹ and some trade lawyers.⁴² There are many aspects of the decision that are difficult to justify—including the notion that measures that apply to the production process for a product cannot be regarded as internal measures for the purposes of Article III, which would mean that measures that apply equally to domestic products and imports would nevertheless be GATT-illegal, being considered as quantitative restrictions under Article XI.

The forced reading of the General Agreement that characterizes some aspects of the panel's decision must be considered, however, in light of its overall interpretation of the normative structure of the GATT, and it is this interpretation that must be the basis of any fundamental critique of the decision. The panel's view of the GATT is revealed most clearly in the concluding remarks of the panel:

The panel wished to note the fact, made evident during its consideration of this case, that the provisions of the General Agreement impose few constraints on a Contracting Party's implementation of domestic environmental policies... As a corollary to these rights, a Contracting Party may not restrict imports of a product merely because it originates in a country with environmental policies different from its own. It seemed evident to the panel that, if the CONTRACTING PARTIES were to permit import restrictions in response to differences in environmental 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.⁴³

The fundamental dividing line that the panel sees is between environmental policies for the sake of protecting one's own environment, and policies that somehow dictate to another Contracting Party how it should protect its own environment. This seems a mischaracterization of the problem. First of all, the United States was not aiming paternalistically, as it were, to dictate to Mexico how it should regulate a purely domestic environmental problem. The measure was aimed at the preservation of dolphins as a species surviving in the world's oceans, i.e. of the global environmental commons. There was no domestic Mexican jurisdiction over dolphins that was being encroached upon. Second, the American legislation was not interfering with any specific obligations or rights assigned to Mexican fishermen under Mexican law. Despite the adoption of extraterritoriality language by the panel, the American dolphin protection measures did not impose any obligations on Mexican fishermen that were in actual conflict with environmental laws or policies of the Mexican government. The Mexican government did not have an environmental policy forcing Mexican consumers to eat dolphin-destructive tuna, for instance, or enjoining Mexican fishermen to kill dolphins when fishing for tuna. Nor was the lifting of the import ban on the tuna necessarily conditional upon the

Mexican government adopting identical legislation to the American dolphin protection legislation. Mexico was free to permit access to its own market for dolphin-destructive tuna, whether caught by Mexican or foreign fishermen. As long as Mexican fishermen did not use fishing technology that threatened the lives of dolphins, their tuna was free to enter the United States. It is true that, in order for Mexican fishermen to use dolphin-threatening technology *and* for their tuna nevertheless to be admitted to the United States, the Mexican government would be required to adopt similar rules to those in force in the United States. But this is far from the massive intrusion on Mexican legal sovereignty evoked by the panel's suggestion that the American measures virtually forced the Mexicans either to adopt identical environmental protection laws to those of the United States or give up their legal rights under the GATT.

By making access to the US market depend upon either an American-like regulatory scheme or adoption of different technology by Mexican fishermen, the US measures did place a commercial disadvantage or burden on Mexican fishermen in that, if their government failed to act, the only way they could get access to the US market was to acquire and use a different fishing technology, presumably less efficient or in any event more costly.

However, the panel was also prepared to accept that these kinds of commercial disadvantages might be permissible under Article XX(b) if 'necessary' to protect the United States' own environment. What is most questionable is the panel's view that where the preferences of the trade-restricting state are for protection of the global commons rather than for protection of its own domestic environment, Article XX(b) and XX(g) can *never* be relied on.

This view seems based upon several different arguments, some of which are more explicit than others in the panel's reasoning. The first is that the drafting history suggests that Article XX(b) was only intended to apply to protection of animal or plant life or health within one's own boundaries. This view of the drafting history is contradicted by evidence that the drafters were likely aware that at the time the GATT was negotiated, there were various international conventions and agreements as well as some unilateral legislation that involved import and export restrictions linked to global conservation goals (e.g. for endangered species).⁴⁴ In not restricting the wording of XX(b) explicitly to domestic animal and plant life, the drafters may well have intended to make room in the GATT for these preexisting conservation-related restrictions.

Moreover, other provisions of Article XX suggest that its purpose was not to be limited to exempting measures to protect domestic interests within the trade-restricting state. The clearest example is the exemption for products made with prison labour—clearly, what is at issue here is preferences concerning the morality of prison labour in the *exporting* country, not simply in one's own country. Similarly, the general view of Article XX(f) which refers to the 'protection of national treasures of artistic, historic or archaeological value' is that it permits not only restrictions on the export of a Contracting Party's own national treasures, but import and export restrictions on national treasures of *other* Contracting Parties as well.⁴⁵ A final view, also implicit in the panel's report, reads into the legal order of the GATT a prohibition on unilateral action to protect the environment beyond one's borders. Undoubtedly, certain kinds of unilateral action that are extraterritorial violate particular rules of international law, both treaty law (e.g. the Law of the Sea Convention) and customary international law.⁴⁶ These include direct

assertion of control over activity in international waters through the use or threat of military force. Yet apart from the risk described above of increased cheating on trade concessions, it is hard to understand why a *sui generis* rule on non-intervention for environmental purposes should be read into an international regime concerned with preserving and enhancing international commercial exchanges. There is a considerable body of public international law on the issues of non-intervention and the use of economic sanctions against other states. But—at least in its current form—the GATT dispute settlement mechanism has, arguably, neither the institutional competence nor the legitimacy to interpret and develop these public international law rules. In any event, there is no general public international rule against unilateral action to protect the environment as long as such action does not result in illegal assertion of jurisdiction over international waters or territory or usurpation of the territorial jurisdiction of another state.⁴⁷ Clearly, it would be inappropriate to be simply dismissive of the important sovereignty concerns that underpin the panel's ruling. In our estimation, however, these concerns were more appropriately addressed in the panel's observation that the United States had not pursued with sufficient vigour international cooperation as a means of protecting the dolphin population (either bilaterally with Mexico or on a multilateral basis), and therefore that the adoption of unilateral trade restrictions was precipitous and hence not clearly 'necessary' within the meaning of Article XX(b).

The *Tuna/Dolphin I* ruling was never adopted by the GATT Council, Mexico and the United States having agreed to resolve the dispute through diplomatic negotiation. This ultimately led to the conclusion of a *multilateral* agreement on the protection of dolphins in the Eastern Tropical Pacific Ocean—the Agreement for the Reduction of Dolphin Mortality in the Eastern Pacific Ocean, which took effect in January 1993, and to which nine countries including Mexico are signatories.⁴⁸ However, even as amended in 1992, the US legislation did not fully exempt from the embargo countries that had signed the Agreement, although it did provide for a 'fast track' avenue for getting an exemption, if one accepted monitoring under the Agreement of one's commitment to reduce dolphin mortality rates.

Tuna/Dolphin II

In *Tuna/Dolphin II*,⁴⁹ the European Union challenged provisions for a secondary embargo in the US tuna legislation. Ostensibly aimed at 'leakage' from the primary embargo by transshipment of dolphin-unfriendly tuna through a third country, these provisions were, however, interpreted by a US court to extend to all cases where the exporting country did not have a primary embargo of its own, regardless of whether the tuna it was exporting to the United States had in fact been caught in a dolphin-unfriendly manner. Interpreted in this way, the secondary embargo clearly went beyond what was necessary to prevent circumvention of the primary embargo through shipment of dolphin-unfriendly tuna through third countries.

In considering the EU complaint that the measures violated Article XI of the GATT and could not be saved by any of the exceptions in Article XX, the panel reconsidered the approach of the *Tuna/Dolphin I* panel to Article XX. It forcefully rejected the view expressed in *Tuna/Dolphin I* that Article XX(b) and (g) could apply only to save environmental measures taken to protect the domestic environment. The panel noted that

neither the GATT nor 'general international law' prohibits in principle measures related to things or matters located outside a country's own territory. Moreover, in addressing itself to the original intent argument of the *Tuna/Dolphin I* panel, the *Tuna/Dolphin II* panel, pursuant to the relevant Vienna Convention provisions, considered evidence from the *travaux préparatoires* of the 1947 GATT, coming to the conclusion that it was far from clear that the framers had intended to exclude global environmental measures from the ambit of Article XX(b) and (g).

The *Tuna/Dolphin II* panel went on, however, to invent a new kind of limit on the scope of XX(b) and (g). It suggested that the exemptions stated in these paragraphs could not be applied to measures the *sole* environmental impact of which is through inducing other countries to change their policies. The panel stated: 'If... Article XX were interpreted to permit Contracting Parties to take trade measures so as to force other Contracting Parties to change their policies within their jurisdiction, including their conservation policies, the balance of rights among Contracting Parties, in particular the right of access to markets, would be seriously impaired' (para. 5.26). This reasoning seems based on a misunderstanding of Article XX—this Article does not create or destroy any acquired, legal rights of Contracting Parties, but rather permits on a case-by-case basis exemptions from other GATT strictures, if a set of strict criteria are met. In order for Contracting Parties to have a 'right' not to have their market access disrupted by sanctions-type measures even where such measures could be justified under Article XX, this 'right' must be embodied in a legal rule or norm. No such legal rule or norm exists in the text of the GATT itself. And, as the International Court of Justice held in the *Nicaragua* case,⁵⁰ there is no general customary rule of international law that prohibits economic sanctions.

In dicta, the *Tuna/Dolphin II* panel took the view that not only the secondary embargo but also the primary embargo could not be justified under Article XX, suggesting that it viewed the environmental impact of the primary embargo *as well* solely in terms of inducing policy changes in other countries. This assumption reveals an ignorance of economics. Quite aside from its impact on policies abroad, the embargo has the direct result of eliminating demand for dolphin-unfriendly tuna in the USA; all things being equal, if fewer dolphin-unfriendly tuna are demanded, fewer such tuna will be caught, and fewer dolphins will be killed.⁵¹ Thus, there will be an environmental impact, irrespective of any changes to other countries' policies. Moreover, apart from whatever impact it might have on the policies of any foreign government, the primary embargo places incentives on tuna fishers to adopt the methods necessary to avoid killing excessive quantities of dolphins.

Taxes on Automobiles

In *Taxes on Automobiles*,⁵² the European Community challenged, under Article III of the GATT, taxes and related measures of the United States, some of which were aimed at reducing air pollution caused by automobile emissions. The 'gas guzzler' tax, enacted by Congress in 1978 and doubled in 1990, was imposed on the sale of automobiles that did not meet mandated fuel economy requirements. The EC argued that the tax violated the National Treatment requirement with respect to domestic taxation in Article III:2. Much along the lines of the view taken by the panels in *Tuna/Dolphin I* and *II* concerning the

National Treatment requirement in Article III:4, the EC claimed that distinctions based on other than physical characteristics of a product (in this case its fuel economy) could not satisfy the National Treatment standard. Thus, domestic automobiles meeting the fuel economy standard were for Article III purposes to be regarded as identical *products* to imported automobiles not meeting the standard. In deciding this issue, the panel in *Taxes on Automobiles* took a very different approach from the *Tuna/Dolphin* panels. It held that the distinction in question had a legitimate non-protectionist objective—the conservation of fossil fuels—and therefore that imported cars that did not meet the standard did not have to be treated as ‘like products’ to domestic cars that did; distinctions, if non-protectionist, did not necessarily have to be based on physical characteristics of a product, as long as they were based on objective criteria related to a genuine non-protectionist policy objective. The panel also noted that the fuel economy threshold itself had been set at a level such that many domestic as well as imported vehicles did not meet it at present, therefore suggesting the scheme had not been designed in a protectionist fashion.

The EC also argued that the Corporate Average Fuel Economy (CAFE) provisions violated Article III. CAFE stipulated that for purposes of determining whether the vehicle of a particular manufacturer met the fuel economy threshold, an average would be used that would allow manufacturers to offset large low-fuel economy vehicles against *domestically produced* small high-fuel economy vehicles (the major policy goal here being to encourage domestic manufacturers to produce more small cars). The panel held that this measure fell within Article III:4, which applies to laws, regulations and requirements, even though it was related to the taxation measures already discussed. The panel did not see the distinction in question between cars whose manufacturers have achieved a given overall level of fuel economy in their fleets and those that have not—as inherently discriminatory, even though the distinction did not apply to the individual *products* as such but rather to the behaviour of their manufacturers. It did, however, find an element of discrimination, because foreign manufacturers were less likely to have domestic production against which to offset the lower fuel economy of their imported products.⁵³

Clearly, in *Taxes on Automobiles*, the panel did not accept the idea developed in the *Tuna/Dolphin* cases that measures on products as such are to be sharply distinguished from other measures, such as production and process methods (PPMs). If products can be distinguished on the basis of how well their manufacturers perform in advancing the objective of fuel conservation, then they can equally well be distinguished on how well their producers achieve the equally legitimate policy objective of dolphin conservation. Yet despite the divergent approaches of these unadopted panels, the trade policy élite has simply accepted the notion of a sharp divergence between measures on products and PPMs as if such a distinction had been written into the GATT all along and not simply invented in the *Tuna/Dolphin* case.

The matter has been further confused by the introduction into the WTO Technical Barriers to Trade (TBT) Agreement of the concept of product-related PPMs. Thus in Annex 1 of the TBT Agreement, a technical regulation is defined as a ‘document that lays down product characteristics or their related processes and production methods’. Here, the mainstream interpretation would be that this excludes those PPMs that go to aspects

of processes and production methods that have effects aside from those on the physical characteristics of a product, such as the import ban on dolphin-unfriendly tuna.⁵⁴

Reformulated Gasoline

In *Reformulated Gasoline*,⁵⁵ Brazil and Venezuela challenged requirements of US environmental legislation that conventional and reformulated gasoline sold in the United States conform to a minimum level of 'cleanness', set in terms of a 1990 baseline for emissions. This baseline was determined either on a refinery-specific, 'individual' basis, or on the basis of average 1990 US gasoline quality. Which kind of baseline would apply depended upon whether an entity was a domestic refiner, importer or foreign refiner. While individual baselines (with some qualifications) were used for domestic refiners and importers, calculated on the gasoline actually sold or imported by the entity in question in 1990, foreign refiners were regulated exclusively on the basis of the constructed (average 1990 US quality) baseline. The panel accepted the arguments of Venezuela and Brazil that this differential treatment constituted a violation of the National Treatment obligation in Article III:4. The panel then considered the US claim that, even if a violation of III:4, the differential treatment was justified as a measure 'necessary' to protect life and health under XX(b) or as 'relating to' the conservation of natural resources under Article XX(g). With respect to XX(b), the panel found that the United States had not demonstrated that the method of calculation imposed on foreign producers was the least-trade-restrictive means of achieving its environmental objectives. Thus, the panel rejected US arguments that verification and compliance would be very difficult to execute with respect to individual baselines for foreign refineries, given the way that gasoline is shipped as a fungible commodity, and the lack of US regulatory control over foreign refineries. Also, the USA could have achieved its clean air goals equally well by simply applying the statutory or constructed baseline to *both* domestic *and* imported gasoline. In the case of XX(g), while accepting that clean air was an 'exhaustible natural resource' for purposes of this provision, the panel applied a stringent interpretation of 'relating to', much along the lines of the *Herring and Salmon* case, as meaning 'primarily aimed at'. Then, in the manner of *Salmon and Herring Landing Requirements*, it viewed this meaning as implying a least-restrictive-means test, and came to the conclusion that the measures in question were not 'primarily aimed at' conservation of exhaustible natural resources because there were many options available to the United States for attaining the desired air quality without discriminating against imported gasoline.

Having found that the US measures could satisfy the requirements of neither XX(b) nor XX(g), the panel considered it unnecessary to examine whether, under the *chapeau*, the measures constituted 'a disguised restriction on trade' or 'a means of arbitrary and unjustifiable discrimination between countries'.

The AB rejected the reading of a least-restrictive-means test into Article XX(g), finding that the panel had failed to interpret the provision in question in accordance with Vienna Convention rules for the interpretation of treaties, which required that the 'ordinary meaning' be given to the words of a treaty. The expressions 'necessary to' and 'relating to' on their ordinary meaning did not imply the 'same kind or degree of connection between the measure under appraisal and the state interest or policy to be promoted or realized' (p. 17). However, given that none of the Parties in the appeal had

challenged the notion that 'relating to' implied the idea of being 'primarily aimed at', the AB refused explicitly to overrule the *Herring and Salmon* panel on this occasion. It did note, however, that "'primarily aimed at" is not itself treaty language and was not designed as a simple litmus test for inclusion or exclusion from Article XX(g)' (p. 18). In any case, the AB—having rejected a least-restrictive-means approach to XX(g)—found that the measures in question were indeed, in the relevant sense, primarily aimed at conservation of exhaustible natural resources:

The baseline establishment rules, whether individual or statutory, were designed to permit scrutiny and monitoring of the level of compliance of refiners, importers and blenders with the 'non-degradation' requirements. Without baselines of some kind, such scrutiny would not be possible and the Gasoline Rule's objective of stabilizing and preventing further deterioration of the level of air pollution prevailing in 1990, would be substantially frustrated.

(p. 19)

It is important to note that, unlike the panel, the AB found that in applying XX(g), it was important to consider whether the measures as a whole, and not simply the otherwise GATT-illegal (in this case discriminatory) element, are aimed at conservation.

The AB went on, however, to make a very significant finding concerning the importance of the *chapeau* (preamble paragraph) of Article XX in a determination of whether otherwise GATT-illegal measures can be justified under the Article. Thus, Article XX analysis must proceed in two steps: (1) provisional characterization of the measure as falling within one (or more) of the specific exceptions in paragraphs XX(a)–(j); (2) 'further appraisal of the same measure' under the criteria of the *chapeau* (p. 22).

The AB interpreted the *chapeau* as being aimed at the prevention of protectionist 'abuse' of the exceptions in Article XX:

The chapeau is animated by the principle that while the exceptions of Article XX may be invoked as a matter of legal right, they should not be applied so as to frustrate or defeat the legal obligations of the holder of the right under the substantive rules of the General Agreement. If those exceptions are not to be abused or misused, in other words, the measures falling within the particular exceptions must be applied reasonably, with due regard both to the legal duties of the party claiming the exception and the legal rights of the other parties concerned.

(p. 22)

The AB chose to read the three concepts in the *chapeau* together, such that 'arbitrary discrimination', 'unjustifiable discrimination' and 'disguised restriction' all went in interrelated and overlapping ways to the question of whether there was 'abuse or illegitimate use' of the exceptions available in Article XX. It held that the United States had not explained why its concerns about verification and compliance in the case of foreign refineries could not be resolved by cooperation with foreign authorities, and that the record had not included any evidence that the United States had attempted to enter

into such cooperation. Also, in imposing the statutory requirement on imported gasoline, the USA had not attempted to obviate imposing costs on foreign refiners that it had clearly thought important to relieve in the case of domestic entities. The first omission of the United States, its non-pursuit of cooperation, showed that the discrimination was 'unjustified'; the second omission, a willingness to alleviate certain costs for domestic but not foreign entities, pointed to a 'disguised restriction on international trade'.

The AB ruling in *Reformulated Gasoline* is an important advance towards the development of a principled jurisprudence on environmentally based trade measures. The AB found in the text of Article XX itself a mechanism for ensuring that the exceptions in XX(b) and (g) do not lead to protectionist abuse and therewith pose a threat to the integrity of the trading system; it therefore pointed to at least one way in which this latter goal could be furthered without the results-based manipulation involved in the *Tuna/Dolphin* panels, where an admittedly genuine concern for the avoidance of abuse and the integrity of the system led to the invention of legal distinctions without a textual basis, and the resultant removal of entire classes of measures from possible justification under Article XX.

Turtles

In *Shrimp/Turtle*,⁵⁶ several Asian Members challenged a trade embargo pursuant to a domestic US scheme aimed at preventing shrimp fishing techniques that produce high mortality rates of sea turtles, an endangered species included in Annex I of the CITES. The scheme permitted unrestricted entry into the United States of shrimp from any country, provided that it was not harvested with technology that endangered sea turtles. However, where foreign shrimpers chose to employ methods that could endanger the turtles, the access of their shrimp to the United States would depend upon the harvesting country having a regulatory programme similar to that of the United States, aimed at controlling incidental turtle deaths, or a determination that the harvesting environment of the country was such as not to pose any concern about incidental sea turtle deaths. Pursuant to State Department guidelines, where shrimpers used turtle excluding devices (TED) of the kind required in the United States, they were eligible to export their shrimp to the United States, even if their home government did not have in place a regulatory programme requiring the regulation of shrimping for turtle protection purposes. However, a decision of the US Court of International Trade interpreted the legislation as requiring that the ban be extended to all shrimp imported from countries without the requisite regulatory programmes, even if caught with TED-equipped trawlers.

The complainants, basing their claims on the approach of the *Tuna/Dolphin* panels, argued that the ban was a violation of Article XI, even if part of a scheme that imposed similar turtle conservation methods on US shrimpers. Interestingly, the United States chose not to 'dispute' the claim of an Article XI violation; the panel made a finding of Article XI violation which it said was independent of whether this statement by the USA amounted in legal terms to a concession. The panel came to this conclusion in a summary and unreasoned fashion, pointing to the word 'prohibited' in the legislation, and previous panel reports, presumably the unadopted *Tuna/Dolphin* reports. However, the fact that a measure is worded in terms of a prohibition on trade is in itself no proof that, taken in its overall regulatory context, it should be regarded as an Article XI measure and not simply

a means of enforcing at the border a domestic regulatory scheme, and therefore should be considered under Article III (recall the discussion of *Lobsters* above). As for previous panel decisions, the *Shrimp/Turtle* panel did not even bother to consider whether the treatment of Article III in the *Japanese Alcoholic Beverages* and *Periodicals* cases⁵⁷ might alter the weight to be attached to the exclusion of so-called PPMs from consideration as measures on 'products' within the meaning of Article III on grounds that they do not go to the physical characteristics of the products themselves. (Indeed, there would be no reason not to give equal weight to the interpretation of 'like' products in the unadopted *Taxes on Automobiles* panel as to the invention of PPMs in the also unadopted *Tuna/Dolphin* panels.)

The most serious defect in the panel ruling, however, is its approach to Article XX. Apparently relying on the emphasis on the *chapeau* of Article XX in the *Reformulated Gasoline* AB decision, the panel held that measures such as the shrimp embargo were as such outside of the ambit of Article XX by virtue of the general risk they posed to the integrity of the multilateral trading order. The panel never even considered whether the measures might fall within XX(b) or (g), holding them to be simply excluded in light of the overall purpose and intent disclosed in the *chapeau* of preventing damage to the integrity of the trading system.

According to the panel,

In our view, if an interpretation of the *chapeau* of Article XX were followed which would allow a Member to adopt measures conditioning access to its market for a given product upon the adoption by exporting Members of certain policies, including conservation policies, GATT 1994 and the WTO Agreement could no longer serve as a multilateral framework for trade among Members as security and predictability of trade relations under those Agreements would be threatened. This follows because if one WTO Member were allowed to adopt such measures, then other Members would also have the right to adopt similar measures on the same subject but with differing, or even conflicting, policy requirements. Indeed, as each of these requirements would necessitate the adoption of a policy applicable not only to export production...but also domestic production, it would be impossible for a country to adopt one of those policies without the risk of breaching other Members' conflicting policy requirements for the same product and being refused access to these other markets.

(para. 7.44)

In a landmark ruling, the AB of the WTO reversed the panel on the issue of whether trade measures directed at other states' environmental policies could be justified under Article XX(g). In so doing, the AB put a definitive end to the notion that the justification of such measures is *per se* inconsistent with the aims and structure of the multilateral trading system, thus rejecting the approach to Article XX in *Tuna/Dolphin*, as well. However, the AB also emphasized the importance of the criteria in the *chapeau* of Article XX in ensuring that these kinds of measures are not applied in an inflexible manner that does

not take into account local conditions in the targeted country, as well as other factors, such as the possibilities for a negotiated cooperative approach.

Thus, the AB ruling in this case, and a further AB ruling (that dealt with a challenge by Malaysia as to whether the United States had fully implemented the first ruling), have created a new legal baseline for the trade and environment debate. These decisions therefore merit close analysis.

Understanding the Appellate Body rulings in *Turtles*⁵⁸

In its first ruling in *Shrimp/Turtle*, the AB of the WTO did two things. First of all, it reversed certain key findings of the panel, including the finding that the *chapeau* of Article XX creates a *per se* exclusion of unilateral trade measures to protect the global environment. Second, the AB went on to ‘complete the analysis’—an expression the AB has used in previous cases for the jurisprudential technique of going forward to apply the law as correctly understood to the facts of the dispute. This jurisprudential technique must be understood in light of the absence of any explicit authority of the AB to remand a case back to the original panel for re-decision in light of the AB’s clarification of the law.

The AB first of all addressed the panel’s finding that the *chapeau* of Article XX excluded the possibility of unilateral environmental trade measures of the kind at issue in this case. The AB found three errors of law in the panel’s treatment of the *chapeau*. The first error was that the panel had considered the *chapeau* before even investigating whether the measures could be provisionally justified under one of the heads of Article XX, most notably in this case XX(g), which applies to measures ‘in relation to’ the conservation of exhaustible natural resources. In a previous case, *Reformulated Gasoline*, the AB had set out the proper approach to Article XX, which was to begin with a consideration of whether the measure could be justified under one of the heads of Article XX, and then only if there was such provisional justification, to consider whether the party maintaining the measure was in compliance with the *chapeau*, clearly, the panel in *Shrimp/Turtle* had not followed this sequential approach to Article XX analysis. The sequencing of Article XX analysis stipulated by the AB in *Gasoline* was not accidental or arbitrary, but rather directly linked to the AB’s understanding of the *chapeau* as directed to preventing *abuse* of a Member’s rights under Article XX. It is conceptually impossible to know whether a Member is abusing their rights, until those rights have in the first instance been determined.

The second error of law in the panel’s approach to the *chapeau* was that the panel ignored the fundamentally limited ambit of the *chapeau*. As the AB had stressed in *Gasoline*, the *chapeau* is concerned only with the *application* of measures, not whether the measures themselves are justified under Article XX. In *Shrimp/Turtle*, the AB reiterated this point:

In the present case, the Panel did not expressly examine the ordinary meaning of the words of Article XX. The Panel disregarded the fact that the introductory clauses of Article XX speak of the ‘manner’ in which measures sought to be justified are ‘applied’. In *United States—Gasoline*, we pointed out that the *chapeau* of Article XX ‘by its express terms addresses, not so much the questioned measure or its specific contents as

such, *but rather the manner in which that measure is applied*” [emphasis added]... What the panel did, in purporting to examine the consistency of the measure with the *chapeau* of Article XX, was to focus repeatedly on the *design of the measure itself*... The general design of a measure, as distinguished from its application, is, however, to be examined in the course of determining whether that measure falls within one or another of the paragraphs of Article XX following the *chapeau*.⁵⁹

The AB might have disposed of the appeal based entirely on these findings of error of law in the panel report. The result would have been a reversal of the conclusion by the panel that the United States could not justify its measure under Article XX. In other words, the United States would have ‘won’ the case. It will be recalled that the *Tuna/Dolphin* rulings had been based not on the *chapeau* of Article XX, but on the notion of inherent territorial limits on the environmental exceptions in Article XX(a) and XX(b). Thus, had the AB simply reversed the panel and stopped there, the validity of the *Tuna/Dolphin* approach to environmental trade measures would have remained a matter of uncertainty, to be decided presumably in future litigation.

Instead, the AB went on to find that the panel had made a third error of law, namely to *assume* that unilateral measures that conditioned market access on the policies of the exporting countries are, as a matter of general principle, not justifiable under Article XX. This was an assumption common to the panel ruling in *Shrimp/Turtle* and to the older *Tuna/Dolphin* rulings. In identifying this error of law, the typically cautious AB used emphatic language, suggesting disapproval of the basic approach taken in *Tuna/Dolphin* as well as by the panel below in *Shrimp/Turtle*. This language is well worth citing at length:

In the present case, the Panel found that the United States measure at stake fell within that class of excluded measures because Section 609 conditions access to the domestic shrimp market of the United States on the adoption by exporting countries of certain conservation policies prescribed by the United States. It appears to us, however, that conditioning access to a Member’s domestic market on whether exporting Members comply with, or adopt, a policy or policies unilaterally prescribed by the importing Member may, to some degree, be a common aspect of measures falling within the scope of one or another of the exceptions (a) to (j) of Article XX... It is not necessary to assume that requiring from exporting countries compliance with, or adoption of, certain policies (although covered in principle by one or another of the exceptions) prescribed by the importing country, renders a measure *a priori* incapable of justification under Article XX. Such an interpretation renders most, if not all, the specific exceptions of Article XX inutile, a result abhorrent to the principles of interpretation we are bound to apply.

(para. 121)

With this holding, the AB rejected the traditional approach to environmental trade measures in the GATT/WTO system, without so much as a citation to the unadopted

Tuna/Dolphin panel reports. Given that the AB had already reversed the specific findings of the *Shrimp/Turtle* panel with respect to the *chapeau* of Article XX, and given the radical shift of perspective implied in these words, some interpreted this paragraph as dicta, of uncertain legal significance in future cases. But when the AB ruled on Malaysia's challenge to the United States' implementation of its original ruling, the AB went out of its way to make clear that paragraph 121 was *not* dicta, but rather a fundamental basis of its entire ruling. The AB made clear that the paragraph was intended to give legal guidance to future panels.⁶⁰

Having already done more than it strictly needed to do to reverse the panel in its first *Shrimp/Turtle* ruling, the AB went on to complete the analysis, showing how Article XX ought to be applied to the facts of this case. The first stage in 'completing' the analysis was to determine whether the US measure was covered by any of the specific heads of Article XX. The United States had invoked Article XX(g) ('in relation to conservation of exhaustible natural resources'), and in the alternative, Article XX(b) ('necessary for the protection of...animal life'). However, the USA preferred to make its case under XX(g), since the language 'in relation to' in XX(g) suggests a looser requirement of nexus between the measure and the objective than the language 'necessary' in XX(b).

In previous GATT jurisprudence (*Thai Cigarette* and *Tuna/Dolphin*), 'necessary' had been interpreted as triggering a very high level of scrutiny: a measure could only pass muster if it used the 'least-restrictive means' to achieve its end. The tendency of GATT panels had, however, also been to interpret 'in relation to' in XX(g) as not significantly relaxing the level of scrutiny determined by the 'necessary' language in XX(b). As noted above, in *Reformulated Gasoline*, the AB held that there is a significant difference in the closeness of connection suggested by the ordinary meaning of 'in relation to' as opposed to 'necessary'. Based on *Reformulated Gasoline*, the United States understandably preferred that its measures be considered under XX(g) rather than XX(b). Conversely, the complainants preferred XX(b), with its necessity test. In this connection, the complainants argued that the expression 'exhaustible natural resources' applied only to mineral resources such as petroleum or coal that were unable to reproduce biologically.

According to the complainants, this meaning to exhaustible natural resources represented the understanding common at the time that the original GATT was drafted in 1947. But the incorporation of GATT into the WTO framework in 1994 created a new interpretive context that the AB was bound to follow. The preamble to the WTO Agreement, which established this new framework, referred to sustainable development as an objective of the WTO system. The AB therefore chose to interpret the notion of 'exhaustible natural resources' in light of evolving international legal instruments and policies to promote 'sustainable development'. These instruments and policies provided ample evidence that endangered species are considered 'exhaustible', despite individual members of the species having reproductive capacities. Thus, inasmuch as they were endangered, or threatened with extinction, the species of sea turtles at issue were considered by the AB to be exhaustible natural resources within the meaning of Article XX(g).

This finding is not necessarily incompatible with an 'original intent' view of the meaning of the GATT. Because the framers of the GATT may have thought of exhaustible natural resources in terms of non-living mineral resources, it does not follow that they believed that XX(g) should be frozen by such an understanding. In other words,

the framers might have thought that living resources are not exhaustible, *and* they might have intended XX(g) to be interpreted in light of the evidence *at the time of the dispute* concerning whether a given resource was exhaustible. On this interpretation of original intent, a finding that sea turtles are exhaustible based upon the evidence in 1998 would not be at odds with the intent of the framers concerning the proper reading of Article XX(g). Moreover, a reading of 'exhaustible' frozen in 1947 could easily lead to absurdity: hypothetically, a WTO Member might end up being able to justify otherwise GATT-inconsistent trade restrictions under XX(g), even where the best available scientific evidence suggested the resource was not in danger of running out—and just because it was thought to be running out more than a half-century earlier! The issue under Article XX is surely whether a Member has a legitimate reason today for taking trade-restricting measures, not whether they would have had a legitimate reason in 1947.

By taking seriously the reference to sustainable development in the preamble of the WTO Agreement, the AB was able to make the point that dispute settlement in respect of environmental trade measures must not simply take into account scientific evidence as such about whether a resource is exhaustible, but must also consider relevant principles and norms from international environmental law and policy, in interpreting the provisions of the WTO Agreements. In other words, environmental values and interests are to be brought within WTO dispute settlement.

Having established that the endangered species of sea turtles fell within the meaning of 'exhaustible natural resources', the AB went on to examine whether the US measures were 'in relation to' the conservation of such exhaustible natural resources. Here, following its approach in *Reformulated Gasoline*, the AB applied a 'rational connection' or reasonableness standard in assessing the fit between the US measure and the goal of conserving exhaustible natural resources, and easily found that the measure met this standard.

There is some evidence in the language the AB used, however, to suggest that it was thinking not *merely* in terms of rational connection, but was also deploying an implicit conception of proportionality. Thus, the AB not only held that there was a 'direct connection' between the main features of the US scheme and the conservation of sea turtles, but also found that 'Section 609, *cum* implementing guidelines, is not disproportionately wide in its scope and reach in relation to the policy objective of protection and conservation of sea turtle species' (para. 141). What the AB appears to mean here by proportionality in scope and reach is whether *all* the trade-restricting features of the scheme have some reasonable connection to turtle conservation—it does *not* appear to be *balancing* in any way the environmental benefits against the costs to trade entailed in the US measure. Thus, the AB does not engage in a *comparative* analysis of the environmental benefit of the measure versus its trade-restricting effects. Indeed, it simply does not speculate on either benefits or costs, nor on their incidence or level. The AB looks only at proportionality in terms of how the *design or structure* of the measure fits with its goal.

One of the issues that the AB found necessary to raise but not decide was whether XX(g) requires a territorial nexus of some kind between the exhaustible resource and the WTO Member seeking to justify its measure. Merely noting that all of the endangered species of turtles could be observed at one time or another in US waters, the AB stated that *were* a nexus required, it existed under these facts. The failure to decide the issue of

whether there are jurisdictional or territorial limits on XX(g) must be understood in light of another aspect of the text of XX(g). This is the condition that XX(g) measures must be taken in conjunction with restrictions on domestic production or consumption of the resource. By virtue of this condition, Article XX(g) already requires that there be a link between environmental trade measures and *domestic regulation* dealing with the same conservation problem. Were a WTO Member to target its conservation concerns solely at the policies of other countries, without putting its own house in order, then it would not be able to meet this condition of XX(g). The question, then, of whether there is an *implicit* territorial or jurisdictional limitation in XX(g) may therefore be largely moot, since Article XX(g) by its explicit language only applies to environmental trade measures that are coupled with domestic environmental regulation. Once it has been established that the state taking the environmental trade measures is also imposing restrictions on its own producers and/or consumers in an even-handed way, why should it be necessary to go further, for example, to identify whether the species being protected is itself sometimes to be found within US territory? If the purpose of a nexus is to ensure that in acting in response to a global environmental problem, the USA is not simply engaging in protectionist interventionism in a situation of no legitimate concern to it, then should it not be enough to establish, as the text of Article XX(g) establishes, that in so acting, the USA has been even-handed, imposing a conservation burden on its own producers and consumers, and not merely attempting to externalize the costs of environmental protection to the producers of other countries?

Policing unilateralism through the conditions in the chapeau

The overall boldness with which the AB has rejected the bright-line rule against unilateral environmental trade measures initially seems to suggest that the AB simply gives short shrift to concern that such measures are susceptible to protectionist abuse, or tend to impose on other countries policy solutions ill-adapted to the conditions in those other jurisdictions.

But a careful reading of the AB's application of the *chapeau* undermines this interpretation. According to the AB, the *chapeau's* safeguards make it possible to reconcile unilateral measures with the GATT/WTO framework. As the AB emphasizes, the conditions in the *chapeau* control the abuse of rights and regulate the overall balance of rights and obligations struck by Article XX. However, interpreting the *chapeau* so as to vitiate the meaning of the rights contained in the operative paragraphs of Article XX would be inappropriate. Just as a bright-line rule against unilateral environmental measures would make Article XX inutile, so too would an excessively strict interpretation of the *chapeau's* conditions. Such an interpretation would make it impossible, in practice, for unilateral measures to survive judicial scrutiny.

The AB acknowledged the delicate nature of *chapeau* interpretation: 'The task of interpreting and applying the chapeau is, hence, essentially the delicate one of locating and marking out a line of equilibrium between the right of a Member to invoke an exception under Article XX and the rights of other Members under varying substantive provisions (e.g. Art. XI) of the GATT 1994, so that neither of the competing rights will cancel out the other' (para. 159; emphasis added).

The AB found that the application of the US scheme constituted 'unjustifiable discrimination' within the meaning of the *chapeau*. One element of unjustified discrimination was that while the USA refused to negotiate seriously with the complainants, it did negotiate seriously over this issue with Western hemisphere trading partners. The failure of the State Department to negotiate seriously with the complainants, in the manner in which the USA did negotiate with the Western hemisphere countries, was a failure in application, since, as noted above in the discussion of the background to this case, Section 609 *itself* contained a requirement to negotiate with *all* relevant countries: thus, this failure was appropriately considered under the *chapeau*, which deals with the manner of application of a Member's scheme. The AB also found the application of the US scheme unjustifiably discriminatory on the separate grounds that (1) it was a rigid, extraterritorial extension of US law to other countries, and (2) it wholly disregarded the conditions prevailing in other countries. To be certified (and gain access to US shrimp markets), all countries were required to have a TED programme essentially identical to that of the USA, regardless of conditions in those countries. This was certainly discriminatory in relation to the negotiated settlement accepted by the United States with respect to the western hemisphere countries, in that the latter allowed the specific circumstances of the exporting countries to be taken into account in determining the means they adopted to satisfy the US conservation objective. It was unjustified because, as the AB suggests, other measures more acceptable to the exporting country might have achieved the legitimate conservation objective of the US. Indeed, as the AB notes, this was already implicit in the scheme itself, which allowed for the possibility of certification in the case of a turtle conservation programme 'comparable' (though not identical) to that of the USA.

Furthermore, the scheme as applied barred imports of shrimp caught with TEDs, merely because they were caught in waters of countries not certified by the USA. Here the AB was *cumulating* the effect of country-based application with the effect of using a rigid, US-derived standard as the standard of *country* certification. These two features of the application of the scheme, *taken together*, lead to a conclusion of *unjustified* discrimination since they lead to a conclusion that the application of the scheme 'is more concerned with effectively influencing WTO Members to adopt essentially the *same* comprehensive regulatory regime as that applied by the United States to its domestic shrimp trawlers...[than the objective of protecting sea turtles]' (para. 165; emphasis added). Thus, the ultimate problem is not with country-based application as such but 'when the measure at issue does not allow for any inquiry into the appropriateness of the regulatory program for the conditions prevailing in those exporting countries'.

Perhaps the most pervasive interpretation of the AB decision in *Shrimp/Turtle* is that the AB, under the *chapeau*, imposed a duty to negotiate seriously as a precondition to the application of unilateral trade measures to protect the global environment. Clearly, the failure of the USA to negotiate seriously with the complainants figures prominently in the AB's finding that, cumulatively, a number of features of the application of the US scheme amount to 'unjustified discrimination'. However, the AB never did hold that the requirements of the *chapeau*, in and of themselves, impose a *sui generis* duty to negotiate. What it did clearly say is: (1) undertaking serious negotiations with some countries and not with others is, in circumstances such as these, 'unjustifiable discrimination'; and (2) a failure to undertake serious negotiations may be closely

connected with, and indeed be part and parcel of, various discriminatory effects of a scheme, and may reinforce or perhaps even tip the balance towards a finding that those discriminatory effects amount to 'unjustifiable discrimination' within the meaning of the *chapeau*. By taking each of these propositions separately and carefully examining them in context, we can discern the extent to which the AB is actually inferring a duty to negotiate from the requirements of the *chapeau*, and the extent and nature of that duty.

As for the first proposition, within GATT/WTO jurisprudence, offering different terms of market access to some Members and not others will almost always constitute 'discrimination'. Thus, it is hardly controversial that by offering negotiated market access to some Members and not others, the USA was engaging in 'discrimination'. One does not need to infer any self-standing duty to negotiate in order to arrive at this conclusion. However, the AB had to consider not only whether there was discrimination, but whether that discrimination was unjustifiable. In other words, could it be justified in terms of the objective of the United States, the protection of endangered species of sea turtles? To answer this question, the AB very logically had resort to the relevant international environmental law that related to biodiversity. (The AB had already used this body of international environmental law in defining the meaning of exhaustible natural resources in XX(g), and it had justified proceeding this way by pointing to the reference to sustainable development in the preamble of the WTO Agreement.) Turning now to international environmental law, including the Rio Declaration, the AB cited various statements to the effect that transboundary or global environmental problems should be dealt with to the greatest extent possible by cooperation and consensus (paras 168–9), and unilateralism avoided as much as possible. On this understanding of the appropriate approach to global environmental commons problems, it would indeed be very difficult to argue that the USA could be *justified* in not offering serious negotiations to all relevant countries—since international environmental law demands that cooperative solutions be attempted to the *greatest* extent possible, and unilateralism avoided to the *greatest* extent possible. But here the AB was not *incorporating* into the *chapeau* a duty to negotiate from international environmental law—it was merely using a baseline from international environmental law to determine whether, in the circumstances, the *discriminatory* behaviour of the USA was *also* unjustifiable.

Had the AB intended to read into the *chapeau* a self-standing duty to negotiate seriously, it would have given some guidance as to the extent of such a duty, and its relationship to a corresponding duty of good faith on those countries who are invited into negotiation. After all, the duty of cooperation to solve international environmental problems that is found in the international environmental instruments that the AB cited is a duty on the part of *all* states who are affecting the commons problem at issue. Thus, the duty to cooperate to solve international environmental problems can on the one hand be understood as a discipline on a country that resorts or is planning to resort precipitously to unilateralism, but it could equally be regarded as a *possible justification* for unilateral measures, to pressure a country or countries *refusing* to negotiate in good faith towards a cooperative solution to a commons problem. But since the AB was not reading a self-standing duty to negotiate into the *chapeau*, it did not need to expand on these complexities. The USA was required to negotiate seriously with the complainants exactly to the extent it had already negotiated with the Western hemisphere countries, no more and no less. And this, again, because the 'unjustified discrimination' was not the failure

to negotiate as such, but the failure to treat the complainants as well as the USA had treated the western hemisphere countries.

In its second ruling in *Shrimp/Turtle*, the AB clarified that the duty of negotiation under the *chapeau* simply amounted to a requirement to make a 'comparable negotiating effort' with the complainants, i.e. comparable to that which the USA had invested in the case of the Western hemisphere countries. The implication is that had the USA negotiated with *no one*, it would not have run afoul of the *chapeau*.

Yet in its first ruling, the AB had also seemed to be saying that failure to negotiate had contributed to another element of 'unjustified discrimination'—the rigid application of the scheme without regard for different conditions in different countries. The importance of negotiation to the operation of environmental trade measures is not discussed or even referred to in the AB's second ruling. This is apparently because the AB found, in its second ruling, that the USA was able to build into *unilateral* operation of its scheme sufficient flexibility, by certifying countries that had a programme comparable in environmental effectiveness, even if it worked differently from the domestic US regulation. In other words, the AB suggests that if a Member has adequately accounted for different conditions in different countries, then whether that country has engaged in negotiation may be irrelevant for purposes of the *chapeau* (unless of course, as with the USA here, it has done so in a way that is not even-handed, seriously negotiating with some countries but not others).

An even more serious misreading of the AB's invocation of international environmental law with respect to the duty of cooperation is that the AB held that global environmental trade measures may only be taken, if at all, pursuant to an already negotiated multilateral framework. In other words, a Member has a duty not only to negotiate but to actually succeed in achieving a multilateral framework under which trade measures are permissible (or required), before taking such measures. This reading simply ignores the exact wording of the international environmental instruments cited by the AB. These instruments require cooperation and the avoidance of unilateralism 'as far as possible'. The wording 'as far as possible' clearly anticipates that there will be situations where it will not be possible to avoid unilateralism.

The misunderstanding concerning the need to conclude a multilateral environmental agreement is also put to rest by the AB in its second ruling: 'Requiring that a multilateral agreement be *concluded* by the United States in order to avoid "arbitrary or unjustifiable discrimination" in applying its measure would mean that any country party to the negotiations with the United States, whether a WTO Member or not, would have, in effect, a veto over whether the United States could fulfill its WTO obligations. Such a requirement would not be reasonable' (para. 123).

In this connection, it should be noted that there is nothing in the wording of the *chapeau*, or indeed in any other part of Article XX of the GATT, to suggest that the agreement of other WTO Members, or for that matter any other state, is a precondition for exercising the rights in Article XX(g). By contrast, *where* the drafters wanted to make the exercise of some kind of exception to GATT disciplines contingent on agreement or collective action among Members or states generally, they did so explicitly. The most obvious example is Article XXI(c), which provides an exception where Members are taking action 'in pursuance of...obligations under the United Nations Charter for the

maintenance of international peace and security'. There are a number of other examples as well.

In considering the question of flexibility, the AB made an important clarification of its original report, namely that a Member is *not* required to sacrifice the achievement of its environmental objective to any extent whatsoever in order to accommodate different conditions in different countries. Some interpretations of the original report, notably that of Professor Joel Trachtman, had found the AB to be engaged in a balancing analysis in its application of the *chapeau*. However, in the 21.5 ruling, the AB states unambiguously that, consistent with the *chapeau*, a Member imposing environmental trade measures may require a programme *comparable in effectiveness* to that which exists in the Member's own domestic law (para. 144). A Member need not go further in accommodating affected Members—for example, it need not adjust the statutory or regulatory requirements to the particular circumstances of each country, as long as it provides a reasonable mechanism for assessing whether *any* country's programme is comparable (para. 149).

Country-by-country vs. shipment-by-shipment certification

The *panel* in its 21.5 ruling had found that certifying countries with a programme of comparable effectiveness did not suffice to satisfy the *chapeau* requirement of 'flexibility'; it was essential as well, according to the panel, that the United States was now admitting shrimp caught in a turtle-friendly manner from non-certified countries (shipment-by-shipment certification).⁶¹ The panel suggested that shipment-by-shipment certification was a separate requirement to that of flexibility in country-by-country certification; a 'specific solution' was required (i.e. permitting entry of shrimp from non-certified countries) in order for the USA to bring itself into conformity. Thus, according to the panel, even if the USA altered the application of the scheme so as to provide other countries' *governments* with adequate flexibility to achieve the environmental objective through different types of *policies*, it would still also have to allow in shrimp from countries with turtle conservation policies that do not meet even these new flexible requirements, provided that the particular *shipment* of shrimp happens to have been fished in a turtle-friendly manner.

In its appellate submission, Malaysia argued that although the revised guidelines did permit shipment-by-shipment certification, there was litigation before the US courts challenging this aspect of the revised guidelines as inconsistent with the requirements of the statute, and thus that US implementation, inasmuch as it required shipment-by-shipment certification, was legally insecure. The AB rejected this argument, noting that it could only assess conformity on the basis of existing legal facts, and could not speculate as to future decisions of the US courts (paras 93–5).

This, however, does not answer the underlying issue of whether shipment-by-shipment certification is a *sine qua non* for the operation of this kind of scheme consistent with the requirements of the *chapeau* of Article XX. One should first of all note that shipment-by-shipment inspection was not presented as a separate requirement implicit in the *chapeau* by the AB in its original ruling; rather, the AB had mentioned the absence of shipment-by-shipment inspection as evidence that the administrators of the US law were treating the statutory scheme more in the manner of an extraterritorial extension of US domestic law than as a global conservation measure.⁶² In other words, the AB was pointing to a

number of factors that suggested inadequate appreciation by the administrators of the character of the statutory scheme, and above all its focus on conservation of the global commons rather than on bringing foreign actors under the ambit of US law. Such lack of appreciation could explain the various elements of inflexibility that, cumulatively, amounted to unjustified discrimination within the meaning of the *chapeau*.

The United States did not appeal the panel's interpretation that, absent shipment-by-shipment certification, the revised US scheme would not be in conformity with the requirements of the *chapeau*. One reason may be that in defending the shipment-by-shipment approach against challenges in the US courts, the executive branch of the US government would actually have found helpful a panel ruling that such an approach was actually required under Article XX to meet the United States' WTO obligations.

Nevertheless, in its 21.5 ruling, the AB notably does *not* include shipment-by-shipment certification as even one aspect of the flexibility required by the *chapeau*, let alone as a separate *sine qua non* requirement. Here, it is important to reflect on the AB's re-emphasis of the importance of paragraph 121 in its original ruling. As discussed above, in that paragraph, the AB suggested that there is nothing in the overall structure of Article XX that would prevent a Member from conditioning imports on whether Members comply with or adopt a policy or policies unilaterally prescribed by the importing Member. Indeed, in that paragraph, the AB made the even stronger statement that if such policy-conditioned measures were excluded from the ambit of Article XX, this would render 'most, if not all, of the specific exceptions of Article XX inutile'.

Malaysia had argued that this statement in paragraph 121 was mere dicta; in its 21.5 ruling, the AB held that, to the contrary, 'This statement expresses a principle that was central to our ruling in *United States—Shrimp*.' If the US law were to be interpreted by the courts as excluding shipment-by-shipment certification, it would still be in principle justifiable under Article XX, since Article XX, according to the AB, contemplates measures that condition market access not only on the practices of foreign producers, *but on the adoption of certain policies* by the government of the WTO Member state whence the product originates. To say that the *chapeau* requires shipment-by-shipment inspection in the *application* of the US scheme would be to interpret the *chapeau* in a manner that is inconsistent with the AB's overall understanding of the structure and purpose of Article XX, as articulated in paragraph 121 of its original ruling, and reaffirmed with emphasis in paragraph 138 of its 21.5 ruling. Since the United States could conceivably have a law that *explicitly* excludes shipment-by-shipment inspection, conditioning *all* market access on the turtle conservation *policies* of the country of origin, it makes no sense that the *chapeau* would be a *per se* bar to application of the law in a manner that excludes shipment-by-shipment inspection. On the other hand, on the facts, where administrators are applying a statute in a manner that is more trade restrictive than its ordinary meaning as interpreted by the courts, then this extra, legally unmandated degree of trade restrictiveness *could* constitute evidence of unjustified discrimination (as the AB found in its original ruling).

The future of the product/process distinction after Turtles

One element of the *Tuna/Dolphin* approach that was not explicitly rejected by the AB in *Shrimp/Turtle* was the product/process distinction; since the United States did not contest

the claim of an Article XI violation, and pursued the case solely under Article XX, no issue of whether or how Article III:4 (National Treatment) applied was raised.

However, at least in one place in the first AB ruling in *Shrimp/Turtle* there is an indication of where the AB's thinking may lie on this question. A puzzle concerning the statement in paragraph 121 of the original AB report about unilateralism is why the AB regarded most of Article XX as *inutile*, unless it allowed for market access to be conditioned on the *policies* of exporting Members. To find that Article XX may contemplate in some situations these kinds of measures is one thing—to consider that Article XX is mostly about such measures is quite another. This puzzle can be approached by considering the counterfactual situation that the US measure was concerned only with shipment-by-shipment certification and did not in any way involve conditions on market access related to the government *policies* in other WTO Members. How could Article XX be considered inutile in such a situation? The only plausible reason is that such process-but-not-policy-based measures need not violate any operative provision of the GATT in the first place. Therefore, Article XX is, by and large, not necessary to justify them. Thus, if the United States had a law that stated that all shrimp, whether they are caught in the USA or elsewhere in the world, must be caught in a turtle-friendly manner in order to enter the USA, such a measure could be regarded as consistent with the National Treatment obligation in GATT Article III:4, because it provides 'no less favourable treatment' to like imported products. Such a measure would arguably not be discriminatory, because it would deal only with a characteristic of the product, its method of production, and would not distinguish between different *countries* and their turtle conservation *policies*. However, there is a conventional wisdom in traditional GATT/WTO circles, the 'product/process distinction', which suggests that where a regulation treats products differently on the basis of their process of production (e.g. whether a given shrimp has been fished with a turtle-friendly or turtle-deadly method), it is a *per se* violation of the GATT and could only be justified under Article XX. We have challenged this conventional wisdom in other scholarship; the AB's remark that Article XX would be largely inutile unless it could be used to justify measures conditioned under other countries' *policies* suggests that the AB itself may not subscribe to the conventional wisdom of the product/process distinction, and may view Article XX as unnecessary for purposes of justifying *process-based* measures of a kind that condition market access on how the imported product is produced, rather than on some kind of policy in the country of origin of the imported product.

Indeed, in its *Asbestos* decision (discussed above in Chapter 3, on National Treatment), which came between the original AB ruling in *Shrimp/Turtle* and the AB's subsequent 21.5 ruling, the AB appears to have left the door open for the possibility that non-discriminatory process-based measures are consistent with Article III:4. First of all, it held that in determining whether products are 'like', the physical characteristics of different products, and their relevance to 'likeness', must be assessed in a purposive manner, in light of the objectives of Article III as a whole, above all the avoidance of protective discrimination against imports: no particular physical characteristic is dispositive, in the abstract, of whether a product is 'like' within the meaning of III:4 or 'unlike'. Other factors, such as consumer preferences, must be considered in forming a judgment based on the criteria that the AB approved in *Japan—Alcohol* and subsequent cases for assessing likeness in the context of Article III:2, which deals with National

Treatment in taxation. Moreover, there may be additional criteria or factors that could be decisive, besides those already developed in the taxation cases.

In fact, in *Japan—Alcohol* and subsequent cases (see Chapter 3 above), the AB, in holding physical characteristics to be only one consideration in the determination of whether products are ‘like’ (albeit an important one), has undermined the entire formal semantic logic of the product/process distinction, which is that the reference to ‘product’ in Article III means that National Treatment *as such* is about the comparison of the treatment of products understood solely in terms of bundles of physical characteristics.⁶³

Perhaps of equal or greater significance in assessing whether the product/process distinction forms any real part of the WTO jurisprudence is the dictum of the AB in *Asbestos* that even where two products are deemed to be ‘like’ for purposes of Article III:4, they may still be treated differentially in regulation, provided that the result is treatment ‘no less favourable’ for the ‘group’ of imported products compared against the ‘group’ of like domestic products. Thus, *arguendo*, if a panel were to hold that turtle-friendly and turtleunfriendly shrimp were ‘like’ products, it would still need to consider whether treating turtle-unfriendly shrimp differently would lead to less favourable treatment of imported shrimp *as a group* than domestic shrimp *as a group*. This would require a judgment as to whether, in singling out turtle-unfriendly shrimp, the regulatory scheme in its structure, design and operation is systematically biased against imported shrimp as a group. A scheme that was even-handed between imports and domestic shrimp, and focused appropriately on conservation goals, might well pass this test.

Reflecting on the product/process distinction in light of the original AB ruling in *Shrimp/Turtle*, John Jackson predicted that ‘the product-process distinction will probably not survive and perhaps *should* not survive’ although, as he also rightly notes the issue ‘remains open’, in the sense that there is no ruling where the AB has explicitly treated a processbased measure as consistent with National Treatment.⁶⁴ We believe that, in the respects discussed above, the *Asbestos* ruling strengthens this prediction of Jackson’s.

Article XX(b): evolution of the jurisprudence⁶⁵

As discussed above, *Turtles* was decided exclusively on the basis of Article XX(g) (measures ‘in relation to the conservation of exhaustible natural resources’). However, the key finding in paragraph 121 of the AB’s first ruling in *Shrimp/Turtle*, which reverses the *Tuna/Dolphin* approach of *per se* unjustifiability for measures directed at other states’ policies, is explicitly worded so as to suggest that it applies, *mutatis mutandis*, to Article XX as a whole, which would include XX(b), measures ‘necessary’ for the protection of human or animal life or health.

In the *Korea—Beef* and the *Asbestos* cases, the latter arguably in some measure an environmental case, the AB has considerably evolved the jurisprudence as to how the test of ‘necessity’ is to be applied where it appears in Article XX. In general, this development can be characterized as one of greater sensitivity to the challenges and choices facing domestic regulators, and away from the rather rigid and inflexible approach evidenced in the *Thai Cigarette* ruling, for instance.

In its notice of appeal, Canada also challenged the panel’s ruling that, although a violation of Article III:4, the French ban was justified under the GATT’s exception for measures to ‘protect human...life or health’. Specifically, Canada argued that the panel

had committed errors of law in its interpretation of paragraph XX(b), developing a too deferential and permissive reading of the GATT's general exception. The AB, after having found that the French ban did not violate Article III:4 GATT, could, for reasons of judicial economy, have decided not to rule on this issue. Nevertheless, it decided to address the Canadian claims, using this as an opportunity to clarify some important issues relating to Article XX(b), establishing a more deferential approach, sensitive to Members' regulatory choices and domestic regulations that address vital health interests. In examining the panel's approach to Article XX(b), the AB adopted a two-step approach. In a first step, it addressed the question of whether the French ban was indeed directed at the objectives cited in Article XX(b), notably in this case to protect human health. In a second step, it examined whether the measure at issue was 'necessary' to achieve the specific public policy goal, a level of protection against health risk. This approach is in line with previous decisions on measures falling under some of the individual sub-headings of Article XX.⁶⁶

In its first step, when analysing whether the panel was right in concluding that the French ban fell within the category of measures embraced by Article XX(b) of the GATT 1994, the AB found that 'the panel remained well within the bounds of its discretion in finding that chrysotile-cement products pose a risk to human life or health'.⁶⁷ For reaching its decision, the panel had to weigh evidence as to whether the French ban was designed to *protect* health. It did this in line with *Thai Cigarette*, which had established that 'the use of the word "protection" implies the existence of a risk', and that this consequently meant that a panel had to begin its analysis 'by identifying a risk for public health'.⁶⁸ Thus, if there were no evidence that asbestos poses a risk to human health, then a ban on asbestos would not appear to be designed to protect health. In the case of asbestos, however, its deadly and carcinogenic characteristics are well and widely recognized, by the consulted scientists and including by the relevant international bodies. This more than ample evidence on the dangers of asbestos allowed the panel to conclude that the measure was designed to protect health, and the AB upheld the panel's finding on that.⁶⁹ However, neither the AB nor the panel said anything about *how much* evidence of health risks is needed to regard a measure as 'for the protection of health'. Arguably, this risk requirement should be *de minimis*, i.e. the minimum needed to assert with some plausibility that the measure is directed towards the goal of protecting health. With respect to asbestos, the health aspect was, as noted, obvious. In other cases, panels may have to come to grips with measures that respond to less orthodox conceptions of 'health'—for instance, conceptions that only 'organic' food products are healthy, which are not underpinned by conventional scientific understandings, but reflect more holistic views of human health as implying harmony with natural processes. Here a panel should arguably defer to measures that are taken pursuant to such appreciations of the nature of human health, where the structure and design of the scheme are consistent with it being directed towards such a conception of health, as opposed to some other policy purpose. At the same time, it would obviously be appropriate, in considering the meaning of health, for the panel, pursuant to Article 31 of the Vienna Convention, to consider definitions of the notion of health, and health risks, in international health law and policy, especially as reflected in legal instruments and related policy statements of the World Health Organization.

After having found that the French ban is a measure that protects human life or health within the meaning of Article XX(b), the panel went on to evaluate the ‘necessity’ of the measure. Canada appealed the panel’s ‘necessity’ analysis on four grounds,⁷⁰ but here again the AB upheld the panel’s findings, concluding that there was no ‘reasonably available alternative’ to the prohibition of the French import ban, and therefore that the French measure was ‘necessary to protect human health’ within the meaning of Article XX(b). The AB’s reasoning is interesting for a number of reasons.

First, the AB made it very clear that it is each WTO Member’s ‘right to determine the level of protection of health that [it] consider[s] appropriate in a given situation’.⁷¹ France had decided that it wanted to ‘halt’ the spread of asbestos-related health risk, and the AB accepted its goal of reducing these health risks to zero. Here, the AB rejected categorically the notion that a Member’s right to determine its level of protection should be subject to considerations of proportionality. Thus, a Member may choose zero risk as its goal, even though if it had chosen a slightly less ambitious goal, that goal could have been achieved with a vastly less-trade-restrictive policy instrument. In effect, as long as it declares its goal as zero risk, a Member can be fully justified in its choice of a highly trade-restrictive instrument that achieves 100% reduction in risk, even where the Member could achieve a 98% or 99% reduction of risk through a policy instrument that is not trade restrictive at all. This outcome respects the hierarchy of norms reflected in Article XX—health trumps liberal trade as a value, in the presence of any genuine conflict between the two.⁷² However, one must consider this finding in tandem with a related finding, in *Korea—Beef*, that a Member will not easily persuade the panel that its objective is zero risk, if the policy instrument it chooses is structurally incapable of achieving that objective.⁷³

Another significant finding of the AB in addressing Canada’s claims on appeal in *Asbestos* is that a Member may single out the elimination of one kind of health risk as its objective, even if it chooses not to take regulatory action against certain other risks. Thus, France can have as an objective zero risk from asbestos, while not necessarily having such an objective with respect to the risks posed by substitute products. This approach accepts that there is a wide range of social, economic and cultural factors that may affect a Member’s level of protection, other than the gravity of the consequences from materialization of the risk. The fact that in banning asbestos, France is permitting the use of substitute products that may also pose some risk to health does not compromise its choice of zero risk as the level of protection against *asbestos*-related health risks. If France were prevented in those circumstances from making such a choice of level of protection, this would be to compromise what the AB rightly identifies as the entirely acceptable strategy of ‘seek[ing] to halt the spread of a highly risky product while allowing the use of a less risky product in place’.⁷⁴ Moreover, France could set its level of protection, and respective approaches to asbestos-containing and substitute products based on *existing* scientific evidence of the relative riskiness of the two. Before seeking to eliminate the risk from asbestos, it was not required to investigate exhaustively the risks from the use of substitutes.

Having thus established France’s chosen level of protection, the AB went on to consider the meaning of ‘necessary’ in Article XX(b). Canada claimed that the ban on chrysotile asbestos was not ‘necessary’, since a less trade-restrictive measure, a ‘safe use’ regime, was available to achieve France’s chosen level of protection. In considering

Canada's claim, the AB, on the one hand, approved the test in the GATT *acquis* for necessity, namely whether there is a reasonably available alternative less restrictive of trade. On the other hand, the AB referred to its judgment in *Korea—Beef*, where certain refinements were introduced to that test.

In *Korea—Beef*, the AB had observed that while one meaning of 'necessary' in ordinary language is 'indispensable', this is not the only meaning.⁷⁵ One can coherently speak of it having been necessary to do something, without the very strong implication that no other choice was available at all. However, even this less strict notion of necessity is much closer to the idea of the action being indispensable than to the idea that it merely makes a contribution to the goal or objective in question.

The AB thus bifurcates the necessity test. There are situations where the claim may be that a measure is indispensable, i.e. the only available measure to achieve a Member's chosen level of protection, and there are other situations where a Member may be able to justify its measure as 'necessary' within the meaning of Article XX, even if the fit is not *that* close. In these latter situations, determining whether the admittedly not indispensable measure is nevertheless 'necessary' 'involves in every case a process of weighing and balancing a series of factors which prominently include the contribution made by the compliance measure to the enforcement of the law or regulation at issue, the importance of the common interests or values protected by that law or regulation, and the accompanying impact of the law or regulation on imports or exports'.⁷⁶ Thus, the AB introduces an alternative, less-strict proportionality test into those heads of Article XX where the word 'necessary' is found. What it is crucial to understand, however, is that the AB does not introduce proportionality as an *additional* requirement where the measure is indispensable—a measure that is indispensable for achieving a Member's chosen level of protection will be 'necessary', regardless of it being vastly more trade restrictive than the next less trade-restrictive alternative,⁷⁷ and regardless of whether the next less trade-restrictive alternative comes very close to achieving the Member's chosen level of protection. Thus, although it is introducing balancing or proportionality analysis into Article XX, the AB is nevertheless preserving the hierarchy of norms reflected in Article XX. In fact, it is introducing balancing so as to provide Members with an *additional* 'margin of appreciation' in making regulatory choices to achieve the purposes stated in those provisions of Article XX that entail a necessity test.

In *Asbestos*, the AB further refined the necessity test in Article XX. Since in *Asbestos*, France's claim, logically enough, was that no other measure than a ban could achieve its chosen level of protection, namely zero asbestos-related risk, and the AB accepted that claim, this was a case where the measure was claimed to be, and was found to be, 'indispensable'. Thus, the AB did not have to go on to engage in the kind of balancing that was discussed in *Korea—Beef*. What the AB did do, however, was to suggest that there may be differing levels of scrutiny applicable to the analysis of whether a measure is *indispensable*, depending on the importance of the objectives or interests it serves. Thus, it noted that a factor held to be of importance in *Korea—Beef* in conducting a proportionality analysis pursuant to the less-strict branch of the necessity test might be more generally relevant to the ease with which a panel is prepared to find a measure 'necessary'. In other words, the importance of the values and interests at stake will also operate to determine the level of scrutiny when a panel is considering a claim that the measure is 'indispensable' to achieve a Member's chosen level of protection.⁷⁸ Here, the

AB went on to assert: 'in this case, the objective pursued by the measure is the preservation of human life and health through the elimination, or reduction, of the well-known, and life-threatening, health risks posed by asbestos fibres. The value pursued is both vital and important in the highest degree.'⁷⁹

In judging the relative importance of various objectives contained in Article XX, the AB would appear to be altering or at least supplementing the hierarchy of norms in the Treaty. The intuitive appeal of the notion that health is a vitally important objective, and our annoyance at the way in which the panel was dismissive of health under Article III:4, should not blind us to the ramifications of the interpretive move the AB is making here. One appealing view of Article XX is that it deals with the potential tension between trade liberalization and other values, through a series of provisions that scrutinize the relation of means to ends, rather than the value of the ends pursued themselves, provided those ends fall within a discrete head of Article XX. Does the AB really have the legitimacy to say to a society that, for instance, the pursuit of religious purity or piety is a less compelling objective than the protection of human health? Does it have the *bona fides* to make a determination that the rights of people count for more than the 'rights' of animals? We would suggest that to remain consistent with its role as a Treaty interpreter under Article 31 of the Vienna Convention, whenever the AB is hierarchizing objectives within the heads of Article XX, it must do so following the hierarchies implicit or explicit in international law more generally. In defence of the AB, it had already cited statements alluding to international health law and policy materials early in its judgment,⁸⁰ which suggested wide international recognition of the gravity of France's objective. This being said, the implications for democratic self-determination of the AB hierarchizing objectives are somewhat attenuated, if only somewhat, by the fact that it is so doing in order to provide, in certain cases, a greater 'margin of appreciation' to Members.

How, then, does this greater 'margin of appreciation' figure in the AB's rejection of the Canadian claim that 'safe use' is a reasonably available alternative measure? The AB makes several observations about this claim. The first is that 'safe use' is not a well-tested alternative, the efficacy of which is already demonstrated; this is on the basis of the scientific record before the panel. The second is that there is some actual scientific evidence that available 'safe use' procedures still leave some residual risk from the asbestos. The third is that 'safe use', even if it did effectively protect against these risks in some contexts, would be particularly doubtful in other contexts, those such as do-it-yourself home renovations or the building industry, of the greatest importance to France. Here, the AB makes it clear that a Member is under no obligation to attempt to achieve its level of protection using alternatives which lack certainty of effectiveness, before having recourse to a more, and indeed much more, trade-restrictive option. This clearly reverses the tendency, visible in the *Thai Cigarette* case for example, to have a Member's measure fail the necessity test if there is some hypothetical less trade-restrictive alternative available, which *may* or *might* be effective in the circumstances. In *Thai Cigarette*, the panel was considering a ban on foreign cigarettes by Thailand, which was concerned about the sophisticated techniques tobacco multinationals use to market such cigarettes among young people in particular, creating new generations of tobacco addicts. The panel determined that various kinds of regulation on the marketing and advertising activities of these multinationals were 'reasonably available' less restrictive alternatives, despite evidence on the panel record from the World Health Organization that it had proved

impossible for developing countries, in a number of cases, to achieve their objectives by regulating multinationals in this manner. The corporations tended to find ways of circumventing such regulatory efforts. Applying the 'margin of appreciation' in *Asbestos* to these facts, it seems almost certain that the Article XX(b) issue would have been decided the other way by the AB, as in *Thai Cigarette*, the efficacy of the suggested alternatives certainly remained to be demonstrated, especially in the context in which they would be applied.

The WTO Trade and Environment Committee

It was in part dissatisfaction with the pre-Uruguay Round treatment of trade and environment issues in dispute settlement that led to insistence by some Members, particularly the United States, that trade and environment be recognized as an official part of the WTO agenda. This resulted in the Marrakesh Decision on Trade and Environment, directing the establishment of a WTO Trade and Environment Committee (CTE). The CTE is charged with examining, *inter alia*, trade measures for environmental purposes including those taken pursuant to multilateral agreements, the relationship between multilateral trading norms and environmental taxes and charges, ecolabelling, and exports of domestically prohibited goods. In its first two years of work, a number of promising proposals were put before the CTE, including several (by the EC, New Zealand and Switzerland) that relate to the negotiation of an Understanding that would clarify the relationship of GATT Article XX to trade measures taken pursuant to the multilateral environmental agreements. The EC proposal, in its most far-reaching form, is for an Understanding that would explicitly permit under Article XX measures taken pursuant to a multilateral environmental agreement (MEA), either where specifically mandated by the agreement or where otherwise necessary to protect the environment, provided the criteria in the *chapeau* of Article XX are met. 'The WTO would not judge the legitimacy of the environmental objectives or the necessity of the measures taken to achieve these objectives because the multilateral character of the trade measures would be the best guarantee against abuse'⁸¹ provided that the multilateral agreement was 'open to participation by all parties concerned with the environmental objectives of the MEA, and reflected through adequate participation their interests, including significant trade and economic interests'. Another proposal, by New Zealand, would explicitly legalize measures taken pursuant to an MEA against parties to the agreement, even when not specifically mandated by the text, as well as mandated measures against non-parties provided the agreement reflected a genuine multilateral consensus. A WTO panel would determine the existence of such a consensus on the basis of the following conditions: '(i) negotiation of and participation in an MEA to be open on equitable terms to all interested countries; (ii) broad participation of interested countries in both geographical terms and representing varying levels of development; and (iii) adequate representation of consumer and producer nations of the products covered by the MEA.'⁸² In addition, the trade measures would have to meet a proportionality and least-restrictive-means test.

In the Doha Declaration, the CTE is given a renewed and specific mandate to undertake negotiations concerning the relationship of MEAs to the WTO treaties (Doha Declaration, para. 31(j)). Little progress has been made, with Members not even agreed on what kind of outcome would be desirable—an interpretive statement or something less

definitive (such as guidelines on applying provisions of MEAs in disputes under the WTO treaties). One view in the CTE, supported by the United States and some other Members, is that the focus should be narrow—looking only at specific provisions of MEAs that actually mandate or authorize trade measures. Others seek a broader scope, examining the possibility of trade measures facilitating the objectives of MEAs, even where such measures are not specified in the MEAs themselves.⁸³ One controversy that has arisen in these talks arises from the fact that the CTE has been reluctant to admit, even as observers, official representatives of the multilateral environmental regimes in question, even though the meaning and scope of those agreements will be affected by the outcome of the negotiations.

We ourselves are sceptical of the case for trying to define in a general way and *ex ante* the relationship between MEAs and WTO treaties. After the AB rulings in *Shrimp/Turtle*, it seems clear that the WTO dispute settlement system is capable of dealing with this issue on a case-by-case basis. Some expert commentators, such as Joost Pauwelyn, express a concern about possible ‘conflict’ between MEAs and WTO rights and obligations.⁸⁴ We view such conflicts as quite hypothetical. In the case of the GATT, it is difficult to see how any trade provision of an MEA would be in conflict with GATT rights and obligations, since Article XX(b) and (g) of the GATT, as interpreted in recent jurisprudence, appear to allow a broad range of trade measures that have a close relationship to environmental goals, provided such measures are not applied in an arbitrary and unjustifiably discriminatory manner or as a disguised restriction on international trade. We would be sceptical of the claim that the fulfilment of a state’s obligations under, for example, CITES or the Basel Convention on Hazardous Wastes could not be achieved except in conflict with these disciplines on protective discrimination. In the case of GATS and TRIPs, the situation is a bit more complicated because the exceptions or limitations are stated in a more complex fashion; but in these cases as well, it is far from clear that trade measures based on MEAs would *ever* fail justification under the relevant provisions of these treaties.

For us, the *real* question is what role MEAs can or should have in the *interpretation* of WTO law in specific cases. Pauwelyn believes that the WTO treaties have a lower status in the hierarchy of international law norms than MEAs, because while the former are based on benefits to individual signatory states from specific concessions of other states (bilateral obligations), the obligations in the latter reflect a community or global public interest and are thus obligations *inter omnes* parties, i.e. to the entire treaty community, not just to individual Members who benefit as the case may be. This means according to Pauwelyn that even if not all the parties to an MEA may be parties to the WTO Agreements, they may nevertheless alter or contract out of WTO rules in an MEA among themselves. While Pauwelyn’s argument has some force to it, nevertheless there are a number of WTO treaty provisions that have a community interest nature including aspects of dispute settlement, institutional arrangements for tariff negotiations, and arguably the MFN principle as well. It would thus in our view be imprudent to make a general characterization of WTO obligations as lesser in rank than MEA provisions, generally speaking.

Therefore, we believe that one should start with the assumption that WTO treaties and MEAs should both be interpreted so as to render neither set of rights and obligations ineffective. This notion of complementarity reflects the basic international law norm of

effectiveness in treaty interpretation. Thus, as a general matter, the dispute settlement organs ought not easily to assume a conflict of obligations exists, but instead begin by attempting to read the WTO rules in such a manner as to fulfil or not frustrate the other treaty rights and obligations. Since each dispute is different, engaging a different set of relevant WTO rules and a different set of relevant MEA provisions, tackling the question of complementarity *ex ante*, through general or abstract interpretive statements, in our view is likely to be an exercise in frustration, of little use or guidance to a panel or the AB faced with a novel set of legal and environmental facts not anticipated by the drafters of the general interpretive statement.

It is helpful here to consider the different ways in which provisions of an MEA might become implicated in a trade and environment dispute under the WTO:

- 1 An MEA, or practice pursuant to an MEA, might provide evidence of a wide range of international consensus on a fact relevant to the dispute, such as whether a species is endangered, for instance, and requires protection as an 'exhaustible resource' under Article XX(g). The CITES played such a role in the *Shrimp/Turtle* dispute.
- 2 An MEA could provide a definition of a term of art contained, but not defined, in a WTO treaty itself, such as 'exhaustible resources' in Article XX(g) in the *Shrimp/Turtle* dispute.
- 3 An MEA might assist the panel in applying a rather generally defined term, such as 'risk assessment' in the Sanitary and Phytosanitary (SPS) Agreement, in a highly technical but also controversial context; for instance, the guidelines on risk assessment on living modified organisms in the Cartagena Biosafety Protocol could assist a panel in interpreting what the requirements of SPS 5.1 mean in the specific context of biotechnology.
- 4 An MEA, if it is open for participation by all WTO Members, might contain 'international standards' within the meaning of either the SPS or TBT Agreements. In the case of SPS, this would be so where the MEA addresses matters not addressed by the specific standard-setting organizations named in the relevant Annex to SPS. If such were the case, and a WTO Member were deemed to 'conform to' the international standard in the MEA, its measures would be presumed to be consistent with both SPS and GATT Article XX. In the case of TBT, where a provision of an MEA promulgates a relevant international standard, by virtue of TBT 2.4 a WTO Member would be obliged to use that standard as a basis for its domestic regulations.
- 5 An MEA might provide a standard or benchmark—accepted by a wide range of different countries at different levels of development—for the interpretation of some quite general or open-ended norm in a WTO treaty; for example, in the *Hormones* case, the AB found that the Precautionary Principle, although not an international legal rule that in any way trumped the provisions of the WTO treaties, would be useful in understanding the meaning of 'sufficiency' of scientific evidence (SPS 2.2) in certain circumstances.
- 6 An MEA and the practice related thereto could provide evidence of whether trade action in response to environmental practices or policies is justified as 'necessary' under Article XX; for instance, where a WTO Member has been found in non-compliance with an MEA and has failed to alter its policies, or is a 'hold out' from a relevant MEA, it may be easier to find that unilateral trade measures are 'necessary'

within the meaning of XX(b) than where the matter has not yet been given an opportunity to resolve itself within the framework of the MEA. Here we refer to the discussion above of the emphasis that the AB in *Shrimp/Turtle* placed on serious effort to negotiate an MEA in that instance.

This non-exhaustive list displays how difficult it would be to attempt to govern the role of MEAs in WTO disputes through a set of general or abstract interpretive statements or guidelines *ex ante* of particular disputes. It would make more sense to reserve action within the CTE or the WTO General Council for *ex post* adjustment of dispute settlement outcomes that deal with MEAs in a case-by-case fashion. For instance, if a WTO tribunal were to interpret the WTO Agreements in such a way as to frustrate the purposes and operation of an MEA in a specific situation, a waiver could be granted to allow the MEA to function properly in that specific situation.

In addition to the issue of the relationship of MEAs to WTO rules, the Doha Declaration also stated agreement of WTO Members to negotiations on liberalization of trade in environmental goods and services. Here there are several difficult questions. First of all, what is an environmental good? Narrow definitions focus on products such as pollution abatement technologies, which are used to reduce or prevent specific environmental harms; but some WTO Members, such as the EC, are seeking to define environmental goods much more broadly, to include 'products made in an environmentally sound manner'.⁸⁵ Others would include products, such as bicycles, that are substitutes for other products that create environmental externalities, such as cars and motor scooters. In the case of environmental services, there is the additional issue that some of these services, such as refuse disposal, may themselves cause transboundary environmental externalities.

There is a set of environmental issues related to the TRIPs Agreement, which largely relate to the effects on biodiversity in developing countries of intellectual property rights over genetic resources; these issues are being discussed as part of the Doha Development Agenda in the TRIPs Council, not the CTE, and are canvassed in the chapter of this book on trade and intellectual property rights, Chapter 13.

Another issue that has sometimes been raised in the CTE is that of domestically-prohibited goods. Some developing countries have called for notice requirements where goods that are regarded as too dangerous to be permitted domestically in the country of production are being exported to developing countries. At the same time, there is the legal issue as to whether the government of the country of production can ban these exports consistent with Article XI of the GATT, and whether if not, such a ban could be justified under Article XX(b) of the GATT. Arguably in cases of domestically prohibited goods, an export ban is merely one modality of *enforcing* a general regulatory decision that a product is too risky to be consumed or released in the environment; the general regulatory decision is the real measure, and not being *targeted* at exports, it should not be considered a violation of Article XI. This is analogous to the situation covered by the Interpretative Note to Article III:2 of GATT, where it is emphasized that enforcement at the border in the case of *imports* does not transform an overall scheme that applies to both domestic and imported products into something different from an internal measure (for example, an Article XI prohibition or restriction on imports).⁸⁶

THE NORTH AMERICAN FREE TRADE AGREEMENT

The NAFTA is the first comprehensive trade treaty that deals explicitly with the relationship between trade and environmental protection. Nevertheless, the key NAFTA provisions on the environment are unlikely to play any significant role in sustaining or enhancing levels of environmental protection in the Member countries and, in the case of the provisions on technical standards, may actually threaten high environmental standards. The NAFTA environmental side-agreement, the North American Agreement on Environmental Cooperation, does not establish any substantive transnational environmental norms or standards. However, it does establish an institutional framework from which such norms or standards may eventually emerge. As well, the side-agreement binds the Parties to effective enforcement of their own domestic environmental laws, and provides for dispute settlement and, ultimately, sanctions where a NAFTA Party persistently fails to enforce these laws.

Article 104: Environmental and Conservation Agreements

Article 104 states that in the event of an 'inconsistency' between the NAFTA and the trade provisions of several major environmental treaties, including the CITES, the provisions of the environmental treaty shall prevail 'to the extent of the inconsistency'. The kinds of trade obligations in question are, generally speaking, export and/or import bans, which would normally run afoul of Article 309 of the NAFTA. Article 309 incorporates into the NAFTA the GATT Article XI prohibition on both export and import restrictions and prohibitions.

Since any measure saved by Article 104 is, therefore, likely also to constitute a violation of Article XI of the GATT, will Article 104 have any real significance in enabling the implementation of environmental treaties? This will depend on whether Article 104 applies to the Parties' pre-existing GATT obligations as well as to the provisions of NAFTA. Article 103(1) of the NAFTA states that 'The Parties affirm their existing rights and obligations with respect to each other under the *General Agreement on Tariffs and Trade* and other agreements to which the Parties are party.' Article 103(2) then goes on to state: 'In the event of any inconsistency between the provisions of this Agreement and such other agreements, the provisions of this Agreement shall prevail to the extent of the inconsistency, except if otherwise provided in this Agreement.'

Does the expression 'other agreements' in 103(2) mean any agreement besides the NAFTA to which the Parties are signatories, including GATT, or does it refer to 'other agreements' as defined in Article 103(1)—i.e. agreements other than the GATT and NAFTA? If the second interpretation is correct (i.e. that NAFTA does not take precedence over GATT although it does over agreements other than GATT), then Article 104 is likely to have very little effect. The one case where Article 104 would still have an impact is if, in the future, an otherwise GATT-inconsistent environmental treaty received a waiver under Article XXV:5 of the General Agreement. In that case, while the treaty would no longer entail violation of the NAFTA Parties' GATT obligations (i.e. due to the waiver), it could still be in violation of their NAFTA obligations. Here, Article 104 *would* apply to resolve the inconsistency in favour of the environmental treaty. Finally, it is to be noted that any dispute between NAFTA Members concerning a treaty listed under

Article 104 is to be referred to the NAFTA dispute settlement process rather than to the GATT (Article 2005.3).

Article 1114: Environmental Measures

Article 1114(2) states in part that ‘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 investor.’ This provision is the most innovative of the NAFTA provisions on the environment, in that it does recognize explicitly the danger of an environmental ‘race to the bottom’, where investors are attracted to the NAFTA jurisdiction with the lowest environmental standards—thereby possibly exerting downward pressure on standards elsewhere as the Parties compete for the jobs that come with investment. However, the actual provisions of Article 1114 may be inadequate to its purpose. First of all, and of greatest significance, the language ‘a Party should not waive’ connotes something less than a full legal obligation—generally, NAFTA obligations are expressed by the more clearly imperative word ‘shall’.

One drawback in adopting existing environmental measures as the baseline is that removal or relaxation of some existing environmental measures may actually be justified, from an environmentalist perspective, in light of changes in technology as well as shifts in the choice of environmental instrument, for instance from ‘command and control’-type regulations to taxes and charges. For example, if Canada implements a new reforestation management system that results in much more rapid reforestation, why should Canada not be able to exploit any competitive advantage that comes from being able to provide producers located in Canada with more liberal quotas for timber than a less effective conservation system in the United States would permit?

Finally, the proposed dispute settlement process with respect to Article 1114(2) does not appear to lend itself to the kind of in-depth investigation that would be required to determine if a Party was under-enforcing its own laws in order to encourage investment. Thus, Article 1114(2) states: ‘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.’ Is this process of ‘consultations’ intended to exclude further recourse to the normal NAFTA dispute resolution mechanism that allows for in-depth investigation and the assessment of expert opinion? While the normal dispute resolution mechanism applies to all the provisions of NAFTA, it does so ‘[except] as otherwise provided in this Agreement’ (Article 2004). It is unclear whether the provision for consultations in Article 1114 would constitute one of these exceptions to the application of the Chapter 20 dispute settlement mechanism. It could be argued that the Chapter 20 mechanism still applies, since elsewhere in the NAFTA, when the Parties have wished to exclude recourse to Chapter 20 procedures, they have done so through an explicit exclusionary clause (see Annex 1137.2, Exclusions from Dispute Settlement).

The NAFTA provisions on the environment fall far short of an effective environmental charter, especially if one balances the strict scrutiny of a Party’s differentially higher trade-impacting environmental standards provided for in Chapter 9

against the rather weak limits on investment-impacting downward movement in a Party's standards stipulated in Article 1114(2). It is perhaps not surprising, therefore, that the Clinton Administration would insist on the negotiation of supplemental provisions in a parallel accord. It is to this side-agreement that we shall now turn our attention.

The North American Agreement on Environmental Cooperation (NAAEC)

The NAAEC, often referred to as the NAFTA environmental side-agreement, states a set of general objectives that include fostering 'the protection and improvement of the environment in the territories of the Parties', increased 'cooperation...to better conserve, protect and enhance the environment', and the avoidance of 'trade distortions and new trade barriers' (Article 1). The NAAEC also contains a set of 'general commitments', which include public reporting and education about environmental matters, assessment of environmental impacts where appropriate, and the promotion of economic instruments of environmental regulation (Article 2). In addition, Article 3 stipulates that 'each Party shall ensure that its laws and regulations provide for high levels of environmental protection and shall strive to continue to improve those laws and regulations'. However, Article 3 also recognizes 'the right of each Party to establish its own levels of domestic environmental protection'. It is difficult, but not impossible, to reconcile these two aspects of Article 3. One approach would be to argue that Article 3 permits a Party to set its own levels of protection, as long as those levels are 'high' by some objective standard. An alternative interpretation, which would greatly attenuate the significance of Article 3, is that each Party must set a level of environmental protection that is 'high', but that the meaning of a 'high' level of environmental protection is to be determined by each Party's domestic values and priorities.

Article 5 requires that 'each Party shall effectively enforce its environmental laws and regulations through appropriate government action' and gives a list of examples of such actions, ranging from the use of licences and permits to contractual and voluntary arrangements for environmental compliance. Article 6 requires that 'interested persons' be able to request a Party's regulatory authorities to investigate possible violations of domestic environmental laws and regulations. Since the NAAEC does not contain a definition of 'interested persons', whether this includes, for example, environmental NGOs will depend on the standing rules in each Party's domestic legal system.

Of all these obligations, *only* a Party's obligation to enforce effectively its own environmental law can be regarded as 'hard' trade law, for only this obligation carries with it the possibility of binding dispute settlement and, ultimately, sanctions for non-compliance. Thus, where there is a complaint that 'there has been a persistent pattern of failure [of a NAFTA Party] to enforce its environmental law', Part V of the NAAEC provides for a dispute settlement process that closely parallels the general NAFTA dispute settlement process set out in Chapter 20. A rather significant difference is that a request for a panel must be approved by a two-thirds vote of the Parties. This means that where, for instance, Canada requested a panel to investigate an alleged persistent failure of Mexico to enforce its environmental laws, it would have to obtain the agreement of either Mexico or the United States in order for dispute settlement to proceed (Article 24(1)).

If, in its final report, a panel concludes that, in fact, a persistent failure of enforcement has occurred, the Parties to the dispute 'may agree on a mutually satisfactory action plan, which normally shall conform with the determinations and recommendations of the panel' (Article 33). If no such action plan is agreed upon, then, after 60 days (but within 120 days) of the final report, the complaining Party may request that the panel reconvene and determine an appropriate action plan and/or a monetary assessment against the offending Party. If the panel subsequently determines that an action plan (either mutually agreed upon or stipulated by the panel itself) is not being implemented, it may impose monetary assessments against the offending Party (Article 34(5)(b)). Where the offending Party fails to pay a monetary assessment within 180 days after it is imposed, the complaining Party may suspend concessions under the NAFTA itself 'in an amount no greater than that sufficient to collect the monetary enforcement assessment'. Annex 34 states, *inter alia*, the limits on monetary assessments: 'For the first year after entry into force of the NAAEC, these shall not exceed \$20 million US. Thereafter, an assessment may not exceed 0.007% of total trade in goods between the Parties during the most recent year for which data are available' (Annex 34, Article 1). Here, 'between the Parties' most logically refers to the total trade between all three NAFTA Parties, not that between the two Parties to the dispute.⁸⁷ The latter interpretation would create the arbitrary result that a monetary assessment arising out of exactly the same violation would vary enormously depending, for instance, on whether Canada or the United States was the complainant. Here, it should be stressed that monetary assessments are not intended as compensation for injury to the complaining Party's trade from persistent violation of the Agreement, but rather as an enforcement measure or sanction—they are not paid to the complaining Party but rather are paid into a fund to be spent at the direction of the NAFTA Parties for improving or enhancing environmental protection in the territory of the offending Party (Annex 34, Article 3). In the case of a monetary assessment against Canada, a rather disingenuous procedure replaces withdrawal of trade concessions as the sanction of last resort where the assessment remains unpaid. The panel decision imposing the monetary assessment is to be registered in a domestic Canadian court and to be subject to an enforcement order of that court, just as a foreign civil judgment might be enforced according to principles of conflict of laws (private international law). The ultimate effect is really the same as with the withdrawal of trade concessions, but the insertion of this separate procedure allowed the Canadian government of the day to make the (rather empty if literally true) public claim that it had succeeded in adhering to its position that no trade sanctions should be attached to the violation of environmental obligations.

If only Article 5 obligations are genuinely enforceable through dispute settlement and sanctions, what is the real significance of the various other, more general obligations and commitments in the NAAEC? The answer to this question will lie in the effectiveness of the institutional mechanisms that are aimed at fulfilling the broader promise of the NAAEC through ongoing cooperative efforts concerning environmental regulation and standards.

The NAAEC provides for the establishment of four institutions for environmental cooperation: the Commission, the Council, the Secretariat and the Joint Public Advisory Committee. The Commission is the umbrella organization that encompasses the other three institutions (Article 8). The Council comprises ministerial-level representatives of the Parties who are required to meet at least once a year. The Council may make

recommendations with respect to a wide variety of environmental matters, including 'transboundary and border environmental issues, such as the long-range transport of air and marine pollutants' and the 'protection of endangered and threatened species' and 'eco-labelling'. Perhaps most significantly, the Council, 'without reducing levels of environmental protection', may establish a process for developing recommendations on the 'greater compatibility of environmental technical regulations, standards and conformity assessment procedures'. This, in effect, gives the Council a mandate for the development of harmonized minimum environmental standards. In carrying out these various responsibilities, the Council may establish committees, working groups or expert groups, and seek the advice of NGOs (Article 5). It should be noted that recommendations of the Council are to be made by consensus (Article 6), and that a Contracting Party's obligation is merely to 'consider' such recommendations, not to implement them.

The Secretariat consists of a permanent professional staff which provides administrative and technical support to the Council, headed by an Executive Director appointed for a (once renewable) three-year term (Article 11(1)). In addition to this general support function, the Secretariat is charged with preparing an annual report of the Commission, based upon instructions from the Council (Article 12(1)). The report is to contain, *inter alia*, data on each Party's compliance with its obligations under the Agreement (Article 12(2)(c)) and 'relevant views and information submitted by non-governmental organizations and persons' (Article 12(2)(d)).

Finally, Articles 14 and 15 establish a procedure whereby an NGO may bring a submission before the Secretariat asserting that a Party is failing to enforce effectively its own environmental law. Upon approval by a two-thirds vote of the Council (i.e. by two of the three Parties), the Secretariat may prepare a 'factual record' concerning the NGO's claims, based upon the NGO's submissions as well as any 'relevant technical, scientific or other information', including submissions by the Party that is the object of the complaint. The Council may decide, by a two-thirds vote, to make the factual record public. It is to be emphasized that no formal dispute settlement or sanctions ensue in consequence of an adverse factual record. However, such a record would provide a strong evidentiary basis for a complaint against the offending Party should either of the other Parties choose to lodge one in accordance with the separate Part V dispute settlement procedures. Once made public, an adverse factual record would also assist environmental NGOs in bringing public pressure to bear upon the other NAFTA Parties to lodge such a complaint.

The Joint Public Advisory Committee consists of 15 members, five of which are appointed by each Party (Article 16(91)). The Committee may participate in the process of developing a factual record in accordance with Article 15. The Secretariat must also provide the Committee, *inter alia*, with the draft annual report, presumably for comment before its final adoption.

In assessing the significance of the NAAEC, at least as much emphasis should be placed on the broader institutional framework it establishes as on the rather limited enforceable legal obligations it contains. This framework holds the promise of setting in motion a process for the evolution of genuine regional environmental norms, linked (albeit indirectly) to the evolution of deeper economic integration among the NAFTA Parties. Although the NAAEC does not, by any means, transcend the state-centric

paradigm of traditional international law⁸⁸ (i.e. only Parties have direct access to dispute settlement), it does acknowledge in important ways the legitimate stake that NGOs have in the process of monitoring and enforcing NAAEC legal obligations, i.e. that environmental protection is not just a matter between governments, but is of direct concern to individuals throughout the NAFTA region. Although there is yet to be a formal complaint or dispute panel under the legal obligations established by the NAAEC, it does seem to have given birth to a set of active, if only partly effective, institutions. The Secretariat has, for example, developed a concrete work programme of cooperation in areas such as ecological mapping to determine pollution flows across North America, the development of consistent laboratory procedures for assessing environmental risk, assessment of environmental training needs, and cooperation in conservation of biodiversity and forest ecosystems.⁸⁹ These kinds of initiatives represent forms of win-win cooperation that raise few of the sovereignty concerns entailed in enforcing the legal obligations of the NAAEC. However, this being said, the work programme of the Secretariat is badly under-funded.⁹⁰ Another achievement of the Commission is an agreement on the phase-out or reduction of certain toxic substances throughout North America—PCBs, DDT, clordane and mercury. However, specific action plans on these substances are yet to be developed, so the agreement is really a resolution or agreement in principle.⁹¹

At the time this book went to press (early 2005), the Secretariat had received over 40 submissions from NGOs concerning possible violations of the obligation of a NAFTA Party to enforce its own environmental laws, and in nine cases factual records have now been developed and published. A number of the early submissions were rejected as falling outside the terms of the NAAEC. The first submission, filed in June 1995, by among other NGOs the Biodiversity Legal Foundation, alleged that fiscal restraint legislation in the USA that prohibited the Fish and Wildlife Service from making final determinations for species or critical habitat designations for the remainder of fiscal year 1995 and cutting its budget had the effect of a failure to enforce the US Endangered Species Act.⁹² In its reply to this submission, the Secretariat refused to take the matter further, finding that 'the alleged failure to enforce environmental law results from competing legislative mandates, and not from other action or inaction taken by agencies or officials'.⁹³ This establishes a fundamental limitation on the obligation of each country to enforce its own environmental law—such an obligation does not extend to a requirement that non-environmental legislation not frustrate such enforcement. Other submissions have not been taken further by the Secretariat because they complained of non-enforcement that had occurred in the past (an environmental assessment on a particular project) or because parallel actions were being pursued in domestic courts, therefore making a judgment that a country was not enforcing its own laws premature. One complaint made to the Commission, by the Sierra Club, concerned a 'rider' on a US budget-cutting statute that essentially eliminated the possibility of review of salvage timber sales for environmental effects.⁹⁴ This complaint was not taken further by the Secretariat on the same basis as it invoked with respect to the first complaint, i.e. that 'The Secretariat cannot...characterize the application of a new legal regime as a failure to enforce an old one.'⁹⁵ In this second determination, the Secretariat also stressed the importance of a factual record showing that non-enforcement was actually occurring, thereby suggesting that even if the 'rider' had been in regulation not legislation, it would

have been essential to show that it resulted in an actual pattern of non-enforcement of the relevant environmental framework law.

The first submission to give rise to a determination by the Secretariat that a full factual record should be developed was filed by Mexican NGOs with respect to non-enforcement of Mexican environmental law.⁹⁶ This complaint alleged that during the evaluation of a project for a cruise terminal on Cozumel Island, a range of Mexican environmental laws had not been effectively enforced, and that two coral reefs were being endangered by the project. A Factual Record was prepared and submitted to the Council in April 1997, and a final version publicly released later that year.⁹⁷ It is clear from the Record that the Mexican government vigorously and completely denied the claims of the petitioners. The Factual Record presents intricate and arcane arguments on both sides concerning whether extensions of environmental authorizations were granted in accordance with Mexican law, and whether and for what elements of the project a comprehensive *de novo* environmental assessment might have been required, as well as the applicability of various wildlife preservation provisions in respect of the location of the pier in proximity to coral reefs. However, while the dispute was being dealt with by the NAAEC Secretariat and before the Factual Record was provided to the Council, the Mexican authorities appear to have placed a number of conditions on the donation of federal lands required to realize the project.⁹⁸ One may speculate that the prospect of a full Factual Record being published thus had some impact on the Mexican government, despite its complete rejection of the claim that it had not previously been enforcing its own environmental laws.

Finally, under the NAAEC NGOs may also make submissions on matters not directly related to the issue of a NAFTA Party's enforcement of its environmental law. One such submission actually became the subject of a Secretariat report. The submission concerned the death of migratory birds at the Silva Reservoir in Mexico. The Secretariat struck a panel of scientific experts to investigate the matter, which found that the death of the birds was related to high levels of toxins in the area.⁹⁹ The Secretariat suggested a number of options for dealing with the problem, including that the reservoir be monitored for waterbird mortality, that the reservoir be drained if there is evidence of a waterbird mortality problem, that birds be kept off the reservoir, or that the topography of the reservoir be altered to make it less susceptible to these problems. However, in terms of formal recommendations that the Council would make to Mexico, these were limited essentially to the recommendation that the Mexican government conduct a comprehensive evaluation of the problem and the possible solutions to it. The panel of scientific experts had, by contrast, some very specific suggestions as to the environmental measures needed to remedy the root source of the problem, including proper treatment of raw-discharge municipal waste and large industrial waste sources. These suggestions are now being pursued with the support of the Secretariat.

The (modestly) positive results attained by the NAAEC and its institutions belie the scepticism of many environmentalists about the significance of the side-agreement.

The investor-state dispute settlement provisions of NAFTA: a threat to the environment?

Several cases under the investor—state provisions of the investment chapter of NAFTA (Chapter 11) have apparently dealt with environmental issues. Corporations have sued NAFTA governments for violations of National Treatment, fair and equitable treatment under international law, and even expropriation, in connection with changes to environmental policies. In those cases that were settled or where the investor was successful, *Ethyl*, *Metalclad* and *S.D.Myers*, there was clear evidence of intentional protectionist, discriminatory or abusive treatment towards the investor, i.e. these cases did not deal with a situation where legitimate environmental policies were in tension with investor rights, but where the government in question had other, impermissible motives. A more recent case, *Methanex*, is different in this respect—it challenges a general non-discriminatory ban by California on a gasoline additive, which is based on bona fide scientific evidence of environmental harm. Notably, the NAFTA investor-state arbitral tribunal threw out almost all of Methanex's claim at the preliminary jurisdictional stage, allowing it, however, an opportunity to prove that the actions complained of entailed intentional, invidious discrimination against Methanex. In sum, experience to date suggests that investors will only be successful in NAFTA Chapter 11 claims where they can produce actual compelling evidence that the environmental policies in question were applied or altered with the direct intent of treating the investor in an abusive, discriminatory fashion. All these cases are discussed in connection with the NAFTA investment jurisprudence as a whole in Chapter 14 of this book, on trade and investment.

CONCLUSION

While controversy over environmental trade measures continues, the two WTO Appellate Body rulings in the *Shrimp/Turtle* dispute have gone a considerable distance to providing a jurisprudential framework for the application to such measures of Article XX exceptions, with which most WTO Members and many environmental groups appear to be able to live. The Appellate Body has acknowledged that unilateralism raises special concerns in the WTO system, which need to be carefully addressed, while at the same time it may be a necessary, legal and legitimate response in certain circumstances.

Increasingly, the issues that are prominent on the trade and environment agenda, such as the dispute over regulation of genetically modified organisms (GMOs), the concern with export of domestically prohibited goods (DPGs), and the concern about biodiversity effects of intellectual property rights in genetic resources, do not produce the kind of North-South polarization characteristic of the debate over environmental trade measures discussed in this chapter. Developed and developing countries find themselves on both sides, as it were, on all of these issues. Moreover, these kinds of issues are understood to revolve around complex relationships between WTO rules and other international agreements, and for all but the most extreme (and marginal) activists, the question is one of interpretation and incremental evolution of the trade and environmental norms and practices, rather than a zero-sum struggle between the cause of the environment on the

one side and that of trade liberalization on the other. At the same time, arguments about 'unfair trade' have increasingly focused on non-environmental policies, with environmentalists now largely accepting that there will naturally be a gap in environmental protection standards between countries with different levels of wealth and development, and instead focusing on the redistributive and other policies needed to help close that gap.

Trade, labour standards and human rights

INTRODUCTION

The trade/labour linkage has a long history.¹ It has become one of the most contentious contemporary issues in trade and labour policy circles and debates.² The idea of using international labour standards to protect workers from economic exploitation was first promoted by individual social reformers in Europe in the first half of the nineteenth century at the early stages of the Industrial Revolution. The work of these reformers was later taken over by various non-governmental organizations. Calls for international labour legislation increased dramatically during the second half of the nineteenth century and found expression in various international organizations that were formed (often international associations of trade unions).

Intergovernmental action for international labour legislation began to be reflected in international conferences beginning in 1890. Many of these early efforts were motivated by the concern that in the absence of international labour standards, international competition in an environment of increasingly freer trade would precipitate a 'race to the bottom'. The Treaty of Versailles in 1919 established the International Labour Organization (ILO). The preamble of the ILO Constitution notes that 'the failure of any nation to adopt humane conditions of labour is an obstacle in the way of other nations which desire to improve the conditions in their own countries'. Under Article 33 of the ILO Constitution, the governing body may recommend that the Conference take such actions as it may deem wise and expedient to secure compliance with recommendations of commissions of inquiry or where the matter has been referred to the International Court of Justice with the recommendation of the Court. Some commentators have suggested that this does not completely rule out the question of trade sanctions, as is apparently contemplated as a possibility in the case of recent adverse ILO determinations against Myanmar (Burma) with respect to forced labour. However, the ILO, a tripartite organization of government, employers and worker representatives, has mostly pursued its mandate by setting minimum international labour standards through Conventions and Recommendations, subject in the former case to ratification by Member States and promoted by investigation, public reporting and technical assistance, but not formal sanctions.

The ILO formally entered the trade/labour interface debate in 1994 at the time of discussion of a possible inclusion of a social clause in the GATT/WTO, the establishment of a link between trade and labour in differing forms within NAFTA and the EU, and the conditioning of trade preferences and concessions by some developed countries on respect for labour standards. The ILO set up a working party on the social dimensions of the liberalization of international trade, but in 1995 the ILO's governing body concluded that the working party would not pursue the question of trade sanctions and that further

discussion of a link between international trade and social standards or a sanction-based social clause mechanism would be suspended. However, in 1998, the ILO adopted a Declaration of Fundamental Principles and Rights at Work providing that all members have an obligation to respect and promote certain core labour standards (CLS): (1) freedom of association and the right to engage in collective bargaining; (2) the elimination of forced labour; (3) the elimination of child labour; and (4) the elimination of discrimination in employment. This Declaration parallels in many respects references to core international labour standards in the UN Universal Declaration of Human Rights (1948) and the UN Covenant on Civil and Political Rights and UN Covenant on Economic, Social and Cultural Rights that came into force in 1976.³ The ILO membership, however, rejected a proposal by its Director-General in 1997 that the ILO promote and administer a country-based certification and labelling programme for products from countries complying with core labour standards.⁴

The 1948 Havana Charter that was intended to embody the framework for a new world trading system declared that 'Members recognize that unfair labour conditions, particularly in production for export, create difficulties in international trade and accordingly each member shall take whatever action may be appropriate and feasible to eliminate such conditions within its territory.' However, the Havana Charter was never adopted because of opposition in the US Congress, and the GATT in Article XX refers only to measures relating to products of prison labour (Article XX(e)), measures necessary to protect public morals (Article XX(a)), and measures relating to human life or health (Article XX(b)). The Ministerial Declaration following the first WTO Ministerial Conference in Singapore in 1996 appears to have removed labour issues from the WTO agenda and remitted them to the ILO. The recent Doha Ministerial Declaration reaffirms this position.⁵

A number of international commodity agreements, starting with the first international tin agreement of 1954, contain labour standards provisions but they contain no dispute settlement or enforcement mechanisms, and according to critics the inclusion of such clauses was intended to protect industries in developed countries from competition from developing countries.⁶

Under 1984 US Generalized System of Preferences (GSP) legislation, the US President in determining eligibility for GSP status must take into account, among other things, whether the concerned country is taking steps to ensure internationally recognized workers' rights. The Caribbean Basin Economic Recovery Act of 1983 was the first US legislation in recent history to condition trade on foreign labour standards. The Omnibus Trade and Competitiveness Act of 1988 expanded the provisions of the 1974 Trade Act to cover cases involving alleged violations of internationally recognized labour rights: if investigations by the US Trade Representative show that US trade rights have been violated, his or her office may authorize retaliatory measures, including imposition of restrictions on imports from the concerned country.⁷

The EU first mooted the possibility of linking labour standards to trade preferences by proposing the introduction of labour standards into the Lomé Convention in 1978 to ensure that developing countries with labour conditions which met the requirements of international labour conventions should not be penalized in their trade with the EEC by being outcompeted by countries that do not comply with such conventions. This proposal was not implemented in the face of intense opposition from developing countries. In

1994, the EU finally established a link between trade and labour standards in the context of its relationship with developing countries through its GSP system where additional GSP preferences were offered to countries committing themselves to respect international labour standards.⁸

With respect to trade and labour standards linkages in regional trading arrangements, within the European Union the social dimension of European integration took concrete form in 1991 when 11 of the 12 Member States (excluding the UK) signed the community's Charter of Fundamental Social Rights. Another important step in the development of EU social policy was the adoption by the 11 Members (excluding the UK) of the Protocol on Social Policy at Maastricht in 1991. The content of the Social Chapter is fundamentally the same as that of the Charter and contains a number of guarantees of basic labour rights. Under NAFTA, the North American Agreement on Labor Cooperation requires the NAFTA Parties to effectively enforce their own labour laws, and they are subject to specialized dispute settlement processes and ultimately fines enforceable through trade sanctions in the event of findings of non-enforcement.

As noted above, the recent Doha Ministerial Declaration launching a new multilateral round confirms the 1996 Singapore Ministerial Decision to remit all international labour standards issues to the ILO. However, the issue of a trade/labour linkage seems unlikely to go away. Regionally, the potential expansion of NAFTA into a Free Trade Area of the Americas (FTAA) will raise the scope and status of the NAFTA Labor Side-Agreement in this broader context. And unilateral trade actions by states on account of labour practices prevailing in other states may well provoke trade disputes that will require adjudication by international trade dispute settlement bodies.

Recently, the debate over trade and labour rights has been extended to human rights more generally, an entirely logical development, as we suggest below. However, in the case of other human rights, the debate is much less focused on 'linkage', including sanctions, and much more on the effects of trade obligations on the ability of states, especially developing countries, to fulfil economic, social and cultural rights, such as the right to health or to adequate food. Here, developing countries, although wary about sanctions, have been generally supportive of efforts to evaluate and interpret trade agreements in human rights terms.

TRADE AND LABOUR

The choice of policy objective

Reviewing both contemporary and historical debates about the case for a trade policy—labour standards linkage, several normative rationales for a trade policy—labour standards linkage emerge and are often largely elided in debates, which then greatly complicates the task of evaluating the appropriate choice of instrument and choice of institutional arrangement for vindicating the chosen policy objectives.

Unfair competition

It is often argued that countries that sell goods into export markets that are produced by processes that fail to respect or comply with internationally recognized labour standards are engaging in an unfair form of competition that deprives domestic producers in export markets and producers and exporters in third-country markets who comply with these standards of legitimate market share. Countries where internationally recognized labour standards are not complied with are often accused of 'social dumping' or indirect or implicit and illicit subsidization. These economic activities, entailing either lax labour laws or ineffective enforcement of nominally compliant laws (or both), are analogized to economic dumping and direct subsidization that may attract antidumping duties or countervailing duties under Article VI of the GATT and current WTO Agreements on antidumping and subsidization and countervailing duties.⁹

Without further and careful specification, this rationale for linking international trade policy and/or sanctions with labour standards is largely incoherent. From the perspective of importing countries, generically lower labour costs in exporting countries enhance consumer welfare in importing countries, and by more than reductions in producer welfare in the latter. From the perspective of exporting countries, particularly developing countries, the latter rightly argue that in the early stages of industrialization, entailing mass production of low-technology products (e.g. textiles, clothing, footwear, processed agricultural products), low-cost and low-skilled labour is one of the principal sources of their competitive advantage, and to deny them the ability to exploit this is to consign them forever to low value-added commodity production for developed-country markets ('hewers of wood and drawers of water').

However, it is crucial not to overstate the significance of this source of comparative advantage. While it is true that the earnings of low-skilled workers relative to high-skilled workers in the USA and other developed countries have declined in recent years (or unemployment levels increased), most empirical studies show that increased trade with low-wage developing countries may account for at most 20% of this reduction, and most of the increase in the wage gap between skilled and unskilled workers is attributable to technological change and, in the case of the USA, also to rapidly declining rates of unionization.¹⁰ More importantly, there is almost no evidence that the reduction in relative earnings of unskilled workers in developed countries that is reasonably attributable to increased trade with developing countries relates to non-compliance with core labour standards rather than simply lower wages. Even in this latter respect, as Paul Krugman and many other economists have pointed out,¹¹ the growth rate of living standards essentially equals the growth rate of domestic productivity. In the case of the USA, exports are only 10% of GNP, which means the USA is still almost 90% an economy that produces goods and services for its own use. Data show almost a one-to-one relationship between labour productivity and labour costs in manufacturing in a wide range of developed and developing countries.¹² Labour productivity, or total factor productivity, is a function of many factors, including public investments in education and training, healthcare, infrastructure, and law and order. Thus, it is a fallacy to assume that low wages are the principal driving force behind today's global trade or foreign direct investment flows. This relationship between labour productivity and labour costs explains

why internationally most firms are not seeking to relocate to, for example, Bangladesh despite its low wages, and why most international trade and foreign direct investment flows are still dominated by developed countries as countries of origin and countries of destination.

Economic theory strongly suggests that the immediate imposition of common international labour standards across the board, based on developed-country standards, would substantially reduce total economic welfare as conventionally measured in importing countries, exporting countries and globally.¹³ Yet this is of course a mischaracterization or caricature of what those who favour linkage are demanding, which is at most a gradual progressive movement towards higher standards as appropriately contextualized to the situation of individual developing countries. Besides, at least with respect to CLS, the welfare effects of compliance are likely to be positive in developing countries themselves. Price effects in importing countries are likely to be minor. An important OECD study published in 1996 concluded that compliance with CLS is likely to have no negative implications for exporting countries in terms of export and growth performance.¹⁴ There remain some sceptics about the welfare implications of particular CLS (for example the scope of the collective bargaining entitlement, or the peremptory termination of child labour without pre-empting inferior substitution effects through rendering basic education more accessible).¹⁵ A recent ILO study, using state-of-the-art techniques of economic modelling, predicts, however, substantial welfare gains from the elimination of child labour over a two-decade period, net of the required investment in education and related programmes.¹⁶ Another study, by Morici and Schultz, echoes the OECD 1996 conclusions, finding a significant positive correlation between improvements in respect for CLS and economic growth and development in southern countries.¹⁷

Even stated in fairness rather than welfare terms, if it is unfair for firms and workers in developed countries to have to compete with firms and workers in developing countries with access to low-paid, low-skilled labour, by the same token it is equally unfair for developing countries to have to compete with firms and workers in developed countries that depend on highly skilled labour forces, highly developed infrastructure, large public investments in education and research and development, extensive healthcare systems, effective law and order, and superior institutions, in most cases reflecting collective or public investments on a scale that far exceeds the capacity of most developing countries. Thus, this unfair competition argument, in and of itself, is totally indeterminate and carries high risks of the trade policy-labour standards linkage being exploited for protectionist ends. In this respect, it is important to emphasize that the unfair competition argument focuses principally on the welfare implications of non-compliance with international labour standards for citizens or interests in *importing countries*.

The race to the bottom

As the brief historical exegesis of the trade/labour linkage in the introduction to this chapter makes clear, a major motivation for promoting international labour standards in the first place and then subsequently a trade policy-labour standards linkage (as, for example, reflected in the preambles to the ILO Constitution and Havana Charter) is that low labour standards (including low wages) in exporting countries may undermine higher

labour standards in importing countries and precipitate a so-called 'race to the bottom'—a form of Prisoner's Dilemma—that can only be pre-empted by international agreement on and enforcement of minimum labour standards.¹⁸

This argument is a variant on the unfair competition argument reviewed above but instead of assuming that importing countries will maintain the *status quo* with respect to their more stringent labour standards and accept a loss of market share assumes that such countries will in fact progressively dilute standards in order to avoid losing market share to imports from countries where these standards are not adhered to, resulting in a low-level equilibrium trap where all countries relax their labour standards to what many regard as suboptimal levels, yet all countries simply retain their pre-existing share of trade or investment after the race to the bottom has run its course.

Despite the durability of this concern, for reasons given above, most notably that differences in conditions of employment largely reflect differences in productivity, there is little reason to suppose that liberal trade and investment regimes will precipitate a race to the bottom. Moreover, the empirical evidence provides no support for the claim that liberal international trade and investment regimes are leading developed countries to relax their CLS or labour standards generally or that foreign direct investors are investing in countries with weak CLS. Indeed, the evidence suggests that, with the notable exception of China, countries with weak CLS attract very little foreign direct investment either in general or specifically in the sectors where CLS are weak. Even Export Processing Zones (EPZs) typically provide superior employment conditions to surrounding markets.¹⁹ Some commentators, while conceding that weak CLS in some developing countries have not caused a weakening of labour standards generally in developed countries, argue that developing countries with weak CLS that compete against each other in export markets may be stuck in a low-level equilibrium trap with respect to efforts to enhance CLS *vis-à-vis* each other.²⁰ If the OECD and later findings discussed above are well founded—that CLS have no adverse effects on export performance and economic growth, and may have positive effects—this concern is not warranted. It is important to emphasize that race-to-the-bottom concerns, like unfair competition concerns, largely emanate from the perceived welfare implications of non-compliance with international labour standards for citizens and interests in *importing countries*.

Core labour standards as human rights

Various core labour standards have been characterized as human rights in the UN Universal Declaration of Human Rights, the subsequent International Covenant on Civil and Political Rights, and the International Covenant on Economic, Social and Cultural Rights. The ILO's 1998 Declaration of Fundamental Principles and Rights at Work enumerates a short list of core international labour standards which are defined more fully in eight background Covenants that are incorporated by reference, i.e. freedom of association and collective bargaining, the elimination of forced labour, the elimination of child labour, and the elimination of discrimination in employment, which is also consistent with the characterization of certain core labour standards or rights as human rights, especially those that guarantee basic freedom of choice in employment relations.

Amartya Sen argues in his recent book, *Development as Freedom*,²¹ that, the basic goals of development can be conceived of in universalistic terms where individual well-being can plausibly be viewed as entailing certain basic freedoms irrespective of cultural context: freedom to engage in political criticism and association, freedom to engage in market transactions, freedom from the ravages of preventable or curable disease, freedom from the disabling effects of illiteracy and lack of basic education, and freedom from extreme material privation. According to Sen, these freedoms have both intrinsic and instrumental value. Importantly, in contrast to the unfair competition and race-to-the-bottom rationales for linking international trade policy and international labour standards, the human rights perspective focuses primarily on the welfare of citizens in *exporting*, not *importing* countries. The assumption underlying this concern for basic or universal human rights is that failure to respect them in any country is either a reflection of the decisions of unrepresentative or repressive governments rather than the will of the citizens, or a sign of the majoritarian oppression of minorities, for example children, women or racial/religious minorities; alternatively, there may be paternalistic concerns that citizens in other countries have made uninformed or ill-advised choices to forgo these basic rights.

In our view, the linkage of international trade policy, including trade or other economic sanctions, with core labour standards that reflect basic or universal human rights is a cogent one. When citizens in some countries observe gross or systematic abuses of human rights in other countries, the possible range of reactions open to them include diplomatic protests, withdrawal of ambassadors, cancellation of air landing rights, trade sanctions or more comprehensive economic boycotts, or at the limit military intervention. Arguing that doing nothing is always or often the most appropriate response is inconsistent with the very notion of *universal* human rights. In extreme cases, such as war crimes, apartheid, the threat of chemical warfare in the case of Iraq, genocide in the case of Serbia, or the Holocaust in the case of Nazi Germany, excluding *a priori* economic sanctions from the menu of possible options seems indefensible. Whether it is the most appropriate option may, of course, be context-specific and depend both on the seriousness of the abuses and on the likely efficacy of the response/choice of instrument, issues to which we turn next. But it is sufficient for present purposes to restate the point that to the extent that core labour standards are appropriately characterized as basic or universal human rights, a linkage between trade policy and such labour standards is not only defensible but arguably imperative, in contrast to the other two rationales for such a linkage which, despite their much longer historical lineage, are largely spurious and inconsistent with the central predicates of a liberal trading system. However, core labour standards viewed as basic or universal human rights, by promoting human freedom of choice, are entirely consistent with a liberal trading regime that seeks to ensure other human freedoms, in particular the right of individuals to engage in market transactions with other individuals without discrimination on the basis of country of location.²²

Having said this, the scope and definition of the class of human rights viewed as sufficiently universal as to warrant potentially the imposition of trade sanctions for their violation is problematic in various respects. Even CLS are not susceptible to uncontentious understandings of their scope. Should child labour be defined only in terms of a minimum working age, or should some subset of exploitative child labour practices be targeted? What practices exactly constitute discrimination in the workplace? What

constitutes forced labour beyond slavery? When is freedom of association and the right to engage in collective bargaining fully respected, given that most countries deny or limit the right to strike in various contexts? Beyond CLS, while civil rights, for example to be free from genocide, apartheid, torture, detention without trial, etc., may be reasonably well understood and subscribed to (at least in principle), the exact limits of political rights, for example to engage in political association, criticism or dissent, or even to vote, are much less widely agreed.²³ The scope of many economic, social and cultural rights is controversial.²⁴ These controversies do not obviate the normative force of the rights themselves, but do have implications for the choice of instrument and choice of institutional arrangements for addressing the trade-policy labour standards linkage, to which we now turn.

The choice of instrument

ILO Conventions and 'soft' or voluntary initiatives

The ILO's Conventions on minimum international labour standards are the most prominent form of law in this context, in that they depend on ratification by individual Member States and are subject largely only to investigation and reporting by ILO organs and the provision of technical assistance to enable countries to build capacity to implement them. Thus, compliance with ILO norms depends on a combination of public identification, embarrassment and shaming (a mild stick), and technical assistance to promote compliance (a mild carrot). The ILO has been widely criticized by proponents of a trade/labour linkage for ineffective enforcement of its norms and indeed variable ratification of its Conventions by many countries, including major developed countries such as the USA (which has, of course, been a prominent proponent of a trade/labour linkage). Many of the 'soft' marketdriven mechanisms described below have emerged in part out of frustration by NGOs and other interest groups with the ineffectiveness of the ILO.

One class of 'soft' instruments entails a range of certification, labelling and voluntary code of conduct mechanisms that purport to identify firms or products that conform to core international labour standards and hence are responsive to information market failures if consumers in importing countries derive private disutility from consuming goods produced in violation of CLS.²⁵ The efficacy of these mechanisms turns largely on market reactions to the signals that they entail, principally by consumers and to a lesser extent by investors. These instruments are attractive in some respects in their focus on consumer (not producer) welfare in importing countries in that they depend on consumer preferences and a willingness to pay to vindicate those preferences and hence are consistent with the normative predicate of liberal trade theory, which largely focuses on the potential for free trade to enhance consumer welfare. Typically, such mechanisms are either self-initiated by firms or industry associations or are initiated by NGOs of various kinds, who negotiate them with firms or trade associations. The most ambitious initiative of this kind to date is the Global Compact, launched by UN Secretary-General Kofi Annan in 1999 and entailing voluntary corporate endorsements of nine principles, including CLS. Among the most prominent scholarly advocates of voluntary approaches are Archon Fung, Dara O'Rourke and Charles Sabel, who argue for a strategy that they

call 'Ratcheting Labour Standards'. This would entail an ambitious programme of information-gathering and monitoring of firms, who would be systematically compared with their peers operating in the same part of the world in terms of labour rights performance. Assuming that consumers in rich countries will reward firms that do better than their competitors and engage in 'best practices', Fung *et al.* argue that if the monitoring and evaluation programme is credible, firms will start to compete with each other with respect to labour standards performance, thus ratcheting up those standards.²⁶

In August 2003, the UN Sub-Commission on the Promotion and Protection of Human Rights unanimously adopted the 'Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights', which seeks to provide a universal framework for corporate responsibility, guiding the many uncoordinated existing voluntary initiatives. In respect of rights of workers, the norms prohibit forced or compulsory labour and economic exploitation of children (which notably falls short of a prohibition of child labour as such), and include the obligation to provide a 'safe and healthy working environment', and to provide workers 'with remuneration that ensures an adequate standard of living for them and their families', and freedom of association and collective bargaining. The content of these rights is linked to various binding international human rights instruments, of both the ILO and the UN.

'Soft' or voluntary approaches suffer from a number of limitations. Currently, they apparently apply to a small percentage of exports in a number of sectors where non-compliance with core labour standards is thought to be common, for example about 5% of exports in the textile and clothing industries, and they vary widely in various dimensions, for example (1) which core labour standards are recognized; (2) how these core labour standards are defined, if at all; and (3) how effectively adherence to these standards is monitored, if at all.²⁷

In explaining the low, inconsistent and often ineffective application of these mechanisms, a number of explanations suggest themselves which in turn raise serious questions about attaching primacy to consumer preferences in importing countries in this context, despite the initial appeal of mechanisms that depend on consumer welfare as their reference point and the compatibility of this reference point with the predicates of free trade.²⁸ First, consumers, even if fully informed about conditions under which imports are being produced and violations of core international labour standards that particular modes of production may entail, in fact do not care enough about the intrinsic values reflected in these core labour standards (viewed as basic or universal human rights) to put their money where their mouth is. However, even if this were to be the case, the fact that the process of production and exchange may entail production or consumption externalities for other citizens in exporting or importing countries, as is largely inherent in the notion of universal human rights, suggests that consumer preferences cannot be decisive in a human rights context.

A second explanation is that consumers in importing countries do care about these human rights values but are poorly informed about the conditions under which the goods they are consuming are produced in exporting countries. The cost of acquiring this information exceeds the value that they place on this information. In this respect, the voluntary and decentralized nature of the soft law mechanisms currently employed in this context almost certainly exacerbates the information problems faced by consumers in importing countries. As noted above, the proposal by the Director-General of the ILO in

1997 that the ILO should promote an integrated scheme for increasing the effectiveness of consumer choice by labelling exports as having been produced in countries that conform to core international labour standards was rejected by the main decision-making body of the ILO, in large part because of strenuous opposition from developing countries.

Yet a further explanation for the low, inconsistent and often ineffective application of these mechanisms is that consumers in importing countries do care about these intrinsic human rights values but confront serious collective action problems in that individual consumers who may be prepared to pay a premium for goods produced in conditions that meet core labour standards will be concerned that other consumers who share their concerns may opportunistically purchase lower-priced goods, relying on other consumers to bear the financial costs of vindicating their collective preferences. However, if every consumer suspects every other consumer of being likely to behave opportunistically, i.e. to free-ride on their sacrifices, an effective voluntary collective response may not emerge.

A recent major World Bank study examined the relatively modest results attained so far through voluntary corporate responsibility. The study came to the following conclusion, based on consultations with the various stakeholders in such schemes, including businesses:

Overall, the consultations, and subsequent analysis, indicate that while meaningful progress has been made in apparel, and to a lesser degree in agriculture, the existing 'system' of implementation may be reaching its limits in terms of its ability to deliver further sustainable improvements in social and environmental workplace standards. This is in some ways natural when one considers that current approaches are not the result of a systematic effort to marshal the forces of the public and private sectors, trade unions and NGOs, and workers. Instead, it is clear from the consultations that current efforts are the result of a series of steps often taken through ad hoc and isolated decisions.²⁹

Beyond these reasons for not according primacy to consumer preferences in this context, a further serious limitation is associated with soft law mechanisms that link consumer responses to imports of offending goods, for example goods made with child or forced labour, conflict diamonds, etc. These mechanisms are unresponsive to violations of either core labour standards viewed as universal human rights or universal human rights defined more broadly that are occurring in non-traded goods sectors. For example, it is widely agreed that most child labour is not employed in export sectors (between 5 and 10%) but in domestic agriculture, services, retail and the informal sector generally.³⁰ Many abuses of civil and political human rights are not related in any direct way to traded goods sectors, like, civil rights abuses in Sudan and Burma, to take two current examples.

Other hard law options

The first and most fundamental issue that arises in choosing hard law instruments is the scope of the trade policy—labour standards linkage. If we conceptualize at least core labour standards as universal human rights, how can we justify privileging these particular human rights over at least some subset of universally proclaimed universal

human rights (subject to the definitional issues noted above)? Surely genocide, torture, detention without trial, etc. warrant at least as serious concern from the international community, and at least as serious a set of legal sanctions, as violations of core international labour standards. To privilege core labour standards over these other human rights is quite overtly to elide the various normative rationales for intervention reviewed earlier in this chapter and to risk a protectionist rationale for trade or other economic sanctions.

Related to this point, a further issue arises relating to the scope of the linkage between trade policy and core labour standards: why should trade or other economic sanctions be contingent on imports of offending goods? As in the discussion of market-driven soft law instruments and limitations thereof, why should child labour in non-tradable goods sectors or human rights violations in non-tradable goods sectors warrant any less concern, or any less severe sanctions, than such abuses in tradable goods sectors?

It follows from these two points that in our view, trade or other economic sanctions should not be confined to core labour standards, but should extend to at least some subset of universally accepted rights more generally, and that such sanctions should not be limited to imports of goods directly produced by the offending practices. This in fact suggests a very broad domain for linking trade and other economic sanctions with universal human rights. However, it also suggests some significant constraints on their invocation. In particular, both the substantive rules governing their invocation and the procedures by which they may be invoked should be consistent with the human rights rationale for intervention and should exclude the unfair competition and race-to-the-bottom rationales for intervention.

In terms of substantive rules, this requirement assigns considerable significance to rules of non-discrimination and consistency. For example, suppose hypothetically that it is the case that the USA has no textile sector but a significant clothing sector and that child labour is employed in producing exports for the US market in India in both sectors but the USA seeks to impose trade sanctions only against clothing imports from India and not textile imports. Alternatively, even if the USA seeks to apply trade sanctions against both clothing and textile imports from India, it does not seek to do so against similar imports from Pakistan made with child labour for geopolitical or other reasons. While it is important to screen out cases of disguised protectionism in cases where trade sanctions have been unilaterally invoked, ostensibly on human rights grounds, this should not require sanctioning countries to apply sanctions to either all countries in violation of CLS (or human rights), or none—an all-or-nothing requirement that is likely to make ‘the perfect enemy of the good’. In other words, as a matter of international trade law, there should be a negative duty not to discriminate for protectionist reasons, but there should be no positive duty to take affirmative action. While a sanctioning country may choose not to sanction all violations of CLS (or human rights) everywhere in the world, this form of trade sanction ‘under-reach’ should surely not be a legitimate concern of an international trade body, which cannot plausibly be transformed into a global human rights crusader. In contrast, the problem of sanction ‘under-reach’ may be a legitimate concern of other international organizations (such as the ILO, or UN Human Rights Committees), but this calls for action on their part (e.g. by adopting a regime like the Convention on International Trade in Endangered Species (CITES), *requiring* multilateral sanctions by members in particular cases). For the WTO, the principal

concern is sanction 'over-reach', where the sanctioning country's action in targeting some imports and not others seems principally explicable on the basis that in the former case it has a domestic industry to protect and in the latter case it does not. Where it imposes trade sanctions in the latter case they entail no benefits to the domestic producers of competitive products (who are non-existent), but costs to domestic consumers, and thus it can be viewed as an action against material interest that can only be explained by the sanctioning country's genuine concern with CLS (or human rights) violations in exporting countries (similarly in the case of bans on exports or foreign direct investment), where the government of the sanctioning state, by taking action, is seeking to solve collective action problems among its own consumers or citizens. On this approach, in the hypothetical example above, the differential treatment of clothing and textile imports from India would be suspect, but the failure to sanction similar imports from Pakistan, for non-trade-related reasons, would not be.

In terms of procedural requirements for the invocation of trade or other economic sanctions against violations of universal human rights in other countries, a number of options present themselves. First, a basic choice has to be made (although often overlooked in debates over the trade/labour standards linkage) between sticks and carrots. Rather like the European Community's GSP regime, it is not difficult to imagine developed countries offering developing countries significant trade concessions (e.g. accelerated implementation of the phase-out of the Multi-Fibre Arrangement) if they commit themselves to an accelerated phase-out of offending labour or other human rights abuses. Unlike the Uruguay Round Agreements, which entailed for the most part a single undertaking by Member states, such an arrangement in this context might more appropriately take the form of a plurilateral agreement (like the Uruguay Round Government Procurement Code) where this is an option offered to developing countries and, for those who choose it developed countries would bind their trade concessions (unlike GSP treatment). The commitments made by countries to observe core international labour standards and other universal human rights would have to be reasonably precisely defined in terms of ILO or UN Conventions or Covenants, so that violations of these commitments could be rendered reasonably justiciable through an appropriate international dispute settlement process (perhaps vested in the WTO, but not necessarily or exclusively so, as we explore further below). However, one of the limitations of the carrot option, as pointed out by Howard Chang,³¹ is that it creates moral hazard problems in that countries may persist in violations or engage in more egregious violations in order to attract larger concessions (or carrots).

A second option would be to require all countries that are parties to either a regional or a multilateral arrangement like the WTO to commit themselves to effectively enforcing their own existing labour laws (as under the NAFTA Labor Side-Agreement), with enforcement provided through supranational or international dispute settlement processes and penalties. The limitations of this option are obvious enough: first, it addresses only violations of core international labour standards and not other universal human rights; second, it assumes that Member countries have already enacted substantive laws that reflect these standards and that the only problem is ineffective enforcement, which in many cases may not be the central problem.

A third option is to allow private party-initiated petitions for trade sanctions under domestic law analogous to antidumping duties and countervailing duties. We

unequivocally reject this option as espousing in its most naked form the two rationales for a trade/labour standards linkage that we regard as illegitimate and as carrying the highest risk of protectionist abuse of this linkage.

A fourth option would be unilateral *state* action against imports from offending countries. This is possible based upon the Article XX exceptions in the GATT, as will be explained in the next section of the chapter. Article XX contains important disciplines to prevent measures that are disguised protectionism or have arbitrary elements. It would be expected, were a WTO Member to justify such action under Article XX, that the dispute settlement organs of the WTO would rely heavily on the judgment of the ILO and/or UN human rights organs in determining the seriousness of the situation to which the unilateral sanctions are a response, and also in determining whether the sanctioning state—and the international community—have exhausted less trade-restricting alternatives. An example of how such an option might work is the current ban by the United States on all trade with Burma, based upon grave labour and human rights abuses by the current military junta. In 2000, in response to the complete failure of the Burmese regime to respond to the recommendations of an ILO inquiry into labour rights abuses, the ILO for the first time in its history invoked Article 33 of its Constitution, which allows the Membership collectively to authorize or encourage compliance measures against a Member by other Members. In this case, ILO Members were to ‘review, in the light of the conclusions of the Commission of Inquiry, the relations that they may have with the Member State concerned and take appropriate measures to ensure that the said Member cannot take advantage of such relations to perpetuate or extend the system of forced compulsory labour referred to by the Commission of Inquiry, and to contribute as far as possible to the implementation of its recommendations’. In 2003, citing (in the preamble) this recommendation of the ILO, the US Congress adopted the Burma Freedom and Democracy Act (2003), which banned all trade with Burma, but giving the President discretion to modify or lift the ban in the case of adequate progress towards the respect of core labour rights, *inter alia*. Notably, the legislation requires the President to consult with the Secretary-General of the ILO in exercising his discretion under the Act; the assumption is that the future of US sanctions should be linked to multilateral judgments about the situation in Burma. While some members of Congress raised questions about WTO consistency during the period when the legislation was being debated, a group of WTO scholars from leading US law schools issued a joint statement through the Free Burma Coalition, explaining how, in the case of Burma, sanctions could be defended under Article XX of the GATT, especially given the actions already taken by the ILO.

After the legislation passed (virtually unanimously in both Houses) and was signed into law by President Bush, very little international criticism was directed at the United States for its ban, including among delegates at the WTO. The legislation was not even mentioned by name in the recent Trade Policy Review of the United States in the WTO. This shows that there is tolerance of unilateral action by the international community where that action is preceded by a clear multilateral determination that the country concerned is an egregious violator of core labour rights and that cooperative approaches for addressing the situation have been exhausted. Another factor is that the activist community within Burma (including the opposition leader, who had been put once again

under house arrest) strongly supported the sanctions; they could thus not be characterized as the imperialistic imposition of 'Western' values.

A fifth option would be for all Member States who are parties to either regional or multilateral trading arrangements to negotiate a comprehensive set of rules setting out commitments to observe core international labour standards and other universal human rights (perhaps incorporating by reference relevant international documents). On this approach, which is analogous in some respects to that entailed in the Uruguay Round TRIPs Agreement (which incorporates by reference the Berne, Paris and Rome Conventions), trade sanctions would come at the end of the dispute settlement process and not at the beginning. In other words, a country complaining that another country was in violation of its core labour standards or other human rights commitments would have to demonstrate a breach of these commitments and would carry the burden of initiating and proving, at least *prima facie*, such violations, and only if the complaint is upheld by the dispute settlement body could retaliatory trade sanctions be authorized in the event that non-compliance continued. This approach has several virtues. First, trade sanctions cannot be imposed until there has been a multilateral judgment that a violation of relevant core international labour standards or other human rights has occurred, and the country seeking to impose such sanctions bears the initial burden of initiating a complaint and proving a *prima facie* case. Second, it has the virtue of any rule-based system of laying out the substantive ground rules with some precision in advance and thus minimizes the potential for protectionist abuse of the regime. Third, and relatedly, it renders problems of justiciability more tractable.

The choice of institutional regime

Having discussed the choice of objectives and the choice of instruments in light of those objectives in shaping a trade/labour standards linkage, the remaining question is the choice of institutions to administer this linkage in light of choice of objectives and choice of instruments. Two important and related considerations are relevant here: first, institutional specialization, as in many other domains, has many virtues in vindicating desired policy objectives;³² second, because human rights, not trade effects, motivate the trade/labour linkage that we advocate, vesting exclusive or even primary jurisdiction in an international trade body risks compromising the normative rationale for the linkage, for example by giving primacy to adverse trade effects in either importing or exporting countries.

In cases of egregious abuses of universal civil human rights, for example apartheid or genocide, it is difficult to imagine as plausible the vesting of this function in a trade organization (like the WTO). Rather, following current international practices, one would imagine that the appropriate international organ for authorizing or perhaps requiring such sanctions is the UN Security Council. In other less egregious cases, there will still obviously be questions of institutional legitimacy and competence in vesting the administration of such a regime in a trade organization. One option here entails a sharp and exclusive institutional division of labour. For example, with respect to core labour standards, the authorization or requirement for the imposition of trade or other economic sanctions could be vested in the ILO by way of elaboration of its sanctioning power under Article 33 of the ILO Constitution. This would follow, by way of analogy, the

example of regimes such as the above-mentioned CITES, which requires signatory states to ban imports of endangered species or products therefrom. However, critics of the ILO are sceptical of the willingness or capacity of the ILO to implement and administer effectively such a regime. Defenders of the ILO, on the other hand, worry that the attachment of economic sanctions to the powers of the ILO may destabilize the organization, causing states to withdraw from Membership or to withhold ratification of its Conventions to an even greater extent than is the case at present.

Another option is to imagine some form of horizontal coordination among international agencies, whereby, for example, the ILO would be wholly or largely responsible for determinations of systematic and persistent violations of core labour standards, or UN Committees on Human Rights for systematic and persistent violations of other universal human rights (other than the most egregious abuses), and the WTO would be responsible for overseeing the implementation of sanctions and ensuring that arbitrary and unjustifiable forms of discrimination and disguised protectionism are avoided, as well as proportionality in the scale of the trade sanctions imposed. A variant on this option would be to have international organizations such as the ILO or UN Human Rights Committees nominate members to dispute settlement panels or the Appellate Body of the WTO in cases involving complaints of violations of core labour standards or other universal human rights, and at the same time take steps to render the WTO dispute settlement process both more transparent and more inclusive in terms of admissibility of *amicus curiae* briefs from interested members of civil society.³³

Our preference would be for some form of horizontal coordination with specialized international agencies with expertise and legitimacy in the labour standards or human rights fields who would make determinations of systematic and persistent violations of relevant norms despite whatever carrots and sticks (assisting and shaming) that the agency typically first brings to bear on violators. Thus, the 'necessity' test would largely fall within these agencies' domains, although such determinations may be precipitated by unilateral state trade action under one of the options reviewed in the previous section, a complaint by the targeted country, and a reference under the Dispute Settlement Understanding (Article 13) by the WTO panel seized with the complaint to a relevant specialized international agency for findings on violations of relevant international norms, which the WTO panel should accept as presumptively dispositive of the referenced issues. Indeed, this option becomes much more attractive with this form of horizontal coordination. Such determination may also go some distance towards meeting the non-discrimination/ disguised discrimination conditions in the *chapeau* to Article XX of the GATT. With respect to the proportionality of the proposed trade response, the WTO for its part should again be influenced by the nature of the horizontal agency's findings as to the seriousness and persistence of the violations. Because adverse trade effects are irrelevant in our proposed framework of analysis, trade sanctions cannot be quantified in these terms. Here more imaginative fashioning of trade remedies is called for. For example, the NAFTA Labor Side-Agreement provides for a system of fines, ultimately enforceable by trade sanctions, if a Member State is found by a specialized panel to have engaged in a systematic and persistent practice of not enforcing its own labour laws, with the fine payable to the offending country to enhance its labour law enforcement.³⁴ This form of sanction suggests one option. Another option may entail denial of access to the dispute settlement process of the WTO as a complainant for so

long as a Member State is non-compliant. A yet further option is suspension of voting rights in the WTO while non-compliance persists. Crippling a non-compliant country economically (particularly a poor developing country) with trade sanctions should be reserved as the remedy of last resort.

THE EXISTING AND EVOLVING LEGAL AND INSTITUTIONAL FRAMEWORK

The World Trade Organization

In the Havana Charter, which was to be the blueprint for the failed International Trade Organization (ITO), there was a stipulation that members were to take measures against 'unfair labour conditions'.³⁵ The GATT contains no explicit provision either permitting or requiring trade action against labour rights violations. Article XX(e), however, permits otherwise GATT-inconsistent measures 'relating to the products of prison labour'.

In determining the legality of labour rights-related trade measures under the WTO framework, it is important to distinguish between four kinds of measures: trade measures that condition imports on the labour conditions under which specific products are manufactured (for instance a ban on rugs manufactured with exploitative child labour); sanctions against a specific country or countries (the US ban on trade with Burma, mentioned above); labelling, voluntary codes of conduct and associated monitoring mechanisms; and GSP preferences linked to labour rights performance.

The first kind of measure treats products differently based upon circumstances surrounding their production. Under Article I of the GATT, every WTO Member is required to provide unconditional Most Favoured Nation (MFN) treatment to every other WTO Member with respect to 'like products'. The *Belgian Family Allowances* ruling is often cited for the proposition that this requirement of unconditionality excludes the possibility of distinguishing between products based upon labour conditions. However, the *Belgian Family Allowances* case dealt with conditionality based on the system of social protection adopted by particular countries, and was thus not origin-neutral (and was in fact closer to the second kind of measure identified above). In the adopted *Canada—Autos* report, the panel held that non-discriminatory, i.e. non-origin-based, conditions were permissible even with respect to 'like' products under Article I: 'We therefore do not believe that, as argued by Japan, the word "unconditionally" in article I:1 must be interpreted to mean that making an advantage conditional on criteria not related to the imported product itself is *per se* inconsistent with article I:1, irrespective of whether or not such criteria relate to the origin of the imported products' (para. 10–24). On the other hand, a more recent panel, the *EC—GSP* panel, (discussed in chapters 2 & 15), without even so much as a citation to *Canada—Autos*, took a very different approach to unconditionality in article I:1, holding that it excluded even origin-neutral conditions; (The panel's finding on this matter was not considered by the Appellate Body).³⁶ On the *Canada—Autos* approach, a genuinely (both *de jure* and *de facto*) origin-neutral condition related to the respect for core labour rights in the production of a product might well be found not to violate article I:1, even if products produced in violation of such rights were found to be 'like' those that are not (an issue we will explore in more depth

below, when we discuss National Treatment under the GATT). On the *EC—GSP* approach, there would clearly be a violation of article I:1, thus requiring that the measure be justified under an exception in Article XX of the GATT.

Article III:4 of the GATT requires that imported ‘products’ receive treatment no less favourable than that to be afforded to ‘like’ imported products. A long-standing issue in GATT and WTO jurisprudence is whether products may be considered ‘unlike’ based upon process and production methods (this issue is considered *in extensio* in Chapter 16). In the *Asbestos* case, the WTO AB set forth a framework for evaluating whether products are ‘like’ under Article III:4; this framework neither explicitly endorses nor rejects the idea that process and production methods are relevant to the assessment of likeness. However, the AB’s reasoning strongly suggests that products may be considered ‘like’ based on consumer tastes and habits. Thus, if there is sufficient evidence that consumers distinguish between products produced in conditions violating CLS and those produced in conditions consistent with CLS, or *would* distinguish these products if they had perfect information, then the former products might well be found to be ‘unlike’ the latter. It should be noted that in the *Asbestos* case, the AB emphasized that the principle of avoiding protectionism stated in Article III:1 should inform determinations of ‘likeness’. Thus, in evaluating factors such as consumer preferences, the dispute settlement organs will be attentive to the possibility of protectionist manipulation or abuse as ingredients in product-based labour rights trade measures.

Even if, however, products produced in conditions that violate CLS were found to be ‘like’ products not produced in such conditions, in order to establish a violation of Article III:4 it would be necessary to show that the difference in treatment between ‘like’ products leads to less favourable treatment of the ‘group’ of imported products in relation to the ‘group’ of like domestic products (*EC—Asbestos*, para. 100). In the case of CLS, it might well be difficult to show such less favourable treatment of imports, since all ILO Members, and thus essentially all WTO Members, are equally obliged to conform with CLS; thus, such a condition is not, by definition, ‘less favourable’ to exports, since exporting countries are bound just as much to ensure such rights are respected as importing countries.

By contrast to product-related measures of the kind just described, sanctions targeted at particular countries that violate CLS are very likely to be found to contravene Article I of the GATT, since they discriminate based on the country of origin of the goods; it might of course be argued the discrimination is nevertheless based on origin-neutral *criteria*, namely CLS themselves. However, this argument would only be persuasive if the importing country were to ban trade from all countries that run afoul of CLS, regardless of other factors, including geopolitical considerations, which, as argued above in this chapter, it would be unrealistic to expect. Furthermore, a general import ban (because it does not impose a condition applicable to both domestic and imported products alike but rather targets imports alone) would be a violation of Article XI of the GATT, which outlaws prohibitions and restrictions on trade.

Thus, such an import ban would need to be justified by the importing country under Article XX.

The possibility has been raised that Article XX(a), which permits otherwise GATT-inconsistent measures ‘necessary to protect public morals’, might be invoked to justify trade sanctions against products that involve the use of child labour or the denial of basic

workers' rights.³⁷ In its ruling in *Turtles I* that Article XX can be, in principle, used to justify measures that condition imports on other countries' policies, the AB went beyond the case of XX(g) ('exhaustible natural resources') which was at issue in that case and explicitly mentioned, *inter alia*, XX(a). There is no GATT or WTO jurisprudence on the interpretation of XX(a), and the reference to prison labour in XX(e), as well as the fact that explicit language on labour rights was in the failed Havana Charter, arguably suggest that if GATT Article XX had been designed to encompass sanctions with respect to labour rights, explicit language would have been used to articulate such an exception. This being said, the interpretation of public morals should not be frozen in time and, with the evolution of human rights as a core element in public morality in many post-war societies and at the international level the content of public morals should extend to universal human rights, including labour rights. This is consistent with a dynamic interpretation of Article XX of the kind which the AB gave to Article XX(g) in the *Shrimp/Turtle* case, discussed earlier in the trade and environment chapter (Chapter 16).³⁸ In the modern world, the very idea of public morality has become inseparable from the concern for human personhood, dignity and capacity reflected in fundamental rights. A conception of public morals or morality that excluded notions of fundamental rights would simply be contrary to the ordinary contemporary meaning of the concept.

In the *Gambling* case (*United States—Measures Affecting the Cross-Border Supply of Gambling and Betting Services* WT/DS285/R, November 10 2004), in interpreting the 'public morals' exception in Article XIV of GATS, the panel favored a dynamic approach to the meaning of 'public morals': 'In the Panel's view, the content of these concepts for Members can vary *in time* and space, depending upon a range of factors, including prevailing social, cultural, ethical and religious values (para. 6.461; emphasis added)'. The panel suggested that each WTO Member has considerable discretion to determine what practices would violate the moral code of the community. Based on the panel's deferential reasoning as to the content of public morals, there is no reason why the content of 'public morals' could not extend to beliefs of the importing country concerning the wrongfulness of consuming products produced in a context—either corporate or national—where basic labour rights are not respected. Further, based on dictionary definitions, the panel found that 'public morals' concerned the interests of 'the community or nation as a whole.' The notion here is of the *broadness* and *generality* of the interests concerned, and thus *a fortiori* the interests of the *global* community as reflected in human rights treaties of an *erga omnes partes* character, would be encompassed by 'public morals.'

As interpreted by the AB in *Shrimp/Turtle*, the *chapeau* of Article XX provides an important check against protectionist or other abusive implementation of trade bans for ostensible labour rights purposes. In determining whether the measures in question are applied so as to constitute arbitrary or unjustified discrimination or a disguised restriction on international trade, the AB would examine factors such as whether a trade ban inappropriately singles out the target country, whereas other countries might, against the objective criteria in question, merit similar treatment. Here it would be important to determine whether the labour rights situation in the particular countries in question has been singled out as especially grave or warranting particular attention by the international community, including the ILO and the UN human rights organs (it will be recalled that this was clearly the case with Burma). Here it should be emphasized that the *chapeau*

only prohibits arbitrary and unjustified discrimination against countries where the same conditions prevail—not *all* discrimination. Thus, a sanctions-imposing state might still justify singling out one target country and not including others where the labour rights situation is similarly grave, by citing geopolitical or other principled policy reasons why it would be inappropriate to ban trade from the other countries in question.

Furthermore, the import ban must be 'necessary' for the protection of public morals, according to the terms of paragraph XX(a). The concept of 'necessity' as elaborated by the AB in the *EC—Asbestos* and *Korea—Beef* cases in relation to other paragraphs of Article XX where the word 'necessary' appears has a bifurcated structure. A measure may be necessary if it is 'indispensable' to achieving the objective in question, which entails an examination of whether there is any reasonably available less trade-restrictive alternative. Since as discussed above often a range of less restrictive alternative instruments might exist to address noncompliance with CLS, it would be up to the state seeking to justify its ban to show that these instruments have proven, or are likely to prove, ineffective. Again to return to the example of Burma, such a requirement might well be met where the ILO itself has essentially declared that other available alternatives to induce a country to engage with the international community concerning its labour rights practices have failed. A second version of the 'necessity' test applies where the measure in question cannot be shown to be indispensable, but nevertheless has a close relationship to the given objective, here protection of public morals. In this latter instance, a further requirement is imposed, namely to show that the trade-restricting effect of the measure is not out of all proportion to the achievement of its objective.

With respect to the third type of measure, voluntary labelling or other code of conduct-based approaches to achieving CLS compliance through consumer action, generally the GATT itself does not apply where there is no element of mandatory government action (albeit GATT norms may extend to indirect mandatory action, such as 'informal guidance' by governments to industry that they implicitly may face various kinds of informal sanctions for not complying with; see the *Japan—Semiconductor*, *Canada—FIRA* and *Japan—Film (Kodak/Fuji)* panels).

These approaches, however, may be disciplined under the Technical Barriers to Trade (TBT) Agreement; the Agreement requires WTO Members to ensure that voluntary standard-setting exercises comply with a code of good practice. This code, *inter alia*, entails that voluntary standards be based on relevant international standards, and that setting of standards and monitoring of compliance in voluntary systems not constitute protectionism, and be undertaken so as to avoid unnecessary obstacles to trade. While no clear definition of international standards is given in the TBT Agreement, an international standards-setting body is defined as an organization open to all WTO Members. Based on this definition, both ILO Conventions and the Declaration on Core Labour Standards would constitute 'international standards' within the meaning of TBT, as would the recently proclaimed UN norms of corporate responsibility, discussed above.

The fourth kind of measure, GSP preferences conditioned on labour rights performance, is already used extensively by both the USA and the EU. Recently, India challenged a relatively new aspect of the EU scheme, namely a provision that gave a further additional margin of preference to those developing countries able to certify that CLS were being effectively implemented in their domestic law and regulations. India also challenged a related scheme for environmental performance, and drug enforcement. In

the end, India dropped the claims about the labour (and environmental) preferences, limiting its argument to drug preferences. While upholding the general conclusion of the panel that the drug enforcement preferences were not consistent with the GSP Enabling Clause instrument (see Chapter 15, 'Trade and Developing Countries'), the Appellate Body (*European Communities—Conditions for the Granting of Tariff Preferences to Developing Countries*, WT/DS246/AB/R, 'Report of the Appellate Body') emphasized that one important reason for its finding that the drug preferences violated the non-discrimination requirement implicit in the Enabling Clause was that the drug preferences were not based on objective and transparent criteria; *in dicta* the AB hinted that it took a more favorable view of the EC labour preference scheme in this respect. It is thus far from clear that the AB would have found the additional margins of preference for labour rights performance to be inconsistent with the Enabling Clause, had India pursued its claim with respect to the labour preferences.

Internal trade law of the United States and the European Union

US trade law provides for withdrawal of trade concessions with respect to countries that fail to respect international workers' rights. For example, Section 301 of the US Trade and Tariff Act of 1974 as amended in 1988³⁹ provides the United States Trade Representative with discretionary authority to recommend a wide variety of trade sanctions against countries which, *inter alia*, engage in acts, policies and practices that 'constitute a persistent pattern of conduct denying internationally recognized worker rights'. As already noted, the Burma Freedom and Democracy Act of 2003 bans all trade between the United States and Burma on, *inter alia*, grounds of egregious violations of core labour rights.

In addition, with respect to developing countries in particular, trade preferences granted under the GSP⁴⁰ are denied to a country that is determined not to be 'taking steps' to implement internationally recognized workers' rights.⁴¹ These are defined as: the right of association; the right to organize and bargain collectively; freedom from any kind of forced or compulsory labour; a minimum age for the employment of children; and acceptable conditions of employment with respect to minimum wages, hours of work, and occupational safety and health. Although application of trade sanctions against unfair labour practices involves a unilateral judgment by the US authorities about the domestic policies of other countries, the language of the US statute does suggest as a reference point certain widely accepted international norms, as reflected in the Conventions of the ILO. In other words, although the process is unilateral, it refers to rights recognized in international instruments. Section 301 measures, however, could include withdrawal of trade concessions bound in WTO schedules, and would therefore result in a conflict with WTO obligations as they currently stand (subject to justification under Article XX(a), which as discussed above would entail the claim that the measures are necessary to protect 'public morals').

In fact, while GSP preferences have been withdrawn numerous times, Section 301 action has yet to be taken on the basis of consistent non-compliance with international labour rights. The relevant legislation with respect to GSP preferences allows interested parties to bring a petition before the GSP Subcommittee, an inter-agency group of US trade officials, requesting review of the labour rights performance of a country with, or

seeking, GSP status. The review may result in a recommendation to the President that a country's GSP status be withdrawn. The OECD notes:

In reviewing workers' rights petitions, the GSP Subcommittee undertakes a thorough investigation in order to obtain a balanced view using information from a variety of sources. The Subcommittee looks in particular for evidence of progress in the country's legislation and in its practices, and relies on ILO Conventions and Recommendations as benchmarks for interpreting progress.⁴²

The OECD further notes that the pressure created by public exposure and scrutiny of labour practices in such reviews may have an impact on performance, even apart from the threat of actual sanctions through GSP withdrawal. According to the OECD as well, '[from] 1984 through 1995, 40 countries have been named in petitions citing labour rights abuses according to GSP law', with fewer than half these cases being pursued by the Subcommittee to the stage of a formal review.⁴³ According to Dufour, among the countries that have had their GSP status withdrawn by virtue of a recommendation of the Subcommittee are the Central African Republic, Chile, Liberia, Myanmar, Nicaragua, Paraguay, Romania and the Sudan.⁴⁴ A later study of the effects of labour conditionality in US GSP preferences, by Elliot, came to the conclusion that 'The US experience in applying worker rights conditionality to trade benefits under the GSP suggests that external pressure can be helpful in improving treatment of workers in developing countries and that linkage of trade and worker rights need not devolve into simple protectionism.'⁴⁵

In 1995, the European Union amended its GSP programme so as to condition the granting of a margin of preferentiality in excess of a base rate upon, *inter alia*, respect for certain core labour rights; the relevant EU regulations refer explicitly to the ILO Conventions concerning freedom of association and collective bargaining, as well as child labour. This provision came into force in 1998. In addition, GSP status may be withdrawn altogether where a country permits any form of slavery or the exportation of products made with prison labour.⁴⁶

NAFTA and the North American Agreement on Labor Cooperation

In the context of NAFTA, US concerns in particular about Mexican labour practices led to the negotiation of a parallel accord on labour standards. Mexican labour laws do provide for most of the workers' rights contained in the ILO Conventions, but are widely believed to be un- or under-enforced.⁴⁷ Some proponents of NAFTA attribute this un- or under-enforcement to a shortage of labour inspectors.⁴⁸ However, the problem is likely much more deeply rooted, reflecting widespread corruption of politicians or public officials (especially at the regional or local level) and the use of intimidation and violence to keep workers from organizing in some parts of Mexico, such as the economically important *Maquiladora* zone. Furthermore, as Morici suggests, there may be collusion between the Mexican government and the official Mexican trade union movement to keep workers unorganized in the *Maquiladoras* so as to attract more foreign investment into Mexico.⁴⁹

The North American Agreement on Labor Cooperation (NAALC), usually referred to as the NAFTA Labor Side-Agreement, has two major components. The first is a hard legal obligation on the part of NAFTA Parties to enforce their own domestic labour laws adequately, particularly with respect to occupational safety and health, child labour, and minimum wage standards (Articles 3, 27). This obligation may be described as hard, in that a binding dispute settlement process may, where there is 'persistent failure' to enforce these labour laws, lead to a monetary judgment against the offending Party. In the case of a successful action against Canada, the monetary judgment can be enforced through an order of a Canadian domestic court; in the case of the USA and Mexico, it may be enforced through withdrawal of concessions under NAFTA. Another substantive obligation of the Side-Agreement is that 'each Party shall ensure that its labor laws and regulations provide for high labor standards consistent with high quality and productivity workforces, and shall continue to strive to improve those standards in that light' (Article 2). However, this obligation is hedged by the qualifying language that it is subject to 'the right of each Party to establish its own domestic labor standards', and—unlike the Article 3 obligation—no means of legal enforcement is contemplated for this obligation.

A Commission for Labor Cooperation is provided for, comprised of a Council and a Secretariat (Article 8), charged with, *inter alia*, promoting the collection and dissemination of data on labour issues, the production and publication of reports and studies, and the facilitation of consultation between the Parties on labour matters (Article 10). Article 11 provides a list of specific matters regarding which the Council 'shall promote cooperative activities between the Parties, as appropriate'. NAALC Annex 1 states that the Parties are 'committed to promote' a range of labour principles, including freedom of association and the right to organize, prohibition of forced labour, 'labor protections for children and young persons', and elimination of employment discrimination (the commitment to these and the other principles is subject to the important qualification that no minimum standards are being set for domestic law).

The primary avenue for complaints by interested Parties that a NAFTA Party is not enforcing its labour laws is through the National Administrative Office (NAO) of one of the other two NAFTA Parties. Thus, the US NAO typically receives complaints about underenforcement or non-enforcement of Mexican labour law. The NAO may accept or reject the complaint for review, and in the case of rejection must furnish written reasons to the complainant. Such a review produces a report, which may or may not recommend Ministerial Consultations. The sole avenue through which enforcement action may eventually be taken against a NAFTA Party is, however, through panel dispute settlement, and two of the three NAFTA Parties must consent to the striking of a panel. To date, various complaints have been accepted for review by NAOs, with Mexico named as the offending Party in all but one (which complained of US practices). Several of the submissions have resulted in Ministerial Consultations. In almost all cases, the complaints have concerned failure to enforce the right of free association and the right to organize. An important exception is a recent complaint concerning pregnancy-based discrimination by *Maquiladora* employers (submission US 9701). It has been claimed that the publicity effects of these complaints, and the reports and consultations in which they have resulted, have led to some positive adjustments in labour law enforcement;⁵⁰ however, the Mexican and in one case the US authorities have not surprisingly left unacknowledged the role of the NAALC in altering their dispositions on the matters at

issue. Many of the cases have involved antiunion activity by major multinational corporations or their local affiliates, including General Electric, Honeywell and Sprint: in these kinds of cases, it has been difficult to ascertain whether the NAO report had a positive impact on the practices of the corporation, even if it did not result in the government itself improving its enforcement of labour laws. In no case has a matter been taken to an arbitral panel.

In the ITSPSA case, workers in Mexico were subject to various kinds of intimidation and harassment surrounding a vote on the certification of an independent union (i.e. a different union from the official state union). The Ministerial Consultations actually resulted in a Ministerial Agreement between the USA and Mexico that Mexico would promote secret ballots and 'neutral' voting places (where workers could not be subject to intimidation as in the workplace itself). However, Mexico does not appear to have honoured this Agreement, and a complaint by US unions to the US Department of Labor concerning Mexico's failure to comply with the Agreement was dismissed in 2001. Based on these and other developments from the inception of NAFTA up to 2003, Compa presents a pessimistic overall assessment of the results from the NAFTA Labor Side-Agreement:

The NAALC has failed to achieve its high purpose. Apparently more eager to maintain diplomatic niceties rather than tackle and solve worker rights violations, the three governments have demonstrated a lack of will to hold one another to their NAALC commitments. Some investigations and reports have led to significant findings and recommendations, but they have not produced change. Ministerial consultations resulted only in research projects and trilateral conferences. Although these are often informative, they have not directly addressed or resolved worker rights violations documented and proven in NAALC proceedings.⁵¹

Because of the role of the provinces in labour matters under the Canadian constitution, Canada's full participation in the NAALC process was subject to a minimum threshold of voluntary provincial involvement. In 1997, the threshold specified in the NAALC was crossed, with the federal government and three provinces (Manitoba, Quebec and Alberta) having decided to participate. Finally, there is an additional mechanism in the NAALC, as yet unused, which contemplates the striking of Evaluation Committees of Experts, which may be requested by a Party under certain conditions: a Committee may deal with 'technical standards' in eight areas, which include, *inter alia*, prohibition of forced labour, labour protection for children and young persons, and elimination of employment discrimination.

Bilateral agreements

Labour rights provisions have been incorporated into at least two recent bilateral trade agreements, the US-Jordan Free Trade Agreement and the US-Cambodia Textile Trade Agreement. In the case of the US-Jordan Agreement, the provisions (unlike NAFTA) are incorporated in the main treaty text, not a side-agreement. Moreover, the obligations in question are subject to the general dispute settlement procedures of the Agreement.

Nevertheless, by an exchange of letters, the USA and Jordan have agreed that disputes concerning the labour provisions of the Agreement shall not result in the imposition of sanctions. The provisions in question are very similar to those in the NAALC. Thus, 'a Party shall not fail to effectively enforce its labor laws in a manner reflecting trade'. In addition, 'each Party shall strive to ensure that it does not waive or otherwise derogate from, or offer to waive or otherwise derogate from [domestic labor laws] as an encouragement for trade with the other Party'. The rather odd language 'in a manner reflecting trade' appears to be some sort of qualifier, suggesting that labour obligations only apply in sectors or situations where there is actual trade between the USA and Jordan.

The relevant provision in the US-Cambodia Agreement is different. It reads as follows: 'Cambodia shall support the implementation of a program to improve the working conditions in the textile and apparel sector, including internationally recognized core labor standards, through the application of Cambodian labor law... The Government of the United States will make a determination...whether working conditions in the Cambodian textile and apparel sector substantially comply with such labor law and standards.' If the USA determines that the Cambodian garment industry is in substantial compliance, it could increase Cambodia's textile quota by up to 14% per year, above the standard 6% quota increase.⁵²

HUMAN RIGHTS BEYOND LABOUR RIGHTS⁵³

In the last 50 years, the body of international human rights law has achieved a moral plateau rarely associated with any other area of international law. In fact, the power and righteousness of human rights is so great that virtually every modern cause has sought to cloak itself in the language of human rights. Louis Henkin, a leading academic, has described ours as the 'age of rights' and human rights as the 'only political-moral idea that has received universal acceptance'.⁵⁴ Philip Alston, another prominent scholar, has argued that the 'characterization of a specific goal as a human right elevates it above the rank and file of competing societal goals, gives it a degree of immunity from challenge, and generally endows it with an aura of timelessness, absoluteness and universal validity'. Founded on the Universal Declaration of Human Rights (UDHR), which Henry Steiner has described as the 'spiritual parent' of other human rights treaties, human rights law is now an indispensable part of the international landscape.

There is today an impressive catalogue of universal and regional human rights treaties and institutions. Whether their mandate is simply to monitor, encourage compliance with or enforce human rights, this maze of norms and institutions has sharply contracted the traditional international legal concept of state sovereignty, which once granted states impunity with respect to internal misconduct. Human rights do not, of course, negate the sovereignty of states, although they constrain it in important ways. International law does not replace national law; rather, international law instructs sovereign states on internationally accepted human rights and, for the most part, leaves it to states to implement those norms domestically.

Human rights law has modified international law in fundamental ways. Since the Second World War, it has become an uncontested principle of international law that a

state's treatment of its own citizens is not solely a matter of domestic jurisdiction. It is true, of course, that human rights is not the only doctrine of international law that constrains the power of the state. In recent decades, the forces of globalization and the unparalleled predominance of global capitalism in the political and economic choices of states have further undermined the authority of the sovereign state. But ideas and values implicit in human rights have added an entirely new dimension to our understanding of the concept of state sovereignty.

Whereas previously the state, or the monarch representing it, was the absolute sovereign, human rights norms now vest sovereignty in the people. This concept of sovereignty, which is expressed in the Universal Declaration, the International Covenant on Civil and Political Rights (ICCPR) and the International Covenant on Economic, Social and Cultural Rights (ICESCR), is termed popular sovereignty.

Human rights as customary international law

Constitutionally, human rights are based on the United Nations Charter. UN treaty instruments and bodies that address human rights issues are created pursuant to the UN Charter. The Charter specifically charges the UN to promote the entire gamut of human rights. It asks the UN to promote 'higher standards of living, full employment, and conditions of economic and social progress and development' and 'universal respect for, and observance of, human rights and fundamental freedoms for all without distinction as to race, sex, language, or religion'. To underline the seriousness with which it took human rights, the UN asked the Economic and Social Council to 'set up commissions', including those 'for the promotion of human rights'. The Charter further requires Member States to 'take joint and separate action' in cooperation with the UN to promote human rights.

The UN Charter does not resolve the question of hierarchy of law, or, put differently, whether human rights law has primacy over other domains of international law. However, the preamble reaffirms 'faith in fundamental human rights, in the dignity and worth of the human person, in the equal rights of men and women and of nations large and small'. The promotion and protection of human rights is thus one of the 'ends' or purposes for the establishment of the United Nations. The Charter states that one of the 'purposes' of the UN is to 'achieve international cooperation in solving international problems of an economic, social, cultural, or humanitarian character, and in promoting and encouraging respect for human rights and fundamental freedoms for all without distinction as to race, sex, language, or religion'. Although the term 'human rights' appears in scattered places in the UN Charter, and is terse and even cryptic, there can be no argument that it is mentioned in vital contexts, a fact that underlines the centrality of human rights to the UN system.

In international law, the status of a rule is determined by its source as law. There are four recognized sources of international law: international conventions or agreements; custom; general principles of law common to the major legal systems of the world; and the judicial decisions and teachings of distinguished writers. Of these, the most relevant for our discussion are the first two, namely treaty law and customary international law. The status of human rights in international law, therefore, is determined by its location within the sources of international law. All human rights norms do not have the same

status in international law. While some may be located in customary international law, most are codified in human rights treaties.

Unlike treaty law, which is based on the consent of states, customary international law binds all states. Customary international law 'results from a general and consistent practice of states followed by them out of a sense of legal obligation'. Thus customary international law binds all states without exception and irrespective of their consent. In contrast, international treaty law only binds those states which have given their express consent to the treaty or agreement in question. For human rights, this distinction is critical because the location of a human rights norm in either source changes its status in international law and could constitute the difference between an automatically binding obligation and a voluntary commitment. Customary international law, unlike treaty law, must be obeyed by states, their wishes notwithstanding.

The scope and content of the customary international law of human rights, as indeed of all customary law, is a work in progress. While there are certain human rights whose status as custom is generally agreed upon, that list is not necessarily complete or closed. But it is clear from existent international law that a 'state violates international law if, as a matter of state policy, it practices, encourages or condones' the following conduct: genocide; slavery or slave trade; the murder or causing the disappearance of individuals; torture or other cruel, inhuman or degrading treatment or punishment; prolonged arbitrary detention; systematic racial discrimination such as apartheid; and consistent patterns of gross violations of internationally recognized human rights. The last category, that of 'consistent violations of internationally recognized human rights', has a very broad scope and includes the human rights protected in all the major universal human rights treaties. Such violations infringe customary international law if there is a 'consistent pattern of gross violations' as a matter of state policy.

Two vitally important concepts in understanding the status of human rights in international law are those of *jus cogens* and obligations *erga omnes*. Rules of *jus cogens*, or pre-emptory norms of general international law, describe international obligations from which derogation is not permitted under any circumstances, even in cases of emergency. *Jus cogens* has been defined by the 1969 Vienna Convention on the Law of Treaties as 'accepted and recognized by the international community of states as a whole as a norm from which no derogation is permitted and which can be modified only by a subsequent norm of general international law having the same character'.⁵⁵ Rules of *jus cogens* trump all other rules of international law, and are therefore in the first rank in the hierarchy of the law of nations.

The Vienna Convention anticipates the emergence of new rules of *jus cogens* in the future, a point that underscores the fact that *jus cogens* is an evolving concept, and that the substance and nature of its rules change with the progress and development of international law and morality. Although there is no list, as such, of rules that constitute *jus cogens*, prohibitions against the slave trade or slavery, genocide, piracy and violations of human rights are regarded as pre-emptory norms of international law or *jus cogens*. Additionally, these practices give rise to obligations *erga omnes*, that is they give all states an interest in their prohibition. This point was emphasized by the International Court of Justice in *Barcelona Traction, Light and Power Company, Ltd.* In that case, the court's opinion read, in part:

[A]n essential distinction should be made between the obligations of a State towards the international community as a whole, and those arising vis-à-vis another state in the field of diplomatic protection. By their very nature the former concern all States. In view of the importance of the rights involved, all States can be held to have a legal interest in their protection; they are obligations *erga omnes*. Such obligations derive, for example, in contemporary international law, from the outlawing of acts of aggression, and of genocide, as also from the principles and rules concerning the basic rights of the human person, including protection from slavery and racial discrimination. Some of the corresponding rights have entered into the body of general international law...; others are conferred by international instruments of a universal or quasi-universal character.⁵⁶

Views from distinguished international law institutions and scholars give much of international human rights a customary legal character, and some of it the status of *jus cogens*. The position that human rights are obligations *erga omnes* is increasingly gaining ground. In particular, the International Law Institute has taken one of the most vigorous positions on this issue.⁵⁷ It wrote the following in 1989:

This international obligation [to respect human rights]...is *erga omnes*; it is incumbent on every State in relation to the international community as a whole, and every State has a legal interest in the protection of human rights. This obligation further implies a duty of solidarity among all States to ensure as rapidly as possible the effective protection of human rights throughout the world.

International law is increasingly treating fundamental basic human rights as a part of customary international law. First, the Universal Declaration on Human Rights is now deemed to possess a normative, obligatory character that gives at least portions of it the status of customary international law. Although not a treaty, and therefore not binding, the UDHR is so widely accepted by governments that they invoke it, refer to it, and use it as a guide for fashioning constitutional and other laws as well as for formulating both domestic and foreign policy. Its acceptance by states has been so total and universal that it may now be said to meet the standard of *opinio juris sive necessitatis*, a practice that states follow out of a sense of legal obligation. Mary Ann Glendon has written that the UDHR 'is already showing signs of having achieved the status of holy writ'.⁵⁸

A large portion of the body of human rights law has acquired this obligatory character in international law. The universal acceptance in principle of human rights by states of all political stripes and their invocation at the domestic and international levels, coupled with the active involvement of virtually all states, individually and collectively, to promote and protect human rights through the United Nations and regional human rights systems in Africa, the Americas and Europe, has led to a certain belief that states have assumed human rights obligations beyond the mere acceptance of treaty law.

The status of economic, social and cultural rights

The entire human rights corpus is based on the UDHR, the ICCPR and the ICESCR, the trio of documents referred to as the International Bill of Human Rights. In its 30 Articles, the UDHR proclaims two broad categories of rights: these are, on the one hand, civil and political rights, and, on the other, economic, social and cultural rights. Although for political and historical reasons the rights in the ICCPR have received more recognition than those in the ICESCR, the UDHR treats the two sets of rights as indivisible, interrelated and interdependent. It is, however, a fact that civil and political rights are more developed jurisprudentially than economic, social and cultural rights. Critically, however, trade policies and globalization affect economic, social and cultural rights, in particular. Hence the necessity of safeguarding these rights within the context of the GATT/WTO regime.

The civil and political rights that are provided for in Articles 3–21 include the rights to life, liberty and the security of the person; the prohibition against slavery, torture and cruel, inhuman or degrading treatment; freedom from arbitrary arrest and detention; the presumption of innocence and the right to a fair trial; and the freedom of speech, thought, religion, belief, conscience, assembly, movement and association. In Articles 22–7, the UDHR provides for economic, social and cultural rights. These rights include the right to social security, the right to work, the right to equal pay for equal work, the right to education, the right to rest and leisure, the right to security in the event of disability and unemployment, the right to health, and the right to take part in the cultural life of the community. The UDHR makes no distinction and creates no hierarchy among the rights that it promulgates.

Briefly, the schism in human rights is a product of the bipolar ideological confrontation between the East and the West immediately following the Second World War. While the Soviet Union and its socialist allies posed as champions of economic and social rights, the West touted the primacy of civil and political rights. Soon after the adoption of the UDHR in 1948, positions hardened and eventually the UN decided to develop two separate covenants for the two sets of rights, each with different institutional and enforcement mechanisms and strategies. In a reflection of this ideological bias, many governments and human rights groups in the West became unsympathetic and even hostile to the idea of economic and social rights as ‘rights’. It was argued unsuccessfully by these opponents that economic and social rights were not rights but ‘equities’ or ‘concerns’. Furthermore, it was argued that, unlike civil and political rights, these rights were not justiciable in courts of law.

In reality, the opposition to economic and social rights in the West reflects the ideological divisions in the world that characterized the Cold War era, with social and economic rights being identified, misleadingly, with forms of collectivism and redistribution incompatible with individual liberty and market economies. One result of this fear was the creation within the ICCPR of the Human Rights Committee as its oversight body and the denial of a similar body for the supervision of the implementation of the ICESCR. In 1987, the Committee on Economic, Social and Cultural Rights was specially established by the UN Economic and Social Council to monitor the ICESCR. Importantly, while the ICCPR requires states to realize their obligations under it

immediately, the ICESCR resorts to the language of gradualism, asking each state to 'take steps, individually and through international assistance and cooperation, especially economic and technical, to the maximum extent of its available resources, with a view to realizing progressively the full realization' of the rights in the Covenant. This vague and permissive language has only served as an excuse for governments that are all too eager to avoid their obligations under the ICESCR.

It has been part of UN doctrine that the entire family of rights—civil and political as well as economic, social and cultural—are indivisible. The conceptual interdependence of the two sets of rights is beyond dispute. At the UN World Conference on Human Rights held in Vienna in 1993, over 180 countries affirmed that all human rights are 'universal, indivisible and interdependent and inter-related'. The Vienna Declaration and Programme of Action goes on to assert that 'while the significance of national and regional particularities and various historical, cultural and religious backgrounds must be borne in mind, it is the duty of states regardless of their political, economic and cultural systems to promote all human rights and fundamental freedoms'. Considering the opposition of some states to the notion of universality, the strength and clarity of this wording is significant.

The interrelation of rights can be illustrated by a few examples. The right to form trade unions, for example, is guaranteed in the ICESCR, while the complementary rights to association and assembly are provided for in the ICC PR. The prohibition against non-discrimination in relation to the provision of and access to education can be derived from Article 2 of the ICESCR and Article 26 of the ICCPR. Interpretations of both sets of rights almost always blur their supposed distinctions. In any event, it is now widely recognized and accepted that a society that denies basic social and economic rights cannot be stable and democratic and respect civil and political rights, and vice versa. In his magisterial work *Development as Freedom*, the philosopher and economist Amartya Sen has shown how economic development and human freedom are mutually independent.⁵⁹ Sen vigorously challenges the view that human rights are 'luxury goods' that poor countries cannot afford until they have achieved a certain level of prosperity; instead, the improvement of economic welfare depends upon respect for rights in many and complex ways. More recently, Alan Sykes has noted that generally speaking there is a positive correlation between a country's openness to trade and its tendency to respect human rights. This puts into question the idea that poor countries should or must sacrifice human rights—or postpone their realization—for the sake of openness to trade, and an outward-oriented development strategy.⁶⁰

Human rights and WTO law

We now proceed to consider a number of areas where, beyond the labour context (in whole or in part), international human rights law is relevant to the interpretation and evolution of international trade norms, focusing on the WTO.

Government procurement

Government procurement policies are important in the calculation of human rights. There is a long-standing practice of government procurement conditionalities related to rights or

other social objectives in a broad range of countries. Christopher McCrudden, a leading authority on the subject, has written the following:

The use of public procurement to put such policies into effect has a long history, most notably in pursuit of racial and gender equality the Canadian government has introduced preferential award of federal contracts to Aboriginal peoples. The South African government currently uses a system of 'targeted' procurement as part of its policy on social integration. One of the earliest International Labour Organization conventions (No. 94) requires a linkage between certain fair labour standards and government contracts, and this has been widely ratified. In addition, several European countries have various different types of policies for achieving women's equality attached as requirements in the award of public procurement contracts.⁶¹

There are set-asides for minority businesses in many US state and federal procurement laws.

The WTO Agreement on Government Procurement (GPA) provides for National and MFN treatment when foreign suppliers bid for government procurement contracts. It also provides that qualifications that are not essential to ensure the ability to perform the contract may not be imposed on suppliers. While on the face of it the MFN requirement prevents the exclusion of bidders on the grounds that the government of their country of origin violates human rights, Article VIII(b) of the GPA seems to allow the imposition of qualifications based on human rights performance. It appears, however, that the qualifications must be made a condition of the contract itself. That is, they must deal with the practices of the firm in question, and not the government of its country of origin.

The government procurement policies of the State of Massachusetts in the United States recently gave prominence to procurement disputes. The state's procurement laws require that suppliers have no dealings with Myanmar (Burma). Burma's labour rights record has been the subject of censure by a resolution of virtually the entire membership of the ILO. Burma is not a party to the GPA but the European Union was concerned that the Massachusetts stipulation would prevent European companies doing business with Burma from bidding on government contracts in Massachusetts. The EU then commenced dispute settlement proceedings against the United States at the WTO. Those proceedings were only suspended when the United States Court of Appeals upheld a lower court judgment which found constitutional defects in the Massachusetts statute. The US Supreme Court found the Massachusetts law unconstitutional, thereby rendering further proceedings at the WTO moot.

Even if the Massachusetts law violated some provisions of the GPA, it might still have been justified under the exceptions provision of the Agreement, which allows measures that are, *inter alia*, necessary for reasons of public order. This concept, which is based on the idea of *ordre publique* in private international law, relates to the fundamental public policies of a society, and not merely order in the sense of civil peace and public security. McCrudden has suggested that public order should be interpreted to include the emerging international public policy of human rights.

The GPA will surely be subject to review by the Membership of the WTO in the coming years. In addition, procurement rules with respect to services are being negotiated. These will provide opportunities to further develop the position that human rights-based procurement conditions are consistent with WTO law. It is anomalous and unjustifiable that WTO regulations should force a country to provide better treatment to foreign bidders than to domestic enterprises, prohibiting it from imposing on the former human rights-based requirements that it routinely imposes on the latter.

The trade policy review mechanism

The Marrakesh Agreement Establishing the World Trade Organization codifies a longstanding GATT practice of periodic review of trade policies of Member countries. The review, which is done by the WTO Secretariat on the basis of information provided by the WTO Member, examines policies and their impact. A government statement of its policies and the Secretariat report are then discussed at a WTO meeting. The 'review mechanism enables the regular appreciation and evaluation of the full range of individual Members' trade policies and practices and their impact on the multilateral trading system'. Regrettably, these policies and practices are not evaluated as to their impact on human rights or compliance with other international commitments. Democracy, the rule of law, human rights and the protection of labour rights have generally been overlooked, although there recently have been references to 'social stability'.

The perspective from which the policies of Members are examined needs revision. Currently, the only issue considered in these examinations is whether a Member's policies and practices support free trade. It is clear, however, that the perspective through which a Member's policies are reviewed should not be that of free trade alone but rather that of the 'functioning of the multilateral trading system'. As stated in the preamble to the WTO Agreement, the objectives of this system are not free trade as such but, *inter alia*, 'ensuring full employment and a large and steadily growing volume of real income and effective demand' and 'allowing for the optimal use of the world's resources in accordance with the objective of sustainable development'. International organizations concerned with human rights, including labour rights and development, should participate in the review process at the WTO. They should be prepared to respond when the reviews do not appropriately reflect the social and developmental goals of the multilateral trading system.

The skills and expertise of the WTO Secretariat responsible for research and report writing must be addressed if the Trade Policy Review Mechanism (TPRM) exercises are to properly examine the impact of trade policy on these other issues. Do the people who evaluate country reports have the requisite expertise in democracy and the rule of law, and the protection of labour rights? The TPRM process can draw on any 'information available to it' instead of simply relying on data provided by governments. This would allow the use of information made available by NGOs and other international organizations such as the ILO. It is important to establish guidelines for the provision of information from independent sources relating to trade and its impact on human rights.

Trade-related intellectual property rights

Human rights norms require some protection of an author's control over and ability to obtain compensation for their work or invention. This is reflected in Article 15 of the UN Covenant on Economic, Social and Cultural Rights, as noted in a 2001 Statement by the UN Committee on Economic, Social and Cultural Rights:

Article 15.1 (c) of the Covenant, together with article 27 of the Universal Declaration on Human Rights, requires the protection of the moral and material interests of authors in their works. The Committee considers that these intellectual property rights must be balanced with the right to take part in cultural life and to enjoy the benefits of scientific progress and its applications. Moreover, article 15.2 of the Covenant requires that States parties undertake steps necessary for the conservation, development and diffusion of science and culture. To be consistent with a human rights-based approach, intellectual property regimes should be conducive to realizing these goals. The Committee therefore encourages the development of intellectual property systems and the use of intellectual property rights in a balanced manner that meets the objective of providing protection for the moral and material interests of authors, and at the same time promotes the enjoyment of these and other human rights.⁶²

This notion of a balance between intellectual property rights and other human rights may have interpretive significance in applying the various exceptions and limitations provisions of TRIPs, including exceptions that relate to educational and other 'fair use' of copyrighted material; it should be noted that in the WTO TRIPs Agreement itself there are statements about the importance of applying the Agreement with a view to an appropriate balance between the interests of creators and users of intellectual property (see Chapter 13 of this book).

In the debate concerning the patent provisions of TRIPs and access to essential medicines (see Chapter 13 for a brief account), the right to life and health, *inter alia*, in the Economic, Social and Political Covenant became relevant. A 2002 resolution of the UN Human Rights Commission called upon states '[t]o ensure that their actions as members of international organizations take due account of the right of everyone to the enjoyment of the highest attainable standard of physical and mental health and that the application of international agreements is supportive of public health policies which promote broad access to safe, effective and affordable preventive, curative or palliative pharmaceuticals and medical technologies'. In this regard, the Commission resolution welcomed the achievement at Doha of the Declaration on TRIPs and Public Health, requiring that TRIPs provisions on patents be interpreted in such a manner as to facilitate access to essential medicines in poor countries.⁶³

With respect to a different issue, one currently under discussion within the WTO TRIPs Council, the protection of indigenous peoples' traditional knowledge (for example concerning the properties of plants the genetic resources of which developed-country multinationals have often sought to exploit through patenting; see Chapter 13), the UN

Committee on Economic, Social and Cultural Rights has observed: 'in adopting intellectual property regimes, States and other actors must give particular attention at the national and international levels to the adequate protection of the human rights of disadvantaged and marginalized individuals and groups, such as indigenous peoples'.⁶⁴

Services

The UN human rights institutions have expressed concern about the human rights effects of services liberalization commitments under GATS, which constrain domestic regulatory autonomy in areas such as healthcare, provision of basic goods (e.g. water) and education. Thus, the High Commissioner for Human Rights has emphasized the importance of an *ex ante* evaluation of the effects of such commitments, including in human rights terms:

The High Commissioner highlights the voluntary nature of commitments to liberalize trade in services and stresses the need to make commitments on the basis of sound empirical evidence. To this end, the High Commissioner encourages States to undertake public, independent and transparent human rights assessments of the impact of liberalization policies—both past policies and future options—on the enjoyment of human rights, through a participatory and consultative process with concerned individuals and groups. The High Commissioner encourages States to use these assessments as the basis for WTO negotiations on progressive liberalization.⁶⁵

CONCLUSION

Increasingly, discussion in the international policy community on the relationship between liberal trade and labour rights has focused on the issue of compliance with core universal rights, which have a close relationship to the rights contained in general international human rights instruments such as the UN Declaration and the UN Covenant on Civil and Political Rights. Competitiveness-based claims about 'social dumping' have become less prominent, and the notion that the objective should be to obtain some kind of 'level playing field' between developed and developing countries is now less and less heard, even from labour rights advocates on the left of the political spectrum. In sum, contrary to the picture still painted by some free traders, the claim for a trade and labour rights link is not some fanatical or protectionist adventure to attempt harmonization of conditions of work across the world, regardless of different economic and cultural conditions. The UN human rights institutions have increasingly addressed themselves to the challenge of ensuring that trade liberalization commitments enhance rather than constrain the ability of states, and particularly developing countries, to realize, in particular, economic and social rights, such as the right to health.

18

Trade and competition policy

THE BASIC ECONOMIC FUNCTION OF COMPETITION LAWS

In exploring the relationship between trade policy and competition policy, it is useful at the outset to review briefly the underlying economic theory on the welfare implications of animate both trade policy and competition policy can be clearly kept in focus.¹ The concept of ‘market power’ or ‘monopoly power’—these terms will be used interchangeably—monopoly, so that similarities and differences in the welfare frameworks that conventionally drives most aspects of modern competition laws. Whether one is concerned with a single firm monopoly, competitors colluding with a view to acting as if they were a monopoly, a firm seeking to predate on existing or potential rivals in order to exclude them from the market, restrictive vertical distribution arrangements, or a merger that may lead to a dominant position, in every case the focus is on the social welfare implications of excessive market power. In economic terms, market power basically means the ability to increase prices profitably above (or reduce non-price dimensions of competition below) competitive levels by a non-trivial amount for an extended period of time. In order to establish whether any of the foregoing arrangements involve excessive market power, it is obviously necessary to define one or more relevant product and geographic markets in which the firms in question are alleged to be exercising market power, which largely turns on demand-side and supply-side substitution possibilities—an exercise that is central and problematic in most antitrust cases.² Whether market power in a market, once defined, can in fact be effectively exercised turns on factors such as whether incumbents’ market shares indicate a likelihood of unilateral abuse of dominance or explicit or tacit collusion and the scale of barriers to entry (including regulatory barriers, trade barriers, incumbents’ intellectual property rights, minimum viable scale of entry and the extent of entrants’ sunk costs, access to critical inputs and distribution channels, and customers’ switching costs).

The traditional economic analysis of monopoly has a structural and static focus. It examines the welfare implications of a firm *being* a monopolist. Although most laws relating to monopolization or abuse of dominant position deal with *conduct* entailed in attempting to acquire, defend or enlarge a monopoly position, the static analysis provides the foundation for legal concerns that have a more dynamic or conduct-oriented focus. Thus, we begin with this conventional static analysis, which is shown in Figure 18.1.

In a ‘perfectly competitive’ market, firms would price at PC (where the marginal cost curve intersects the industry demand curve), and would produce QC of output. Aside from transitory effects, there are no ‘economic profits’ to be made. The monopolist, in contrast, will maximize its profits by restricting output to QM—the point at which its marginal cost and marginal revenue curves intersect.³ It therefore prices at PM.⁴

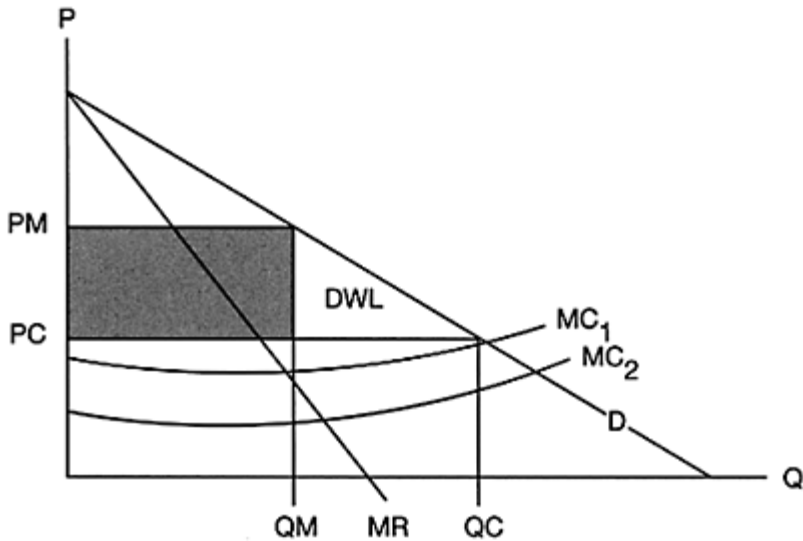


Figure 18.1 Welfare effects of monopoly.

As can be observed from Figure 18.1, there are several undesirable consequences of monopoly relative to a competitive market. First, quantity is lower (by $QC-QM$). Second, price is higher (by $PM-PC$). Third, consumers on the demand curve between PC and PM are priced out of the market even though the resource costs entailed in serving them (as represented by MC_1) are lower than the prices that they are willing to pay. Compelling them to reallocate their expenditures to less preferred forms of consumption creates the so-called 'dead-weight-loss' triangle designated as DWL in the diagram (allocative inefficiency). Fourth, consumers who remain in the market (i.e. those consumers on the demand curve above PM) are required to transfer part of the 'consumer surplus' that they would have realized under competitive conditions (with price at PC) to the monopolist (as reflected in the hatched rectangle). Although such wealth transfers in themselves have purely distributional effects and are not a misallocation of resources, political opposition to monopolies often focuses on this factor. Moreover, it may often be the case that the lure of monopoly profits will induce socially wasteful investments in rent-seeking activities, rendering at least part of the rectangle indirectly an additional measure of resource misallocation.⁵ Finally, some lines of objection to monopoly are non-economic in nature, such as democratic concerns that large concentrations of economic power carry the potential for undue political influence.⁶

The model of monopoly depicted in Figure 18.1 assumes a single monopoly price. However, a monopolist may be able to do even better than this if it is able to price discriminate by raising the price to highly inelastic customers on the demand curve above PM and/or lowering the price to more elastic customers on the demand curve between PM and PC . At the limit, a perfectly discriminating monopolist would charge every consumer on the demand curve his or her reservation price and appropriate the entire

consumer surplus under the demand curve and above PC. While this strategy would exacerbate the wealth transfer implications of monopoly noted above, it would also raise the monopolist's output to the competitive level (QC) by ensuring that all consumers prepared to pay more than the resource costs of producing a unit of output are in fact served, thus eliminating the dead-weight-loss triangle (or allocative inefficiency). In the real world, however, perfect price discrimination is almost never feasible because it would entail a monopolist having both perfect information about each customer's reservation price (i.e. elasticity of demand) and the ability to prevent arbitrage between low-price and high-price purchasers. Thus, one is more likely to observe attempts to segment customers into several broad groups (e.g. business and leisure travellers, adult and children cinema-goers, etc.), who are charged different prices reflecting general differences in their elasticities of demand. In such cases, it is not possible, as a matter of *a priori* analysis, to deduce whether total industry output is likely to rise or fall relative to the single monopoly price scenario (although typically it will rise).⁷

There is an important additional implication of monopoly to be noted from Figure 18.1. Suppose that in moving from a competitive to a monopolized industry the monopolist is able to reduce its cost of production from MC1 to MC2 through various economies of scale and/or scope, thus releasing resources for more productive use elsewhere in the economy. Two opposing welfare (as opposed to distributional) effects result. The negative welfare (i.e. misallocation) implications of the dead-weight-loss associated with monopoly remain, but there are now also productive efficiency gains from the savings in resources. As Williamson demonstrated in a seminal article with respect to mergers, depending on the elasticity of demand (and therefore the size of the dead-weight-loss triangle), if monopoly results in a reduction in average costs in the order of 5–10%, the merger must give rise to price increases in excess of 20% (with an elasticity of -2) and in excess of 40% (with an elasticity of -0.5) for the net allocative effects to be negative.⁸ This raises difficult questions as to whether some form of efficiency defence should be available to firms achieving monopoly power.⁹ In effect, this would entail the adoption of a total welfare rather than consumer welfare criterion, i.e. maximization of the sum of producer and consumer surplus.

It should be noted that some analysts worry about the opposite phenomenon. Undisciplined by competition, a monopolist may be able to enjoy 'the quiet life' which, through excessive management perks and general organizational slack, results in its costs rising above or rates of innovation falling below the level which would prevail in a competitive market ('X or dynamic inefficiency'). Other commentators discount this possibility by arguing that even monopolists (or their shareholders) have an incentive to maximize rather than dissipate monopoly rents (although this may not be as likely in the case of state-owned monopolies where monitoring incentives are often weak).

An important point to emphasize from this brief review of the basic economics of monopoly is that economic concerns over the effects of monopoly (or market power) focus primarily on its adverse effects on consumers. Competition policy is thus primarily concerned with protecting *consumer welfare*, not preserving some given state of competition or number of competitors. Conceived of as consumer protection legislation, competition laws should not normally be encumbered with other policy objectives such as protecting small businesses, or industrial policy concerns such as promoting 'national champions', or democratic political objectives. This view of the purposes of competition

policy has now won wide though not unqualified acceptance among antitrust scholars and enforcement authorities in the United States, Canada, the EU and many other industrialized countries (while recognizing that this still leaves room for much debate as to the effects on consumer welfare of particular practices in particular cases). This has been an important advance over earlier and widely divergent understandings as to the purposes of competition policy. It also provides a normative framework consistent with liberal trade policy for assessing the global welfare effects of private restrictions on competition.

INTERNATIONAL DIMENSIONS OF COMPETITION LAWS

The nature of the concerns

The USA and Canada have possessed domestic competition laws for more than a century. For many other industrialized countries and the European Union, competition laws are a much more recent phenomenon (mostly adopted after the Second World War). About 50 Members of the WTO have no competition laws at all. In other cases, countries may have competition laws on the books but lack the institutional capacity to implement and administer an effective domestic competition law regime. Among Member countries with competition laws, there are significant substantive, institutional and procedural differences. These differences or divergences in domestic antitrust or competition regimes have led to increasing calls for harmonization or integration much like the impetus for harmonizing domestic intellectual property regimes that led to the Uruguay Round TRIPs Agreement.¹⁰ Dr Sylvia Ostry argues¹¹ that, as tariffs and other border measures have been eliminated or reduced, the new arena for international policy cooperation is moving beyond the border to domestic policies. The basic reason for this shift lies in changes in the extent and nature of the international linkages among countries, which have produced a new type of friction which she calls 'system friction'. Ostry argues that a globalizing world has a low tolerance for system divergence. In particular, different traditions of government involvement in domestic economies and different industrial organization traditions have rendered increasingly contentious public-private distinctions in international trade law where trade regimes have traditionally focused on governmentally induced impediments to trade but not private restrictions on competition (including foreign competition). This view often argues for broad international commitments to ensuring effective market access or contestability, whatever the source of existing constraints thereon.

In this chapter we ask how domestic competition policies (or their absence or the ineffective or selective enforcement of them) may improperly constrain international trade and investment.¹² It is now widely argued that as firms attempt to improve or maintain their competitive position in an increasingly more open economic environment, they may take actions aimed at effectively locking competing imports or foreign investors out of their domestic market.¹³ A dominant firm or a colluding group may engage in predatory behaviour, such as price cutting, to fend off the efforts of a foreign rival trying to get access to its market. Some forms of price discrimination such as loyalty bonuses, rebates and discounts accorded to local purchasers may deter them from dealing with

foreign firms. A group of firms may engage in horizontal exclusionary behaviour by collectively practising predatory pricing or by collectively boycotting distributors who deal with foreign firms seeking to gain market access or suppliers who deal with foreign firms trying to establish a presence. Import cartels may seek to exercise monopsony power against foreign suppliers. The operation of trade associations may also be anti-competitive if they provide a forum to organize industry cartels with exclusionary effects on foreign competitors or are used to discriminate against foreign-controlled domestic companies by limiting their rights to participate in association activities, including access to product or service certification regimes, thus impairing their competitiveness. Vertical restraints may also be a vehicle to impede market access and presence. If incumbent manufacturers have tied up all distributors or retailers through exclusive dealing arrangements or through full vertical integration, a foreign entrant will have to overcome barriers created by the larger amount of capital required and risks entailed in setting up its own distribution network. Alternatively, a producer which controls all distribution outlets may charge foreign rivals a higher price in order to allow access to the market, thus limiting their competitiveness. Global rationalization through mergers and acquisitions can promote monopoly, oligopoly or oligopsony in domestic markets. Strategic alliances, which are becoming increasingly common in high-technology sectors where research and development costs are often substantial, may be efficiency enhancing but may also provide a vehicle to segment markets or to achieve a dominant position.¹⁴ State-owned or protected monopolies may foreclose competitive foreign entry and distort competitive conditions in upstream or downstream competitive markets in which these domestic entities are also active. Firms given protected homemarket positions may be able to use their supracompetitive profits to engage in 'strategic' (predatory) dumping in export markets. Alternatively, monopolies or mergers leading to dominant positions may be permitted by domestic antitrust authorities if most of their output is sold in foreign markets where rents can be realized by supracompetitive prices at the expense of reductions in foreign consumer welfare; similarly, in the case of export cartels or domestic cartels that sell most of their output in foreign markets.

Past efforts at international coordination of domestic competition policies¹⁵

This section provides a brief historical review of efforts at international coordination of domestic competition policies.

Multilateral fora

In the 1940s, the precursor to the GATT—the Havana Charter and the International Trade Organization (ITO) that it contemplated—envisaged multilateral regulation and review of restrictive business practices (Chapter V). These provisions would have obliged the Members of the proposed ITO to take appropriate measures to prevent private commercial enterprises that had effective control of trade from restraining competition, limiting access to markets or fostering monopolistic control in international trade. Member nations would have been entitled to complain about prohibited restraints to the ITO. The ITO would have been authorized to investigate and to demand information in

the course of its investigation, and to recommend remedial action to the governments of Member nations. Upon finding a complaint valid, the ITO would have been required to publish its findings and request full reports from the offending Member State about the progress of its remedial measures. However, the Charter could not withstand opposition in the US Congress motivated by concerns over institutional incursions into US domestic political sovereignty.¹⁶

In 1953, the United States, Canada and others, through the Economic and Social Council of the United Nations, prepared a draft agreement envisaging the formation of an international coordinating agency which would receive, investigate and recommend remedial action relating to complaints about restrictive business practices in international trade. Five years later, at the insistence of Norway, the GATT struck a committee to study the extent to which, and how, the GATT should undertake to deal with such practices. These early attempts to reach international agreements yielded no practical results: differences in national policies at the time were too great to move beyond general recommendations.¹⁷

In 1980, the United Nations Conference on Trade and Development (UNCTAD) adopted a Code on Restrictive Business Practices.¹⁸ However, the Code takes the form of recommendations which lack binding legal force, and it has had negligible impact. Similarly, the UN Commission on Transnational Corporations has encountered severe difficulties in attracting legal endorsement by industrialized countries of a proposed Code of Conduct for TNCs, which would include provisions on restrictive business practices similar to those contained in the UNCTAD Code.¹⁹ In both cases, developing countries promoted provisions designed to control and regulate the conduct of multinational enterprises that were widely perceived in less-developed countries as abusive and rapacious, while developed countries sought to apply strong competition principles to state-owned as well as private enterprises. These differences in perspective resulted in often vague and largely exhortatory provisions.²⁰ The OECD Agreement on Restrictive Practices Affecting International Trade of 1986 (which has a lineage dating back to more modest OECD initiatives beginning in 1959) is endorsed by all OECD Members but imposes only modest obligations, i.e. Member States commit themselves to notifying other Member States where enforcement action is contemplated that may affect important interests of the latter and to providing an opportunity for consultations.²¹ Conciliation provisions, including use of the good offices of the OECD Committee on Competition Law and Policy, in the event of Members being unable to resolve conflicts, have rarely—if ever—been invoked.

An important recent development has been the incorporation of competition-related provisions in various GATT/WTO Agreements.²² For example:

- 1 The Agreement on Technical Barriers to Trade contains detailed rules regulating the adoption of technical regulations and conformity assessment procedures by non-governmental bodies to ensure that they are not more trade restrictive than necessary.
- 2 The Understanding on the Interpretation of Article XVII of the GATT provides for increased surveillance of state trading enterprises. In the recent *Canadian Wheat Board* case (discussed in the chapter on Trade in Agriculture), the Appellate Body, however, rejected an expansive reading of Article XVII as including disciplines of an anti-trust nature (abuse of market power), instead viewing Article XVII as a kind of *lex specialis* of standard GATT provisions on trade in goods.

- 3 The Agreement on Safeguards requires Member States not to encourage or support the adoption or maintenance by public and private enterprises of non-governmental measures equivalent to voluntary export restraints.
- 4 The General Agreement on Trade in Services includes rules designed to ensure that monopolies and exclusive service suppliers do not nullify or impair obligations and commitments under the GATS, particularly where monopolies are also active in related competitive market segments. The 1997 Plurilateral Agreement on Basic Telecommunications Service incorporates regulatory principles. In the recent *Telmex* decision (discussed in the chapter on Trade in Services), the panel took a very broad view of the meaning of anti-competitive practices in the Reference Paper—arguably broader than that reflected in the domestic competition policies of many WTO Members, aimed at preventing anti-competitive practices by major suppliers (such as anti-competitive cross-subsidization, use of information obtained from competitors, and withholding technical and commercial information) and ensuring that the interconnection practices of such suppliers do not impede market access and meet nondiscrimination requirements.
- 5 The TRIPs Agreement permits the application of competition policy to abuse of intellectual property rights, including compulsory licensing.
- 6 The Agreement on Government Procurement regulates tendering procedures so as to ensure optimum effective international competition and addresses certain competition problems such as collusive tendering.
- 7 The TRIMs Agreement requires the WTO Council on Trade in Goods to consider whether the Agreement should be complemented with provisions on investment policy and competition policy.
- 8 At the first WTO Ministerial in December 1996 in Singapore, Members agreed to constitute a WTO working group to study more broadly the interaction between trade policy and competition policy.
- 9 The current Doha multilateral round of trade negotiations contemplates the possibility of multilateral negotiations on certain core principles of competition policy (discussed at the end of this chapter).

Bilateral agreements²³

The United States has negotiated formal, bilateral, competition-law enforcement protocols with Canada²⁴ (recently renegotiated and expanded),²⁵ Australia,²⁶ Germany²⁷ and the EU.²⁸ While important variations exist among these protocols, all are roughly patterned on a model of cooperation recommended by the OECD and now promoted by the US International Antitrust Enforcement Assistance Act of 1994.²⁹ They do not extend, for the most part, beyond requiring the Parties to notify each other of pending enforcement actions that may have an impact on important interests of the other Party, and to take account of the views of the latter in deciding whether to proceed.³⁰ The Canada—US Mutual Legal Assistance Treaty goes somewhat further in requiring assistance from the Parties in criminal matters (including criminal aspects of competition policy), extending to the use of formal investigative powers where suspected criminal conduct has occurred in one country but the Parties involved in the conduct reside in the

other country. The recent US-EU Protocol and the renegotiated Canada-US Agreement go somewhat further again in identifying a set of both negative and positive comity principles by which the Parties will be guided in deciding whether to forgo or exercise jurisdiction. Positive comity principles require a country to give sympathetic consideration to taking enforcement action against conduct on its territory that is allegedly causing harm to interests in another country. Negative comity principles, in contrast, require a country not to take enforcement action that may affect another country's nationals before consulting the latter country's government.

Regional trading blocs

Under Articles 81 and 82 of the Treaty of Rome, the EU has been successful in adopting a unified competition policy for all Member States with respect to transactions that have a Community dimension. Moreover, with respect to transactions covered by the Treaty, enforcement is unified in the European Commission, and adjudicative authority resides with the Court of First Instance and ultimately the European Court of Justice.³¹

NAFTA contains a short chapter (Chapter 15) on competition policy, monopolies and state enterprises. Under this chapter, each Party commits itself to adopting and maintaining measures to proscribe anti-competitive business conduct and to take appropriate action with respect thereto. Pursuant to this commitment, Mexico has enacted a comprehensive competition law. The Parties also commit themselves to cooperating on issues of competition-law enforcement policy, including mutual legal assistance, notification, consultation and exchange of information relating to the enforcement of competition laws in the free trade area. However, no Party may have recourse to dispute settlement under the Agreement in the foregoing matters. In the case of monopolies and state enterprises, each Party commits itself to ensuring that state-sanctioned monopolies will minimize or eliminate any nullification or impairment of benefits anticipated under the Agreement. Moreover, in the case of both privately owned and government-owned monopolies, they are committed to act solely in accordance with commercial considerations in the purchase or sale of goods or services in the relevant market, and to provide non-discriminatory treatment to investments of investors, and to goods and service providers, of another Party.³² With respect to services generally, Article 1201 contains several obligations aimed at ensuring that licensing and certification measures of Parties do not 'constitute an unnecessary barrier to trade'. The telecommunications chapter (Chapter 13) provides that where a monopolist competes in a segment of the market that is open to competition, a Party must ensure 'that the monopoly does not use its monopoly to engage in anticompetitive conduct', including discriminatory network access requirements. Under the intellectual property chapter (Chapter 17), Parties may limit the intellectual property rights they are otherwise obligated to recognize where licensing practices or conditions 'constitute abuses of intellectual property rights having an adverse effect on competition in the relevant market'. In the case of patents, compulsory licensing is explicitly contemplated as a potential remedy.

This brief historical sketch of efforts to date, either to harmonize domestic competition laws or to create some form of supranational review process for anti-competitive or restrictive business practices, suggests modest progress over the past four decades (with the notable exception of the European Union).

A FRAMEWORK FOR EVALUATING FUTURE INTERNATIONAL INITIATIVES³³

Introduction

A multiplicity of national competition policies in a world of significant and growing economic integration is costly. First, there are enforcement costs. These include the additional costs that antitrust authorities incur when investigating conduct in other jurisdictions, as well as the additional costs from attempting to enforce their orders extraterritorially. Enforcement costs also include the higher transaction costs that accrue to parties from complying with the laws of several jurisdictions. Pre-notification of mergers, for example, can become a substantial burden when many different laws require different information or entail different decision time-lines. These costs are becoming increasingly significant as more countries adopt merger review regimes.³⁴

A second source of costs results from the effect on substantive laws from the interaction of trade and competition policies. Countries may strategically distort antitrust policies in order to capture a larger share of the surplus in a supranational market even at the expense of reducing the overall surplus. An obvious example is the exemption for export cartels that exists in several laws, including those of Canada and the United States. Export cartels earn supracompetitive profits at the expense of foreign consumers, increasing domestic but harming global welfare. Thus, the basic premise of proponents of international harmonization of competition laws is that in a globalizing economy, divergent domestic competition laws impose major economic costs on firms that are active in international markets and are likely to entail distortions that reduce global economic welfare.

The central issue that this premise raises is why domestic *competition* laws (relative to other domestic laws) raise distortions that require special efforts at international harmonization. Divergent domestic laws and policies of a vast array of kinds entail essentially the same sort of problems for economic agents active in many different domestic markets. For example, firms trading into or investing in a foreign market are likely to face a need to comply with foreign laws and policies relating to taxation, health and safety laws, environmental regulation, labour laws, language laws, labelling laws, civil rights laws, etc. that diverge from the laws and policies that prevail in their home jurisdictions and in many other jurisdictions in which they may choose to trade or invest. Multiple compliance costs represent some kind of 'tax' on the international movement of goods, services, capital and people, yet there is not the same call for harmonization in other areas as there is with antitrust.

On the assumption that nation-states have chosen laws or policies that are in their own public interest, requiring them to abandon or modify these laws and to adopt internationally harmonized policies within these various domains is likely to reduce national welfare and to have an ambiguous impact on global welfare. Where public choice factors explain the adoption of domestic laws or policies that reduce both global and domestic welfare, international trade regimes may facilitate their mitigation through reciprocal tariff and related concessions that enlist export interests as a political counterweight to domestic import-sensitive interests and through the reciprocal adoption of a principle of non-discrimination (National Treatment) that precludes the adoption of

protectionist non-tariff barriers to trade that may otherwise undermine tariff concessions. This latter principle is often conceived of as a principle of negative integration (prohibiting countries from adopting certain policies), in contrast to a principle of positive integration (prescribing what domestic policies countries must adopt) that in part animates projects of deep political and economic integration (such as the EU).

Short of abandoning any notion of national sovereignty and assigning a very large role to supranational institutions (as in the EU) in negotiating and mandating harmonization of all these policy domains, costs from divergent policies in a number of areas are simply a fact of life in a world of nation-states. Requiring states to forego policy autonomy in these areas, beyond constraints on discriminatory application of domestic laws to foreigners, may entail significant domestic welfare losses.³⁵

Thus, the threshold question for those advocating antitrust harmonization is whether divergences in domestic competition laws and policies are different in some important qualitative or quantitative dimension from these other manifold domestic policy divergences. For example, why should a foreign firm trading into or investing in the USA have any greater right to complain that US antitrust law on horizontal or vertical arrangements is more stringent than in their home jurisdiction or in other jurisdictions in which they do business, relative to a variety of other distinctive domestic laws that they will have to comply with in the USA? Similarly, why should US firms seeking to trade and to invest in, for example, Japan have any greater right to complain of laxer Japanese competition laws on horizontal arrangements or vertical restraints than US firms face at home relative to a variety of other Japanese laws that impose distinctive requirements on firms doing business in Japan (e.g. large store laws, store opening hours, labelling laws, etc.)?

In the balance of this chapter, we review the benefits of having localized antitrust policies, and focus on the role of National Treatment and extraterritoriality in addressing the costs from self-interested competition policies. We further suggest that the extraterritorial application of domestic antitrust law can be desirable from a domestic and global perspective, but that it requires some organizing principles.³⁶

Justifying National Treatment

In order to understand the attraction of National Treatment as a principle to govern domestic competition policies, it is helpful first to understand the costs and benefits of maintaining distinctive local competition policies. That is, why do policies diverge in the first place?

The best way to start the analysis may be to ask what competition policies countries would adopt in an autarkic (closed economy) world, and then ask how a liberal international trade and investment regime may influence countries to change competition policies that they deemed optimal in autarky.³⁷

In autarky, it seems reasonable to assume that well-intentioned or public-interested governments would adopt competition policies that are designed to maximize domestic social welfare. Social welfare here obviously means the welfare of local residents given that the costs and benefits of domestic policies are fully internalized. There is a range of reasons for supposing there would be significant policy differences across countries, assuming public-interested governments. First, there may be differences as to the

objectives of competition policy, ranging from an efficiency (total welfare) objective to a consumer welfare objective to a populist (decentralization of power) objective, to preserving small businesses to integrating regional markets or even to promoting the 'public interest' broadly defined.³⁸ Moreover, as is evident in the history of various countries' domestic competition laws, these objectives may vary through time. Second, even if there is convergence in objectives, material conditions may vary from one country to another, requiring a different mix of policy instruments.³⁹ For example, very small economies with thin markets may have to live with much higher concentration levels than would be acceptable to countries with much larger markets. It is not surprising, for example, that Canada has an explicit efficiencies defence to mergers, while the USA does not; high concentration levels may be necessary to obtain scale economies. For similar reasons, small economies may assign a larger role to economic regulation or even state ownership.⁴⁰ Third, countries may simply have different understandings of relevant and contested bodies of economic theory that inform their policy choices, for example on the efficiency properties of various kinds of vertical restraints, or different cultural traditions that are more hospitable to certain practices or arrangements than other traditions, for example vertical and horizontal *keiretsu* in Japan. Fourth, if one drops the assumption of well-intentioned or public-interested governments, one might imagine that differences in competition policies are likely to emerge because of different configurations of political interests in different countries that, according to public choice theory, might shape competition policies in different ways. For example, in some countries concentrated producer interests may dominate diffuse consumer interests in the political process and succeed in having enacted competition laws that are extremely lax with respect to abuse of market power, while in other countries a politically engaged citizenry may be more effective in resisting this distortion. In countries with authoritarian or despotic governments, it is difficult to predict what policy objectives are likely to motivate the government in formulating competition laws.

Now assume a world where there are substantial trade and investment flows between and among countries. We can then ask whether in such a world the differences in competition policies that one might observe in an autarkic world are likely to diminish or increase, and in what ways and for what reasons? There are some reasons why countries might choose to reduce differences in their competition laws from those of other countries. For example, in order to attract investment from other countries or to encourage imports from other countries, there may be incentives to avoid imposing burdens on foreigners that they do not face in their home countries. Alternatively, countries may wish to facilitate the investigation or review of international cartels or mergers.

On the other hand, in an open international trade and investment environment, there may also be incentives for countries to adopt protectionist or beggar-thy-neighbour competition policies (among other policies) that produce benefits for their residents but externalize costs to foreigners. These inter-jurisdictional externalities may increase domestic welfare but reduce foreign welfare and perhaps global welfare.⁴¹ It is also conceivable that some countries may adopt lax competition laws in general, or sectoral exemptions from them, to promote the growth of 'national champions' or to provide local businesses with an opportunity to grow to minimum efficient scale prior to exposing them to foreign competition (a version of the infant industry argument often invoked by

developing countries to support import substitution policies). Finally, various models suggest that a country with a strong competition policy may reap gains from international trade; therefore, countries may face incentives to pursue stricter competition policies than their trading partners, resulting in divergence of competition policies.⁴²

Self-interest is most obviously manifest in laws that explicitly discriminate against foreign interests, which we consider in this section.⁴³ The widespread exemption for export cartels in general or in particular sectors provides an excellent example: domestic producers benefit at the expense of foreign consumers. Canadian merger law provides another example. Section 96 of the Canadian Competition Act⁴⁴ provides an efficiency defence to mergers. In applying the defence, authorities are to consider whether efficiency gains will result in '(a) a significant increase in the real value of exports; or (b) a significant substitution of domestic products for imported products'.⁴⁵ Obviously, self-interested competition policy would also include the discriminatory application of domestic laws. Allowing an anti-competitive merger of domestic producers who typically export to other countries would fall in this category.

As a matter of policy, there are several different ways of addressing the costs of self-interested, divergent competition policies.⁴⁶ It is common to propose some kind of harmonization of competition policies. Guzman suggests that 'international business activity requires the adoption of substantive international standards to govern antitrust'.⁴⁷ Assuming that countries act to maximize their own welfare, international antitrust faces the problem that national policies will not be, in general, the best policies from a global perspective.⁴⁸ Furthermore, in Guzman's view, 'once one recognizes the impact that trade has on antitrust policy, the need for an international antitrust regime becomes clear'.⁴⁹ However, few concrete steps have been taken towards substantial harmonization of competition law. The Draft International Antitrust Code (the Munich Code),⁵⁰ produced by the International Antitrust Working Group (primarily a group of German competition scholars) in 1993, is one prominent recent initiative in this area. The Munich Code proposes a complete mandatory World Competition Code, setting out minimum standards to be incorporated into the GATT, and enforceable in domestic jurisdictions by an International Antitrust Authority operating under the auspices of the WTO.

We do not find comprehensive harmonization proposals attractive even if they were feasible.⁵¹ They are unattractive because there are significant benefits to maintaining independent policies, including divergent objectives across countries and divergent means of achieving those objectives.⁵²

We would instead rely in part on the National Treatment principle.⁵³ This principle as elucidated in trade law requires countries in framing and applying their laws not to discriminate between domestic and foreign producers of like or directly competitive products by treating the latter less favourably than the former. We suggest that adherence to this principle in the competition law context could play a valuable role in permitting the diversity of competition policies and its attendant benefits to flourish, while limiting harmful forms of local self-interest. Prohibiting the discriminatory application of laws would be the most difficult aspect of the National Treatment principle to enforce, but this is also true with respect to the interactions of many aspects of domestic law or regulation and international trade law, where very difficult questions of adverse effects or *de facto* discrimination are raised in the National Treatment context.⁵⁴ Problems of enforceability, while real, are not insuperable.

The National Treatment principle prohibits countries from framing or enforcing domestic competition laws, such as laws on abuse of dominance, predatory pricing or vertical restraints, so as to favour domestic producers over foreign producers of like or competitive products. However, probably reflecting its mercantilist history, international trade law emphasizes market access rather than consumer welfare.⁵⁵ As Tarullo notes, ‘trade policy is usually concerned with promoting the interests of specific competitors, whereas competition policy is usually concerned with promoting competitive markets... trade negotiators tend to stress the result of “effective” access (i.e. sales), rather than the relative competitiveness of the market in an economic or antitrust sense’.⁵⁶ Thus, the National Treatment principle does not, as traditionally formulated in trade law, prohibit discrimination between domestic and foreign consumers of like or competitive products. To address potential problems that this presents, we would favour a limited form of extraterritoriality (an ‘effects’ doctrine) that would permit countries in respect of inbound commerce to sanction conduct originating abroad that adversely impacts either consumer or total welfare in the importing country, provided that such action satisfies the National Treatment principle. We develop this principle in the next section.

Resolving conflicts: defining the jurisdiction of trade and competition laws

The National Treatment principle, as traditionally formulated, compels state actors not to discriminate between domestic and foreign producers of like or directly competitive products. This eliminates some of the most egregious forms of self-interested, globally harmful policies. But it leaves open some potentially difficult questions of conflict resolution, particularly over the scope for extraterritorial application of local laws. The advantages of a relatively weak supranational principle in preserving local choice over antitrust policy also present disadvantages in leaving open the possibility of conflict. This section reviews principles of conflict resolution that allocate authority over particular problems to trade or competition laws. It is helpful to begin by reviewing two scenarios, based loosely on actual antitrust experience.

Example 1: export cartels

Let us suppose that Japan has no competition laws at all or at least no laws dealing with cartels, and members of a Japanese cartel export their output to the United States at inflated prices that reduce the welfare of US consumers. Let us suppose further that domestic US antitrust law would prohibit such cartels if they involved domestic parties. This is similar to the case of *Hartford Fire Insurance Co. v California*,⁵⁷ decided by the US Supreme Court. Applying Japanese laws to the conduct in question would entail a form of extraterritorial application of these laws to the market most impacted by the conduct, i.e. the US market. Applying US laws to the conduct of the Japanese firms would entail the extraterritorial application of US laws to parties and conduct located elsewhere. Given our assumption of no local competition laws in Japan and a US ban on cartelization, neither a Japanese decision not to prosecute the cartel nor an American decision to prosecute would violate National Treatment. There is therefore a divergent approach to the same fact pattern and a conflict that needs resolving.

Example 2: vertical restraints

Let us assume now that under Japanese competition law, there is no prohibition on exclusive dealing arrangements, or at any rate the law is much more permissive than US law in this respect, and US firms seeking to export into the Japanese market face difficulties in securing distribution outlets because of exclusivity arrangements between local distributors and suppliers. This broadly parallels the claim before the WTO by the United States in *Japan—Measures Affecting Consumer Photographic Film and Paper*.⁵⁸ Suppose, *arguendo*, that US law would not permit these exclusive arrangements. The USA may wish to argue that while Japanese law may permit such conduct, the extraterritorial application of US vertical foreclosure or exclusivity laws would enhance access by US exporters to the Japanese market. Again, the divergent approaches of US and Japanese law do not violate the National Treatment principle; we assume that each jurisdiction would apply its own laws without discriminating between foreign and domestic producers.

These examples are structurally very similar, yet for the reasons discussed below we conclude that the extraterritorial application of US antitrust law is legitimate in the first case (inbound commerce) but not in the second case (outbound commerce). Carefully considering the appropriate domains of trade and competition law can help resolve these kinds of conflicts.

Competition policies around the world universally take maximizing consumer welfare in any particular market as at least a central objective, if not the exclusive objective. A total welfare or total surplus standard would weigh both consumer and producer surplus. However, only a producer welfare standard would ignore consumer welfare, and no competition law, by definition, espouses such a standard, as a general norm, because it would be maximized by eschewing competition law altogether. The USA explicitly seeks to maximize consumer welfare, as demonstrated, for example, by its price standard in the efficiencies defence context in merger review. Canada too places significant emphasis on consumer welfare, both in the Competition Act's purpose clause and in particular legal contexts. Its statutory efficiencies defence in merger review, for example, while arguably supporting a total welfare test that would not discriminate between producers and consumers, has been held by the Federal Court of Appeal to require consideration of a transfer from producers to consumers as potentially harmful.⁵⁹ The EU also takes harm to consumers seriously, for example providing that high prices by a monopolist can in themselves constitute an abuse of dominance. Producers may benefit in their capacity as purchasers of inputs from effective competition laws and may in some instances also incidentally benefit from particular antitrust rules, like those against predation, but the rules generally stem from a concern about consumer welfare.

This is not to say that in all jurisdictions consumer welfare is the exclusive focus. The EU, for example, seems sometimes to consider harms to rival producers when two firms propose to merge. But it is accurate to describe most competition policies in the developed world as for the most part adopting the dictum from *Brown Shoe Co. v United States*⁶⁰ that antitrust law is at base not about protecting competitors but rather about protecting competition. The EU Commissioner of Competition has recently stated that EU competition laws are principally concerned with protecting consumer welfare.⁶¹ Nowhere, for example, will the complaint that low prices are driving a firm out of business get far without more; rather, the complainant would need to show that the prices

are unreasonably low and predatory, which in turn requires a careful examination of the facts, including price-cost comparisons. While all could agree on the facts that low prices are indeed harming a competitor, protecting competitors from low prices is not *per se* ordinarily an aim of antitrust law.

Antitrust law is thus generally about promoting either consumer welfare or total welfare. Trade law, on the other hand, recognizes that domestic governments may pursue objectives other than domestic consumer or total welfare. Free trade maximizes domestic welfare on net, but this does not prevent those harmed by it from lobbying against it. Public choice theory predicts that concentrated interest groups may be influential in distorting domestic law to impede trade. As a consequence, countries enter into agreements with other countries entailing reciprocal commitments to allow foreign producers access to their markets.⁶² These involve commitments to abolish tariffs and quotas, as well as commitments not to adopt laws that either explicitly or in their operation discriminate against foreign producers. The locus of concern in the trade law context is found in producers who are excluded from foreign markets. There will be incidental (and often substantial) benefits for domestic consumers from the focus on producers, but the law in its operation seeks to constrain reciprocally domestic governments from adopting laws that deny foreign producers access to a market. To substantiate a complaint, the producer must show harm and discriminatory conduct; the effect on domestic consumers from trade-reducing laws is largely beside the point as a matter of trade law.

The different principles that animate trade and competition law lead in many different contexts to a coherent method of determining the appropriate scope for the extraterritorial application of competition law (on the assumption that no country has violated the National Treatment principle). In particular, extraterritorial application of competition law is appropriate to remedy the harm that domestic antitrust laws seek to address: harm to domestic consumer or total welfare. This implies that extraterritorial application is appropriate in the first example. A Japanese export cartel aims to raise prices and harm US consumers. Since the conduct would be illegal under US law (that is the US authorities do not violate National Treatment by applying their law to such a cartel) *and* since the alleged conduct would harm US consumers, it is appropriate that US antitrust law applies extraterritorially. Recent evidence suggests that international cartels impose severe costs on importing countries, including many developing countries.⁶³ But our limited principle of extraterritoriality permits importing countries to act unilaterally in all such cases and does not suggest a need for international competition laws beyond voluntary cooperation between states in investigating and prosecuting such practices.

This contrasts with the vertical restraints example. In this example, the only harm to the USA comes in the form of harm to its producers. Given the conflict between Japanese and US law without either country violating National Treatment, we suggest that it is appropriate to look to first principles in ruling out extraterritorial application of US vertical restraints law. US antitrust law is explicitly not about protecting producers, but rather about protecting competition. The harm to US producers in the example is not a harm that its domestic antitrust law cares about in itself; rather, vertical restraints law exists to promote competition and consumer or total welfare. Applying US antitrust law to protect US producers in foreign markets would therefore be inappropriate and would entail a global race to the most stringent competition laws, which are unlikely to be

globally welfare maximizing. We oppose, therefore, the US assertion of jurisdiction in such cases and in particular the amendment in 1992 and 1995 to the US Antitrust Enforcement Guidelines for International Operations, repealing footnote 159 and asserting jurisdiction over conduct that harms US exporters in outbound commerce even if US consumers are not harmed.⁶⁴

On the other hand, harm to producers as the result of exclusionary practices is indeed the domain of trade law as is the more general issue of market access by foreign producers. If Japanese permissiveness towards vertical restraints is in essence a form of protectionism, US producers may have a complaint under trade law (as claimed unsuccessfully in *Japan—Measures Affecting Consumer Photographic Film and Paper*),⁶⁵ at least if the law is being applied in a discriminatory fashion. Where this is not the case but Japanese policy on exclusionary policies reduces consumer welfare in Japan, this cost is internalized to Japan and it is its prerogative to decide whether to amend or apply its competition laws to address this harm.

Although there is some symmetry between the export cartel and vertical restraints examples in that neither involves the violation of National Treatment with respect to competition policy, and in both cases local Japanese laws and conduct harm US interests, there is a crucial asymmetry in the distribution of the effects. The vertical restraints case results in harm to foreign producers in export markets (outbound commerce) and thus is appropriately left to trade law; the cartel case results in harm to foreign consumers in import markets (inbound commerce) and is therefore an appropriate context for the extraterritorial application of US antitrust law.

Example 3: monopoly

Let us assume a monopoly has developed in the EU that exports all of its output to the USA, and exports monopoly overcharges along with the output to US consumers.⁶⁶ US antitrust law on monopolization does not include supracompetitive pricing *per se*, but requires proof of some exclusionary, disciplinary or market foreclosure practice while, under European Community law monopoly pricing *per se* may constitute an abuse of dominant position. In this case, US consumers are harmed but not in a way that would attract liability for a US producer under US domestic antitrust law. EU consumers are not harmed, but this conduct would potentially violate EU laws if it took place within the EU.

We can resolve the potential conflict here by again relying on first principles. The USA would not challenge high prices *simpliciter* charged by a local monopolist; therefore, it would be a violation of the National Treatment principle to challenge the European monopolist on this basis. On the other hand, it would not be a violation of National Treatment for the EU to address the monopolist's prices, since it would do the same in the case of a local monopolist selling into the EU market (although as a matter of European law the European Commission or courts may lack jurisdiction if EU citizens are not harmed). This would create a conflict with US law in this context, which should be resolved by reference to our extraterritoriality principles that assign jurisdiction in cases of conflict to the jurisdiction where consumer welfare is prejudiced. If the monopolist sells some of its output in both US and EU markets, then obviously the EU would have jurisdiction over the monopoly overcharges.

Example 4: dumping

This jurisdictional approach to extraterritoriality helps resolve other potential conflicts, including a vexing problem for trade law: the domain of antidumping and predation laws. Suppose that Japanese steel producers sell steel into the United States. US steel producers object that the steel is being sold at low prices that cause them material injury. What law should resolve the dispute?

Current trade law would permit US producers to seek trade remedies under antidumping provisions in the GATT (Article VI), depending on the prices charged by Japanese producers in the US relative to their home market. Our approach suggests that this is inappropriate. Trade law (as opposed to trade theory) is about harm to producers excluded from foreign markets; competition law is about harm to local consumers. In the steel example, US producers are obviously not being excluded from Japanese markets and it is inappropriate to rely on trade law to remedy any potential problem. If, on the other hand, Japanese producers are preying on US steel firms, there may be a claim that US consumers will be harmed in the long run and this would be an appropriate case for the extraterritorial application of US predation laws. That meeting standards for predation, which are constructed out of concern for consumers not producers, is much more difficult than meeting antidumping standards would not come as a surprise to local firms that pursue trade remedies, not competition remedies. However, but for the special dispensation for antidumping laws in the GATT, such laws would clearly violate the National Treatment principle by applying pricing constraints to foreign producers that do not apply to domestic producers of like or competitive products. Hence, there is a strong case for abolishing this flagrant exception to the National Treatment principle and relying instead on non-discriminatory domestic antitrust predation or abuse of dominance laws, albeit applied extraterritorially.⁶⁷

Aside from questions of internal consistency, the key advantage of the National Treatment principle and the jurisdictional limitations on extraterritoriality (applicable to inbound but not outbound commerce) that we suggest is that they preserve the benefits of localized competition policy. The principles allow local governments to devise competition laws to suit local conditions and to engage in policy experimentation. Allowing violations of National Treatment would allow countries to adopt globally undesirable self-interested laws, and an overly permissive approach to extraterritoriality would interfere with local governments' ability to adopt distinctive competition laws. For example, extraterritoriality in the vertical restraints example would hinder Japan's ability to adopt its own distinctive vertical restraints regime. Looking to the country whose consumers are affected by conduct helps resolve the jurisdictional division between trade and competition policies.

Another instrumental advantage of the conflicts regime we propose is one of institutional competence. It is the role of antitrust authorities wherever situated to determine the effect of conduct on consumer or total welfare, while trade authorities typically only seek to determine whether foreign producers have been excluded from a market by discriminatory restraints on trade.⁶⁸ Allocating matters engaging consumer or total welfare to antitrust authorities and matters engaging producer welfare to trade authorities exploits the comparative advantage of the different agencies.

In summary, trade law adopts as its purpose the promotion of international trade by ensuring that producers have non-discriminatory access to foreign markets; competition

law generally adopts as its purpose the promotion of either consumer or total welfare. The extraterritorial application of competition law is only coherent if predicated on the protection of the interests of domestic consumers. Protecting the interests of producers in export markets is the domain of trade law.

Residual issues

Adherence to National Treatment and the restriction of extraterritorial application of local law to cases involving local consumers resolves many, but far from all, problems that arise through the interaction of trade and competition policies. The following example serves as a useful context for discussing remaining issues.

Example 5: a supranational merger

Here we assume a merger between two firms selling their output into supranational or global markets (for example large commercial aircraft manufacturers). Suppose one country—perhaps where the two merging parties are located—approves the merger on the grounds of efficiencies (cost savings) likely to be generated by the merger, but another country disapproves the merger on account of a likely increase in the price of the product in question as a result of the reduction in competition. The latter country does not realize in any direct way the efficiencies associated with the merger. This broadly reflects the *de Havilland* case, where the Canadian⁶⁹ competition authorities approved a merger and the European Community⁷⁰ authorities disapproved it. The European Commission prohibited the acquisition of *de Havilland*, a Canadian-based commuter aircraft producer (owned by the American firm Boeing), by a European joint venture, ATR (owned by French and Italian interests), on the grounds that the merger would give the merged entity excessive market power in the European market. The example is also similar in some respects to the inter-jurisdictional conflicts between the USA and the EU in the McDonnell Douglas—Boeing merger⁷¹ and the GE/Honeywell merger. In our view, this example is conceptually similar to Example 1 (export cartels), and does not differ in important analytical respects from a major international cartel (like the vitamin cartel)⁷² impacting many domestic markets.

Several issues arise with this example. We consider them in order of the most to the least troubling.

Multiplicity of jurisdictions/race to the strictest

By assumption, the merging parties sell in a supranational market. That is, there will be a multiplicity of jurisdictions that can both comply with National Treatment principles and legitimately (under our analysis) apply their laws extraterritorially given the potential for harm to local consumers. This creates the potential problem of inconsistent decisions about the same merger. The nature of relief in merger cases is typically injunctive, either permitting the merger to proceed in its entirety, permitting a modified merger to proceed after divestitures, or forbidding any form of the merger. If several jurisdictions review a merger and each relies on injunctive remedies, the rule that prevails will be the strictest. This undermines the autonomy of antitrust regimes, just as US extraterritorial application of vertical restraints law in Example 2 would undermine Japanese efforts to employ a

permissive approach to vertical restraints. Furthermore, Guzman argues that as harmed countries impose their laws to transactions that cause harm to them, they will block not only globally inefficient anti-competitive activities, but also many efficient activities (i.e. all activities that cause a net loss to a particular country, but that yield global benefits outweighing that loss). Guzman rightly concludes that in this scenario, domestic law may be more stringent than the optimal global policy.⁷³

There are a number of responses to the problem of jurisdictional multiplicity/race to the strictest. First, the choice of a merger in the example was deliberate because of the difficulty in generating strictly local remedies. Allowing firms to merge in all jurisdictions but one is often not feasible in cases involving global or supranational markets. However, in many other antitrust contexts, idiosyncratic local remedies are entirely feasible. Consider Example 3 involving a European monopolist charging high prices in the EU and USA. There is no reason why the EU could not penalize the monopolist for high prices in the EU, while US authorities decline to intervene with respect to sales in the USA. Likewise, exclusivity provisions may be unenforceable in some local markets, but permissible in other jurisdictions. Even mergers that involve many local markets can sometimes appropriately be addressed by local divestitures. The problem of the race to the strictest should not be exaggerated; as an empirical matter, there will be some difficult supranational cases, but many problems can be addressed differently by different jurisdictions.

A second, more radical response to the problem of jurisdictional multiplicity/race to the strictest is to rethink the injunctive nature of antitrust remedies. Instead, a damages remedy could accommodate jurisdictional multiplicity without requiring any jurisdiction to cede sovereignty over the substantive content of its antitrust regime. In the merger context, for example, rather than responding yes, no, or yes with conditions to a merger, antitrust authorities considering a merger involving several jurisdictions could instead calculate the local damages to consumers stemming from the merger and require the merging parties to pay this amount by way of a fine or damages (perhaps in the form of a reduction in prices in that jurisdiction). If there are gains elsewhere that offset local damages, the merger will proceed. If not, it will not. This approach has benefits analogous to the efficient breach benefits of awarding damages rather than specific performance for breach of contract. The requirement of National Treatment would be important in this context, as there will be a temptation for individual jurisdictions to make spurious findings in order to extract extortionate damages from foreign merging firms. But if the principle of National Treatment is adhered to, the strictest regime would set the highest price for the merger (at least relative to the size of local sales), but this is entirely appropriate given local views of the harms from the merger. The strictest regime would not, however, have a veto over the merger, which would violate at least the spirit of the National Treatment principle by ignoring the impact of its decision on foreign producer and consumer welfare.

A third response to the problem of jurisdictional multiplicity is to consider a lead jurisdiction approach. Just as nations with legal jurisdiction over a matter may cede authority to other nations under principles of comity, it may be appropriate for local jurisdictions to cede authority to a lead jurisdiction in antitrust matters. Campbell and Trebilcock have argued for a lead jurisdiction model that comes in different variants.⁷⁴ The least intrusive is a coordinating agency model, where the lead jurisdiction would

coordinate a review of the merger for all affected countries, reach a dispositive decision with respect to its own jurisdiction, and merely make findings and recommendations for other affected countries. While this model would not prevent divergent outcomes, it would reduce transaction costs with regard to activities affecting supranational geographic markets.⁷⁵ A more intrusive model would be a lead jurisdiction with dispositive powers not only with respect to its own jurisdiction but with respect to other affected jurisdictions. A third variant of a lead agency model would entail some kind of supranational appeal mechanism, not on the merits of the merger but on the conflict of laws issue and in particular who the appropriate lead agency is for evaluating the merger. In each model, the choice of lead jurisdiction should build on the concern for consumers that animates competition policy. That is, the country that represents the largest share of consumption should presumably be the lead jurisdiction.⁷⁶ The presence of producers in a jurisdiction should have no impact on the choice.

Conflicts of principle

While really a subset of the problem of jurisdictional multiplicity, it is worth pointing out a further problem arising from jurisdictional conflicts. While generally competition laws are designed to promote consumer welfare, in some cases they explicitly account also for producer welfare. For example, as mentioned, Canada has an explicit efficiencies defence in merger review which balances anti-competitive effects with efficiency gains.⁷⁷ This implies that in some cases, Canada may approve a merger in part out of a regard for producer welfare. Assuming there is multi-jurisdictional conflict over a particular merger, resolving the conflict by reference to the location of consumers is at least complicated by the Canadian emphasis on producer welfare (as an element in a total welfare test). *De Havilland* provides a relevant context since, while production of commuter airlines was in part located in Canada, customers were for the most part located in Europe. Resolving the conflict by deferring to Europe because of customer location ignores the producer (or total welfare) emphasis of the efficiencies defence in Canada.

Two of the responses to the problem of jurisdictional multiplicity apply to this context. First, this problem only arises where idiosyncratic local remedies are unfeasible, which as an empirical matter is not true in the vast majority of antitrust cases. Second, an international agreement to impose damages (or fines) rather than injunctions can better accommodate conflicting decisions. An additional response is that while each antitrust law may recognize qualifications to an emphasis on consumer welfare, the basic approach is to protect consumers from anti-competitive distortions. Canadian antitrust law generally protects consumers, so it is not unreasonable to ask it to cede jurisdiction to Europe on the basis of consumer welfare.⁷⁸

General distortions from trade

The example of an international merger raises another possible problem with the interaction of trade and competition policies that the National Treatment principle (applicable to outbound commerce) and a limited extraterritoriality principle (applicable to inbound commerce) may not address. Guzman⁷⁹ and Iacobucci⁸⁰ consider whether countries' general approach to antitrust will be distorted by trade flows. Even if all

countries adhere to National Treatment, trade patterns may distort local competition laws. Net exporters in imperfectly competitive markets may often favour a lax policy, net importers in such markets a strict policy.⁸¹ In addition, Guzman suggests that since in a world with unlimited extraterritoriality the strictest approach across jurisdictions will prevail in any given case, trade will lead to overly strict antitrust rules (from a global welfare perspective) imposed by net importers in imperfectly competitive markets.⁸²

Aside from our earlier responses to the race to the strictest concern, including consideration of local remedies, we do not view the general distortions from trade as a significant problem for our approach. First, the trade surplus in any given country in the long run must be balanced. Guzman argues that while trade overall may be in balance over time, trade in *imperfectly* competitive markets may not balance over time.⁸³ The problem with his analysis is that the presence of imperfectly competitive markets is at least in part dependent on local competition and trade policies. Oil, for example, is a commodity that almost certainly would sell in a competitive market if not for OPEC. The endogeneity of the competitiveness of markets makes the predictive value of Guzman's analysis problematic. Predicting which countries are net exporters or importers in imperfectly competitive markets in order to predict the strictness of their policies depends on the policies themselves. It may therefore be difficult for a local-welfare-maximizing government to disentangle market and legal effects in order to decide whether, over time, it will be a net importer or exporter in imperfectly competitive markets and thus how to distort its policies.

Second, Guzman argues that the combination of trade-distorted competition policies and the veto power of the strictest policy would lead to excessively strict global policies.⁸⁴ It is not clear that net importers in imperfectly competitive markets will always adopt overly strict rules. The strategic trade literature shows that countries may intervene in imperfectly competitive markets in an attempt to shift rents from foreign firms to domestic firms.⁸⁵ Applying similar analysis to international antitrust can provide valuable insights.⁸⁶ The following example shows that the strategic self-interest of an importing country may lead to *lax* competition policy. Suppose that two US firms and two European firms each serve the European market. The market is imperfectly competitive and Europe is a net importer. The two EU firms propose to merge. Guzman would argue that the EU should object. But a domestic-welfare-maximizing EU antitrust authority may come to the opposite conclusion. The EU will have to balance two effects. On the one hand, the merger will decrease competition and harm local consumers. On the other hand, the merger will benefit local producers. If all effects are internal to the EU, the net effect may be negative and the EU should object to the merger—this is the economic basis for antitrust policy. But not all effects are internal. Rather, the merger could result in a larger or smaller share of overall profits for EU producers, depending on the model of oligopoly that prevails. This complicates the self-interested calculus for the EU. It is possible that by allowing the merger, total producer rents in the market increase and that the EU realizes a larger share of these rents. The gains in profit for the merged EU firm could offset losses to EU consumers. Rent-shifting could cause net importing countries to impose a lax policy in some cases. Again, the predictive value of Guzman's analysis is questionable.⁸⁷

Finally, as an empirical matter, the net trade surplus in imperfectly competitive markets is unlikely to have significant distortionary effects on policies. The value of

exports less imports was only 5.1% of GDP in Canada in 2001,⁸⁸ which is a small, open economy with a relatively large trade surplus. Assuming that imperfectly competitive markets are not disproportionately important in export as opposed to import markets, the effect of trade is even smaller if one considers only the surplus that arises in imperfectly competitive markets. If countries can discriminate in the application of their policies between foreigners and locals, it is reasonable to suppose that their standards will vary depending on the position of local firms and customers in any given case. But if countries adhere to a policy of non-discrimination, we are sceptical that the trade surplus or deficit in imperfectly competitive markets will have a significant effect on the general choice of competition policy.

RECENT DEVELOPMENTS IN INTERNATIONAL ANTITRUST

Recent events in international antitrust demonstrate the likely futility and undesirability of a substantive harmonization agenda. Even apparently modest proposals for harmonization have engendered strong disagreements, indicating that harmonization is impractical. Moreover, the reasons for disagreement may sometimes relate to self-interest, but often seem motivated by good faith differences in opinion over optimal law.

Proposals for sweeping international harmonization competition laws, such as those espoused by the Munich Group or by Guzman, do not reflect current mainstream preoccupations with the costs, in terms of global welfare, of divergent national competition policies. The Doha Ministerial Declaration of 14 November 2001, launching the current multilateral round of trade negotiations, identified (in para. 25) an apparently much more modest trade and competition policy agenda principally promoted by the EU:

In the period until the Fifth Session, further work in the WTO Working Group on the Interaction between Trade and Competition Policy will focus on the clarification of: core principles, including transparency, non-discrimination and procedural fairness, and provisions on hard core cartels; modalities for voluntary cooperation; and support for progressive reinforcement of competition institutions in developing countries through capacity building. Full account shall be taken of the needs of developing and least developed country participants and appropriate flexibility provided to address them.

While this is a much more modest agenda than comprehensive international harmonization of competition laws (with a much-reduced focus on market access issues), a recent report released by the WTO Working Group on the Interaction between Trade and Competition Policy to the WTO General Council⁸⁹ reports a striking diversity of views among Member States on all of these issues. In the final hours of the 2003 Cancun Ministerial the EU dropped its insistence that competition policy be included in the Doha negotiating agenda.

With respect to transparency, the report states that in principle transparency should permeate all aspects of a country's competition regime, including legislation, policies, institutional structures, decision-making processes, enforcement priorities, policy and

procedural guidelines, case selection criteria, exemption criteria, appeal processes, and details of all relevant outcomes and decisions made. However, recognizing that 50 or more Members of the WTO have no competition laws at all and that many countries' competition laws exist on paper only,⁹⁰ such a set of requirements is likely to be extremely burdensome, especially if it includes all case-specific decisions made by enforcement authorities, such as advisory opinions and settlements. Moreover, the question of the protection of confidential information, including commercial and business secrets, is likely to be viewed very differently in different legal cultures.

With respect to the principle of non-discrimination, a diversity of views was reported on whether it should apply only to *de jure* discrimination or also to instances of *de facto* discrimination, and how easy or difficult it would be to distinguish the latter from reasonable exercises of prosecutorial discretion. Moreover, a number of countries have general exemptions for export cartels, and most countries have various sectoral exemptions from competition laws. Developing countries argued more generally for special and differential status so that they would not be obliged to apply competition laws to expose domestic industries to foreign competition or acquisitions, and to be permitted to maintain export cartels in commodity markets, on an infant industry rationale.⁹¹ Thus, many developing countries argued for the addition of special and differential status to the core principles, while some developed countries argued for the addition of the principle of comprehensiveness to the list of core principles (obviously strongly antithetical principles).

With respect to the principle of procedural fairness, one view was that four broad concepts could be identified that were likely to promote fairness, namely (1) the right of access to and right to petition a competition authority; (2) the right of a firm subject to investigation to know the basis for an antitrust authority's objection before the authority took action, and the right of that firm to respond; (3) the right to appeal an agency's decision; and (4) timeliness. Each of these concepts is contestable and ambiguous, and the report notes that there was no broad consensus on the meaning of procedural fairness in the context of competition-law enforcement, partly because notions of fundamental fairness differed between legal systems and were influenced by the political and legal cultures in which relevant agencies operated.

With respect to hard-core cartels, the report notes a lack of any consensus on the definition of hard-core cartels as opposed to other kinds of horizontal arrangements,⁹² and whether, even if they could be defined, they should be subject to *per se* illegality or rule of reason review; whether, even if these two issues could be resolved, there should be some common position on penalties or sanctions for participation in such cartels; and moreover, even if all these issues could be resolved, whether certain exemptions should be permitted from the prohibition against hard-core cartels.

As to modalities for voluntary cooperation in the administration and enforcement of competition laws, the report again notes a wide diversity of views as to the various forms that cooperation might take, how mandatory Voluntary' cooperation should be in various contexts and how confidentiality of information exchanged should be protected.

As this review demonstrates, significant harmonization of substantive areas of law seems very unlikely given the variety of views expressed about apparently much more modest proposals. Moreover, the reasons for disagreement, such as different conceptions of hardcore cartels, or different conceptions of procedural fairness, often seem rooted in

fundamental differences in approach, not parochial self-interest. Harmonization would create costs as countries would be forced away from their (non-strategic) conceptions of optimal law.

CONCLUSION

In the end, we are inclined to view efforts at international harmonization of competition laws, whether ambitious or apparently more modest in scale, as largely a solution in search of a problem. To the extent that diversity of national competition laws poses problems in a context of dramatically increased international trade, we believe that the two core principles that we have identified—the National Treatment principle and limited (inbound) extraterritoriality—adequately address the most serious problems. Voluntary cooperation between national competition authorities in the investigation and enforcement of competition laws can be promoted by bilateral treaties or agreements of the kind that already exist between a number of national enforcement authorities. To the extent that pointless incompatibilities between international competition laws exist with respect, for example, to information requirements and decision time-lines in merger reviews, a convergence on common requirements is best promoted through forums such as the International Competition Forum, which represents about 80 national antitrust enforcement authorities. Similar spontaneous regulatory convergence on best practices in various other areas of antitrust-law enforcement can also be most effectively promoted through such a forum.⁹³

We are opposed to proposals (like Guzman's) to vest in the WTO a mandate to negotiate a single, comprehensive harmonized international antitrust regime (like the TRIPs Agreement)⁹⁴ by employing cross-issue trade-offs or side-payments to induce countries to adopt domestic antitrust regimes. Threats of trade sanctions, for example, in the absence of agreement to a harmonization agenda may be effective in achieving such harmonization, but this would compel countries to opt for laws that they (non-strategically) do not consider optimal in terms of their own domestic welfare.⁹⁵ The only distinctive institutional feature of vesting a competition policy mandate in the WTO would seem to be the mandatory dispute settlement process. However, it is not clear what purpose this process would serve in practice with respect to inevitably platitudinous and largely non-justiciable encomia to transparency and procedural fairness, or why countries in their own self-interest will not be induced to take appropriate unilateral action against hard-core or other cartels, supplemented where appropriate through voluntary cooperation arrangements with other enforcement authorities.⁹⁶ Only with respect to the principle of non-discrimination or, as we would prefer more narrowly to define it the principle of National Treatment, would the WTO seem to have a legitimate mandate in the trade and competition policy area, but this mandate already exists and, while no doubt difficult to discharge in the case of complaints of *de facto* discrimination, especially involving allegations of discriminatory non-enforcement of laws (state inaction rather than state action),⁹⁷ it is not obviously a less tractable mandate than in many other areas of domestic law and regulation where the WTO already has frequently had to address issues of *de facto* discrimination.⁹⁸

In our view, it would be the ultimate incongruity that the desire to harmonize all or some aspects of national competition laws may come at the price of eliminating competitive politics and policy-making. Competition in the latter domain is important for social welfare, just as is competition in the economic domain.⁹⁹

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The international movement of people¹

INTRODUCTION

Classical free trade theory assumed that goods could often be readily traded across national borders but that the factors of production employed to produce those goods (land, capital and labour) were fixed and immobile. In the contemporary world, largely due to technological changes, this has become dramatically untrue of capital, and much less true of labour. However, the frequent political resistance to international mobility of goods is often dramatically intensified in the case of the international mobility of people. Here we move from the domain of international trade policy to the domain of immigration policy. The most critical linkage between the two relates to international trade in services, especially services which require physical proximity between service supplier and service user. As international trade in services of various kinds continues to grow, the line between trade in services and migration of people becomes increasingly blurred. Of the economic integration regimes reviewed in this book, only the EU to date has committed itself to free internal movement of people, subject to substantial efforts at harmonization of minimum professional and vocational qualifications and without any automatic entitlement to national citizenship of Member States. NAFTA (Chapter 16) contains a much more limited set of provisions for issuance of temporary entry visas for business, professional and technical personnel in connection with international business activities. The GATS contemplates multilateral negotiations over a similar set of arrangements for temporary entry visas.

In a globalizing world, we see dramatic increases in the international movement of goods, services and capital but next to no growth in the international movement of people. From 1950 to 1999, the average annual growth rate of world real GDP was 3.8%; the average annual growth rate in the trade of goods by volume over the period was 6.2%; from 1980 to 1999, the average annual growth rate in the trade of services was 7%; from 1982 to 1999, the average annual growth rate in the stock of foreign direct investment was 13%. In contrast, the annual growth rate in the number of immigrants worldwide between 1965 and 2000 was only 1.77%, which does not differ significantly from the rate of growth in world population of approximately 1.72% annually over the same period. In fact, the proportion of the world's population that is made up of migrants has actually decreased since 1965 from 2.4% to 1.97%.² While trade and investment are in some cases substitutes for immigration, in other cases they are complements, thus suggesting that at least in part these contrasts are explicable by reference to the much more restrictive nature of most countries' immigration policies. Bob Hamilton and John Whalley³ have estimated that the elimination of all global restrictions on labour mobility could result in a net *doubling* of worldwide annual GNP. Less sanguine assumptions result in estimated gains that are still highly significant from the perspective of global

economic welfare and far exceed the gains from further trade liberalization.⁴ In addition, Hamilton and Whalley report that complete immigration policy liberalization would engender a dramatically fairer distribution of world income.⁵

These figures raise important positive and normative puzzles that are of increasing importance in so-called knowledge-based economies in a globalizing world where human capital and agglomeration economies are often the principal source of comparative advantage.

STYLIZED FACTS ABOUT IMMIGRATION POLICIES IN RECEIVING COUNTRIES

While the details of immigration policies in major destination countries such as the USA, Canada and Australia vary widely, they typically entail three primary classes of immigrants: a family class, an independent class and a refugee class. Generally speaking, each of the three classes is subject to a quota limiting the number of immigrants who are admissible under the rubric of the relevant class in any given year (however, inland refugee claimants are at least theoretically evaluated against the criteria set out in the 1951 UN Convention Relating to the Status of Refugees (the Geneva Convention) irrespective of any quota). In the USA, family sponsorship accounts for a substantially higher percentage of legal immigrants than independent immigrants, relative to Canada and Australia. Canada and Australia apply an elaborate points system for determining the admissibility of independent immigrants, designed with the objective of admitting those with a high probability of effective economic integration. The USA applies more loosely defined priority criteria to this category of immigrant. All three countries provide for short-term visas for tourists, students and temporary workers. In the USA, illegal immigration is a major phenomenon (amounting to perhaps 400,000 immigrants a year, compared to about 800,000 legal immigrants).

Australia's population is 21.5% foreign-born, Canada's foreign-born population is 16.8%, and the foreign-born in the USA represent 9.8% of its population. Canada's annual intake of legal immigrants (approximately 225,000 immigrants) is 0.74% of its population. In 2000, the independent class accounted for 58.7% (including dependents), the family class accounted for 26.6%, and the refugee class accounted for 11.8% of the Canadian intake of immigrants. The US legal immigration intake (about 800,000 a year) is about 0.25% of its population. Family members account for about 72% of the intake, independent immigrants about 12%, and refugees about 8%. Australia admits about 85,000 immigrants a year—0.44% of its population—about 39% family members, 47% independent immigrants, and 12% refugees.

Apart from Australia, Canada and the USA, the other primary immigrant-receiving area is the European Union. The countries of the EU do not (as of yet) have one officially agreed upon and collectively administered immigration policy relating to citizens of third-party countries, but they do have a very liberal policy for the internal movement of people. Title IV of the EC Treaty, established in international law by the Treaty of Amsterdam as of 1 May 1999, provides for, *inter alia*, the free movement of all persons—citizens and non-citizens—within the EU, and tighter control of external borders.⁶ On 1 May 2004 (five years from the full implementation of the Treaty of

Amsterdam), all internal border checks in the EU cease. In addition, all EU states will share a harmonized set of rules governing the granting of external visas. These common rules will include common procedures and conditions concerning visa issuance, common rules regarding third-country nationals who do not require visas, and a common set of standards regarding the physical format of visas. Asylum and immigration policies will be governed in common by the Council of the European Union based on rules that have yet to be finalized.⁷

Labour mobility guarantees for citizens of Member countries within the Union have existed since 1961 when the inaugural six countries founded the EU. These labour mobility guarantees have been progressively liberalized, with the free internal movement of people guaranteed by the Treaty of Amsterdam representing the fullest liberalization possible. A significant number of EU nationals are currently making use of the existing guarantees (in 1999, approximately 1.8%, or 2.7 million) by working in Member States other than their countries of origin.⁸ By virtue of Articles 39 and 40 of the EC Treaty, EU citizens currently have, *inter alia*, the right to look for and engage in paid employment in any Member State; the right to reside in the Member State with his or her family in which the EU citizen is working and remain in the country of employment even after employment has ceased; and the right to equality of treatment with nationals of any other Member State, including access on the same terms to social programmes, tax advantages, publicly subsidized education, publicly provided or subsidized housing, civil law standing as a plaintiff or complainant, wage guarantees, and minimum standards of living. In short, 'Once employed, EU law provides that every worker and his family enjoy the same social advantages as national workers, whether he is resident in that country or [commutes across the border].'⁹ One major caveat associated with equal treatment and eligibility for social assistance surrounds those who are present in another Member State in pursuit of work. Job-seekers are not eligible to receive social assistance benefits in the Member State to which they have been admitted for residence until they have secured employment. Frontier workers—those who reside in one Member State but commute for employment purposes to another Member State—are bound by the laws of the country of employment, and as such usually receive social benefits and pay taxes in the Member State in which they are employed, not in the country of residence.¹⁰

NORMATIVE CRITIQUES OF PREVAILING IMMIGRATION POLICIES

At current levels, approximately only one out of every 50 of the world's people are living outside their country of origin.¹¹ The barriers to the international movement of people—for the skilled and unskilled, from developed and developing countries of origin alike—stem primarily from restrictive immigration policies in developed countries. Aggregate average income in the wealthiest 20 countries is more than 37 times greater than the average income in the world's 20 poorest countries.¹² The World Bank estimates that 2.8 billion people (about half of the world's population) live on incomes of less than \$2 a day.¹³ With economic disparity so great and the international movement of people so low, the deleterious effects of the restrictive immigration policies of the developed nations are clear.¹⁴ Notwithstanding the fact that hundreds of thousands of people migrate from less-

developed countries (LDCs) to developed countries each year, incumbent governments and residents of the most-developed countries have been and continue to be highly successful at perpetuating a state of affairs in which 'the huddled masses' are kept at bay. Many highly skilled and well-educated individuals in both developed and developing countries harbour a strongly held desire to emigrate to countries in which they can participate in their field of specialty and make productive contributions that are less likely to be made (for lack of complementary human capital and financial resources) in their countries of origin. As will be demonstrated, the extent to which immigration policies that keep the highly skilled and the relatively unskilled alike from migrating freely are normatively justifiable varies dramatically from the perspectives of economic welfare, communitarianism and liberalism.

An economic perspective

The welfare effects of immigration

With a set of assumptions that only tenuously approximate reality, neoclassical economic theory suggests that an optimal immigration policy would be not to have one at all.¹⁵ That is, neoclassical economic theory suggests that borders should be open since any constraint on the operation of the international labour market (e.g. closed or only semi-open borders) will generate distortions in economic decision-making and impose welfare costs globally in terms of foregone production and, consequently, unrealized welfare gains. This suggests that prevailing restrictive immigration policy regimes are deeply misguided. Given the complexity of the issues involved, however, placing much importance on this initial appeal to the conclusions of neoclassical economic theory is premature.

In general, immigration policies are evaluated in two competing ways (although others are conceivable). The first entails the use of a global welfare function that weighs equally the welfare of all persons, wherever they may reside. The second is to use a narrow, nationalistic welfare function in which only the effects on 'insiders'—not including those in the country of origin or the immigrants themselves—are considered. Immigration policies are currently debated and designed within nation-states, and it is clear (aside from the issue of whether this is desirable) that countries are concerned about the welfare of 'insiders' to a greater extent than the welfare of 'outsiders'.¹⁶ While Howard Chang, among others, has asserted that the distinction between a national welfare function and a global welfare function is pragmatically unimportant because immigration ultimately benefits both insiders and outsiders,¹⁷ it is almost certainly the case that for liberalized immigration policies to be feasible politically, most natives in recipient countries must be made better off (or at least not worse off) by their adoption.

The current debates and available empirical evidence surrounding the economic impacts of immigration are much more sophisticated than they were even a decade ago. However, there are many issues that are far from satisfactorily resolved because of the sheer complexity of the causes and effects of immigration. First, immigration policies differ functionally among developed countries so that empirical evidence drawn from one country cannot yield conclusive answers to the effects of immigration in another country. Second, as emphasized by George Borjas, the nature of immigrant cohorts to a given

country has not been static over time, reflecting shifts in 'pull' and 'push' factors, as well as changes in immigration policies within countries, making any attempt to draw general conclusions about the desirability of increasing immigration flows even within a given country problematic.¹⁸ Finally, immigrant cohorts to most developed countries have been and continue to be highly heterogeneous—refugees and asylees, family sponsored immigrants, and independent immigrants are often considered together by economists in attempting to evaluate empirically the welfare effects of immigration. It would not be surprising if each subset (and indeed subsets of each subset) of immigrants had separate and differing welfare effects for recipient countries. With these significant cautions in mind, however, the stylized facts and available empirical economic evidence suggest that immigration has been of net benefit to the vast majority of the residents of destination countries, the only possible losers being native workers or prior immigrants with very low skill levels.¹⁹ The data are peculiarly at odds with prevailing public attitudes as revealed by various surveys over the past decade regarding the economic desirability of immigration.²⁰ The surveys generally show that a majority of residents in developed countries would prefer that current immigration levels be reduced, or at the very least maintained, but certainly not increased. The survey results reflect two broad classes of fears: that increased numbers of immigrants will have adverse labour market effects, and will increase the fiscal burden borne by natives.²¹

Recent studies of the effects of immigration on labour markets have generally demonstrated that increased numbers of immigrants have played little observable role in reducing wages or in increasing unemployment.²² After conducting a thorough review of the empirical evidence in the literature, a recent report of the US National Academy of Sciences²³ concluded that 'the weight of the empirical evidence suggests that the impact of immigration on the wages of competing native workers is small'.²⁴ These findings are puzzling given the accepted labour economics account of the expected effects of greater labour market competition. The conventional analysis suggests that by increasing the supply of labour, *ceteris paribus*, wages will decrease among similarly endowed and situated workers. The *ceteris paribus* proviso is an important one. It requires immigrants to increase the supply of labour in domestic labour markets without contemporaneously increasing the demand for labour. However, an offsetting increase in the demand for labour is in fact quite plausible, since immigrants are consumers of goods and services, and the increased demand for and provision of goods and services inevitably associated with their presence ought to result in a corresponding increase in labour demand by domestic suppliers of goods and services.

George Borjas has recently argued that these studies find very little evidence of adverse labour market effects, not because these effects do not exist, but because of the difficulty of isolating the impacts of increased numbers of immigrants in local labour markets.²⁵ Gaston and Nelson have offered a competing theoretical explanation of the empirical finding that immigration has little adverse impact on native workers.²⁶ They argue that the prediction of labour economics that native workers will experience a decrease in wages and an increase in unemployment is dependent upon the paradigmatic labour economics model which assumes (ostensibly adopted primarily for the sake of convenience) that there is only one final good produced in the economy. With only one final good produced in the economy and production technology held constant, the traditional labour market prediction is that since the supply of labour has increased (with

less than a proportional increase in demand for labour), the labour market clearing wage rate must decline. Gaston and Nelson argue that the adoption of a multiple final good model (such as the one favoured by trade theorists) and allowing for trade conditions that permit an approximation of the conditions for factor-price equalization (such as, *inter alia*, fixed commodity prices) could result in no adverse wage or unemployment effect being realized. This is the case because with more than one economy and with each economy producing at least two goods with identical technology (assuming fixed commodity prices), the only way an economy can respond to a unilateral increase in, for example, unskilled labour is to alter its output mix in favour of goods whose production is more intensive in unskilled labour. This theoretical result is uncontroversial in trade theory and is quite robust to changes in assumptions regarding the number of goods, the presence of non-traded and intermediate goods, and even the presence of joint production. Gaston and Nelson soften somewhat this theoretical conclusion by stating that their objective is not to show that 'factor-price insensitivity actually obtains, but that, in a world with more than one output, some of the adjustment to an endowment shock will occur via a change in the output mix, reducing the actual, and measured, costs to the competing factor (i.e. domestic unskilled labour)'.²⁷ The authors also cite recent empirical evidence showing that output-mix adjustments in production cause wage convergence between the northern and the southern states in the USA, which supports their hypothesis that changes in output mix can accommodate differences in labour market conditions.²⁸

The other common economic fear harboured by many members of the public with respect to increased immigration is that immigrants impose a collective cost upon the public sector's finances by burdening the welfare state with disproportionate claims for, *inter alia*, welfare payments, food stamps, subsidized public education, publicly provided or subsidized healthcare, public housing and public pensions.²⁹

The most sophisticated study available on the fiscal impact of immigration in the US, recently produced by the National Research Council (NRC), suggests that each immigrant and their descendants will on average generate a net fiscal benefit of \$80,000 for natives of the USA in net present value terms in 1996 dollars.³⁰ Highly skilled immigrants and their descendants generate a greater fiscal surplus (\$198,000 each) than do lower-skilled immigrants (\$51,000 each), but notably in each case there is a surplus.³¹ Borjas questions the results of the study based on doubts regarding the realism of some of the study's assumptions concerning US fiscal policy and the inevitable uncertainty associated with trying to predict economic activity over extremely long time horizons. In the case of the NRC study, the time period used was 300 years.³² Borjas suggests that a 50-year time horizon would be more appropriate, in which case the average fiscal surplus to each immigrant and his or her descendants would decline to an average of approximately \$11,000 each in 1996 dollars—with a negative return to relatively unskilled and older immigrants.³³ Whether the results of the NRC study or the criticisms and alternative analysis of Borjas offer a better gauge of the fiscal impact of immigrants can best be determined by future empirical work, although the issue is an extremely difficult one to resolve empirically due to the vast array of simplifying assumptions that must be made.³⁴

Thus, the available empirical evidence suggests that immigrants have little impact upon labour market outcomes for natives and that immigrants generate a net fiscal surplus.

Julian Simon has estimated that the average immigrant to the United States has a positive aggregate net present value to American residents of between \$37,500 and \$50,000 (1996 dollars). This estimate includes all influences immigrants have upon the standard of living of natives—including dynamic effects in production and innovation, fiscal effects, and labour market effects.³⁵ Simon's estimate may be on the high side, however, because he relies on the existence of considerable scale and dynamic effects associated with increased population in arriving at this estimate that do not seem fully justifiable given the current degree of international economic integration and specialization in production.³⁶ George Borjas adopts a different approach to measure this 'immigration surplus' and in doing so arrives at a radically lower estimate. Borjas suggests that the benefit to natives from immigrants in the USA is approximately 0.1 % of GDP, which represents less than \$30 per person per year. However, Borjas claims that this benefit comes at a large redistributive cost—owners of capital gain in total approximately 2% of GDP, while suppliers of labour (i.e. native workers) lose approximately 1.9% of GDP. Borjas's position is that the net benefits associated with immigration come at too high a redistributive cost to be attractive.³⁷

The Economic Council of Canada ventures an estimate of the benefits to Canadians of an increase in yearly per capita income of approximately 0.3% for every 1 million immigrants admitted to the country.³⁸ Given that there are approximately 5 million immigrants currently living in Canada,³⁹ the implication of this estimate is that annual per capita GDP is 1.5% higher in Canada than it would be if the country had pursued a policy of closed borders for the past several decades. This currently translates into a benefit of approximately \$349.50 per Canadian per year.⁴⁰ Discounting this annual benefit at 8% per annum, the net present value of Canada's immigrant population to Canadian natives amounts to approximately \$4,368 each. This estimate of immigrant value is considerably larger than Borjas's estimates, but is significantly lower than the value of the effects as estimated by Simon in the US context. In any case, even the most pessimistic of these estimates—Borjas's—is positive, which at least to some extent serves to dispel the myth that immigrants impose a net economic burden on destination countries. However, it is important to emphasize that these findings only apply to the economic effects of immigration at roughly prevailing levels. Although even a considerable increase in the number of immigrants may continue to be welfare enhancing in net terms, at some threshold rate of immigration—perhaps an order of magnitude higher than now prevailing—it is reasonable to expect that negative congestion externalities and adverse labour market or fiscal effects may cause the current net benefit to become a net domestic welfare loss.⁴¹

Indeed, Borjas in the USA⁴² and Reitz⁴³ in Canada report empirical findings that over the past two decades, the economic performance of recent immigrants in terms of employment and earnings has declined significantly relative both to prior generations of immigrants and to the native-born. While the educational qualifications of recent immigrants tend to be higher than those of prior generations of immigrants, they have increased less rapidly than the educational qualifications of the native-born. Moreover, in knowledge-based economies where specialized educational credentials and work

experience carry an increasing premium, rigidities or protectionism in domestic educational and professional institutions in evaluating and recognizing foreign credentials and work experience and difficulties faced by domestic employees in the same regard increasingly penalize skilled immigrants. These findings suggest the need to take concerns over fiscally induced immigration seriously, while at the same time seeking to mitigate inefficient domestic labour market rigidities.

From a global perspective it is sometimes argued that by liberalizing immigration policy, developed countries will exacerbate the 'brain drain', robbing developing countries of their most talented and well-trained citizens, leaving those who remain in developing countries worse off. This position relies on two key assumptions. The first is that skilled workers generate positive externalities in their countries of origin.⁴⁴ The second assumption is that the departing skilled workers do not make up the losses to productivity occasioned by their departure in other ways. The conclusion of this line of reasoning (sometimes advanced disingenuously by those opposed to increased immigration for other, less altruistic, reasons) is that we ought to paternalistically restrict immigration for the good of developing countries taken as a whole, although this will inevitably impose opportunity costs on those who would otherwise prefer to migrate in pursuit of better opportunities.

The first assumption, that skilled workers generate at least some positive externalities in their countries of origin, is almost certainly true. It is unlikely that skilled workers can completely capture their full marginal social product in the form of wages from employers. Especially difficult to capture in wages are those aspects of skilled workers' production that do not accrue to their employers, but instead accrue to fellow employees and indirectly to other citizens in the country of origin. For example, a talented and highly skilled CEO who models leadership and effective managerial skills for subordinate managers will in general not be fully remunerated for the future value that he has generated because many of the subordinate managers will eventually leave the firm to join others. Another example would be a highly skilled engineer who designs physical infrastructure in an innovatively efficient manner, in the process directly reducing the total costs of the construction of the project and indirectly reducing transportation costs for the country at large; the engineer will almost certainly not capture her full marginal social product.⁴⁵ As is the case with most externalities, however, these positive brain-drain externalities defy accurate measurement. To circumvent this problem, some studies have adopted a loss of investment approach which, instead of measuring the positive externalities lost through emigration, seek to measure the direct loss of investments in the human capital of those who have emigrated. One such study by Augustine Oyowe places the loss of investment in the human capital of professionals to the African continent at approximately \$1.2 billion over the period 1985–90.⁴⁶

The second assumption, that departing skilled workers do not benefit their countries of origin in ways sufficient to compensate for lost positive externalities, is less clear. The International Monetary Fund estimates that worldwide monetary remittances reached \$105.2 billion in 1999, \$65.3 billion of which is attributed to remittances to developing countries.⁴⁷ As Oyowe stresses, 'expatriate remittances, particularly from skilled workers who earn higher salaries than the average migrant, constitute an important source of funds for development in their home countries'.⁴⁸ Thus, a rejoinder to the second assumption, that the loss of positive externalities to the country of origin is a cost not

made up by emigrants, is that the exportation of skilled labour and the receipt of remittances may more than make up for the losses of investment in human capital and the loss of positive externalities. Evidence by Goldfarb *et al.* suggests that it might actually be advantageous for developing countries to train professionals for export in exchange for expected remittances—for example in the training of physicians in the Philippines.⁴⁹

Apart from monetary remittances, other possible benefits from exporting skilled labour include the benefits to countries of origin associated with the enhanced human capital obtained abroad by return migrants, who return with even greater skills and know-how and thereby generate higher positive externalities; the facilitation of social and political learning, whereby the evils of corruption and the benefits of democracy and well-functioning markets are witnessed first-hand and relayed to those left behind, perhaps influencing attitudes in the country of origin ('social remittances'); and the establishment of trade contacts in developed countries, so that the benefits of freer international trade can be realized more easily through the existence of transnational business networks. That these factors may partly or wholly counter the losses associated with the emigration does not constitute idle speculation. Theoretical work has confirmed that a beneficial brain drain—or brain gain—is indeed possible with relatively realistic assumptions,⁵⁰ although some of the intangible benefits associated with a brain gain may be associated with other costs, such as the loss of the voice of dissidents who would prefer to emigrate rather than seek to alleviate oppressive political conditions in their country of origin. Notwithstanding such objections, a recent empirical study confirms the relevancy of the findings of this theoretical literature, concluding that 'there is no evidence at all suggesting a decreasing relation between growth in income per capita and migration in developing countries'.⁵¹

Critique of existing policies

Basic health, criminality and national security checks are a standard feature of immigration policies in most developed countries and are likely to be considered valid categories of restraints on immigration by most economists from both a domestic and a global perspective. Terminally ill and elderly would-be immigrants will often not be employed in the labour market because of the limitations imposed by their illnesses or their age and thus will not contribute tax revenues or more generally to the economic production and prosperity of the nation; however, the terminally ill will often draw disproportionately on the healthcare amenities of the welfare state. In addition, some terminal illnesses are communicable. Consequently, many terminally ill would-be immigrants will impose significant costs on the recipient country and can perhaps validly be excluded from admission from a narrow domestic economic perspective, although the precise boundaries of what constitutes an illness that justifies exclusion are problematic.⁵² From a global perspective, it is perhaps also valid to deny terminally ill migrants admission, although the conclusion is not as clear. If the disease at issue is communicable, then it may make sense to in effect 'quarantine' the would-be migrants in their country of origin by denying them entry so as to prevent exposure to the native population in the destination country and therefore preempt a greater number of people from becoming infected worldwide. In addition, if the terminally ill are drawn to and are admitted to countries that have publicly provided or subsidized healthcare (an adverse

selection problem), then the admission of those who are desperately ill and would make use of the healthcare system may threaten the viability and sustainability of the healthcare system as a whole, which would also be welfare reducing globally.⁵³

If one accepts the premise that those with criminal records are more likely to commit crimes in the future, then a criminality check prior to admission is likely to be valid economically from both domestic and global economic viewpoints.⁵⁴ Those with criminal records are less likely to be successful economically in the recipient country's legal labour market and in aggregate will impose increased costs on society through the costs associated with criminal activities. Thus, those with criminal backgrounds are also validly refused entry from a narrow domestic economic perspective. From a global economic perspective, if one adds the assumption that there are diminishing marginal returns to criminality, then criminals may perhaps also be validly denied entry. This is because, *ceteris paribus*, criminal activity is likely to be initially at a lower level in the more advanced developed economies. This makes criminal activity more remunerative and more tempting to engage in on the margin because of the higher rents available. Not unlike corruption, high levels of criminality and the commensurate lack of security of property rights will tend to compromise incentives, reduce economic activity and result in significant welfare costs in terms of foregone output. In addition, the opportunity costs associated with increasing law enforcement efforts in developed countries are likely to be higher than they are in LDCs because of the higher productivity of the labour that must be diverted to law enforcement.⁵⁵

As the recent terrorist attacks in the USA have dramatically underscored, national security checks on would-be immigrants have a similar justification. The now obvious inadequacies in national security screening of would-be immigrants or visitors relate less to substantive immigration law (which in many jurisdictions already contains relevant substantive powers to exclude or deport persons reasonably suspected of terrorist affiliations) and more to ineffective enforcement. Moreover, the challenges entailed in effective national security screening of the millions of tourists and visitors to countries like the USA each year should not be confused with the much more modest challenge of screening much smaller numbers of would-be immigrants.

Current policies in many countries requiring that employers first ensure that no domestic workers are qualified for the job, or demanding that the employer demonstrate that the employment of the foreign worker at issue would not harm domestic workers, are difficult to justify economically. If an employer has extended its recruitment drive to encompass foreign labour markets and is willing to absorb the additional transactions costs associated with sponsorship of a foreign worker, then this commitment should be considered to be *prima facie* evidence that equally qualified workers are not available domestically. In any event, such labour certification conditions constitute blatant protectionism, often preventing employers from hiring the most qualified candidates due to the availability of a marginally qualified domestic candidate. Such restrictions promote mediocrity and inefficiency.

For economic or independent migrants, immigration policies in developed countries sometimes entail passing points tests (as in Canada and Australia) that depend on, *inter alia*, demonstrating language proficiency, possessing significant training and work experience, working in an occupation experiencing high demand, having relatives who are residents or citizens, and being of a demographically attractive age for the destination

country. The available evidence suggests that point system restrictions may be justified from a narrow domestic economic perspective, although the result is not uncontroversial.⁵⁶ The use of a points system helps improve the average skill level of immigrants,⁵⁷ helps ensure that they are better educated (an education that may have been subsidized by the country of origin), ensures that immigrants are more likely to be able to speak at least one of the major languages of the country (so that they can be more readily and productively integrated into the labour market), and helps ensure that immigrants are young enough that they help improve the demographic profile (dependency ratio) of the country (e.g. to maintain public pay-as-you-go pension schemes) and thereby increase the country's overall fiscal surplus. From a global welfare perspective, the use of a points system is more difficult to assess because the welfare of would-be immigrants and others residing in the country of origin must be considered in conjunction with the welfare of the destination country's nationals. Whether or not the use of a points system is globally welfare enhancing depends upon the differences between skilled and unskilled migrants in the relative level of the positive externalities gained by the destination country, the loss of positive externalities and sunk investment in human capital in the sending country (and the associated second-order effects such as reduced future investment), and the change in individual welfare that migrants and reunified families experience from the move. In general, the positive externalities in the destination country may be larger than they would be in the country of origin for skilled workers because of the increased sharing of information and higher level of economic activity in developed countries—the efficiencies latent in the clusters and networks of the 'knowledge-based' economy. The costs sunk into human capital by the country of origin for skilled workers will be higher than for unskilled workers, but may be more than made up for by higher monetary remittances and 'social remittances' made by skilled workers. However, to the extent that these investments are not recouped by the country of origin, these sunk costs represent a loss to global welfare because education (and hence investment in human capital) may be underprovided in the future because the country of origin, as the investor, does not realize the full returns on its investment. The private benefits to the migrant from the move will usually be greater for skilled rather than unskilled workers. Although unskilled workers gain higher wages from migrating, skilled workers gain more in absolute terms. The complexity and the countervailing effects involved in this calculus suggest that from a global perspective, it is ambiguous as to whether or not points systems are welfare enhancing globally.

For family-sponsored immigrants under prevailing immigration policies in many developed countries it is often sufficient for entry to have an immediate family member who is already a citizen or permanent resident of the destination country as a sponsor. From a narrow domestic economic perspective, it may seem *prima facie* that having close relatives in the destination country would likely be irrelevant to subsequent economic performance and that, as a consequence, there should be no importance placed on the presence of relatives in the destination country. However, if the sponsor's welfare is included in the social welfare function, as it generally should be, then the arrival of a close relative has an immediate and significantly positive welfare effect on the destination country. In addition, the presence of immediate family members will likely play an important role in labour market outcomes for most immigrants. Having immediate family in the country will aid labour market participants by providing a

nucleus of social capital that can be used to make the social and cultural transition to a new country. In addition, starting a new business may be much easier if one can hire one's immediate family members to work without having to abide strictly by minimum wage laws. This is beneficial because start-ups are often not profitable in the early stages, and being able to benefit from (imputed) low wage rates may make the difference between failure and success for many immigrant-initiated businesses. This in turn may increase the monetary remittances and 'social remittances' to more relatives left behind in the country of origin. For these reasons, family-sponsored immigration may also be desirable from a global economic perspective, although it is difficult to assess definitively the validity and cogency of this conclusion.⁵⁸

From the perspective of economic welfare, many illegal immigrants (not criminals) are almost certainly beneficial for their host economies. Many illegal immigrants work at jobs that natives do not want to do at prevailing wage levels—i.e. positions that pay remuneration at rates below natives' reservation wage. In addition, illegal immigrants are almost certainly net contributors fiscally because they generate considerable tax revenues for host governments through property taxes, sales taxes and mandatorily withheld income taxes, while remaining ineligible for most social programmes. Moreover, they have little incentive to try to receive benefits from most social programmes for fear of being discovered and returned to their country of origin. The monetary cost of the social services that illegal immigrants do use, such as emergency medical care or public education, almost certainly does not offset the tax contribution illegal immigrants make. From a global perspective, illegal immigration is also welfare enhancing. The illegal immigrants themselves obviously consider themselves better off, or else they would simply return as legitimate citizens, relieved of the stigma associated with their illegal status, to their countries of origin and would not incur the costs and risks of illegal migration. The brain-drain argument is not as strong in the illegal immigration context because many of the illegal immigrants have low skill levels and many who migrate illegally are unemployed in their countries of origin so, if anything, those left behind may have enhanced—not reduced—labour market opportunities.

A communitarian perspective

Philosophically, the primary issue that needs to be addressed in contemplating the appropriate influence of community and culture on immigration policy is the extent to which a nation has a duty to admit (or the prerogative not to admit) outsiders. The ultimate resolution of this issue depends crucially upon the significance placed on liberal ideals and community—the belief in the equal moral worth of individuals versus the belief in the freedom of a collection of persons to govern themselves free from the claims of those outside of the group.⁵⁹ Taking liberty seriously is to a considerable extent irreconcilable with asserting the legitimacy of the exclusion of outsiders.⁶⁰ A strict adherence to the dictates of liberalism demands a recognition that the welfare of outsiders is as valuable as the welfare of insiders. As such, liberal values require strong justification for any restrictions on immigration.⁶¹ A privileging of community over liberty, on the other hand, suggests that the interests of insiders are more important than the interests of outsiders, and that therefore the nation-state, in the interests of insiders, can freely dictate any restrictions on immigration that it may consider desirable.

Historically, countries have often sought to limit immigration to those who are culturally similar to natives or, what amounts to much the same thing, privilege those who are culturally or ethnically similar to insiders for admission. The national origins quota system, the core of US immigration policy from 1924 to 1965, privileged Europeans for admission to the country based on the fact that individuals of European origin made up the bulk of the US population at the time of the 1920 census. The current German *Aussiedler* policy, which grants immediate citizenship (subject to certain quota restrictions) to any ethnic German who can prove German descent, pass a German language test and demonstrate familiarity with German culture, is another example of ethnically driven immigration policies. Australia and Canada also have historical legacies replete with racially discriminatory approaches to immigration policy.⁶²

Australia, Canada and the USA do not currently have immigration policies that explicitly account for the racial or ethnic background of those who seek to immigrate. However, it is important to recognize that racially and ethnically blind immigration policies accompanied by the provision for family reunification immigration in Australia, Canada and the USA have to some extent the effect of muting changes in the *status quo* in terms of the racial and ethnic composition of each of the countries.⁶³ This is partly why the political campaign of the early 1960s (supported by John F. Kennedy, among others) in the USA against the national origins quota system was successful, despite the fact that considerable political forces were mobilized against the reform.⁶⁴ Those who wanted to retain the national origins quota system were mollified by the fact that because the main way for gaining admission under the new regime would be the family sponsorship route, the ethnic composition of America would not change dramatically⁶⁵ (although subsequent experience has largely confounded this assumption). Which of these approaches to immigration policy is most appropriate? Can countries legitimately systematically exclude immigrants of certain nationalities, races or ethnic backgrounds?

Journalist Peter Brimelow has argued that 'there is a sense in which current immigration policy is Adolf Hitler's posthumous revenge on America... The U.S. political elite emerged from the war passionately concerned to cleanse itself from all taints of racism or xenophobia.'⁶⁶ Brimelow claims that there is nothing wrong with not wanting to admit immigrants, but that those who suggest this are unfairly accused of being xenophobic or racist. Brimelow asserts that:

A nation, of course, is an interlacing of ethnicity and culture. Individuals of any ethnicity or race might be able to acculturate to a national community. And the American national community has been unusually assimilative. But nevertheless, the massive ethnic and racial transformation that public policy is now inflicting on America is totally new—and in terms of how Americans have traditionally viewed themselves, quite revolutionary. Pointing out this reality may be embarrassing to starry-eyed immigration enthusiasts who know no history. But it cannot reasonably be shouted down as 'racist.' Or 'un-American.'⁶⁷

Brimelow's position can most positively be regarded as favouring the exclusionary American national origins quota system of US immigration policy of 1924 to 1965.

Brimelow does not suggest that American liberal democratic values are being threatened by increased immigration. The claim is that increased numbers of immigrants who are ethnic and racial minorities are threatening America's traditional view of itself. Given America's troubled past with race relations, this should perhaps be regarded as a positive development.⁶⁸

Political philosopher Michael Walzer is a prominent proponent of the position that in nearly all instances it is legitimate for nation-states, as sovereign entities freely dictating their relationships with other peoples and other nation-states, to choose to exclude outsiders.⁶⁹ Walzer suggests that nations are like clubs. As such, argues Walzer, nations should be able to define their own membership criteria. Walzer's fundamental claim is that:

The distribution of membership is not pervasively subject to the constraints of justice. Across a considerable range of the decisions that are made, states are simply free to take in strangers (or not)—much as they are free, leaving aside the claims of the needy, to share their wealth with foreign friends, to honor the achievements of foreign artists, scholars, and scientists, to choose their trading partners, and to enter into collective security arrangements with foreign states. But the right to choose an admissions policy is more basic than any of these, for it is not merely a matter of acting in the world, exercising sovereignty, and pursuing national interests. At stake here is the shape of the community that acts in the world, exercises sovereignty, and so on. Admission and exclusion are at the core of communal independence. They suggest the deepest meaning of self-determination. Without them, there could not be *communities of character*, historically stable, ongoing associations of men and women with some special commitment to one another and some special sense of their common life.⁷⁰

This position elevates nation-state sovereignty to a level where almost any constraints a nation wishes to impose on immigrants in protection of its culture and its status as a cohesive community are legitimate—even those that are invidiously discriminatory on racial, ethnic, religious or ideological grounds. There are at least two contestable aspects of Walzer's position. The first is that the continuing development and evolution of international human rights norms increasingly suggests that nation-state sovereignty is not as strong as Walzer seeks to suggest. The second surrounds Walzer's implicit assumption that 'communities of character' cannot be defined by common commitment to liberal democratic institutions and the corresponding values of tolerance and inclusion. Liberals in developed countries are likely to argue strenuously that liberal values can and in many countries *do* serve as a basis for 'communities of character'.

In the *Disuniting of America*, Arthur Schlesinger Jr argues a position that straddles the communitarian/liberal divide. Schlesinger believes that children of ethnic minorities should not be entitled to public education catering to their ethnic or national origin in terms of the language of instruction, the historical perspective emphasized or the aspects of world geography concentrated upon. Instead, argues Schlesinger, the American public

education system should be committed to furthering American culture and the importance of liberal democratic institutions. According to Schlesinger,

The militants of ethnicity now contend that a main objective of public education should be the protection, strengthening, celebration, and perpetuation of ethnic origins and identities. Separatism, however, nourishes prejudices, magnifies differences and stirs antagonisms... Watching ethnic conflict tear one nation after another apart, one cannot look with complacency at proposals to divide the United States into distinct and immutable ethnic and racial communities, each taught to cherish its own apartness from the rest. One wonders: Will the center hold? or will the melting pot give way to the Tower of Babel?⁷¹

The liberal aspect of Schlesinger's *prima facie* communitarian position is that he apparently assumes that a relatively liberal immigration policy is demanded philosophically (giving rise to his factional concerns), but that within the bounds of a liberal immigration policy it is legitimate to seek to limit the degree to which the cultural values of immigrants are allowed to permeate the political culture of the USA through the accommodation of different ethnic beliefs, 'histories' and languages in the education system.

Liberal perspectives

Joseph Carens has outlined the consequences of favouring liberty over community from three different liberal perspectives: libertarianism, social contractarianism and utilitarianism.⁷² Libertarianism, as formulated by Nozick,⁷³ demands no more from government than the protection of property rights and the facilitation of exchange through the enforcement of contracts. From a libertarian perspective, then, immigration policies that go any further than pre-empting immigration that might impose any involuntary costs or burdens on residents are unacceptable because they will entail constraints on personal liberty. From a social contractarianism viewpoint, the appropriate immigration policy is the one that would be agreed to behind a Rawlsian 'veil of ignorance' such that the drafters of immigration policy would not know the particularities of their own personal situation (morally arbitrary features such as country of residence, gender, education, ethnicity, etc.), beyond knowing that they represent some human personality in the world.⁷⁴ The purpose of the veil is to ensure that the drafters of the ideal immigration policy would not be bargaining with known endowments and would therefore seek to ensure that the policy drafted would be fair to all concerned, especially the least advantaged. The social contractarian perspective, then, also militates in favour of the relatively free international movement of people, with a similar caveat to libertarianism. Free immigration should occur only so far as the maintenance of public order and respect for rights is not threatened by immigrant flows. From a utilitarianism perspective, Carens argues that the utility of both citizens and immigrants ought to be considered,⁷⁵ with the result that immigration should be allowed to the point where the marginal net benefits accruing to immigrants (if there were no net benefits they would presumably not move)

equal the marginal net costs to citizens of the immigration through, for instance, congestion effects.

Current immigration policies in developed countries do not seem to fit neatly into either the liberal ideology or the communitarian ideology. For example, the widespread adoption (albeit debatable observance) of the 1951 UN Convention Relating to the Status of Refugees (the Geneva Convention) with respect to the admission of refugees undermines one of the core tenets of the communitarian position—community self-definition—by constraining a significant portion of national sovereignty through supranational commitments. Another delegation of state sovereignty with respect to immigration policy can be observed in the EU, where the Treaty of Amsterdam has committed the 13 Continental Members to the eventual free internal movement of people with no internal border checks. However, one might suggest in response that the EU is becoming the relevant sovereign in Europe and so this apparent delegation of sovereignty is no more than the formation of a larger community. Indeed, the contemplated restrictions on migration with respect to Eastern European countries that have recently become new Members suggest that this interpretation may be more accurate. With these possible exceptions, however, the communitarian position is well reflected in the current state of immigration policies among developed nations. Family-sponsored immigration policies reflect a concern that new immigrants should be like old immigrants. Independent admissions based on employer sponsorship, the investment of a considerable amount of financial capital, age, language ability and possession of work experience implicate both communitarian and liberal ideals. The screening process implicates communitarian ideals because such policies define criteria that attempt to maximize the benefit to insiders of immigration. Liberal ideals are implicated to the extent that the screening process does not take into account cultural or ethnic factors, but instead accepts all applicants who exhibit the qualities believed to be important indicators of the ability to succeed in the domestic labour market.

The very necessity of the existence of the Geneva Convention for the protection of the persecuted suggests that the liberal prescription of relatively open borders is (or at least was) not adhered to automatically by the liberal democratic states of the developed world. In addition, with respect to family-sponsored immigration it is not clear how, from a liberal perspective, family-sponsored applicants for admission can make a stronger moral claim for admission than those without family ties (although this may be contested with respect to close relatives such as spouses and minor children). Similarly, from a liberal perspective it should be irrelevant what age one is, how much work experience one has or how proficient one is in the language of the country that one seeks admission to so long as (if one adopts a libertarian perspective) one can credibly pledge not to be a burden on current residents. The idea that each person is of equal moral worth is apt to be blind to family relationships and economic considerations. Therefore, communitarianism and not liberalism currently more accurately describes the predominant approach to immigration policy in almost all developed countries, although liberal ideals have not been without influence.

RETHINKING IMMIGRATION POLICIES

One of the key ingredients of immigration policy in most developed countries is a quota system that restricts the number of immigrants that will be accepted each year in each admission class. These quotas are justified on the basis that completely open borders would be problematic because of negative externalities (e.g. congestion effects) and the political and fiscal stresses that would be placed on the redistributive programmes of the welfare state due to fiscally induced migration.⁷⁶ Despite the problems perceived to be associated with illegal immigration (which are at least in part due to quotas), quota systems are a practical (albeit arbitrary) way of limiting the number of immigrants arriving each year. One of the primary shortcomings of the quota method is that it unduly hampers the flow of immigrants who can demonstrate that they will not be a burden on the amenities of the welfare state. Many would-be immigrants, despite the fact that they are able to demonstrate that they will not be a burden through various means, such as the possession of adequate personal resources or through pre-arranged employment (independent immigrants), through the sponsorship of legally resident or citizen relatives (family immigrants), or through the sponsorship of a private party or organization (refugees selected overseas), are not able to immigrate due to quota restrictions.

Another problem associated with the quota system is that quotas must be set in advance, which places the very difficult (perhaps impossible) task of predicting the needs of the labour market (at least in the case of the independent class quota) in the hands of a centralized bureaucracy. The administration of immigration policies in developed countries is, for the most part, unduly restrictive and bureaucratic. Immigration policies are bureaucratic because immigration laws are managed by centralized bureaucratic agencies that are often given full and independent responsibility for ascertaining and predicting *ex ante* the needs of the labour market for the next year (in Australia and Canada this responsibility includes assessing the demand for various classes of workers), ensuring that the nation's commitments under the Geneva Convention have been respected, and determining the total number of immigrants that should be admitted each year.⁷⁷ Centrally planning for the future needs of the domestic labour market is an assignment that to be done correctly and accurately requires an almost unlimited amount of information, including, *inter alia*, accurate forecasts of the global macroeconomic environment, an assessment of the economic health and prospects of each of the country's major industries, an accurate determination of how well domestic firms are faring internationally, and a sensitivity to changes in demand due to shifting consumer preferences and relative prices of goods and services. The cost of generating an accurate forecast is likely to be prohibitive, and at best such a forecast can only be couched in probabilistic terms. As a result of the stochastic nature of economic outcomes, an ideal immigration policy would take into account the ever-changing dynamic state of the economy and the national labour market in determining the appropriate number of immigrants to admit on a yearly, monthly or even weekly basis. Moreover, given the administrative delays associated with processing immigration applications in virtually all developed countries, the lag between quota-setting and actual admissions is likely to prove highly problematic. Immigration quotas are inequitable to the extent that they

restrict the entry of persons who pose no threat of being a burden fiscally and are insufficiently sensitive to labour market conditions because of the difficulties associated with central planning (i.e. the near impossibility of obtaining and processing sufficient information) and administrative delays.

A priori there is nothing particularly malign about having a bureaucratic body responsible for overseeing immigration policy. Indeed, absent completely open borders, such a body is necessary to oversee whatever restrictions are imposed on the entry of foreigners into the country. Rather, the problematic aspect of bureaucratic bodies charged with implementing immigration policy is that it is often their responsibility to determine how many immigrants ought to be admitted to the country (in the USA this responsibility lies with Congress), and to judge on a case-by-case basis whether or not particular applicants satisfy arbitrary or subjective criteria for admission.

The prescriptions proposed here are centrally motivated by the idea that there is a compelling case for devolving and decentralizing power over immigration decision-making to private parties to a much greater extent than currently prevails, although health, criminality and national security checks should be retained for the reasons outlined earlier. This reorientation would allow the international movement of people to be much freer and would promote a more efficient mix of international movements in goods, services, capital and labour. We now spell out in some detail how such a decentralized approach to immigration policy might operate.

Independent applicants

As a starting premise, those who wish to immigrate who have already secured employment or who have financial resources sufficient to maintain independence from the amenities of the welfare state (except publicly subsidized education and healthcare) should be able to emigrate freely provided that they, either individually or through their employer, have taken out specified minimum coverage private insurance to cover any drawings that they may make against non-contributory social programmes within a certain period of time after entry. This private insurance requirement (akin to mandatory automobile accident insurance) is central to our proposals in seeking to screen out fiscally induced immigration by internalizing a significant portion of the social costs of immigration to would-be immigrants or their sponsors. To the extent that the prescribed minimum coverage proves to be inadequate to reimburse drawings on these social programmes, immigrants and their sponsors would be jointly and severally liable for reimbursement of the deficiency. Labour certification requirements and domestic search requirements are protectionist and inefficient because they impose additional costs on hiring foreigners (making domestic workers arbitrarily more attractive) and are therefore of little (if any) value in a decentralized system. Under a decentralized approach, the labour market would regulate the inflow of persons congruently with demand. Employers would sponsor immigrant workers as frequently as is deemed to be cost justified.

The social programmes that immigrants would be denied legitimate access to immediately after entry would include, *inter alia*, welfare payments, food stamps, public housing subsidies and public non-contributory pensions. Publicly subsidized education and healthcare would not be among the excluded benefits and would thus be available to all immigrants. Public education would not be included in the enumerated items because

public education is one of the primary mechanisms through which liberal democratic states impart liberal values such as tolerance to succeeding generations—a function that is important in establishing and perpetuating the security of a nation's liberal democratic institutions. Publicly subsidized healthcare would not be among the excluded items because, given that the immigrant has presumably already passed a medical examination prior to landing, there is likely to be no significant adverse selection problem or abuse of the system in this regard. Given that education and healthcare are primary goods, it would take a considerable threat of fiscal abuse to pre-empt their use by newly landed immigrants. Furthermore, given the fact that all immigrants are taxed on their income at the same rates and in precisely the same way as are natives, there appears to be little justification for denying them the enjoyment of publicly provided education and publicly subsidized healthcare. Similarly, objections that increased immigration will result in increased negative congestion effects and thus generate demand for more infrastructure such as highways, schools and hospitals are met by the fact that immigrants pay taxes just as do natives.

The responsibilities entitling one to sponsor an immigrant might include taking out specified minimum insurance coverage against any social benefits (excluding publicly subsidized education and healthcare) that the immigrant might draw on during the minimum residence period required for full social programme eligibility. The selection of a minimum residence period is to some extent arbitrary. However, arguably it should not be longer than the period of residence required to qualify for citizenship: in Canada three years, in the USA five years. Longer periods would create normatively problematic first- and second-class citizens. The social programme insurance device would entail a mandatory obligation on the part of the sponsor to pay the premiums required to insure the worker against any drawings he or she may make against the amenities of the welfare state. The sponsored worker would be free to draw on social programmes (other than publicly subsidized education or healthcare, which would be provided as a matter of course), but the state would be entitled to be indemnified for these drawings by the insurance company underwriting the social programme insurance policy held by the sponsor. One of the main advantages of this insurance scheme is that in a competitive private insurance market, insurance premiums would adjust to reflect the expected drawings of immigrants given their observable characteristics such as educational background, occupation, type of sponsor (e.g. employer, family or humanitarian), age, work experience, etc. If it turns out that the fears of fiscally induced immigration are exaggerated and immigrants do not draw public benefits at a significant rate, insurance will be inexpensive and readily affordable for most sponsors. If fears of fiscally induced immigration are well founded, then insurance premiums will be significantly higher, thereby increasing the costs of sponsorship and creating stronger incentives for sponsors to be more selective in screening potential immigrants. Thus, if fears of fiscally induced migration are credible then, all else being the same, the number of immigrants sponsored and admitted will decrease due to the increased costs associated with insurance and sponsorship.

Once a sponsored employee has arrived in the country, employers would be obligated to continue paying premiums on the insurance contract for the full minimum residence period, regardless of whether or not the employee remains employed by the employer (unless a new employer agrees to assume this responsibility). If the employer

subsequently becomes insolvent, winds-up or otherwise cannot be compelled legally to honour their obligation to pay premiums for the period, then the sponsored immigrant would become responsible for taking over the insurance premium payments or else could potentially be held to be in default of the conditions for permanent residence and be subject to deportation from the country.

A related concern in the context of employer-sponsored immigrants might be that fly-by-night or sham employers might sponsor dozens of immigrants, commit to paying their premiums for three years, then promptly declare bankruptcy and/or wind-up their operations. To the extent that this is a concern, however, insurance companies have the incentive to sell insurance only to reputable, well-established businesses, or perhaps demand premium payments up front from companies that present relatively poor or unknown default risks. Moreover, immigrants not covered by current social programme insurance policies would be subject to deportation.

Independent immigrants who are admitted based on having financial assets sufficient to maintain independence from the amenities of the welfare state (for example under investor immigrant programmes) and are thus not sponsored by employers would remain responsible for obtaining social programme insurance coverage of the required minimum amount for the requisite period, although one would expect the premiums to be minimal.

Those admitted to the country on student visas to study would benefit from this liberalized immigration policy regime, as would host countries.⁷⁸ Students from abroad admitted to study at the post-secondary level have in most cases established that they have the motivation and talent required to succeed in an academic environment. This same motivation and talent is often translatable into considerable value in the labour market. If these students are able to secure employment and sponsorship upon graduation, there is little reason to preclude them from doing so. In fact, there appear to be several reasons to encourage them to stay. Most college and university graduates on student visas are fluent in at least one of the country's major languages, are well educated, talented and motivated, and are therefore *prima facie* well equipped to contribute productively to the domestic economy immediately. In addition, they are likely to be relatively young so that their presence can help improve the dependency ratio, and are likely to have already internalized to a considerable extent the values and social mores of the country.

To the extent that young students who stay after completing post-secondary education abroad contribute to a brain drain for the country of origin which is costly—a debatable proposition, as noted above—there may be scope for countries of origin to try to reduce the magnitude of these brain-drain costs. One option may be for countries of origin to demand that students leaving the country to study abroad (or their families) repay the publicly subsidized portion of their primary and secondary education if they ultimately elect to remain abroad after completing their studies (or to post a bond to this effect). Given the fact that the existence of a brain drain is empirically contestable, however, and the further fact that it is unclear who actually pays for publicly subsidized primary and secondary education of emigrating students, such policies may be unwarranted.

Family preference immigration

An arrangement very similar to that envisaged for independent immigrants could be instituted for family preference immigrants. Under the decentralized family preference

system, any individual that is sponsored by a relative (such as a spouse, parent or age-of-majority child) would be eligible immediately for immigration, provided that the would-be immigrant has met health, criminality and national security checks and his or her sponsor has secured social programme insurance of a specified minimum amount on the immigrant's behalf. This would be a highly desirable development because of the extremely long waits currently imposed on family-sponsored immigrants in many developed countries. For instance, in January 1997 in the USA, the family preference queue for siblings of US citizens consisted of 1.5 million applicants, representing a wait of at least ten years (and in some cases as long as 20 years).⁷⁹ As with independent immigrants, family sponsored immigrants admitted through the decentralized process would be eligible to receive publicly subsidized education and healthcare benefits (with the possible exception of those who are 65 years of age or older upon landing, or those who cannot meet the health check, who could be required to obtain independent private health insurance), but any welfare payments, food stamps, public housing subsidies or public pension payments received within a specified period of time after entry would be subject to reimbursement by the sponsor's insurer. The degree of proximity of the family required to make use of the family category of admission (i.e. degree of consanguinity necessary for sponsorship), which is a long-standing matter of contention in immigration policy debates in many countries, is of second-order importance under these proposals given their cost-internalizing nature.

Refugees and asylum seekers

The issue of refugee admissions is less amenable to a decentralized approach to immigration policy. There are two main types of refugees—those who arrive in the host country seeking admission (inland refugee claimants), and displaced persons who are selected overseas for admission to the host country (overseas refugee claimants). Those who arrive uninvited in the desired destination country claiming that they are refugees must be considered for admission in accordance with the host country's obligations under the Geneva Convention (unless, for instance, the country has enacted restrictions—as have Germany, the USA and Canada—providing that the country will not consider the cases of asylum seekers arriving via a 'safe third country' or from 'safe countries of origin'). Because signatory countries have an obligation under international law to consider the cases of inland refugee claimants on their merits by virtue of the Geneva Convention, the decentralized approach is not readily applicable. For refugees selected overseas, however, the decentralized approach will generally be relevant.

Developed countries often establish targets for the number of refugees selected overseas for admission to the host country. A complete abandonment of the quota approach in favour of decentralized overseas admissions may result in a deluge of overseas refugee claimants (although this is probably unlikely). The current quotas are arbitrary, but are to some extent understandable because refugees selected overseas often lack valuable labour market skills such as fluency in the language of the country of landing and/or specialized human capital, and because they may take longer to integrate into the country's labour market (although, as noted above, the empirical evidence does not support fears of long-run non-integration).⁸⁰ Thus, an abandonment of the quota system for overseas refugees should not be ruled out altogether. Despite these concerns,

however, many residents of developed countries take great pride in extending aid to refugees and asylum seekers and are likely to gain psychic utility from the knowledge that they are helping those in desperate need. In addition, to the extent that a decentralized system requires social programme insurance similar to that advocated for the independent and family classes, there is little to fear fiscally from a higher influx of refugees selected overseas.

Canada's approach to the admission of refugees is currently partly decentralized. Private organizations in Canada interested in sponsoring overseas refugee claimants must negotiate a Sponsorship Agreement with the Minister of Immigration, which details the criteria for determining whether or not a person is a refugee, and establishes the sponsor's obligation to provide housing and food for the refugee for up to two years after the arrival of the refugee in Canada. Such a regime could be replaced with a mandatory social programme insurance system similar to that advocated for the independent and family preference immigration contexts. To the extent that private parties derive positive marginal utility from sponsoring refugees and asylum seekers (and provided that they commit credibly to apply the Geneva Convention criteria to the selection of overseas refugee claimants and must maintain social programme insurance for those they sponsor), refugee sponsors should be free to facilitate admittance to those with deserving claims from overseas without limitation (subject again to health, criminality and national security checks). Where refugees cannot satisfy the health test, they should be admissible if their sponsors have obtained adequate permanent, private health insurance.

Illegal immigrants and guest workers

For several reasons, illegal immigration should be discouraged despite its net positive welfare effects; this discouragement, however, should not be through increased border controls, but through accommodation. The psychic costs borne by illegal immigrants associated with the stigma attached to their status, as well as the continual fear of discovery, are considerable (but presumably outweighed by the expected benefits of staying). In addition, patrols are largely ineffective at keeping out those who desperately desire admission, and the costs associated with patrolling borders are significant. Finally, the existence of an underclass of 'others' who are unable to participate politically in the community by voting or running for office and are unable to participate in social programmes is undesirable for humanitarian reasons.

One way to relieve the pressure exerted by illegal immigrants to immigrate is to liberalize immigration policy. By eliminating quotas for immigrant admissions, and by allowing those sponsored by employers or relatives (and supported with social programme insurance) to gain entry so long as they pass health, criminality and national security checks, some of the pressure exerted by illegal immigrants for admission will be relieved. Although obtaining employer sponsorship, securing social programme insurance, and passing health, criminality and national security checks impose transactions costs that would not necessarily accompany illegal immigration, being considered a 'legitimate' or 'legal' immigrant is likely to be of considerable psychic value. In addition, once legally admitted to the country, under these proposals an immigrant would immediately begin fulfilling the period of residency required to participate fully in social programmes and also to naturalize as a citizen (thereby

ultimately gaining the rights associated with political participation such as voting and being eligible to stand for election).

If demanding employer sponsorship and social programme insurance of unskilled immigrants proves to impose too great a burden in terms of transactions costs on employers or would-be immigrants to stem the tide of illegal immigration, another way to eliminate the pressure for illegal immigration would be to liberally distribute temporary worker visas to any employer-sponsored immigrant. Due to the problems associated with trying to expel temporary workers, exemplified by the permanent guest worker phenomenon of Western Europe, this liberal temporary worker system could be accompanied by an automatic graduation to permanent legal immigrant status after a specified period of continuous employment in the host country. That is, if one held a temporary worker visa for, say, three to five years and worked continuously (or nearly continuously, if not with the same employer for the entire period), then one would be automatically extended legal permanent resident status. During the period of residence as a temporary worker, the only social services available would be publicly subsidized education and healthcare services. Upon the automatic grant of permanent resident status, the temporary worker would qualify for full participation in all social programmes and would begin the period of residency necessary to naturalize as a citizen and secure the rights associated with full political participation. Thus, there would be very little incentive for would-be workers to immigrate illegally because they would forego the medium-to-long-term benefits associated with the relatively straightforward process to work legally. The host country would also benefit from the implementation of this system. Immigrants who would have possibly entered the country illegally otherwise would be registered as temporary workers and thus would be easily identifiable by the host country. The introduction of the temporary worker class of admission by creating a registry of temporary workers would help social programme administrators curtail the consumption by such workers of social services to which they are not entitled (such as welfare, non-contributory pension benefits, food stamps, etc.), would (at least to some extent) reduce foregone tax revenues by reducing the incentives to pay workers 'under the table', and would also allow the resources previously allocated to patrolling borders for illegal immigrants to be allocated to more productive uses.

THE MANDATORY INSURANCE PROPOSAL IN CONTEXT

The proposal to require sponsors of immigrants to maintain social programme insurance of a specified amount is not markedly different in motivation from certain aspects of current immigration policies. Several current immigration policy initiatives, such as the requirements of the Canadian investor admission class, the mandatory Canadian ten-year support undertaking for family class immigrants, and the Australian Assurance of Support and its associated pledge bonds, are implicitly designed to combat fiscally induced migration in a manner similar but inferior to the mandatory social programme insurance proposal. The mandatory insurance proposal is also consistent in several respects with, but, again, superior to, proposals to auction off visas (Julian Simon) or to sell entry visas at a fixed lump sum price (Gary Becker) that have been promoted as ways

to combat fears of fiscally induced migration and to attenuate the economic inefficiencies associated with quotas.

In Canada, to qualify for admission as an investor, an applicant has to demonstrate that they have operated, controlled or managed a business; that they have acquired at least \$800,000 in net worth; and that they are willing to make a substantial investment in Canada upon being issued a visa. This last condition entails the investment of \$400,000 for a five-year period in a programme managed by Citizenship and Immigration Canada (CIC). This \$400,000 investment is not refundable after a visa is issued and is repaid without interest at the conclusion of the term. According to the CIC, the funds are remitted directly to the CIC and are not invested by the applicant but instead are delivered to and are secured by the 'provinces and territories that use the funds to create jobs and develop their economies'.⁸¹ Pragmatically, an individual admitted to Canada as an investor has essentially purchased their visa for a sum equal to the net present value of the foregone investment returns that \$400,000 would earn over a five-year period. If \$400,000 is invested for five years and earns a compounded annual after-tax rate of return of 6% per year, then at the conclusion of the five-year period the investment is worth approximately \$535,290. If inflation is running at a rate of 3% per year, then the Canadian investor admission class can be understood as requiring the equivalent of a payment of approximately \$116,702 for admission. A payment of this order of magnitude constitutes a very high barrier to entry and serves to deter all but the wealthiest of would-be immigrants. That such payments are routinely extracted from immigrant investors suggests that Canada's quota system is deterring a considerable number of immigrants who would enhance the nation's welfare, but who cannot afford the steep price of entry nor gain admission in any of the other subclasses.

Applicants sponsored by a permanent resident or citizen of Canada who is a spouse, fiancé, fiancée, parent, grandparent or child over the age of 19 are *prima facie* eligible for admission to Canada in the family class. However, the sponsoring relative must meet certain income requirements, and sponsors must also undertake to provide for the settlement needs of their applicants, including lodging and maintenance, for ten years after the applicant immigrant arrives in Canada.⁸² These undertakings are motivated by precisely the same consideration as that behind the mandatory insurance scheme—to discourage fiscally induced migration. As a matter of practice, however, these undertakings are rarely (if ever) used to recover social assistance payments made to family sponsored immigrants, in large part due to the fact that social assistance payments fall under provincial jurisdiction whereas the undertakings are made to the federal government in the course of the sponsorship process.⁸³ While well intentioned, the central problem with these undertakings is that they are difficult to enforce for two reasons. The first reason is the federal/provincial mismatch in responsibility for making social assistance payments and in enforcing the undertakings. The second reason is that if sponsors fall on financially difficult times, they may not be able to afford to support those they have sponsored. It is difficult (even abstracting from the jurisdictional mismatch issue) to enforce these sponsorship undertakings since sponsors have no insurance coverage for providing for those they have sponsored and are not required to set aside funds *ex ante*.

The Australian system is superior to the Canadian undertaking system in that family sponsors are required to post a bond and formally enter into an Assurance of Support,

which consists of a 'legal commitment by the assurer to repay the Commonwealth of Australia any benefits paid to those covered by the assurance in the first two years after their migration from overseas or grant of permanent residence in Australia'.⁸⁴ The Assurance of Support is supported by pledge bonds in the amount of AU\$3,500 for the primary applicant and AU\$1,500 for each additional adult who is sponsored for admission. The value of the bond less any drawings made by the sponsored immigrant is returned to the assurer at the conclusion of the two-year support period, which helps prevent the default problems that are apparently common in the Canadian experience. The Assurance of Support and the accompanying pledge bonds do not need to come from either the applicant or the sponsor—a third-party assurer is acceptable. The disadvantage of the Australian system is that the value of the bond is fixed without reference to any of the circumstances of the sponsor or the incoming immigrant. Low-risk and high-risk immigrants must pledge bonds of the same amount. Moreover, although the quantum of funds demanded is not extraordinary, AU\$3,500 is a considerable amount of money and many sponsors and immigrants are apt to be unable to afford to finance pledge funds, even if they carry a relatively low risk of default. The mandatory insurance scheme improves upon the pledge bond in three ways. First, insurance premiums can be paid periodically, which reduces the liquidity problem faced by sponsors and immigrants seeking to save the AU\$3,500 demanded for a pledge bond. Second, insurance premiums adjust for the perceived risk that a would-be immigrant poses; pledge bonds are the same value for all would-be immigrants. Finally, insurance coverage for drawings on social assistance can exceed that possible under a pledge bond regime at relatively little additional cost, which gives the state added confidence that newly landed immigrants will not constitute a fiscal burden.

The advantages of the decentralized, mandatory social insurance approach to immigration policy can be demonstrated more clearly still by comparing it with two approaches that have found favour with economists Julian Simon and Gary Becker—the sale, either through auction or through some preset price, of entry visas.⁸⁵ In Simon's proposal, periodic auctions of a certain number of visas would be used to sell admission. Under Becker's proposal, by contrast, anyone willing to pay a certain fee up front for an entry visa (he suggests \$50,000) would be entitled to enter the country (in his example the USA) immediately. These two proposals each improve upon the three-class quota system *status quo* in at least two respects. First, those who have the greatest willingness (and ability) to pay for entry will be able to enter immediately without having to suffer through the often inordinately long waiting periods occasioned by the restrictive nature of the quota system. Only those whose welfare would be markedly improved by gaining immediate entry would choose to pay Becker's fixed fee. Similarly, only those with the highest willingness to pay would purchase a visa in Simon's visa auction. In other words, those with high opportunity costs associated with waiting for entry would no longer have to do so, which would be welfare improving. Second, the admission of such immigrants would not likely constitute a net fiscal burden for the receiving country because the immigrants *ex ante* have made a large fiscal contribution to the country's government through the payment of either Becker's fixed fee or Simon's auction price. Moreover, those who are willing and able to pay a considerable sum of money in order to emigrate are likely to be able to support themselves, either through existing means or through newly acquired means (i.e. through employment in the receiving country), upon arrival.

Each of these proposals suffers from one primary disadvantage. Individuals who do not possess and cannot find a way to borrow the sum required to pay for entry would be hard-pressed to find the means to do so, given the fact that it is difficult in general to borrow against one's human capital. Thus, even skilled and talented immigrants from the poorest countries might find it difficult to gain entry. Becker postulates that third parties might be willing to lend would-be immigrants the funds necessary to immigrate immediately. For example, employers might be willing to make loans to those whom they wish to hire, friends and relatives may pool resources in order to make a loan, and even commercial lenders might make loans for entry permits to those would-be immigrants who are deemed to be good risks. For the poorest immigrants, Becker suggests that the government might be able to lend them money to help pay for the cost of an entry visa in a programme not unlike loan programmes for post-secondary students. To prevent abuse of the system, the country could refuse to grant citizenship to anyone who has not fully repaid their loan.

The decentralized, mandatory social insurance programme addresses the same concerns and shares the same advantages of the proposals of Simon and Becker, but does so more efficiently and more equitably. First, since the traditional quota system would be abandoned, entry would be much easier for most would-be immigrants. With the decentralized, mandatory social insurance programme, there would be no long queues and associated time costs that might cause would-be immigrants to pay a large up-front fee as in Becker's proposal. It is even clearer that the mandatory social insurance programme is an improvement upon Simon's scheme, since Simon would retain quotas for the proportion of visas that are sold. Moreover, assuming that a competitive insurance market would develop if the insurance proposal were adopted, each would-be immigrant would pay a price closely correlated with their expected draw on the amenities of the welfare state—not some predetermined, arbitrary price for entry set by a political process as in Becker's scheme. Simon's proposal has the advantage of using the market to set the price of a visa via an auction, but this price is artificial and depends in large part upon the number of visas that are periodically auctioned off (again, politically determined). In addition, the insurance programme would mitigate (at least to some extent) the liquidity constraints faced by would-be immigrants under the Simon and Becker proposals. Because insurance premium payments would be made periodically, and would in most instances likely be of a considerably lower order of magnitude than the costs associated with Simon's auction price or Becker's proposed fee, even the poorest immigrants would likely find the system to be accessible, though, of course, not perfectly so (perfect accessibility would require immediate, costless entry and thus completely open borders, which would be problematic for reasons outlined earlier). The main advantage of the Simon and Becker approaches, of course, is the relative ease with which immigrants would be able to purchase entry. With the insurance proposal, the advantages for the labour market associated with rapid admission of workers from abroad are not lost, the issue of fiscally induced migration is controlled and, because labour mobility would be considerably higher than it would be under these competing approaches (due to much lower costs associated with entry), a greater increase in global economic welfare might well result.

CONCLUSION

The international movement of people lags behind international movements of goods, services and capital mostly because immigration policies in most developed countries are relatively restrictive. This state of affairs is undesirable because the potential benefits to global economic welfare in terms of increasing world economic output from freer international movement of people are large. In addition, liberalized immigration policies have the potential to decrease global income inequalities. One of the main barriers to opening up the borders of developed countries to unrestricted immigration flows, however, is fiscally induced migration. Impoverished immigrants may be drawn to developed countries by the amenities of the welfare state, which, at the limit, may threaten the viability of the social programmes that constitute the welfare state.

In order to realize most of the economic benefits associated with liberalized immigration flows without impairing the viability of the welfare state, this chapter has argued for abandoning numerical quotas on family sponsored and independent immigrants and relying instead on the mechanisms of sponsorship and minimum mandatory social programme insurance. The sponsorship/mandatory social programme insurance system would protect the integrity of the welfare state by preventing its abuse by newcomers. At the same time, decentralization of immigration decision-making would generate improvements in the efficiency of labour markets in developed countries by decreasing the uncertainties associated with recruiting abroad, by decreasing the waiting period associated with the bureaucratic requirements of immigration agencies and by allowing the needs of the labour market to indirectly determine the number of immigrants admitted each year. The delegation of immigration decision-making power to those benefiting from the decisions, coupled with a policy requiring them to internalize the costs of any social programme abuses through insurance premiums, would generate a much better alignment of incentives than bureaucratic administration of admission requirements (beyond health, criminality and national security checks).

The timing of immigration policy reforms may prove to be a key determinant of how much benefit individual countries will be able to realize from liberalization. Many industries already face increasingly fierce global competition for the recruitment of those possessing highly specialized human capital. Given the empirical fact that once specialized clusters of complementary industries form in a particular locale they tend to be self-perpetuating (agglomeration economies),⁸⁶ an important first-mover advantage may be seized by those countries demonstrating a willingness to dispense with formal immigration quotas and allowing international labour markets to operate more freely. Such initiatives should be complemented by more effective public and private resettlement assistance programmes and credential equivalency determination mechanisms.⁸⁷ These clustering benefits are likely to be most concentrated in the recruitment of those with highly specialized human capital, but may be realized to an indeterminate extent with the recruitment of relatively unskilled workers as well. As natives and highly skilled immigrants are drawn increasingly into employment demanding highly specialized human capital in the so-called 'new' or 'knowledge-based' economy, new complementary opportunities for unskilled workers arise. Dual-career households demand nannies, housekeepers, gardeners and cooks. To the extent that these positions cannot readily be filled by unskilled native workers, growth in highly skilled

occupations may be hampered for lack of affordable ancillary services. Thus, the general liberalization of immigration policy in developed countries will facilitate the reaping of the greatest range of benefits possible. Not only will countries adopting such policies capture a potentially very important first-mover advantage, but they will be able to reinforce this advantage by admitting unskilled workers that are able to meet the requirements proposed above to provide the support services demanded by many highly skilled workers, their families and their employers.

In short, we believe that in an increasingly globalized world economy, developed countries would find it prudent to integrate immigration policy fully and centrally into their external economic policies (along with external movement of goods, services and capital) and to remove it from the largely protectionist, inefficient bureaucratic backwater in which it has languished in most developed countries for much of their history. While the recent terrorist attacks in the USA may create pressures to render existing immigration policies more restrictive rather than more liberal than they currently are—and indeed national security screening obviously needs to be rendered more stringent and effective—we should not allow these events to blind us to the substantial long-term domestic and global welfare gains likely to be realized from more liberal immigration policies.

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Concluding postscript

In this brief conclusion, we consider ‘emerging’ issues for the world trading system—issues that are not, as such, new but have or will have particular salience in the coming years, and which have not been addressed systematically in the current round of multilateral trade negotiations.

TRADE AND CULTURE

Trade in ‘cultural’ goods and services became a matter of prominent contention at the very end of the Uruguay Round negotiations, with a proposal, backed most notably by France and Canada, that the audio-visual sector (movies and television) be largely protected from services trade liberalization by a ‘cultural exception’ or carve-out.¹ The United States objected. In the end, no such ‘cultural exception’ was included in the GATS; the controversy was diffused because, by virtue of the general structure of GATS (see Chapter 12), individual WTO Members had the freedom to simply not bind culturally sensitive sectors in their schedule of commitments, and as for general GATS obligations (most notably Most Favoured Nation) that apply even to unscheduled sectors, GATS permitted the flexibility to file reservations.

The issues, however, are not confined to services trade, as the *Canadian Periodicals* case (see Chapter 3) illustrates; there, magazines were considered to be traded goods, and Canadian local content policies were evaluated under the National Treatment provisions of GATT. In GATT, there is no exception for cultural policy as such: Article XX(f) allows for otherwise GATT-inconsistent trade restrictions that are imposed ‘for the protection of national treasures of artistic, historic or archaeological value’. The narrowest reading of this exception would be that it is strictly limited to the case of trade controls imposed to prevent cultural objects from being removed from their country of heritage or origin (a matter dealt with under UNESCO law). The provision has never been the subject of dispute settlement in the GATT or WTO, so how broadly it might be read is quite unclear. For example, is a local language a ‘treasure of artistic, historic or archaeological value’, or a traditional form of poetry or dance?

Article IV of the GATT specifically allows for ‘screen quotas’, thereby exempting from GATT discipline a practice (typical in Europe at the time) of requiring that screen time be shared between domestic and imported films.² The North American Free Trade Agreement contains a clause that is sometimes called a ‘cultural exception’: thus, Article 2106 incorporates a provision of the earlier Canada—US Free Trade Agreement (FTA) that would exempt some Canadian cultural policy measures otherwise subject to the FTA rules, but at the same time the United States would be able to take unilateral trade retaliatory measures against such policies, even if exempted from FTA disciplines. This

exception is clearly then a double-edged sword, and this is perhaps why Canada did not invoke it in the *Periodicals* dispute.

The issue of trade and 'culture' also extends to debates about traditional knowledge and intellectual property, and issues concerning the way in which biotechnology affects traditional agrarian ways of life. We have flagged these questions where appropriate in the text of this book. As well, there is an important and very broad question about the effects of globalization on cultural diversity and cultural politics: see, for example, Amy Chua's provocative work *World on Fire*, where she discerns considerable increases in tensions between ethnic majorities and minorities in a number of developing countries, because of the economic and social pressures that come from opening up the economy to foreign participation and international competition.

To return to the debate over trade in cultural industries, the US position, which is that 'culture' is essentially the entertainment business, and entertainment is a business like any other, is not widely shared by other countries. While that point of view is sometimes stated with crude arrogance by Hollywood moguls, and is understandably offensive to non-American sensitivities, it poses at bottom the right question: why don't markets and competition in cultural goods and services result in an optimal allocation of resources (including global markets and global competition)?

To this there are a number of possible answers. One is an 'infant industry' argument that is really no different in this sector than others. Canada, for instance, supported the development of a domestic popular music industry through local content requirements for broadcasting. Arguably, without these requirements Canadian performers would not have obtained the 'airtime' to expose consumers to their products. The result was the creation of a now sustainable world-class popular music industry. The downside is the same as well: if we take a look at another cultural industry, book publishing, where Canada also pursued active 'infant industry'-type policies (especially subsidies), the result has been disappointing-the industry has become characterized by economically fragile companies, which seem to have developed a permanent dependence on subsidization for their survival.

A second argument for the special treatment of cultural industries is that this sector is characterized by unfair or imperfect competition. It is often argued that American popular culture is colonizing other societies, as if American movies and television were imposed at gunpoint on consumers in these societies. We strongly support the importance of choice and diversity as values of public policy. Again, the question is why the market does not optimize these (and a very pertinent question, since measures such as local content restrictions themselves limit choice, on the theory that they are needed to expand it).

In fact, the cultural sector is one where major multinationals have arguably used anticompetitive practices, such as exclusive distribution arrangements, to limit consumers' choices. There may be also some evidence of the abuse of intellectual property rights for anti-competitive purposes. We do not exclude the possibility that some existing 'nationalistic' cultural policies may be needed or effective responses to these phenomena, at least in the absence of appropriate and effective antitrust measures. We also support limits on intellectual property rights, which ensure that multinationals cannot suppress the countering or parodying of 'dominant' popular culture through the weapon of copyright.³

With respect to the subsidization of motion pictures—a very important policy in Europe, Canada and elsewhere—the question is more complex than is usually conceded either by Hollywood or by its critics. On the one hand, it is unquestionable that some of these subsidies are outright protectionism—what value is there to Canadian culture in subsidizing cop shows, whose only Canadian feature is that local businesses and actors are involved? On the other hand, in evaluating subsidies policies in other countries, it would be necessary to look carefully at the American tax system, and the possibility that this system provides a more favourable climate for risky investments in big-budget films, for example, than the tax systems of other countries (for instance, European countries).

Finally, there may be a public goods dimension to some cultural products. Fully internalizing the social benefits of films, TV, books and magazines through increased intellectual property rights or greater enforcement may involve excessive transaction costs, or would be undesirable for other reasons (distributive justice). Indeed, to avoid all free riding, one would probably need an intellectual property regime that would be so tight and draconian as to pose significant threats to the public cultural space. Thus, where public goods can be identified, subsidization may be the best response in the circumstances.

A last word on diversity and choice. A range of technological developments have considerably reduced—or promise to reduce—the difficulty of maintaining a wide range of cultural choices within societies, and across societies. These range from the internet to print-on-demand books to global satellite television. Some of these developments answer the problem of economies of scale that might otherwise threaten the capacity to produce and disseminate cultural products in a language spoken by only a small percentage of the world's people, for instance, or where the market in a single country is small. One might not like Al-Jazeera television's editorial content, but one cannot deny that it presents an alternative perspective to that of CNN to the entire Arab world. If Al-Jazeera were able only to reach one national market in the Middle East, its viewer base would probably be narrow, and it would not have the resources to rival other Western networks. But, thanks to satellite television, it can draw on a global audience of Arab speakers.

Cultural critics of globalization worry that these conduits for global communication, and particularly the internet, end up being controlled by American, or Western, multinationals. Of course there is a digital divide between rich and poor countries, but increasing internet access in poor countries is not an insurmountable problem for development. The danger is that the fear of 'control' by multinationals may provide a pretext for greater control, or legitimizing control, by governments—in our view, at the moment, a far greater threat to diversity and choice (consider the case of China).

This brings us to the current state of play of the trade and culture issue as it concerns trade negotiations. The idea of a general or across-the-board carve-out for 'culture' in WTO Agreements is one to which, based on the above considerations, we are not sympathetic; instead, there needs to be a careful analysis of which policies are reasonable, non-protectionist responses to public policy challenges, and which are simply protectionism, an assertion of the supposed intrinsic value of 'buying local'. Perhaps having learned from the difficulty of moving forward with such a proposal in the WTO negotiating forum, proponents of a cultural carve-out have now floated the idea that there should be an independent global legal instrument on 'cultural diversity'. One possibility would be to negotiate such a convention under the auspices of UNESCO. This is the aim

of a group of over 60 countries in the International Network on Cultural Diversity (INCD), led by Canada.⁴ The INCD has produced a draft convention text—a 2003 version of this text contains an operative provision (Article 14) that provides:

Members, recognizing that the maintenance of a cultural space for national products is a necessary condition for preserving cultural diversity at the international level may, when they deem appropriate, adopt measures conducive to guaranteeing such a space, including language and/or content requirements, where applicable. When they adopt such measures, Members...shall ensure that government policies do not undermine the principle of openness to other cultures.

As the language ‘when they deem appropriate’ suggests, the intention is to provide a broad carve-out for existing cultural policies, subject to a vague principle of access to other cultures. The draft—presented to a meeting of culture ministers at the 2002 Johannesburg Summit on Sustainable Development—contains clauses that stipulate that nothing in the convention derogates from existing obligations in international intellectual property conventions, or from human rights. There is no provision that explicitly deals with the relationship between the convention and existing WTO law, although there is a clause that would provide at least moral legitimacy to the campaign for a future ‘cultural exception’ in the WTO. Thus, Article 21 states:

Members pay particular attention to the need to sustain and promote cultural diversity in other international foras where it may be directly or indirectly called into question. When they are called upon to make commitments that could put at risk the preservation of cultural diversity, they consult for the purpose of developing a common approach in that regard. Members refrain from making commitments contrary to the objectives of the present Convention.

It seems unlikely that the draft convention will be incorporated into UNESCO’s own work anytime soon—in the spring of 2003, the UNESCO Secretariat released a study which suggested that there be exploration of the possibility of such a convention, but which fell far short of actually advocating the launch of negotiations in the foreseeable future.

TRADE AND SECURITY

In the post-9/11 world, issues of trade and security loom large, and yet there is no multilateral—or indeed regional—forum in which these issues are being considered systematically. One dimension is the contribution of globalization—free or freer movement of persons, capital and goods—to the maintenance and expansion of non-governmental networks of crime and terror. How do attempts to cut off funding of such networks relate to rules on the liberalization of the financial services sector? To what extent have post-9/11 restrictions on the movement of people—particularly temporary

workers and key personnel—affected foreign investment and services trade? Are there multilateral or regional solutions that can better balance legitimate security needs and open markets?

Existing international trade agreements do contain broad national security exceptions, albeit rarely subject to dispute settlement in the past. The question is whether and in what forum collective action, as opposed to unilateral action based on such exceptions, is necessary and appropriate.

The first attempt in the WTO to address such issues in an explicit way came in 1993, when the WTO Membership considered a WTO waiver in respect of provisions of the so-called Kimberley Agreement on conflict diamonds (see the excellent article by Joost Pauwelyn)⁵ that provided for trade restrictions in the case of non-adherence to the standards in the Agreement, which was essentially aimed at preventing trade in diamonds to finance military conflict in Africa. A question may be raised as to why a waiver was needed at all, given the security and public morals exceptions in the GATT (although, of course, the security exception is for national security as well as trade restrictions pursuant to action of the UN Council; this points out a limit to using trade restrictions through other collective security processes that may need to be addressed systematically).

Other issues are posed by the attempt to link trade and security policy by rewarding allies in military conflict—and punishing those who refuse to be allies. It is fortunate that despite significant tensions with a number of its major trading partners over the decision to go to war in Iraq, neither the US nor those trading partners allowed the tensions to spill over into major trade conflict (despite some comic incidents, such as the infamous renaming of French fries as ‘Freedom Fries’ in certain US cafeterias!). The way in which certain countries were excluded or limited in their ability to bid for contracts in the rebuilding of Iraq is of greater concern, although in the circumstances of occupation, and given that Iraq itself is not a WTO Member, whether existing WTO rules apply, and to what extent, is unclear.

In addition, the USA has been quite selective recently in who it will enter into bilateral trade treaties with, rewarding allies (e.g. Australia) and punishing critics (e.g. New Zealand).

CHINA AND RUSSIA

The accession of China to the WTO and the prospective accession of Russia will pose new challenges for the Organization. China is a huge and dynamic economic force, but also a country that is run undemocratically, and with intervention in much of the economy that remains in the Marxist central planning model. In order to address this predicament, the United States and other countries negotiated understandings with China that both go beyond the letter of its WTO obligations and also appear to allow various kinds of safeguard measures otherwise impermissible under WTO law. But these accords are widely seen as unfair by the Chinese, since they detract from the basic WTO bargain itself in important ways. Similar issues plague the ongoing Russian accession process, particularly government policies in the energy sector. The original GATT model for dealing with state trading enterprises and planned economies is obviously not applicable, for these societies and economies are characterized by extremes of anarchy and planning,

decentralization and central control, and institutions are on the one hand rigid and on the other hand unstable.

Of course, there are many smaller countries that exhibit these features, but the amount of regional and world trade accounted for by China and Russia means that the stakes are huge for the legitimacy and functionality of the trading system.

THE ARCHITECTURE AND FUNCTIONING OF THE WTO SYSTEM

In the Uruguay Round, the institutional deficiencies and challenges of the GATT were systematically addressed through a working group called Functioning of the GATT System (FOGS). There is no such analogous mechanism in the current Doha Round of negotiations. And yet the way in which the WTO does its business—and in particular the way negotiations are structured—is as much to blame for the failure of the Seattle and Doha Ministerials as are the well-publicized substantive disagreements, for instance, over agricultural subsidies. Developing countries in particular have become exasperated with a negotiating process where selected countries negotiate the outlines of a bargain and then others, who were not in the room, are expected to be takers (the so-called ‘Green Room’).

The Director-General of the WTO, Suphachai Panitchpakdi, has cabined the institutional issues off into a group of ‘wise men’, led by former DG Peter Sutherland. This group works in secret and consults, apparently, with no one. (The report was released under the title *The Future of the WTO: Addressing institutional challenges in the new millennium* around the time this volume was going to press: to date, its impact has been quite limited.) It is hardly an auspicious approach to these crucial matters, especially since part of the complaint itself is lack of both internal and external transparency at the WTO (internal transparency refers to the problem that even WTO Members are not always apprised of developments in a timely fashion, even those that may affect them, especially the smaller developing countries; external transparency refers to the openness of the WTO to civil society/NGOs). The ‘wise men’s’ Consultative Board has recently released a report *The Future of the WTO: Addressing Institutional Challenges in the New Millennium*, 2005.

There needs to be a broadly based and open process to discuss questions of architecture and institutional functioning at the WTO.

In this brief conclusion, we can do little more than provide an illustrative list of the matters that need to be addressed.

Architecture

The Uruguay Round of trade negotiations brought into being the WTO as a structure known as the ‘Single Undertaking’. The main features of this structure as exemplified by the WTO Agreement and the covered agreements under its umbrella are as follows:

- (a) All WTO Members must participate in (almost all) WTO treaty regimes (the Single Undertaking concept of the Uruguay Round). Thus, a WTO Member that would gain from participating in liberalization of trade in goods under the GATT must in order to do so also adhere to the obligations of, for instance, the TRIPs Agreement or the

Agreement on Sanitary and Phytosanitary Measures, even if that Member believes that adhering to those Agreements would be disadvantageous to its development.

- (b) As a default, all WTO rules apply to all Members; again, as a *general* rule, no *reservations* are permitted (see WTO Agreement, Article XVI:5). Some flexibilities do exist in the unique structure of the GATS for individual WTO Members to choose what policies they wish to subject to discipline in particular economic sectors, but subject to general rules on technical standards and domestic regulation.
 - (c) Individual WTO Members may not reverse or adjust their obligations, except, in certain instances, through entering into negotiations with other Members and offering compensation, or seeking a waiver that would depend on acceptance by most or, in practice, all of the WTO Membership. While the GATT safeguards regime allows for temporary adjustment of certain GATT commitments, the GATS has no equivalent safeguards (despite a promise to negotiate on them and conclude an agreement by 1998), nor does TRIPs, for instance.
 - (d) Though not formalized, an implicit structural norm is that, despite significant doubts that have been raised about the effects of, for example, TRIPs and GATS on development, the substantive rights and obligations in the Agreements in the Single Undertaking are not to be revisited with a view to explicit amendment, and certainly not between rounds of negotiations, where such changes might be linked to demands in other areas. Thus, the access to medicines issue was handled by the creation of two new instruments that purport to operate within the four corners of the TRIPs Agreement as it now stands or, at most, to provisionally waive, as opposed to amend, problematic provisions of TRIPs. Of course, this may reflect as well the (arguably correct) legal judgment that the various exceptions and balancing provisions in the existing TRIPs Agreement allow the needed flexibility, if rightly interpreted.
 - (e) These WTO meta-structures emphasize an 'all or nothing' approach to multilateral trade deals, and they may have had an important impact on the 'failure' of Seattle and more recently Cancun. They narrow the possibilities for individual WTO Members to shape and reshape their trade rights and obligations in order to pursue development through and within the fulfilment of all internationally recognized human rights. They also may limit the kind of voice that smaller or poorer countries have in collectively shaping or reshaping the rules. As a general matter, these meta-structures are the product of the mindset that trade liberalization is an end in itself, not a means, and that WTO rules and structures should favour linear progress in that direction, even if tolerating some straggling by countries that are in any case on the margins of the global economy.
- Should the Single Undertaking idea be rethought? Does it make sense to negotiate new agreements in areas like investment and competition with the expectation that all WTO Members will adhere to them, on the same terms?
 - What principles might govern the 'opting out' of individual Members from specific obligations that do not make sense for that Member?
 - Does the relationship of the WTO to other international institutions and regimes require better definition and structuring? Of what kind?
 - The fact that the WTO was not included in the organizations participating in the UN Global Compact highlights its relative isolation or autonomy, which may be a

problem in coordinating international regimes that deal with problems of globalization. Would it make sense to try to integrate the WTO into the UN system?

Decision-making

- Should the attempt to negotiate new treaty commitments in the WTO through rounds be rethought? Might an approach where negotiations are ongoing, with timetables suited to the nature of the issues in each case, be more successful, and allow fuller participation of developing countries?
- Are there meaningful alternatives to the consensus rule? Weighted-majority voting? Super majority voting with a right to opt out if a state does not want to be bound by the result? How would such alternatives alter the existing power (im)balance between developed and developing countries in the WTO?
- Should there be a separate decision-making track and rule for matters of a 'house-keeping' or technical nature, where it is a question of the Membership providing guidance, for example, to dispute settlement or other specialized WTO organs, as opposed to binding decisions or rules (the potential of 'soft law' in the WTO)?

Governance and accountability

The fact that the WTO is based on consensus decision-making by delegates of Member governments has been invoked to suggest that there is no need for further accountability of the activities of the WTO as an institution. This ignores the considerable role of the Secretariat as well as particular delegates assigned, for example, as Chairs of negotiating or other committees in the WTO to set agendas, 'frame' the way that issues are discussed, make judgments that have normative impact about the meaning of WTO rules, and even (e.g. the case of Secretariat reports with respect to the Trade Policy Review Mechanism or technical assistance) to judge and advise the policy-makers of individual WTO Members. As the recent Mexican telecommunications dispute illustrates, Secretariat documents may influence interpretation of legal rights and obligations in the WTO by WTO tribunals. While the language of accountability is sometimes used as a *substitute* for that of democratic legitimacy (see the recent article by Robert Keohane and Ruth Grant, 'Accountability and Abuses of Power in World Politics', *American Political Science Review*, 2005), we view accountability as part of good public administration, even if other measures required to establish or strengthen democratic legitimacy

- Is a more transparent and participatory process required for senior appointments in the Secretariat and perhaps Appellate Body? How might it work? Are clearer and more developed conflict of interest rules required?
- How can WTO Secretariat officials and delegates carrying particular responsibilities (chairing committees etc.) be more accountable to the public throughout the world? Should there be a supervisory board of citizens, including some elected officials in individual states, which would oversee the conduct of business by WTO Secretariat officials and delegates with particular responsibilities?

- Should there be a WTO code of best practices to guide such individuals, particularly in their dealings with stakeholders and the public?
- Should the everyday workings and deliberations of the WTO be more transparent? If so, how should this be accomplished?

Technical assistance, policy development and policy surveillance

- How is it possible to ensure that these functions are performed in a manner that is sensitive to controversies about free trade and globalization, and does not unduly advocate a particular approach to domestic regulation and trade policy?
- Should the WTO's choice of 'experts' to perform technical assistance, including training functions, be subject to a more open, pluralistic process?
- Should the materials used to communicate to those who are being provided with technical assistance the meaning of their WTO obligations and the WTO view of desirable policies and policy reforms be subject to outside review, perhaps by a board of individuals of diverse backgrounds, including officials in other organizations such as UNCTAD and UNDP?
- How could the Trade Policy Review Mechanism be reformed to capture better the social and environmental impacts of trade liberalization, and the difficult choices that countries face in finding an ideal policy mix? Should NGOs and broader social interests more generally be engaged directly in the trade policy review exercise?

Transparency and participation

The trend at the WTO is generally a positive one, despite the continued need for changing the mindset that the Organization is a government's 'club'.⁶ There is now a default rule that negotiating proposals are public; they have generally been made accessible, so that they can be subject to broad citizen scrutiny before being cast in stone in packages of rules that must be either accepted or rejected en masse. An enormous amount of WTO documents in areas most relevant to development and human rights is unclassified, and accessible electronically to the general public. In the area of trade in services, for example, publicity of the basic proposals allowed civil society and international institutions to provide useful input and observations, including on the implications of various proposed disciplines and approaches for aspects of development. Civil society has been able to play a functional role at the most recent WTO Ministerial in Cancun, despite limited observer rights, and accreditation of civil society groups has generally respected the notion of inclusiveness. Moreover, some WTO Members have included representatives of broad social interests on their actual delegations, although these do not participate typically in all negotiating activities.

At the same time, there are instances where inclusive participation has been rejected or undermined. To use the example of services again, while the general negotiating proposals have been published, Members' offers for sectoral commitments—which contain the proposed specific disciplines on government policies—have remained confidential in many instances, limiting the ability to provoke broad public debate and scrutiny of the implications, including human rights implications, of the proposed undertakings; much to the consternation of some civil society groups, even polities

apparently committed as a constitutional matter to democratic openness, like the EU, have resisted publicity with respect to what is being proposed in regard to specific commitments.

Another case in point is the Doha-mandated negotiations on the relationship of multilateral environmental agreements (MEAs) to WTO treaties. Those involved in the MEA regimes in question, even at the official level, have had difficulty in being admitted to these discussions, even as observers. At least tentatively, this matter appears to now be resolved in the direction of openness, but the difficulty in question suggests there remain real limits to the extent to which the values of inclusive participation have been mainstreamed into the WTO.

With respect to facilitating inclusive domestic deliberation on proposed trade rules, this is a question partly of ensuring that technical assistance is targeted broadly enough and partly of strengthening domestic political processes as they relate to trade policy. The WTO has made a number of efforts to engage with parliamentarians in Member countries; such efforts at engagement with domestic political structures must, however, from the perspective of inclusive participation, take into account the limits of official structures in the representation of marginalized or disadvantaged groups, and therefore extend further, in civil society itself. Sylvia Ostry has concluded that 'the WTO is an outlier in its rejection of the conception of participatory decision-making' because of its failure to reach out to civil society in this context.⁷

Bilateral and regional trade liberalization and the future of multilateralism

We have noted elsewhere in this book (Chapter 6) the proliferation of bilateral and regional trade agreements in recent years. In the wake of the failure of the Cancun Ministerial, the US and EU officials (the latter backtracking somewhat later) announced a renewed or intensified focus on bilateral and regional efforts. The standard economic arguments in favour of multilateral MFN-based trade agreements have been rehearsed earlier in this book. However, regional and bilateral agreements must increasingly be seen in a broader political context.

At Cancun, developing countries were adamant that investment and competition not be included in the Doha Round of multilateral negotiations—at the same time, many of these developing countries had negotiated strictures on these matters, or were contemplating such negotiation, in the context of bilateral or regional agreements. In those bilateral and regional contexts, the relative power of developed countries like the United States—or the EU—was such, and the leverage available (ties to aid or other development-related matters), that the developing countries in question could not effectively resist the demands in question. While many developing countries have taken the position that TRIPs should be rolled back at the WTO, they have agreed to 'TRIPs-plus' obligations in the regional and bilateral contexts.

From this, one could draw the preliminary lesson that, despite problems such as the Green Room, to which we alluded above, the multilateral forum of the WTO still provides some check on power imbalances between large and small, strong and weak states, at least relative to bilateral or regional negotiations.

Yet the possibility of linking trade and other issues in bilateral and regional contexts is not just a negative matter of being able to pressure developing countries or other weaker powers into accepting terms that are oppressive. Whether in the Balkans or the Middle East, or elsewhere, regional economic integration has the possibility of being closely linked to, and reinforcing, regional efforts for peace and security. This is far from a bad thing.

As well, regional or bilateral agreements have been a source of useful experimentation on how to reflect labour and environmental values in trade accords in positive ways that do not focus on punitive sanctions. The US-Jordan FTA and the US-Cambodia Textile Agreement are two examples of this (discussed in Chapter 17 of this volume).

Overall, we do not believe that there should or could be any wholesale reversal of the trend towards bilateral and regional trade agreements. But this trend does call for the WTO to play the role envisaged, for example, by Article XXIV of the GATT in effectively monitoring and scrutinizing these arrangements to ensure that they do not undermine multilateral norms, for instance through rules of origin designed to play favourites between third countries who are not members of the regional arrangement in question. The *Turkey-Textiles* case, where the panel and the Appellate Body were called upon to consider the consistency of a customs union with Article XXIV, reflects frustration with the inadequate process by which FTAs and customs unions are examined and debated among WTO delegates. The proliferation of rules and dispute settlement decisions in different fora also needs to be addressed. WTO jurisprudence is often cited by regional tribunals (such as NAFTA panels). But many of these tribunals make rulings and interpretations that could be viewed as inconsistent with one another. There is perhaps a need to consider a final appellate court for international trade, perhaps a chamber of the International Court of Justice or the WTO Appellate Body, which would consider appeals from rulings of diverse regional and bilateral dispute settlement mechanisms, and ensure a consistent jurisprudence on issues that are common to the various fora, such as National Treatment. At the same time, such a court would deal with problems of conflicting fora and legal rules where they arose, thus addressing an increasingly important issue in international trade law—multiple overlapping jurisdictions.

Notes

Preface

- 1 E.-U. Petersmann, 'Strengthening GATT Procedures for Settling Trade Disputes', *World Economy*, March 1988, pp. 55–6.

I

The evolution of international trade theory and policy

- 1 This section draws heavily on several widely accessible accounts of the evolution of international trade theory: Douglas Irwin, *Against The Tide: An Intellectual History of Free Trade* (Princeton NJ: Princeton University Press, 1996); Richard G. Harris, *Trade, Industrial Policy and International Competition*, Research Study No. 13, Macdonald Royal Commission on the Economic Union and Development Prospects for Canada (Toronto: University of Toronto Press, 1985); Peter B. Kenen, *The International Economy* (Cambridge: Cambridge University Press, 4th ed., 2000); Richard Caves and Ronald Jones, *World Trade and Payments: An Introduction* (Boston: Little, Brown, 9th ed., 2002), James Gerber, *International Economics* (Boston: Addison-Wesley, 3rd ed., 2005).
- 2 Irwin, *op. cit.*
- 3 For a recent attempt to revive a natural rights justification for free trade, see Robert McGee, *A Trade Policy for a Free Society: The Case against Protectionism* (Westport CT: Quorum Books, 1994); McGee, 'The Moral Case for Free Trade' (1995) 29 *Journal of World Trade* 69.
- 4 See Paul Krugman and Maurice Obstfeld, *International Economics: Theory and Policy* (Reading MA: Addison-Wesley, 4th ed., 1997) pp. 541–2.
- 5 Adam Smith, *The Wealth of Nations* (1776; New York: Modern Library Edition, 1937) p. 424.
- 6 Taken from P. Samuelson and A. Scott, *Economics* (Toronto: McGraw-Hill, 1980) p. 807; for a recent review of the theory of comparative advantage, see Alan Sykes, 'Comparative Advantage and the Normative Economics of International Trade Policy' (1988) *Journal of International Economic Law* 49.
- 7 See Herbert G. Grubel and P. J. Lloyd, *Intra-Industry Trade: The Theory and Measurement of Trade in Differentiated Products* (London: Macmillan, 1975).
- 8 See e.g. Raymond Vernon, 'International Investment and International Trade in the Product Cycle' (1966) 80 *Quarterly Journal of Economics* 190; Vernon, 'The Product Cycle Hypothesis in a New International Economic Environment' (1979) 41 *Oxford Bulletin of Economic Statistics* 255.
- 9 See Krugman and Obstfeld, *op. cit.*
- 10 See William R. Cline, '“Reciprocity”: A New Approach to World Trade Policy', in W. R. Cline (ed.) *Trade Policy in the 1980s* (Washington DC: Institute for International Economics, 1983) p. 152.
- 11 See Cline, *op. cit.*
- 12 See Beth and Robert Yarbrough, 'Reciprocity Bilateralism and Economic “Hostages”: Self-enforcing Agreements in International Trade' (1986) 30 *International Studies Quarterly* 7;

- Alan O. Sykes, 'Mandatory Retaliation for Breach of Trade Agreements: Some Thoughts on the Strategic Design of Section 301' (1990) 8 *Boston University International Law Journal* 301.
- 13 See R. Axelrod and R. Keohane, 'Achieving Co-operation under Anarchy', in K. Oye (ed.) *Co-operation Under Anarchy* (Princeton NJ: Princeton University Press, 1985).
- 14 Adam Smith, *op. cit.*, pp. 434–5.
- 15 See Jagdish Bhagwati and Hugh Patrick (eds), *Aggressive Unilateralism* (Ann Arbor: University of Michigan Press, 1992).
- 16 See Carolyn Rhodes, 'Reciprocity in Trade: The Utility of a Bargaining Strategy' (1989) 43 *International Organization* 273.
- 17 See Yarborough and Yarborough, *op. cit.*; Laura Tyson, 'Managed Trade: Making the Best of the Second Best', and Rudiger Dornbusch, 'Policy Options for Free Trade: The Case for Bilateralism', in R. Lawrence and C. Schultz (eds) *An American Trade Strategy: Options for the 1990s* (Washington DC: Brookings Institution, 1990).
- 18 See Kyle Bagwell and Robert W. Staiger, *The Economics of the World Trading System*, (Cambridge, MA: MIT Press, 2002).
- 19 See Irwin, *op. cit.*, Ch. 8.
- 20 John Stuart Mill, *Principles of Political Economy* (London: Longman, Greene & Co., 1848) p. 922.
- 21 See Robert Baldwin, 'The Case Against Infant Industry Protection' (1969) 77 *Journal of Political Economy* 295.
- 22 See e.g. Paul Krugman (ed.) *Strategic Trade Policy and the New International Economics* (Cambridge MA: MIT Press, 1986); Elhonor Helpman and Paul Krugman, *Trade Policy and Market Structure* (Cambridge MA: MIT Press, 1989); J. David Richardson, 'The Political Economy of Strategic Trade Policy' (1990) 44 *International Organization* 107; Irwin, *op. cit.*, ch. 14.
- 23 Irwin *op. cit.*, Ch. 14.
- 24 See, for example, *Global Monoculture*, N.Y. Times, November 15, 1999; *Globalization v. Mature*, N.Y. Times, November 22, 1999 and *Invisible Government*, N.Y. Times, November 29, 1999.
- 25 For excellent critiques of many of these objections, see Douglas Irwin, *Free Trade Under Fire* (Princeton University Press, 2002); Philippe LeGrain, *Open World: The Truth About Globalization* (London: Abacus, 2002); Martin Wolf, *Why Globalization Works* (New Haven: Yale University Press, 2004); and Jagdish Bhagwati, *In Defense of Globalization* (Oxford University Press, 2004).
- 26 Naomi Klein, *No Logo: Taking Aim at the Brand Bullies* (Toronto: Vintage Canada, 2000), p. 129.
- 27 Thomas L. Friedman, *The Lexus and the Olive Tree* (New York: Anchor Books, 2000), pp. 103–6.
- 28 *Ibid.*, p. 105.
- 29 Francis Fukuyama, *The End of History and The Last Man* (N.Y. Free Press, 1991).
- 30 See also LeGrain, *op. cit.*, pp. 118–131.
- 31 'Special Report: Who's wearing the trousers?; Brands' 360:8238 *The Economist* (London: 8 September 2001).
- 32 Amartya Sen, *Development as Freedom* (N.Y. Alfred Knopf, N.Y., 1999).
- 33 See also LeGrain, *op. cit.*, pp. 293–319.
- 34 WTO, *Canada—Certain Measures Concerning Periodicals* (30 June 1997) WTO Doc. WT/DS31/AB/R (Appellate Body report).
- 35 See Glenn Gottselig, *Canada and Culture: Can Current Cultural Policies be Sustained in the Global Trade Regime?* (University of Toronto Faculty of Law, L.L.M. thesis, 1999; Trevor Knight, 'The Dual Nature of Cultural Products: An Analysis of the World Trade

- Organization's Decisions Regarding Canadian Periodicals', (1999) 57 University of Toronto Faculty of Law Review 165.
- 36 Sen *op. cit.*, Ch. 10.
- 37 See Jeffrey Williamson, 'Winners and Losers over Two Centuries of Globalization', 2002 World Institute for Development Economics Research Annual Lecture (WIDER), pp. 9 and 10; David Dollar and Paul Collier, 'Globalization, Growth and Poverty' (Washington D.C.: World Bank, 2001); Irwin, *Free Trade Under Fire*, *op. cit.*, Ch. 2.
- 38 Williamson, *op. cit.*
- 39 Williamson, *op. cit.*, p. 2.
- 40 See William Kline, *Trade and Economic Distribution* (Washington, DC: Institute for International Economics, 1997); Dani Rodrik, 'Sense and Nonsense in the Globalization Debate', Summer 1997 Foreign Policy 19; Rodrik, *Has Globalization Gone Too Far?* (Washington, DC: Institute for International Economics, 1997); Philippe Aghion, 'Inequality and Economic Growth', in Philippe Aghion and Jeffrey Williamson, *Growth, Inequality and Globalization: Theory, History and Policy* (Cambridge University Press, 1998).
- 41 Paul Krugman, "Competitiveness: A Dangerous Obsession", in *Pop Internationalism* (Cambridge, MA: MIT Press, April 1997), Ch. 1.
- 42 Irwin, *Free Trade Under Fire*, *op. cit.*, Ch. 3.
- 43 See Rodrik, "Sense and Nonsense in the Globalization Debate", *op. cit.*
- 44 See Paul Brenton, Henry Scott and Peter Sinclair, *International Trade* (Oxford University Press, 1997) at p. 86 *et seq.*
- 45 Gary Hufbauer and Jeffrey Schott, *NAFTA: An Assessment* (Washington, DC: Institute for International Economics, 1993) pp. 12 and 13.
- 46 "Survey of Capitalism and Democracy", (Economist Magazine, 28 June, 2003) p. 5.
- 47 Surjit Bhalla, *Imagine There's No Country* (Washington DC.: Institute for International Economics, 2002).
- 48 See Dani Rodrik, *The New Global Economy and Developing Countries: Making Openness Work* (Washington, DC: Overseas Development Council, 1999); Michael Trebilcock, "What Makes Poor Countries Poor? The Role of Institutional Capital in Economic Development" in Buscaglia and Cooter (eds), *The Law and Economics of Development* (JAI Press, 1997).
- 49 Aghion *op. cit.*
- 50 See David Dollar and Aart Kraay, "Growth is Good for the Poor", Working Paper, World Bank, March 2000.
- 51 See e.g. Noam Chomsky, *Profits Over People: Neoliberalism and Global Order* (N.Y.: Seven Stories Press, 1999).
- 52 See Dani Rodrik, *Has Globalization Gone Too Far?*, *op. cit.*, Robert Reich, *The Work of Nations* (N.Y. Vintage, 1991), Chap. 25 (Who is 'Us'?).
- 53 See William Watson, *Globalization and the Meaning of Canadian Life* (Toronto: University of Toronto Press Incorporated, 1998).
- 54 "Globalisation and its critics" *The Economist* (29 September 2001), p. 4. See also LeGrain, *op. cit.*, pp. 161–4.
- 55 See The Economist's Survey of the World Economy, September 20, 1997; Michael Trebilcock, 'The Choice of Governing Instrument: A Retrospective', In Perl Eliadis, Margaret Hill & Michael Howlett (eds) *Designing Government* (Montreal: McGill-Queens Press, 2005).
- 56 LeGrain, *op. cit.*, pp. 243–6.
- 57 Gene M. Grossman and Alan B. Krueger, 'Economic Growth and the Environment' National Bureau of Economic Research, NBER working paper W4634, February 1994, cited in LeGrain, *op. cit.*, p. 245. See also Jeffrey A. Frankel and Andrew K. Rose, 'Is Trade Good or Bad for the Environment? Sorting Out the Causality' (20 September, 2002) NBER Working Paper No. W9201 online: <<http://ssrn.com/abstract=332245>>, which indicates that generally

growth hurts the environment at low income levels, helps it at high income levels, and that trade openness accelerates growth.

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- 59 See Alan O.Sykes, 'International Trade and Human Rights: An Economic Perspective' University of Chicago, John M.Olin Law & Economics Working Paper No. 188 (2D series), pp. 15–18; Jagdish Bhagwati & Robert Hudec, (eds) *Unfair Harmonization: Prerequisites for Free Trade?*, Vols. I & II (MIT: 1997).
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- 61 Jagdish Bhagwati, *Free Trade Today* (Princeton University Press, 2002), *Free Trade Under Fire*, *op. cit.*, pp. 191–204.
- 62 Julie Soloway Institutional Capacity to Constrain Suboptimal Welfare Outcomes From Trade-Restricting Environmental, Health and Safety Regulation Under NAFTA (University of Toronto Faculty of Law, SJD thesis, 1999).
- 63 WTO, *United States—Standards for Reformulated and Conventional Gasoline* (29 April 1996) WTO Doc. WT/DS2/AB/R (Appellate Body report).
- 64 GATT, *Thailand—Restrictions on importation of and internal taxes on cigarettes* (7 November 1990) WTO Doc. BISD 37S/200 (Panel report).
- 65 GATT, *United States—Prohibition of Imports of Tuna and Tuna Products from Canada* L/5198, adopted on 22 February 1982, BISD 29S/91; GATT, *United States—Restrictions on Imports of Tuna* DS21/R (unadopted), 3 September 1991, BISD 39S/155.
- 66 WTO, *United States—Import Prohibition of Certain Shrimp and Shrimp Products* (12 October 1998) WTO Doc. WT/DS58/AB/R (Appellate Body report).
- 67 WTO, *United States—Import Prohibition of Certain Shrimp and Shrimp Products: Recourse to Article 21.5 of the DSU by Malaysia* (22 October 2001) WTO Doc. WT/DS58/AB/RW (Appellate Body report).
- 68 WTO, *EC Measures Concerning Meat and Meat Products (Hormones)* (16 January 1998) WTO Docs. WT/DS26/AB/R and WT/DS48/AB/R (Appellate Body report).
- 69 WTO, *Japan—Measures Affecting Agricultural Products* (22 February 1999) WTO Doc. WT/DS76/AB/R (Appellate Body report).
- 70 WTO, *Australia—Measures Affecting Importation of Salmon* (20 October 1998) WTO Doc. WT/DS18/AB/R (Appellate Body report).
- 71 WTO, *European Communities—Measures Affecting Asbestos and Asbestos-Containing Products* (12 March 2001) WTO Doc. WT/DS135/AB/R (Appellate Body report).
- 72 Sykes, 'International Trade and Human Rights: An Economic Perspective', *op. cit.*, pp. 3–10.
- 73 *Ibid.*, p. 8.
- 74 "Survey of Capitalism and Democracy", (Economist Magazine, 28 June, 2003) pp. 5–6.
- 75 For example, the ILO's 1998 Declaration of Fundamental Principles and Rights at Work enumerates four core international labour standards which are defined more fully in eight background Covenants that are incorporated by reference, i.e. freedom of association and collective bargaining, the elimination of forced labour, the elimination of child labour, and the elimination of discrimination in employment.
- 76 See also Lorand Bartels, Article XX of GATT and the Problem of Extraterritorial Jurisdiction: The Case of Trade Measures for the Protection of Human Rights (2002) 36:2 *Journal of World Trade* 353; Sarah H.Cleveland 'Human Rights Sanctions and International Trade: A Theory of Compatibility' (2002) 5:1 *Journal of International Economic Law* 133.
- 77 See Robert Howse and Michael Trebilcock, "The Fair Trade—Free Trade Debate: Trade, Labour and the Environment", (1996) 16 *International Review of Law and Economics* 61.
- 78 See LeGrain, *op. cit.*, pp. 211–35.

- 79 See, for example, Franz Fischler, 'Scrap CAP? Think Twice!' *Wall Street Journal Europe*, 20 July 2000; Colin Hines, *Localisation: A Global Manifesto.*, Earthscan, 2000; Caroline Lucas and Colin Hines, 'Stopping the Great Food Swap—Relocalising Europe's Food Supply', all cited in LeGrain, *op. cit.*, p. 343.
- 80 OECD, *Agricultural Policies in OECD Countries: Monitoring and Evaluation*, 2001.
- 81 "CAP it all—Reforms to the CAP are Not Serious Enough" *The Economist Newspaper Limited* (28 June 2003).
- 82 See also LeGrain, *op. cit.*, pp. 174–210.
- 83 See Robert Howse and Kalypso Nicolaidis, "Enhancing WTO Legitimacy: Constitutionalization or Global Subsidiarity?" in Marco Verweij and Tim Josling, (eds), *Deliberately Democratizing Multilateral Organization, special issue of Governance* (2003); Jeffery Atik, "Democratizing the WTO" (14 October, 2001) *The George Washington International Law Review*, online: <<http://ssrn.com/abstract=250331>>; J.H.H. Weiler, "The Rule of Lawyers and the Ethos of Diplomats: Reflections on the Internal and External Legitimacy of WTO Dispute Settlement" Harvard Jean Monnet Working Paper No. 9/00, Cambridge, MA (2001) available online: <<http://www.jeanmonnetprogram.org/papers/00/000901.html>>. For further discussion of dispute settlement in the WTO, see Chapter 4.
- 84 See Gilbert Winham, *The Evolution of International Trade Agreements* (Toronto: University of Toronto Press, 1992) Ch. 1.
- 85 S.B.Clough and C.W.Cole, *Economic History of Europe* (Boston MA: D.C.Heath, 1941) p. 458.
- 86 Charles P.Kindleberger, 'The Rise of Free Trade in Western Europe, 1820–1874' (1975) 35 *Journal of Economic History* 20 at p. 23, and Clough and Cole, *op. cit.*, pp. 456–8. See also A.G.Kenwood and A.L.Lougheed, *The Growth of the International Economy* (London: Allen & Unwin, 1971) p. 73. In this respect, the situation in the German states around 1815 is especially striking—8,000km of borders divided the 28 German-speaking states; heavy transit tolls substantially impeded trade.
- 87 Clough and Cole, *op. cit.*, p. 473. James Foreman-Peck, *A History of the World Economy* (Ottawa: Barnes & Noble, 1983) p. 56 also emphasizes that Britain was fiscally more able to reduce tariffs than most at this time because of the substantial size of her commerce with respect to the economy as a whole, and the relative absence of government debt. In Prussia, the Junkers, for the most part large exporters of wheat, favoured free trade. Their dominance of national institutions helped solidify support for the policy in Germany until the 1870s. Then a more cohesive manufacturing sector, and stiff competition from overseas wheat, helped turn the political tide against free trade. See Kindleberger, *op. cit.*, p. 42.
- 88 Clough and Cole, *op. cit.*, pp. 469ff. Such trade treaties actually had their genesis in the late eighteenth century—Britain and France signed a treaty on trade just before the Revolution. The latter saw the renunciation of the treaty almost directly the king was removed from power.
- 89 Kenwood and Lougheed, *op. cit.*, p. 77; and P.Bairoch, 'European Trade Policy, 1815–1914', in P.Matthias and S.Pollard (eds) *The Cambridge Economic History of Europe*, vol. 8 (Cambridge MA: Cambridge University Press, 1989) 1 at p. 36.
- 90 Kenwood and Lougheed, *op. cit.*, p. 78; Clough and Cole, *op. cit.*, pp. 608–9; and Kenen, *op. cit.*
- 91 Kenwood and Lougheed, *op. cit.*, p. 78.
- 92 P.Bairoch, 'European Trade Policy, 1815–1914', in Matthias and Pollard (eds), *op. cit.*, p. 101.
- 93 Kenen, *op. cit.*, p. 213, and P.Bairoch, 'European Trade Policy, 1815–1914', in Matthias and Pollard (eds), *op. cit.*, 1 at pp. 51–2.
- 94 Foreman-Peck, *op. cit.*, p. 57, and Kindleberger, *op. cit.*, p. 45.

- 95 Foreman-Peck, *op. cit.*, p. 57. Kindleberger, *op. cit.*, p. 33, points out that some English industrialists supported free trade in the 1840s as a means of slowing down European industrialization.
- 96 Clough and Cole, *op. cit.*, p. 477.
- 97 P.Bairoch, 'European Trade Policy, 1815–1914', in Matthias and Pollard (eds), *op. cit.*, 1 at pp. 51–2. For a description of the 'colonial pact' see P.Bairoch, 'European Trade Policy, 1815–1914', in Matthias and Pollard (eds), *op. cit.*, 1 at p. 103. It should be noted that colonial policy was not a constant. Britain's stance in this respect was largely dictated by protection on the Continent: in mid-century she was dismantling imperial preference (for a description, see Clough and Cole, *op. cit.*, p. 466), and it was only after the return of protection in the 1880s that the idea of imperial preference regained any real legitimacy. See Kenwood and Lougheed, *op. cit.*, p. 79, and Clough and Cole, *op. cit.*, p. 476. Moreover, colonies were not acquired for economic reasons only; nationalism played an important role as well.
- 98 Kenwood and Lougheed, *op. cit.*, p. 186.
- 99 Foreman-Peck, *op. cit.*, pp. 215–16.
- 100 Kenen, *op. cit.*, p. 216.
- 101 J.H.Jackson, W.J.Davey and Alan O.Sykes Jr. *Legal Problems of International Economic Relations* (St Paul: West, 3rd ed., 1995) ch. 5. R.E.Hudec, *The GATT Legal System and World Trade Diplomacy* (St Paul: Butterworth, 2nd ed., 1990) Part I, contains a detailed description of the negotiations.
- 102 For excellent treatments of the evolution of the GATT, see Judith Goldstein, 'Creating the GATT Rules: Politics, Institutions and American Policy', in J.Ruggie (ed.) *Multilateralism Matters: The Theory and Praxis of an Institutional Forum* (New York: Columbia University Press, 1993) ch. 6; Anne-Marie Burley-Slaughter, 'Regulating the World: Multilateralism, International Law, and the Projection of the New Deal Regulatory State', in Ruggie (ed.), *op. cit.*, Ch. 4.
- 103 Jackson, Davey and Sykes, *op. cit.*, p. 295. See also Hudec, *op. cit.*, Ch. 6.
- 104 Jackson, Davey and Sykes, *op. cit.*, pp. 294ff.; J.H.Jackson, *The World Trading System* (Cambridge MA: MIT Press, 2nd ed., 1979) ch. 2; and Hudec, *op. cit.*, ch. 7. See also *Review of the Effectiveness of Trade Dispute Settlement Under the GATT and the Tokyo Round Agreements: Report to the Committee on Finance, U.S. Senate* (Washington DC: US International Trade Commission, 1985) pp. 11–12; R.E.Hudec, *Enforcing International Trade Law: The Evolution of the Modern GATT Legal System* (Salem NH: Butterworth, 1993).
- 105 Jackson, Davey and Sykes, *op. cit.*, s. 6.2.
- 106 *Ibid*, p. 314; K.W.Dam, *The GATT: Law and International Economic Organization* (Chicago IL: University of Chicago Press, 1970) ch. 5; and Jackson, *op. cit.*, pp. 52–7.
- 107 Dam, *op. cit.*, ch. 14. See also R.E.Hudec, *Developing Countries in the GATT Legal System* (London: Gower, 1987), and Jackson, *op. cit.*, Ch. 12.
- 108 For a very useful review of recent developments in international trade policy, see Margaret Kelly and Anne Kenny McGuirk, *Issues and Developments in International Trade Policy* (Washington DC: International Monetary Fund, August 1992).
- 109 Sylvia Ostry, *The Post Cold War Trading System: Who's On First?* (Chicago: University of Chicago Press, 1997).
- 110 Jackson, Davey and Sykes, *op. cit.*, s. 4.2, provide useful citations to sources for EU history.
- 111 See Chapter 5.
- 112 See Bhagwati: *Free Trade Today*, *op. cit.*, Lecture 3.
- 113 For introductory treatments of the GATT, see Olivier Long, *Law and its Limitations in the GATT Multilateral Trade System* (London: Graham & Trotman, 1987); Frank Stone, *Canada, the GATT and the International Trade System* (Montreal: The Institute for Research

- on Public Policy, 1984); Michael Hart, *Trade—Why Bother?* (Ottawa: Centre for Trade Policy and Law, Carleton University and University of Ottawa, 1992); and Alan Oxley, *The Challenge of Free Trade* (London: Harvester Wheatsheaf, 1990). For more extensive treatments, see Dam, *op. cit.*; Hudec, *The GATT Legal System and World Trade Diplomacy*, *op. cit.*; Jackson, *op. cit.*; and Michael Hart, *Fifty Years of Canadian Tradecraft: Canada and the GATT 1947–1997* (Ottawa: Centre for Trade Policy and Law, 1998).
- 114 See Bhagwati, *Free Trade Today*, *op. cit.*, Lecture 3; Bagwell & Starger, *op. cit.*, Ch. 7.
- 115 For a comprehensive review of international codes and agreements dealing with trade and government procurement, see Arie Reich, *International Public Procurement Law: The Evolution of International Regimes on Public Purchasing* (The Hague: Kluwer Law International, 1991).
- 116 J.Bhagwati, 'Fair Trade, Reciprocity and Harmonization: The New Challenge to the Theory and Policy of Free Trade', in A.Deardorff and R.Stern (eds) *Analytical and Negotiating Issues in the Global Trading System* (Ann Arbor: University of Michigan Press, 1993).
- 117 See, in general, L.Haus, *Globalizing the GATT: The Soviet Union's Successor States, Eastern Europe, and the International Trading System* (Washington DC: Brookings Institution, 1992).
- 118 See Chapter 14.
- 119 The relationship between trade and the environment is discussed in detail in Chapter 15.
- 120 See Michael J.Hahn, 'Vital Interests and the Law in GATT: An Analysis of GATT's Security Exceptions' (1991) 12 *Michigan Journal of International Law* 588.
- 121 See Shelley Kierstead, 'An International Bind: Article XXIV(12) of GATT and Canada' (1993) 25 *Ottawa Law Review* 315.
- 122 WTO, *Ministerial Declaration* (2001) WTO Doc. WT/MIN (01)/DEC/1 (Ministerial Conference, Fourth Session).
- 123 For treatments of the Canada-US FTA, see Debra P.Steger *et al.*, *A Concise Guide to the Canada-United States Free Trade Agreement* (Toronto: Carswell, 1988); Jon Johnson and Joel Schacter, *The Free Trade Agreement: A Comprehensive Guide* (Toronto: Canada Law Book, 1988); John D.Richard and Richard G.Dearden, *The Canada-U.S. Free Trade Agreement: Final Text and Analysis* (Toronto: CCH Canadian Ltd, 1988); Peter Morici, *Making Free Trade Work: The Canada-US. Agreement* (New York and London: Council of Foreign Relations Press, 1990); *The Free Trade Law Reporter* (Toronto: CCH Canadian Ltd, 1989) (looseleaf); Duncan Cameron and Ed Finn (eds), *The Facts on Free Trade* (Toronto: James Lorimer, 1988); John Crispo (ed.), *Free Trade: The Real Story* (Toronto: Gage Educational Publishing Co, 1988); Marc Gold and David Leyton-Brown (eds), *Trade-Offs on Free Trade: The Canada-US. Free Trade Agreement* (Toronto: Carswell, 1988); and Bruce Doern and Brian Tomlin, *Faith and Fear: The Free Trade Story* (Toronto: Stoddart Publishing Co. Ltd, 1991). For the complete legal text of the NAFTA, see NAFTA Text (CCH Inc., 1994). For discussions of the provisions of NAFTA, see S.Globerman and M.Walker (eds), *Assessing NAFTA: A Trilateral Analysis* (Vancouver: The Fraser Institute, 1993); G.C.Hufbauer and J.J.Schott, *NAFTA: An Assessment* (Washington DC: Institute for International Economics, 1993); J.Lemco and W.B.P. Robson (eds), *Ties Beyond Trade: Labor and Environmental Issues Under the NAFTA* (Canadian-American Committee) (Toronto: C.D.Howe Institute, 1993); A.R.Riggs and Tom Welk, *Beyond NAFTA: An Economic Political and Sociological Perspective* (Vancouver: The Fraser Institute, 1993); Government of Canada, *NAFTA: What's It All About?* (Ottawa: External Affairs and International Trade Canada, September 1993); R.Lipsey, D.Schwanen and R.Wennacott, *The NAFTA* (Toronto: C.D.Howe Institute, 1994); and Jon Johnson, *The North American Free Trade Agreement: A Comprehensive Guide* (Toronto: Canada Law Book Co., 1994).
- 124 For a comprehensive and illuminating history of Canadian trade policy generally, see Michael Hart, *A Trading Nation* (Vancouver: University of British Columbia Press, 2002).

- 125 This discussion relies, to a significant extent, on the following sources: F.G.Jacobs and K.L.Karst, 'The "Federal" Legal Order: The U.S.A. and Europe Compared: A Juridical Perspective', in M.Cappelletti, M.Secombe and J.Weiler (eds) *Political Organizations, Integration Techniques, and Judicial Process: Methods, Tools and Institutions*, vol. 1 (Berlin: W.De Gruyter, 1986) [hereinafter *Integration Through Law*]; T.Heller and J.Pelkmans, 'The Federal Economy: Law and Economic Integration and the Positive State—The U.S.A. and Europe Compared in an Economic Perspective', in *Integration Through Law*, M.Brealey and C.Quigley, 'Introduction', in *Completing the Internal Market of the European Community: 1992 Handbook* (London: Graham and Trotman, 1989); G.Hufbauer 'An Overview', in G.Hufbauer (ed.) *Europe 1992: An American Perspective* (Washington DC: Brookings Institution, 1990); D.Swann, *Competition and Industrial Policy in the European Community* (London: Methuen, 1990) Chs 1 and 2; P.Leslie, *The European Community: A Political Model for Canada?* (Ottawa: Supply & Services, 1991); and P.Monahan, *Political and Economic Integration: The European Experience and Lessons for Canada* (Toronto: York University Centre for Public Law and Public Policy 1992).
- 126 *Treaty Establishing the European Economic Community*, 25 March 1957, 298 U.N.T.S. 11 [hereinafter *Treaty of Rome*].
- 127 At the outset, direct enforceability was controversial, as some states adhered to the narrower view of the Treaty as a 'normal' interstate agreement. Early decisions of the Court were of decisive importance in establishing a 'constitutional' status for the Treaty, and in moving the Community towards genuine integration. See *Van Gend en Loos v. Nederlandse Administratie der Belastingen*, Case 26/62 [1963] E.C.R. 1125, and the discussion of this and subsequent cases in D.Wyatt and A.Dashwood, 'The Community Legal Order', in W.Wyatt (ed.) *The Substantive Law of the EEC* (London: Sweet & Maxwell, 2nd ed., 1990).
- 128 Brealey and Quigley, *op. cit.*, p. xxii.
- 129 See *ibid*, p. xxvi.
- 130 On the importance of the abandonment of the unanimity requirement to the realization of Europe, 1992, see for example, L.Bergeron, 'L'integration européenne', ch. 2, in Commission sur l'avenir politique et constitutionnelle du Québec, *Eléments d'analyse institutionnelle, juridique, et demologique pertinent à la revision due status politique et constitutionnelle du Québec*, Document du travail, numero 2, Quebec City 1991, at 116; see also Daniel Tarullo, 'Can the European "Social Market" Survive?', *American Prospect*, Spring 1991; Brealey and Quigley, *op. cit.* p. xii.
- 131 The Article reads as follows: 'The provisions of Articles 30 to 34 shall not preclude prohibitions or restrictions on imports, exports or goods in transit justified on grounds of public morality, public policy or public security; the protection of health and life of humans, animals and plants; the protection of national treasures possessing artistic, historic or archaeological value; or the protection of industrial and commercial property. Such prohibitions or restrictions shall not, however, constitute a means of arbitrary discrimination or a disguised restriction on trade between member states.'
- 132 *Rewe-Zentral AG v. Bundesmonopoverwaltung Branntwein*, E.C.J. 120/78.
- 133 The notion of mandatory requirements suggests that the measures in question must be pursuant to a mandatory legislative scheme and not a mere exercise of executive or administrative discretion.
- 134 Case 178/84 (1988) 1 C.M.L.R. 780.
- 135 See Articles 92(1) and 92 of the Treaty.
- 136 Hufbauer, 'An Overview', *op. cit.*, p. 9.
- 137 Europe, Documents No. 1759/60, February 1992.
- 138 For a discussion in greater depth of some of these institutional changes, see P.Ludlow, 'The Maastricht Treaty and the Future of Europe', *Washington Quarterly*, Autumn 1992, pp. 127–9.
- 139 Discussed in Chapter 4, on trade, exchange rates and the balance of payments.

- 140 See, for a discussion of these issues, R.Portes, 'EMS and EMU After the Fall', 16 *World Economy*, January 1993, pp. 1–15. See also, for a background to some of the tensions among EC Member Countries with respect to macroeconomic policy, L.Pauly, 'The Politics of European Monetary Union: National Strategies, International Implications' (1992) 27 *International Journal* 93.
- 141 See A.Hartley, 'Europe's New Populism', *National Interest*, Winter 1992/93, pp. 37–40.
- 142 On the seriousness of the immigration issue, see Hartley, *op. cit.*, pp. 39–40.

2

The Most Favoured Nation principle

- 1 Six of these stages are described by Snyder, whose work covers the history of the MFN clause until 1940. See Richard Carlton Snyder, *The Most-Favored-Nation Clause: Analysis With Particular Reference to Recent Treaty Practice and Tariffs* (New York: Columbia University, 1948) pp. 238–41 [hereinafter *The MFN Clause*]: see also Akiko Yanai, 'The Function of the MFN Clause in the Global Trading System', IDE APEC Study Centre, Working Paper Series 01/02-No. 3 (March 2002).
- 2 Baron Boris Nolde, 'La Clause de la Nation la Plus Favorisée et les Tarifs Préférentiels' (1932) 39 *Recueil Des Cours* 25.
- 3 Suzanne Basdevant, *La Clause de la Nation la Plus Favorisée* (Paris: 1929) p. 8, cited in *The MFN Clause*, *op. cit.*, p. 238.
- 4 *The MFN Clause*, *op. cit.*, p. 238.
- 5 William Smith Culbertson, *International Economic Politics: A Survey of the Economics of Diplomacy* (New York: D.Appleton and Co., 1925) p. 60.
- 6 *The MFN Clause*, *op. cit.*, p. 239.
- 7 Richard C.Snyder, 'The Most Favoured Nation Clause and Recent Trade Practices' (1940) 55 *Political Science Quarterly* 79 [hereinafter 'MFN and Recent Trade Practices'].
- 8 *The MFN Clause*, *op. cit.*, p. 239.
- 9 See Samuel B.Crandall, 'The American Construction of the Most-Favoured-Nation Clause' (1913) 7 *American Journal of International Law* 709–10.
- 10 *The MFN Clause*, *op. cit.*, p. 239.
- 11 H.Van V.Fay, 'Commercial Policy in Post-War Europe: Reciprocity Versus Most-Favoured-Nation Treatment' (1927) 41 *Quarterly Journal of Economics* 458.
- 12 'The League of Nations, throughout its existence, tried to revive the application of the most-favoured-nation clause. It undertook many studies on the various aspects of the problem and put forth many recommendations to the Member states. For instance, in 1927, the Economic Committee of the League undertook to codify the Clause. In 1929, it elaborated a general doctrine on the drafting, interpretation and application of the Clause. The recommendations are important because they exercised a profound influence on the evolution of a set of rules and a code of commercial policy and formed the basis of most of the post-war proposals bearing on the most-favoured-nation clause. The standard form of the Clause drafted by the League Economic Committee was adopted in Article I(1) of the General Agreement and Article 16(1) of the Draft Havana Charter.' Khursid Hyder (Hasan), *Equality of Treatment and Trade Discrimination in International Law* (Hague: Martinus Nijhoff, 1968) p. 40.
- 13 Hearings before the Committee on Foreign Relations, United States Senate, on 'Treaty of Commerce and Consular Rights with Germany', 7 February 1924, Pt 3, pp. 70, 71, cited by Culbertson, *op. cit.*, p. 94.
- 14 Jacob Viner, 'The Most-Favored-Nation Clause in American Commercial Treaties' (1924) 32 *Journal of Political Economy* 126.
- 15 *Ibid.*

- 16 Carol Bilzi, 'Recent United States Trade Arrangements: Implications for the Most-Favored-Nation Principle and United States Trade Policy' (1985) 17 *Law and Policy in International Business* 211.
- 17 'MFN and Recent Trade Practices', *op. cit.*, p. 84.
- 18 *Ibid.*, p. 85.
- 19 Hyder (Hasan), *op. cit.*, pp. 41–3.
- 20 'MFN and Recent Trade Practices', *op. cit.*, p. 96.
- 21 G.C.Hufbauer, J.Shelton Erb and H.P.Starr, 'The GATT Codes and the Unconditional Most-Favored-Nation Principle' (1980) 12 *Law and Policy in International Business* 63.
- 22 The MFN clause contained in GATT was modelled on the standard League of Nations MFN clause. 'Except for the exclusion of "governmental contracts for public works" the text is, substantially, that contained in the "Suggested Charter for an International Trade Organization", submitted by the government of the United States to the first session of the Preparatory Committee of the United Nations Conference on Trade and Employment, London, October 1946.' GATT Secretariat, 'The Most-Favored-Nation Clause in GATT: The Rules and the Exceptions' (1970) 4 *Journal of World Trade Law* 792. According to Jackson, '[t]he extent to which other nations in the GATT preparatory meetings shared with the United States this intensity of feeling for MFN is not always revealed by the records, but presumably many of them were at least well disposed to the idea since debate generally centered on the extent and application of MFN and not on the question of whether MFN should be included in GATT or the ITO Draft Charter'. John H.Jackson, *The World Trade and the Law of GATT* (Bobbs-Merrill Co., 1969).
- 23 William J.Davey and Joost Pauwelyn, 'MFN Unconditionality: A Legal Analysis of the Concept in View of its Evolution in the GATT/WTO Jurisprudence with Particular Reference to the Issue of "Like Product"', in Thomas Cottier and Petros C.Mavroidis (eds) *Regulatory Barriers and the Principle of Non-Discrimination in World Trade Law* (Ann Arbor: University of Michigan Press, 2000) p. 15.
- 24 John H.Jackson, *The World Trading System: Law and Policy of International Economic Relations* (Cambridge MA: MIT Press, 2nd ed., 1997) p. 159 [hereinafter *The World Trading System*].
- 25 *Ibid.*
- 26 Robert E.Hudec, 'Tiger, Tiger in the House: A Critical Appraisal of the Case Against Discriminatory Trade Measures', in Ernst-Ulrich Petersmann and Meinhard Hilf (eds) *The New GATT Round of Multilateral Trade Negotiations: Legal and Economic Problems* (Deventer: Kluwer Law and Taxation Publisher, 1991) p. 170 [hereinafter 'Tiger, Tiger in the House'].
- 27 *Ibid.*, p. 171.
- 28 *Ibid.*
- 29 Konstantine Gatsios, 'Preferential Tariffs and the "Most Favoured Nation" Principle: A Note' (1990) 28 *Journal of International Economics* 372.
- 30 *The World Trading System*, *op. cit.*, p. 159.
- 31 Warren F.Schwartz and Alan O.Sykes, 'The Economics of the Most-Favored-Nation Clause', in Jagdeep S.Bhandari and Alan O.Sykes (eds) *Economic Dimensions in International Law: Comparative and Empirical Perspectives* (Cambridge: Cambridge University Press, 1997) p. 59 [hereinafter 'The Economics of the MFN']; Davey and Pauwelyn, *op. cit.*, p. 15.
- 32 'The Economics of the MFN', *op. cit.*, p. 60.
- 33 Davey and Pauwelyn, *op. cit.*, p. 16.
- 34 'The Economics of the MFN', *op. cit.*, p. 62.
- 35 See Viner, *op. cit.*, p. 105; 'The Economics of the MFN', *op. cit.*, p. 62.
- 36 *Ibid.* In his comments on Schwartz and Sykes's article, Deardorff advocates that 'the MFN obligation is not really needed to prevent the undermining of concessions'. He does not see

- the 'MFN as primarily intended to prevent negotiated concession from being later undermined. Rather it is there for the more obvious purpose of preventing deals that will harm other parties.' Alan V. Deardorff, 'Comments on Chapter 1 [The Economics of the Most-Favored-Nation Clause]', in Bhandari and Sykes (eds), *op. cit.*, p. 81.
- 37 Kyle Bagwell and Robert W. Staiger, *The Economics of the World Trading System* (Cambridge MA: MIT Press, 2002) Ch. 5.
- 38 'Tiger, Tiger in the House', *op. cit.*, pp. 190–1; J.M. Finger, 'Trade Liberalization: A Public Choice Perspective', in Ryan C. Amacher, Gottfried Haberler and Thomas D. Willett (eds) *Challenges to a Liberal International Economic Order* (Washington DC: The American Enterprise Institute for Public Policy Research, 1979) p. 426.
- 39 For example, according to Finger, 'the United States, in negotiating with the United Kingdom, would request concessions on products for which the United States was principal, or only, supplier of exports to the United Kingdom, and would offer concessions on imports supplied principally or exclusively by the United Kingdom. In this way, the "benefits" and the "costs" tended to be internalised.' Finger, *op. cit.*, p. 426.
- 40 Other MFN provisions in the WTO Agreements are contained in Articles IX. 1, V5 and XIII of the GATT, Article II of the GATS, Article 2.1 of the Agreement on Technical Barriers to Trade, Article 4 of the TRIPS Agreement, and Article 2.2 of the Agreement on Safeguards.
- 41 Davey and Pauwelyn, *op. cit.*, p. 17.
- 42 Appellate Body Report, *Canada—Certain Measures Affecting the Automotive Industry* ('Canada—Autos'), WT/DS139/AB/R, WT/DS142/AB/R, adopted 19 June 2000, DSR 2000:VI, 2995, para. 84.
- 43 *Ibid.*
- 44 Davey and Pauwelyn, *op. cit.*, p. 17.
- 45 Panel Report, *Japan—Trade in Semi-Conductors* ('Japan—Semi-Conductors'), adopted 4 May 1988, BISD 35S/116.
- 46 Robert E. Hudec, *Enforcing International Trade Law: The Evolution of the Modern GATT Legal System* (Salem NH: Butterworth, 1993) p. 541 [hereinafter *Enforcing International Trade Law*].
- 47 The EEC also claimed that the measures taken by the Japanese government to improve access to the Japanese market for semiconductors favoured US products and, therefore, constituted a violation of Article I. The panel's decision was that nothing in the information submitted to it demonstrated that the Japanese measures to improve access to its market for semiconductors favoured US products inconsistently with Article I of the GATT. The panel noted that statistics showed that the growth of sales of semiconductors in Japan from sources other than the United States had been higher than that of the semiconductors originating in the United States.
- 48 Panel Report, *Spain—Tariff Treatment of Unroasted Coffee* ('Spain—Unroasted Coffee'), adopted 11 June 1981, BISD 28S/102.
- 49 Ruling by the Chairman, The Phrase 'Charges of any Kind' in Article I:1 in Relation to Consular Taxes ('Cuba—Consular Taxes'), 24 August 1948, BISD 11/12.
- 50 Panel Report, *United States—Denial of Most-Favoured-Nation Treatment as to Non-Rubber Footwear from Brazil* ('US—MFN Footwear'), adopted 19 June 1992, BISD 39S/128.
- 51 Ruling by the Chairman, *Application of Article I:1 to Rebates on Internal Taxes* ('India—Tax Rebates'), 24 August 1948, BISD 11/12.
- 52 Hyder (Hasan), *op. cit.*, p. 55; *Enforcing International Trade Law*, *op. cit.*, p. 417.
- 53 Panel Report, *US—MFN Footwear*, *op. cit.*, para. 6.9.
- 54 *Ibid.*, para. 6.10.
- 55 For the purposes of licensing, traditional ACP bananas are those supplied by certain ACP countries which are considered traditional suppliers to the EC market. For an extensive discussion of this case, see Raj Bhala, 'The Bananas War' (2000) 31 *McGeorge Law Review* 543.

- 56 An operator was considered a primary importer if it purchased green bananas from producers in third countries, traditional ACP countries or non-traditional ACP countries, or if it produced bananas in these countries and, subsequently, sold them in the EC. The amount of bananas an operator was allowed to import at the in-quota tariff rate was based on an individual reference quantity. This quantity depended on the product of (1) the operator's historical banana import volumes, and (2) the weighting coefficient for that operator determined by the type of activity in which it had been engaged. Primary importation had a coefficient of 57%. In simple terms, this meant that primary importers could obtain access to A and B licences equivalent to 57% of their past import volumes.
- 57 Secondary importers were those operators that, as an owner, supplied and sold green bananas with a view to their subsequent marketing in the EC, while taking on the risk of spoilage or loss. Secondary importers had a weighting coefficient of 15%.
- 58 An operator fell under the category of ripener if, as an owner, it ripened and marketed green bananas within the EC. Ripening was assigned a 28% coefficient. An operator performing all the three activities would have a weighting coefficient of 100%.
- 59 Panel Report, *European Communities—Regime for the Importation, Sale and Distribution of Bananas—Complaint by the United States* ('EC—Bananas III (US)'), WT/DS27/R/USA, adopted 25 September 1997, as modified by the Appellate Body Report, WT/DS27/AB/R, DSR 1997:II, 943, paras 7.193, 7.221.
- 60 *Ibid.*, para. 7.194.
- 61 The difference between the true market price and the price with the quota.
- 62 The distribution occurred by the issuance of export certificates to suppliers from BFA countries, and the subsequent resale of the certificates to category A and B operators, which needed them to satisfy the matching requirement for an EC licence.
- 63 Panel Report, *EC—Bananas III*, *op. cit.*, para. 7.240.
- 64 Appellate Body Report, *European Communities—Regime for the Importation, Sale and Distribution of Bananas* ('EC—Bananas III'), WT/DS27/AB/R, adopted 25 September 1997, DSR 1997:II, 591, para. 206.
- 65 *Ibid.*
- 66 *Ibid.*, para. 207.
- 67 Panel Report, *Belgian Family Allowances (allocations familiales)* ('Belgium—Family Allowances'), adopted 7 November 1952, BISD 1S/59.
- 68 *Ibid.*, para. 3.
- 69 *The World Trading System*, *op. cit.*, p. 163.
- 70 Panel Report, *United States—Restrictions on Imports of Tuna* ('US—Tuna (Mexico)'), 3 September 1991, unadopted, BISD 39S/155.
- 71 *Ibid.*, para. 5.43.
- 72 Fauchald notes that the panel in this case neglected the question of whether *de facto* discrimination was taking place as a result of the fact that the US regulations would likely have affected only a determinate group of countries, which were engaged in the harvesting of tuna in the ETP. Ole Kristian Fauchald, *Environmental Taxes and Trade Discrimination* (London: Kluwer Law, 1998) p. 249.
- 73 Panel Report, *Indonesia—Certain Measures Affecting the Automobile Industry* ('Indonesia—Autos'), WT/DS54/R, WT/DS55/R, WT/DS59/R, WT/DS64/R and Corn 1, 2, 3 and 4, adopted 23 July 1998, DSR 1998:VI, 2201.
- 74 The National Car Programme consisted of two sets of measures. The first set, the February 1996 Programme, provided for the grant of pioneer or National Car company status to Indonesian car companies that met specified criteria as to ownership of facilities, use of trademarks, and technology. Maintenance of pioneer status was dependent on the National Cars meeting increasing local content requirements over a three-year period. The benefits provided were exemption from luxury tax on sales of National Cars, and exemption from import duties on parts and components. Pursuant to the February Programme, Decree No.

002/SK/DJ-ILMK/II/1996 designated PT Timor Putra Nasional (TPN) as a pioneer national motor vehicle enterprise. Decision No. 02/SK/1996 designated TPN to establish and produce a National Car, the 'Timor'. The Timor was to be produced initially in knock-down form in Korea by Kia Motors, for export to Indonesia, where it was to be assembled at TPN's facility in Karawang, Indonesia.

The second set of measures, the June 1996 Programme, provided that National Cars manufactured in a foreign country by Indonesian nationals, and which fulfilled the local content requirements prescribed by the Minister of Industry and Trade, must have been treated as National Cars manufactured in Indonesia, i.e. exempt from import duties and luxury tax.

75 Panel Report, *Indonesia—Autos*, *op. cit.*, para. 14.143.

76 *Ibid.*, paras 14.145, 14.146.

77 [Footnote original:] For instance in the *FIRA* case, the Panel rejected Canada's argument that the situation under examination was the consequence of a private contract with an investor: '5.6 The Panel carefully examined the Canadian view that the purchase undertakings should be considered as private contractual obligations of particular foreign investors vis-à-vis the Canadian government. The Panel recognized that investors might have an economic advantage in assuming purchase undertakings, taking into account the other conditions under which the investment was permitted. The Panel felt, however that even if this were so, private contractual obligations entered into by investors should not adversely affect the rights which contracting parties, including contracting parties not involved in the dispute, possess under Article III:4 of the General Agreement and which they can exercise on behalf of their exporters.' See Panel Report, *Canada—Administration of the Foreign Investment Review Act ('Canada—FIRA')*, adopted 7 February 1984, BISD 30S/140, para. 5.6.

78 [Footnote original:] See Working Party Report on the Accession of Hungary, BISD 20S/34.

79 Panel Report, *Indonesia—Autos*, *op. cit.*, paras 14.145–14.147.

80 Panel Report, *Canada—Certain Measures Affecting the Automotive Industry (Canada—Autos')*, WT/DS139/R, WT/DS142/R, adopted 19 June 2000, as modified by the Appellate Body Report, WT/DS139/AB/R, WT/DS142/AB/R.

81 These importers were American companies (including General Motors of Canada, Ford Motor Company of Canada and Chrysler Canada) that not only imported cars into Canada, but also made cars in Canada.

82 Panel Report, *Canada—Autos*, *op. cit.*, para. 10.22.

83 Henrik Horn and Petros C. Mavroidis, 'Economic and Legal Aspects of the Most-Favored-Nation Clause' (2001) 17 *European Journal of Political Economy* 233, p. 240.

84 Panel Report, *Canada—Autos*, *op. cit.*, para. 10.24.

85 Horn and Mavroidis, *op. cit.*, p. 240.

86 *Ibid.*

87 Panel Report, *Canada—Autos*, *op. cit.*, para. 10.23.

88 *Ibid.*

89 [Footnote original:] Panel Report on *Indonesia—Certain Measures Affecting the Automobile Industry ('Indonesia—Automobiles')*, adopted on 23 July 1998, WT/DS54, 55, 59, 64/R, para. 14.147: 'For the reasons discussed above, we consider that the June 1996 car programme which introduced discrimination between imports in the allocation of tax and customs duty benefits based on various conditions and other criteria not related to the imports themselves and the February 1996 car programme which also introduced discrimination between imports in the allocation of customs duty benefits based on various

- conditions and other criteria not related to the imports themselves, are inconsistent with the provisions of Article I of GATT'
- 90 Panel Report, *United States—Import Measures on Certain Products from the European Communities* ('US—Certain EC Products') WT/DS165/R and Add. 1, adopted 10 January 2001, as modified by the Appellate Body Report, WT/DS165/AB/R, para. 6.54.
 - 91 Davey and Pauwelyn, *op. cit.*, p. 25.
 - 92 Horn and Mavroidis, *op. cit.*, p. 239.
 - 93 At the time of the London session of the Preparatory Committee and later at the Havana Conference, it was suggested that the method of tariff classification could be used for determining whether products are 'like'. EPCT/C.II/PV/12, pp. 7–8; E/CONF.2/C.3/SR.5, p. 4; *GATT Analytical Index: Guide to GATT Law and Practice* (updated 6th ed., 1995) p. 35.
 - 94 Rex J. Zedalis, 'A Theory of the GATT "Like" Product Common Language Cases' (1994) 27 *Vanderbilt Journal of Transnational Law* 33, p. 79.
 - 95 Horn and Mavroidis, *op. cit.*, p. 238.
 - 96 *Ibid.*
 - 97 *Ibid.* The HS is a multipurpose international product nomenclature developed by the World Customs Organization (WCO). It comprises about 5,000 commodity groups, each identified by a six-digit code, arranged in a legal and logical structure. According to the WCO, more than 177 countries and economies use the system as a basis for their customs tariffs and for the collection of international trade statistics.
 - 98 Fauchald, *op. cit.*, p. 136. See also Won Mog Choi, 'Like Products' in *International Trade Law: Towards a Consistent GATT/WTO Jurisprudence* (London: Oxford University Press, 2003).
 - 99 Fauchald, *op. cit.*, p. 136.
 - 100 Zedalis, *op. cit.*, p. 84.
 - 101 Robert E. Hudec, 'Like Product: The Differences in Meaning in GATT Articles I and III', in Cottier and Mavroidis (eds), *op. cit.*, pp. 108–9 [hereinafter 'Like Product: The Differences in Meaning'].
 - 102 *Ibid.*, p. 109.
 - 103 *Ibid.*
 - 104 *Ibid.*
 - 105 *Ibid.*, p. 111.
 - 106 Panel Report, *Japan—Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages (Japan—Alcoholic Beverages I)*, adopted 10 November 1987, BISD 34S/83.
 - 107 *Ibid.*, para. 5.5(b).
 - 108 Choi, *op. cit.*, pp. 95–6.
 - 109 *Ibid.*, p. 96.
 - 110 Appellate Body Report, *Canada—Autos*, *op. cit.*, para. 84.
 - 111 'Like Product: The Differences in Meaning', *op. cit.*, pp. 110–12.
 - 112 *Ibid.*, p. 108.
 - 113 Zedalis, *op. cit.*, p. 39.
 - 114 *Ibid.*
 - 115 Choi, *op. cit.*, p. 98.
 - 116 *Ibid.*
 - 117 Davey and Pauwelyn, *op. cit.*, p. 35.
 - 118 *Ibid.*
 - 119 Zedalis, *op. cit.*, p. 59.
 - 120 Working Party Report, *The Australian Subsidy on Ammonium Sulphate* ('Australia—Ammonium Sulphate'), adopted 3 April 1950, BISD 11/188.
 - 121 Panel Report, *Treatment by Germany of Imports of Sardines* ('Germany—Sardines'), adopted 31 October 1952, BISD IS/53.

- 122 'Like Product: The Differences in Meaning', *op. cit.*, p. 116.
- 123 *Enforcing International Trade Law*, *op. cit.*, p. 427.
- 124 Panel Report, *Germany—Sardines*, *op. cit.*, para. 15.
- 125 *Ibid.*, para. 17.
- 126 Panel Report, *EEC—Measures on Animal Feed Proteins* ('*EEC—Animal Feed Proteins*'), adopted 14 March 1978, BISD 25S/49.
- 127 Panel Report, *Spain—Unroasted Coffee*, *op. cit.*
- 128 *Ibid.*, para. 4.7.
- 129 *Ibid.*, para. 4.6.
- 130 For a criticism of this analysis of 'like products', see 'Like Product: The Differences in Meaning', *op. cit.*, pp. 114–16.
- 131 Panel Report, *Spain—Unroasted Coffee*, *op. cit.*, para. 4.4.
- 132 'Like Product: The Differences in Meaning', *op. cit.*, p. 115.
- 133 According to Hudec, 'GATT tariff negotiating practice had certainly made use of such fine distinctions in order to limit tariff concessions to the products of countries that granted reciprocal concessions in return.' *Enforcing International Trade Law*, *op. cit.*, p. 140. See also 'Like Product: The Differences in Meaning', *op. cit.*, p. 116.
- 134 Working Party Report, *Australia—Ammonium Sulphate*, *op. cit.*
- 135 Panel Report, *Germany—Sardines*, *op. cit.*
- 136 Panel Report, *Canada/Japan—Tariff on Imports of Spruce, Pine, Fir (SPF) Dimension Lumber* ('*Japan—SPF Dimension Lumber*'), adopted 19 July 1989, BISD 36S/167.
- 137 'Like Product: The Differences in Meaning', *op. cit.*, p. 114.
- 138 L/6528; *GATT Analytical Index: Guide to GATT Law and Practice* (updated 6th ed., 1995) pp. 38–9.
- 139 *Enforcing International Trade Law*, *op. cit.*, p. 552.
- 140 See discussion in the introductory part to the like product issue.
- 141 Appellate Body Report, *Canada—Autos*, *op. cit.*, para. 84.
- 142 Panel Report, *EEC—Programme of Minimum Import Prices, Licences and Surety Deposits for Certain Processed Fruits and Vegetables* ('*EEC—Minimum Import Prices*'), adopted 18 October 1978, BISD 25S/68.
- 143 *Ibid.*, para. 4.19.
- 144 Panel Report, *European Economic Community—Imports of Beef from Canada* ('*EEC—Imports of Beef*'), adopted 10 March 1981, BISD 28S/92.
- 145 According to the Regulation, 'beef graded USDA "choice" or "prime" automatically meets the definition above'.
- 146 Schedule LXXII stated that a global quota was being bound on an MFN basis subject to certain product specifications being met.
- 147 Appellate Body Report, *EC—Bananas III*, *op. cit.*
- 148 *Ibid.*, para. 232, footnote 139.
- 149 *Ibid.*, para. 233.
- 150 *Ibid.*, paras 240–8. The European Communities had argued that the licensing system was not discriminatory because the various aspects of the system pursued entirely legitimate policies and were not inherently discriminatory in design or effect.
- 151 *Ibid.*, para. 206.
- 152 Panel Report, *Indonesia—Autos*, *op. cit.*, para. 14.147.
- 153 Panel Report, *Canada—Autos*, *op. cit.*, para. 10.38.
- 154 *Ibid.*, para. 10.45.
- 155 *Ibid.*, para. 10.49.
- 156 Appellate Body Report, *Canada—Autos*, *op. cit.*, para. 78.
- 157 *Ibid.*, para. 85. In reaching this conclusion, the AB noted the panel's conclusion that, in practice, a motor vehicle imported into Canada is granted the 'advantage' of the import duty exemption only if it originates in one of a small number of countries in which an exporter of

motor vehicles is affiliated with a manufacturer/importer in Canada that has been designated as eligible to import motor vehicles duty-free under the MVTO 1998 or under an SRO.

- 158 The BFA was signed after a GATT panel issued a decision on a case brought by Colombia, Costa Rica, Guatemala, Nicaragua and Venezuela in 1993 against the EC challenging the EC's common banana regime. This panel found that the key aspects of the regime created by Regulation 404/93 (the tariff preferences to ACP countries and the import licensing scheme) violated Articles I, II and III of the GATT. After signing the BFA, Colombia, Costa Rica, Nicaragua and Venezuela agreed not to pursue the adoption of the 1994 panel report. Prior to the establishment of the common market organization for bananas in 1993, the same countries mentioned above challenged the banana regimes of individual EC Member States. The report of the panel, issued in June 1993, determined that the quota schemes in place through national legislations violated Articles I and XI:1 of the GATT.

159 Panel Report, *EC—Bananas III*, *op. cit.*, para. 7.69.

160 *Ibid.*

161 *Ibid.*, para. 7.72.

162 *Ibid.*, para. 7.73.

163 *Ibid.*

164 *Ibid.*, para. 7.75.

165 *Ibid.*, para. 7.89.

166 Appellate Body Report, *EC—Bananas III*, *op. cit.*, para. 161.

167 *Ibid.*, para. 163.

168 In 1994, the EC requested and was granted a waiver from its MFN obligations under Article I. Under the operative paragraph of the Lomé Waiver:

[T]he provisions of paragraph 1 of Article I of the General Agreement shall be waived, until 29 February 2000, to the extent necessary to permit the European Communities to provide preferential treatment for products originating in ACP States as required by the relevant provisions of the Fourth Lomé Convention, without being required to extend the same preferential treatment to like products of any other contracting party.

169 Panel Report, *EC—Bananas III*, *op. cit.*, para. 7.110.

170 Appellate Body Report, *EC—Bananas III*, *op. cit.*, para. 183.

171 Panel Report, *EEC Restrictions on Imports of Apples from Chile* ('*EEC—Apples I (Chile)*'), adopted 10 November 1980, BISD 27S/98.

172 The same effort to liquidate excess stocks of apples led the EEC, in April 1988, to enact a regulation suspending the issuance of import licences for (dessert) apples originating in Chile. Another complaint was filed by Chile alleging that the administration and allocation of quantitative restrictions violated Article XIII. Noting that Commission Regulation 984/88 of April 1988 suspended the issuance by the EEC of import licences only in respect of apples originating in Chile, the panel found that this measure was discriminatory and constituted a violation of Article XIII:1. According to the panel, the measure constituted a 'prohibition' in the terms of Article XIII:1, and it was applied contrary to that provision since the like products of all third countries had not been similarly prohibited. Panel Report, *European Economic Community—Restrictions on Imports of Dessert Apples—Complaint by Chile* ('*EEC-Dessert Apples*'), adopted 22 June 1989, BISD 36S/93.

173 This same issue is raised in Panel Report, *EC—Bananas III*, *op. cit.*, para. 7.110.

174 Panel Report, *EC—Bananas III*, *op. cit.*, para. 7.79.

175 *Ibid.*

176 Appellate Body Report, *EC—Bananas III*, *op. cit.*, para. 190.

177 *Ibid.*, paras 190–1.

- 178 Panel Report, *Norway—Restrictions on Imports of Certain Textile Products* ('Norway—Textiles'), adopted 18 June 1980, BISD 27S/119.
- 179 *Ibid.*, para. 14.b.
- 180 *Ibid.*, para. 16.
- 181 L/76, adopted on 13 February 1953, p. 2, para. 6. For more examples, see *GATT Analytical Index: Guide to GATT Law and Practice* (updated 6th ed., 1995).
- 182 Panel Report, *United States—Transitional Safeguard Measure on Combed Cotton Yarn from Pakistan* ('US—Cotton Yarn'), WT/DS192/R, adopted 5 November 2001, as modified by the Appellate Body Report, WT/DS192/AB/R, para. 7.124.
- 183 The MFN obligation of the Agreement on Safeguards is enshrined in Article 2.2.
- 184 Panel Report, *US—Cotton Yarn*, *op. cit.*, para. 7.128.
- 185 Appellate Body Report, *United States—Transitional Safeguard Measure on Combed Cotton Yarn from Pakistan* ('US—Cotton Yarn'), WT/DS192/AB/R, adopted 5 November 2001, para. 119.
- 186 *Ibid.*
- 187 *Ibid.*, para. 124.
- 188 *Ibid.*, para. 126.
- 189 *Ibid.*, para. 127.
- 190 *Ibid.*

3

National Treatment

- 1 See Michael J. Trebilcock and Robert Howse, 'Trade Liberalization and Regulatory Diversity: Reconciling Competitive Markets with Competitive Politics' (1998) 6 *European Journal of Law and Economics* 5.
- 2 The discussion of the GATT and WTO case law that follows is drawn largely from Michael J. Trebilcock and Shiva K. Giri, 'The National Treatment Principle in International Law', in K. Choi and J. Hartigan (eds), *Handbook of International Trade Volume II: Economics and Legal Analyses of Trade Policy and Institutions* (Oxford: Blackwell Publishing, 2005) and (in the case of *Asbestos*) Robert Howse and Elisabeth Tuerk, 'The WTO Impact on International Relations—A Case Study of the Canada-EC *Asbestos* Dispute', in Gráinne de Búrca and Joanne Scott (eds) *The EU and the WTO: Legal and Constitutional Issues* (Oxford: Hart Publishing, 2002).
- 3 The panel stated the following in regard to the context, purpose and object of Article III:2:

Just as Article I:1 was generally construed, in order to protect the competitive benefits accruing from reciprocal tariff bindings, as prohibiting 'tariff specialization' discriminating against 'like' products, only the literal interpretation of Article III:2 as prohibiting 'internal tax specialization' discriminating against 'like' products could ensure that the reasonable expectation, protected under GATT Article XXIII, of competitive benefits accruing under tariff concessions would not be nullified or impaired by internal tax discrimination against like products.

- 4 Report of the Working Party, *Border Tax Adjustments*, adopted 2 December 1970, BISD 18S/102.

- 5 According to the panel, the increasing imports of 'Western-style' alcoholic beverages into Japan bore witness to this competitive relationship and to the potential product substitution through trade among various alcoholic beverages.
- 6 Panel Report, *United States—Measures Affecting Alcoholic and Malt Beverages* ('US—Malt Beverages'), adopted 19 June 1992, BISD 39S/206.
- 7 In the panel's view, even if the wine produced from the specified variety of grape were to be considered unlike other wine, the two kinds of wine would still have to be regarded as 'directly competitive' products in terms of Article III:2, second sentence, and the imposition of a higher tax on directly competing imported wine so as to afford protection to domestic production would have been inconsistent with that provision.
- 8 In the panel's view, consumers who purchased low-alcohol beer might be unlikely to purchase high-alcohol beer and *vice versa*, and the advertising and marketing by manufacturers showed such different market segments.
- 9 Panel Report, *United States—Taxes on Automobiles* ('US—Taxes on Automobiles'), adopted 29 September 1994, DS31/R.
- 10 The EC claimed that all automobiles were 'like' products and that the distinction made on the basis of their value and gasoline consumption resulted in the imposition of internal taxes on imported products in excess of those applied to 'like' domestic products. The USA claimed that the tax measures were applied equally to domestic and imported automobiles and that the USA and EC producers manufactured automobiles with both the low and the high values as well as with high and low gasoline consumption.
- 11 The panel noted that a difference in the physical characteristic of the alcoholic strength of two products did not preclude a finding of 'likeness', especially since alcoholic beverages are often drunk in diluted form. The panel also noted the similar findings in the 1987 *Japan—Alcohol*, case, and that vodka and shochu were classified in the same heading in the Japanese tariffs bindings.
- 12 According to the panel, the use of additives would disqualify liqueurs, gin and genever; the use of ingredients would disqualify rum; and appearance (arising from manufacturing processes) would disqualify whisky and brandy.
- 13 *Japan—Taxes on Alcoholic Beverages*, Report of the Panel, WT/DS8/R, WT/DS10/R and WT/DS11/R (11 July 1996) (96–2651); and *Japan—Taxes on Alcoholic Beverages*, Report of the Appellate Body, WT/DS8/AB/R, WT/DS10/AB/R and WT/DS11/AB/R (4 October 1996) (96–3951), AB-1996–2.
- 14 In its report, the panel stated that such an examination requires two determinations: (1) whether the products concerned are 'directly competitive or substitutable', and (2), if so, whether the treatment afforded to foreign products is contrary to the principles set forth in Article III:1.
- 15 The issue in this case was the Japanese Liquor Tax Law that divided all liquors into different categories and subcategories, and applied different tax rates to each of these categories and subcategories. The tax rates were expressed as a specific amount in Japanese yen per litre of beverage, and for each category or subcategory, the Liquor Tax Law laid down a reference alcohol content per litre of beverage and the corresponding reference tax rate. The European Communities complained, *inter alia*, that Japan had acted inconsistently with Article III:2 of the GATT by applying a higher tax rate on the categories of spirits, whisky/brandy and liqueurs than on each of the two subcategories of shochu. Canada and the United States complained that the higher rates of taxation on imported alcoholic beverages, including whiskies, brandies and other distilled alcoholic beverages, and liqueurs, than on Japanese shochu imposed under the Liquor Tax Law were inconsistent with Article III:1 and III:2 of the GATT.
- 16 The issues raised before the AB were the conclusions reached by the panel that shochu and vodka are like products, and Japan, by taxing the latter in excess of the former, was in violation of its obligation under Article III:2, first sentence, of GATT 1994; and that shochu,

whisky, brandy, rum, gin, genever and liqueurs are 'directly competitive or substitutable products', and Japan, by not taxing them similarly, was in violation of its obligation under Article III:2, second sentence, of GATT 1994. Japan and the United States appealed against the panel's findings.

- 17 According to the panel, even if the adopted panel reports have any legal status, it does not necessarily have to follow their reasoning or results. Although the AB endorsed the panel's conclusion in regard to unadopted panel reports and did not agree with the conclusion on the legal status of adopted panel reports, it, however, agreed that adopted panel reports are not binding, except on the parties to the dispute, even if they create legitimate expectations among WTO Members and should be taken into account where they are relevant to any dispute.
- 18 According to the panel, if the 'aims and effects' test was applied in regard to Article III, then in principle a WTO Member could, for example, invoke protection of health in the context of invoking the 'aims and effects' test, and if this were the case, then the standard of proof established in Article XX would effectively be circumvented and WTO Members would not have to prove that a health measure is necessary to achieve its health objective.
- 19 The panel concluded that the tax imposed on vodka was in excess of the tax imposed on shochu because vodka was taxed at 377,230 yen per kilolitre for an alcoholic strength below 38°–9,927 yen per degree of alcohol—whereas shochu was taxed at 155,700 yen per kilolitre for an alcoholic strength between 25 and 26°–6,228 yen per degree of alcohol.
- 20 Applying the criterion of elasticity of substitution between products, the panel concluded that shochu, whisky, brandy, rum, gin, genever and liqueurs were 'directly competitive or substitutable products'. To find the elasticity of substitution, the panel relied on the conclusions of the 1987 *Japan—Alcohol* case that both white and brown spirits were directly competitive or substitutable products to shochu, the studies put forward by the complainants supporting such elasticity of substitution, and the evidence submitted by the complainants concerning the 1989 Japanese tax reform which showed that the products in question were essentially competing for the same market.
- 21 In the view of the AB, this would eviscerate the distinctive meaning that must be respected due to the distinctions in the wording of the text of Article III:2, first sentence, and Article III:2, second sentence.
- 22 The panel concluded that the products at dispute were not similarly taxed because the differences in the amounts of taxes were not *de minimis* and Japan's Liquor Tax Law did not specifically provide that tax/price ratio was the basis of taxation, as there were significantly different tax/price ratios even within the same product categories.
- 23 For various aspects of the practical difficulties in applying the tests advocated by the AB in *Japan—Taxes on Alcoholic Beverages*, see Sarah Hogg and Mahmud Nawaz, 'Economic Considerations and the DSU', in James Cameron and Karen Campbell (eds) *Dispute Resolution in the World Trade Organisation* (London: Cameron May, 1998) (arguing that the interpretation was focused on *supply side* factors and that the key *demand side* question—whether the products concerned competed in the same market—was not considered as important); and Ramon R. Gupta, 'Appellate Body Interpretation of the WTO Agreement: A Critique in Light of Japan—Taxes on Alcoholic Beverages' (1997) 6 *Pacific Rim Law and Policy Journal* 683 (criticising the vague approach in defining 'like' and 'directly competitive or substitutable' products in light of the importance of predictability and clarity in developing credible dispute settlement procedure).
- 24 *Canada—Certain Measures Concerning Periodicals*, Report of the Panel, WT/DS31/R (14 March 1997) (97–0939); and *Canada—Certain Measures Concerning Periodicals*, Report of the Appellate Body, WT/DS31/AB/R (30 June 1997) (97–2653), AB-1997–2.
- 25 A split-run edition was one that was distributed in Canada, had more than 20% of editorial material substantially the same as the editorial material that appeared in one or more

- excluded editions of one or more issues of one or more periodicals, and contained an advertisement that did not appear in identical form in all excluded editions.
- 26 Canada claimed, *inter alia*, that the panel erred in law in finding that imported US split-run periodicals and Canadian non-split-run periodicals were like products. The US appeal related to some other issues.
 - 27 Based on a single hypothetical example constructed using a Canadian-owned magazine, *Harrowsmith Country Life*, which was previously a split-run periodical but stopped its US edition as a result of the tax, the panel compared two editions of the same magazine, one from before and one from after the discontinuation of the US edition, and concluded that imported split-run periodicals and domestic non-split-run periodicals were 'like' products because the two editions of the said magazine would have common end-uses, were very similar in terms of their physical properties, nature and qualities, and would also have been designed for the same readership with the same tastes and habits.
 - 28 The AB particularly noted the fact that the panel based its findings on a single, incorrect, hypothetical example that involved a comparison between two editions of the same magazine, both imported products, which could not have been in the Canadian market at the same time, but did not examine the evidence of the likeness of *TIME*, *TIME Canada* and *Maclean's*, presented by Canada, or that of *Pulp & Paper* and *Pulp & Paper Canada*, presented by the USA, or the Report of the Task Force on the Canadian Magazine Industry.
 - 29 In its view, the determination of 'likeness' was a delicate process by which legal rules had to be applied to facts, and due to the absence of adequate analysis of facts in the panel report in that respect, it was not possible for the AB to proceed to a determination of 'like' products.
 - 30 The AB rejected the argument of Canada that it did not have the jurisdiction to examine a claim under Article III:2, second sentence, as no party had appealed the findings of the panel on that provision.
 - 31 The AB rejected the argument of Canada that the Task Force Report's description of the relationship as one of 'imperfect substitutability' characterized the absence of perfect substitutability that was required to prove the direct competitiveness or substitutability of products. In its view, a case of perfect substitutability makes products the 'like' products. It also cautioned that the conclusion that imported split-run periodicals and domestic non-split-run periodicals were 'directly competitive or substitutable' did not mean that all periodicals belong to the same relevant market, whatever their editorial content. In its view, a periodical containing mainly current news is not directly competitive or substitutable with a periodical dedicated to gardening, chess, sports, music or cuisine, but news magazines, like *TIME* and *Maclean's*, are directly competitive or substitutable.
 - 32 The AB claimed that the magnitude of the dissimilar taxation was prohibitive.
 - 33 The effects cited were the moving of the production of a split-run magazine of the USA for the Canadian market from Canada to the USA, and the cessation of production of the US edition by a Canadian split-run periodical after the imposition of the tax.
 - 34 *Korea—Taxes on Alcoholic Beverages*, Report of the Panel, WT/DS75/R and WT/DS84/R (17 September 1998) (98–3471); and *Korea—Taxes on Alcoholic Beverages*, Report of the Appellate Body, WT/DS75/AB/R and WT/DS84/AB/R (18 January 1999) (99–0100), AB-1998–7. In this case, the US and EEC complained that the Korean taxes under the Korean Liquor and Education Tax Laws were inconsistent with Article III:2 because they accorded preferential tax treatment to soju, a traditional Korean alcoholic beverage, as compared with that given to certain imported alcoholic beverages.
 - 35 The panel found that the total tax on diluted soju was 38.5%; on distilled soju and liqueurs 55%; on vodka, gin, rum, tequila and admixtures 104%; and on whisky, brandy and cognac 130%.
 - 36 According to the panel, it was based on a very broad generic definition of soju, and then there were specific exceptions corresponding very closely to one or more characteristics of imported beverages that were used to identify products which received higher tax rates.

There was virtually no imported soju so the beneficiaries of the tax structure were almost exclusively domestic producers, and the only domestic product which fell into a category with higher tax rates was distilled soju, which represented less than 1 % of Korean production.

37 *Chile—Taxes on Alcoholic Beverages*, Report of the Panel, WT/DS87/R and WT/DS110/R (15 June 1999) (99–2313); and *Chile—Taxes on Alcoholic Beverages*, Report of the Appellate Body, WT/DS87/AB/R and WT/DS110/AB/R (13 December 1999) (99–5414), AB-1999–6.

38 In the panel's view, studies or surveys that reveal the following all serve as evidence of substitutability in end-uses: (1) a tendency among consumers to regard products as substitutes in satisfying a particular need; (2) that the nature and content of marketing strategies of producers indicate that they are competing for the expenditure of potential consumers in a particular market segment; and (3) that distribution channels are shared with other goods.

39 According to the panel, although whisky and pisco were distilled from different substances, namely barley and grapes respectively, they share the characteristics of being potable liquids with high alcohol content, which was the product of distillation, as well as being receptive to mixing with non-alcoholic beverages. In any event, even the differences in ingredients between whisky and pisco were not sufficient to render these two distilled alcoholic spirits, both of which have a high alcohol content and more or less satisfy a similar need, incapable of being substituted for each other. As for brandy, cognac and some other spirits, the differences in physical characteristics were only post-distillation differences such as colour and smell, which were not sufficiently significant to change the basic character of spirits essentially made from grapes or other fruits.

40 According to the panel, between 70 and 80% of Chilean production consisted of products with an alcohol content of less than 35° and, therefore, enjoyed the lowest tax rate of 27%. Over 90% of pisco was in this category.

41 Under Chilean regulations, most of the imported beverages, such as whisky, had generic names that required them to contain at least 40° of alcohol. Thus, almost 95% of imports would be taxed at the highest rate of 47% or would lose their ability to retain their generic name or would be required to change an important physical characteristic, namely their water/alcohol ratio.

42 Chile argued that the objectives of its tax measure were maintaining revenue collection; eliminating tax distinctions based on type of alcoholic beverage; discouraging alcohol consumption; and minimizing the potentially regressive aspects of the reform of the tax system. Examining the relationship between the stated objectives and the measure in question, the panel claimed that there was no rational reason why such a structure as devised by Chile was necessary for the purpose of maintaining revenue neutrality, as Chile had acknowledged that the same revenue result could be achieved with a single *ad valorem* rate at some point between 27% and 47%. Similarly, the panel claimed that the New System did not achieve the purpose of eliminating type distinctions because the favourable tax treatment accorded to products called 'pisco' was removed, but the system was replaced with one providing unfavourable tax treatment for any products called 'whisky', 'gin', 'vodka' or 'rum', which happened to be primarily imports. Likewise, the panel claimed that there was no direct correlation between the objective of discouraging alcohol consumption and the tax measure because the tax differential between products with 35° of alcohol and 39° of alcohol was not the same as the differential between products with, for instance, 40° and 44° of alcohol as the tax rate almost doubled between 35° and 39° but was the same between 40° and 44°. Since the system was based not just on alcohol content, but on *ad valorem* rates qualified by the additional criterion of alcohol content, there appeared to be no correlation between value and alcohol consumption. Finally, minimizing the regressive aspects of the tax reform would be true only if the factual situation were to remain static. In many markets,

there were relatively low-priced whiskies sold at the same alcohol content as high-priced whisky.

- 43 For a brief commentary on the AB decision in this case, see Raj Bhala and David Gantz, 'WTO Case Review 2000' (2001) 18 *Arizona Journal of International and Comparative Law* 1.
- 44 *Indonesia—Certain Measures Affecting the Automobile Industry*, Report of the Panel, WT/DS54/R, WT/DS55/R, WT/DS59/R and WT/DS64/R (2 July 1998) (98–2505).
- 45 The following draws from Mavroidis, Howse and Bermann, *Law of the World Trade Organisation: Cases and Materials* (Foundation Press, forthcoming).
- 46 *United States—Tax Treatment for Foreign Sales Corporations 'FSC'*, Report of the Panel, WT/DS108/R (8 October 1999) (99–4118).
- 47 *United States—Tax Treatment for Foreign Sales Corporations 'FSC'—Recourse to Article 21.5 of the DSU by the European Communities*, Report of the Appellate Body, WT/DS108/AB/RW (14 January 2002) (02–0152), AB–2001–8.
- 48 *European Communities—Measures Affecting Asbestos and Asbestos-Containing Products*, Report of the Panel, WT/DS135/R (18 September 2000) (00–3353).
- 49 Appellate Body Report, para. 97.
- 50 *Ibid.*, para. 100.
- 51 See Robert L. Howse and Donald H. Regan, 'The Product/Process Distinction—An Illusory Basis for Disciplining "Unilateralism" in Trade Policy' (2000) 11 *European Journal of International Law* 249. Some observers have interpreted the statement in para. 100 in a different way, namely as simply restating the proposition of the *Section 337* case (*United States—Section 337 of the Tariff Act of 1930*, BISD 36S/345), that where there is facially discriminatory treatment of domestic and imported products, nevertheless this may still be consistent with Article 111:4—namely where, although domestic products and imports are governed by different rules or regimes, there is nevertheless no less favourable treatment for imports. If this statement is interpreted this way, however, the next sentence in para. 100 appears to reverse another proposition of the *Section 337* case, i.e. that in cases where there is differential treatment of imports and domestic products, every instance of the differential treatment must result in treatment no less favourable. This is because the next sentence emphasizes that the comparison is between the treatment of the group of like imported products and the group of like domestic products. The AB cannot be reasonably interpreted as intending to overturn such an established jurisprudential principle of the GATT, not even citing or discussing the *Section 337* panel here. In fact, while in *Section 337* the issue is when facially differential treatment of imports may nevertheless be 'no less favourable', in para. 100 the issue is whether a non-national-origin-based regulatory distinction between like products nevertheless constitutes less favourable treatment of imports, i.e. protection. From the point of view of discerning protection in respect of origin-neutral regulatory distinctions, the fact that some imported product or other gets worse treatment than some domestic product or other is not probative and may be quite misleading. This may be an innocent or purely accidental disparate impact. To determine whether an origin-neutral regulatory distinction is protective, we have to discern whether there is a connection between the design and structure of the scheme itself and less favourable treatment of imports—the issue is systemically less favourable treatment of imports, and therefore the proper framework for assessment is the structure and design of the scheme as it impacts on the treatment of the group of like imported products as a whole relative to the group of like domestic products as a whole.
- 52 This is especially evident when we recall the AB's suggestion in para. 100 of the interchangeability of equivalence of the notion of 'less favourable treatment' with the general notion in Article III:1 that measures not be applied so as to afford protection to domestic production. In interpreting that concept with respect to National Treatment in taxation under the second sentence of Article III:2, into which it is explicitly incorporated by

virtue of an Interpretive Note to Article III, the AB has indicated the primary importance of examining the structure and design of the regulatory scheme in order to make a judgment on objective factors as to whether the measure is protective, and has asserted the irrelevance of protectionist intent to that enterprise: *Japan—Alcohol*, *op. cit.* In the subsequent case of *Canada—Periodicals*, however, the AB did not exclude consideration of evidence such as legislative history and ministerial statements, which apparently go to protectionist intent: Appellate Body Report, *Canada—Certain Measures Concerning Periodicals*, *op. cit.* Recently, in *Chile—Alcohol*, the AB held that it was appropriate to ‘relate the observable structural features of the measure with its declared purposes’: Appellate Body Report, *Chile—Taxes on Alcoholic Beverages*, *op. cit.*, para. 72. These are not inconsistent rulings—an inquiry into the structure and design of the scheme may well be decisive with respect to whether it is protective, obviating the need for making sensitive judgments about intent, but this does not mean that in other cases, a more intent-based examination of evidence of protection may well be indicated. Not all findings that a measure is structurally protective imply a cryptic judgment of protectionist animus: domestic regulators or legislators may have designed a measure without turning their minds at all to the possibility of a systematically unfavourable effect on imports. This might happen because of un- or under-representation of importer or foreign producer interests, or surrogate domestic interests, in the regulatory process—that could indicate protection at the deeper level of regulatory and political structure. But the measures themselves may lack any positive protectionist animus. Cf. Robert E. Hudec, ‘GATT/WTO Constraints on National Regulation: Requiem for an “Aim and Effects” Test’ (1998) 32 *International Lawyer* 619 at p. 634.

53 We will refer to all four criteria hereinafter as the *Border Tax Adjustment* criteria.

54 Appellate Body Report, para. 102.

55 *Ibid.*, para. 114.

56 *Ibid.*, para. 115.

57 *Ibid.*, para. 122.

58 *Ibid.*, para. 122.

59 A very similar approach is taken in Marco Bronckers and Natalie McNelis, ‘Rethinking the “Like Product” Definition in GATT 1994: Anti-Dumping and Environmental Protection’, in Thomas Cottier and Petros Mavroidis (eds) *Regulatory Barriers and the Principle of Non-Discrimination in Trade Law* (Ann Arbor: University of Michigan Press, 2000) pp. 343–85. According to Bronckers and McNelis, for physically like products to be characterized as ‘unlike’ on the basis of consumer tastes and habits, it would be necessary for ‘consumers as a whole (rather than specific interest groups)’ to distinguish between the products (p. 375). We do not understand why this should be the case—competing firms in the marketplace often differentiate their products to appeal to subgroups of consumers, and those differentiations may change competitive relationships substantially.

60 Appellate Body Report, para. 137.

61 Thus, in *Canada—Periodicals*, where there was inadequate factual analysis in the panel report, the AB held that it could not go ahead and complete the analysis of ‘likeness’.

62 Appellate Body Report, para. 139.

63 Here we have been inspired by recent work by Joseph Weiler on the distinction between the internal and external legitimacy of the WTO. See Joseph H.H. Weiler, ‘The Rule of Lawyers and the Ethos of Diplomats: Reflections on the Internal and External Legitimacy of WTO Dispute Settlement’, Harvard Jean Monnet Working Paper 9/00 (available online at <http://www.jeanmonnetprogram.org/>). Assessing the first five years of AB rulings, Weiler observes that the AB has practised a legitimization strategy with ‘a keen eye on balancing internal and external legitimacy’ (p. 16).

64 Cass R. Sunstein, *One Case at a Time: Judicial Minimalism on the Supreme Court* (Cambridge MA: Cambridge University Press, 1999).

65 Howse and Regan, *op. cit.*

- 66 Henrik Horn and J.H.H.Weiler, 'EC—Asbestos', in H.Horn and P.Mavroidis (eds) *The WTO Case Law of 2001: The American Law Institute Reporters' Studies* (Cambridge: Cambridge University Press, 2003) pp. 14–40.
- 67 G.Verhoessel, *National Treatment and WTO Dispute Settlement: Adjudicating the Boundaries of Regulatory Autonomy* (Oxford: Hart Publishing, 2002).
- 68 Weiler argues for what he characterizes as a 'third approach', which would entail focusing at the level of Article III analysis on what he calls the 'comparator', the actual grounds of the classification of the products that result in their differential regulatory treatment. Emphasizing the grounds of the classification rather than whether they serve a non-protectionist purpose would presumably allow a more refined analysis, with greater deference being given to grounds such as the protection of human health, and perhaps a stricter inquiry where the grounds are more of a commercial nature (such as quality grading of products). However, Weiler himself does not draw out the significance of his 'third approach' as distinct from the straightforward regulatory purpose approach of Howse and Regan.
- 69 Horn and Weiler, *op. cit.*, pp. 30–1.

4

Dispute settlement

- 1 See J.H.Jackson and W.J.Davey, *Legal Problems of International Economic Relations* (St Paul MN: West Publications, 1986) pp. 294–5; see also United States, International Trade Commission, *Review of the Effectiveness of Trade Dispute Settlement under the GATT and the Tokyo Round Agreements* (Washington DC: USITC, 1985) p. 2 [hereinafter *ITC Report*].
- 2 R.E.Hudec, *The GATT Legal System and World Trade Diplomacy* (Salem NH: Butterworth, 1990) p. 68, and *ITC Report*, *op. cit.*, p. 11; Hudec, *Enforcing International Trade Law: The Evolution of the Modern GATT Legal System* (Salem NH: Butterworth, 1993).
- 3 *ITC Report*, *op. cit.*, p. 8.
- 4 See Hudec (1990), *op. cit.*, p. 77. See also *ITC Report*, *op. cit.*, p. 11. The Netherlands complained that Cuba's consular taxes were a violation of Article I (Most Favoured Nation). The matter was referred to the Chairman, who ruled against Cuba, which complied with the finding a few months later.
- 5 *ITC Report*, *op. cit.*, p. 13. It should be noted that in recent years, the European Court of Justice has veered towards a more deferential approach, distinguishing between product regulations and 'selling arrangements'—the latter will not be found in violation of Article 30 to the extent that they are not explicitly discriminatory. See *Keck and Mithouard* [1993] E.C.R. I-6097.
- 6 *ITC Report*, *op. cit.*, p. 14.
- 7 *The ITC Report*, *op. cit.*, p. 47, states that between 1975 and 1985, 85% of the disputes dealt with by the Contracting Parties went to panels and 15% went to working groups.
- 8 *ITC Report*, *op. cit.*, pp. 15–17. The panel procedures adopted during the Seventh Session are basically the same as those used by panels today, although it was not until the Ninth Session that the practice began of appointing panel members in their individual capacity rather than as representatives of their countries. It should be noted that the use of working parties continued at the Seventh Session. Working parties continue to be used from time to time.
- 9 *ITC Report*, *op. cit.*, p. 17.
- 10 Rosine Plank, 'An Unofficial Description of How a GATT Panel Works and Does Not' (1987) 4 *Journal of International Arbitration* 53 at p. 55.
- 11 *ITC Report*, *op. cit.*, p. 20, and J.H.Bello and A.F.Holmer, 'Settling Disputes in the GATT: The Past, Present, and Future' (1990) 24 *The International Lawyer* 519 at p. 521.

- 12 See *ITC Report, op. cit.*, p. 20; Robert Hudec, Daniel Kennedy and Mark Sgarbossa, A Statistical Profile of GATT Dispute Settlement Cases; 1948–1989' (1993) 2 *Minnesota Journal of Global Trade* 1 at p. 18; Hudec (1993), *op. cit.*
- 13 Perhaps there are cultural reasons for this aversion to legalism—the Japanese have been conspicuous in their absence from participation in GATT dispute resolution processes, at least as complainants. This reluctance to resort to the GATT is often ascribed to Japanese aversion to confrontation. EC trade officials, as well, are fond of explaining EC-USA clashes over the meaning of dispute resolution as reflecting differences in legal culture. The Europeans are said not to share the American fascination with the vindication of rights through legal processes.
- 14 The ITC cites the Textile Agreement of 1962, and the steel export restraints of 1968 as examples. See *ITC Report, op. cit.*, p. 20.
- 15 *ITC Report, op. cit.*, p. 23. The *ITC Report* attributes the aggression to American concerns about declining influence within the GATT, and Congressional concerns about declining exports and growing imports.
- 16 The 'codification' is the Understanding Regarding Notification, Consultation, Dispute Settlement and Surveillance adopted on 28 November 1979, BISD 26S/210 [hereinafter 1979 Understanding].
- 17 *ITC Report, op. cit.*, p. 29. Because of the overall similarity between the Tokyo Codes' dispute resolution mechanisms and the general GATT mechanism, this chapter will make no special attempt to describe ways in which the mechanisms do differ. In any case, few countries have resorted to dispute resolution under the Code mechanisms. Jackson counts only nine disputes between 1979 and 1988 where resort was had to the Code provisions (see J.H.Jackson, *Restructuring the GATT* (London: Pinter, 1990) p. 66; and *ITC Report, op. cit.*, p. 55). Descriptions of the Code provisions on dispute resolution can be found in J.H.Jackson, *The World Trading System* (Cambridge MA: MIT Press, 2nd ed., 1997) ch. 4, and in *ITC Report*, pp. 33–4.
- 18 Jackson, *World Trading System, op. cit.*, p. 116. Jackson blames the EC for blocking US efforts in this direction.
- 19 R.E.Hudec (1980) 13 *Cornell International Law Journal* 145, reprinted in R.Howse (ed.) *The World Trading System: Critical Perspectives on the World Economy*, vol. II (London and New York: Routledge, 1998) p. 125.
- 20 Uruguay Round Understanding on Rules and Procedures Governing the Settlement of Disputes, December 1993 [hereinafter Uruguay Round Understanding].
- 21 Of course, cheating is attractive not because it will maximize short-term aggregate domestic welfare in the cheating state, but because the government may be able to make political gains from the rents that flow to a pro-protection constituency within the state. See the discussion of the political economy of free trade and protection in Chapter 1.
- 22 G.R.Shell, 'Trade Legalism and International Relations Theory: An Analysis of the World Trade Organization' (1995) *Duke Law Journal* 829, reprinted in Howse (ed.), *op. cit.*, pp. 333–416.
- 23 This follows from the analysis in Chapter 1, which indicates how *domestic welfare* can always be increased by unilateral, and even more so by reciprocal, trade liberalization, because the interests of those constituencies that 'lose' from liberalization can always be vindicated through alternative policies that are less welfare reducing than trade restrictions. In new areas, like intellectual property rights, however, where trade liberalization is linked with the prescription or constraint of domestic policy outcomes that may in itself be domestic (or even global) welfare-reducing, each individual state's commitment to a liberal cooperative equilibrium will depend on the perception of the balance between gains from trade and possible welfare losses from being required to adopt less than optimal domestic regulatory outcomes. This is developed at length in Chapter 13 in this book on TRIPs.
- 24 Shell, in Howse (ed.), *op. cit.*, p. 372.

- 25 Of course, dispute rulings always did indirectly affect domestic distributive outcomes, but did not entail constraint of (non-discriminatory) domestic policy instruments. Governments were left free to adopt any non-protectionist policy response of their choice, and as noted could always in principle find a less welfare-reducing instrument than trade restrictions to vindicate the interests of negatively affected constituencies.
- 26 Shell, in Howse (ed.), *op cit.*, p. 372.
- 27 An interesting insight into the hesitant course of progress can be culled from the diplomatic language introducing each of the 1979 Understanding, *op. cit.*, and the 1989 Dispute Settlement Procedures Improvements, BISD 36S/61.
- 28 *ITC Report, op. cit.*, pp. 69 and 79.
- 29 The following figures are taken from the *ITC Report, op. cit.*, pp. 50–64, supplemented by Jackson, *The World Trading System, op. cit.*, p. 120. The ITC study examines 84 cases referred by the Contracting Parties to working parties or panels under Article XXIII:2 or the MTN Codes. Cases settled by consultation are not included because of a paucity of data. The ITC estimates that a much larger number of cases never reach the panel stage; consultations are enough to settle the dispute or the case is simply dropped.
- 30 The ‘DISC’ case; see *ITC Report, op. cit.*, Appendix I.
- 31 Hudec, Kennedy and Sgarbossa, *op. cit.*; Hudec (1993), *op. cit.*
- 32 Plank, *op. cit.*, reprinted in Howse (ed.), *op. cit.*, pp. 60–105.
- 33 *Ibid.*
- 34 *United States—Restrictions on Imports of Cotton and Man-made Fibre Underwear*, Report of the Appellate Body, WT/DS24/AB/R (10 February 1997) (97–0454), AB-1993–3.
- 35 *United States—Imposition of Import Duties on Automobiles from Japan Under Sections 301 and 304 of the Trade Act of 1974*, Request for Consultations by Japan, WT/DS61/1 (22 May 1995) (95–1326).
- 36 *Mexico—Anti-Dumping Investigation of High Fructose Corn Syrup (HFCS) from the United States—Recourse to Article 21.5 of the DSU by the United States*, Report of the Appellate Body, WT/DS132/AB/R (21 November 2001) (01–5170), AB-2001–5.
- 37 *European Communities—Regime for the Importation, Sale and Distribution of Bananas*, Report of the Appellate Body, WT/DS27/AB/R (9 September 1997) (97–3593), AB-1997–3, para. 133.
- 38 *United States—Antidumping Act of 1916*, Report of the Appellate Body, WT/DS136/AB/R and WT/DS 162/AB/R (28 August 2000) (00–3369), AB-2000–5 and AB-2000–6, paras. 89–91.
- 39 *United States—Sunset Review of Anti-Dumping Duties on Corrosion-resistant Carbon Steel Flat Products from Japan*, Report of the Appellate Body, WT/DS244/AB/R (15 December 2003) (03–6603), AB-2003–5.
- 40 *See United States—Imposition of Import Duties on Automobiles from Japan Under Sections 301 and 304 of the Trade Act of 1974*, Request for Consultations by Japan, WT/DS61/1 (22 May 1995) (95–1326).
- 41 *Turkey—Restrictions on Imports of Textile and Clothing Products*, Report of the Appellate Body, WT/DS34/AB (22 October 1999) (99–4546), AB-1999–5, and *India—Quantitative Restrictions on Imports of Agricultural, Textile, and Industrial Products*, Report of the Appellate Body, WT/DS90/AB/R (23 August 1999) (99–3500), AB-1999–3.
- 42 *Korea—Definitive Safeguard Measures on Imports of Certain Dairy Products*, Report of the Appellate Body, WT/DS98/AB/R (14 December 1999) (99–5420), AB-1999–8.
- 43 *United States—Countervailing Duties on Certain Corrosion-resistant Carbon Steel Flat Products from Germany*, Report of the Appellate Body, WT/DS213/AB/R (28 November 2002) (02–6520), AB-2002–04, paras 169–71.
- 44 *Brazil—Measures Affecting Desiccated Coconut*, Report of the Appellate Body, WT/DS22/AB/R (21 February 1997) (97–0695), AB-1996–4.

- 45 *India—Patent Protection for Pharmaceutical and Agricultural Chemical Products*, Report of the Appellate Body, WT/DS50/AB/R (19 December 1997) (97–5539), AB-1997–5, para. 92.
- 46 *EC Measures Concerning Meat and Meat Products*, Report of the Appellate Body, WT/DS26/AB/R and WT/DS48/AB/R (16 January 1999), (98–0099), AB-1997–4, para. 156 [hereinafter *Hormones*].
- 47 *United States—Measures Affecting Imports of Woven Wool Shirts and Blouses from India*, Report of the Appellate Body, WT/DS33/AB/R (23 May 1997) (97–1773), AB-1991–1 [hereinafter *Shirts and Blouses*].
- 48 *United States—Standards for Reformulated and Conventional Gasoline*, Report of the Panel, WT/DS32/R (29 January 1996) (96–0236), paras 1.1–1.5.
- 49 *United States—Anti-Dumping Act of 1916*, Report of the Appellate Body, WT/DS136/ AB/R (28 September 2000) (00–3369), AB-2000–6, para. 150.
- 50 E.-U. Petersmann, ‘How to Promote the International Rule of Law? Contributions by the World Trade Organization Appellate Review System’ (1998) 1 *Journal of International Economic Law* 25.
- 51 *European Communities—Trade Description of Sardines*, Report of the Appellate Body, WT/DS231/AB/R (26 September 2002) (02–5137), AB-2002–3, paras 271–5.
- 52 *Canada—Measures Affecting the Export of Civilian Aircraft—Recourse by Brazil to Article 21.5 of the DSU*, Report of the Appellate Body, WT/DS70/AB/RW (21 July 2000) (00–2989), AB-2000–4.
- 53 *Canada—Certain Measures Concerning Periodicals*, Report of the Appellate Body, WT/DS31/AB/R (30 June 1997) (97–2653), AB-1997–2, pp. 22–3.
- 54 *United States—Definitive Safeguard Measures on Imports of Wheat Gluten from the European Communities*, Report of the Appellate Body, WT/DS166/AB/R (22 December 2000) (00–5593), AB-2000–10, para. 161.
- 55 D. Palmeter and P. C. Mavroidis, ‘The WTO Legal System: Sources of Law’ (1998) 92 *American Journal of International Law* 4. The following discussion owes much to this seminal article.
- 56 *Japan—Taxes on Alcoholic Beverages*, Report of the Appellate Body, WT/DS8, 10–11/AB/R (4 October 1996) (96–3951), AB-1996–2.
- 57 23 May 1969, 1155 *U.N.T.S.* 331, 8 *International Legal Materials* 679 [hereinafter *Vienna Convention*].
- 58 Indeed, one could argue that the expression ‘customary rules of interpretation in public international law’ would be superfluous if it only referred to rules that now constitute customary law in themselves—since these rules are binding by virtue of their status as custom.
- 59 *United States—Restrictions on Imports of Tuna*, Report of the Panel, (16 June 1994) (DS29/R), para. 5.19.
- 60 Palmeter and Mavroidis, *op. cit.*, p. 34.
- 61 *Argentina—Measures Affecting Imports of Footwear, Textiles, Apparel and other Items*, Report of the Appellate Body, WT/DS56/AB/R (98–1190), AB-1998–1 (27 March 1998).
- 62 *Korea—Measures Affecting Government Procurement*, Report of the Panel, WT/DS163/R (1 May 2000) (00–1679).
- 63 *See European Communities—Measures Affecting the Importation of Certain Poultry Products*, Report of the Appellate Body, WT/DS69/AB/R (13 July 1998) (98–2688) AB-1998–3.
- 64 *Rules of Conduct for the Understanding on Rules and Procedures Governing the Settlement of Disputes*, WT/DSB/RC/1 (11 December 1996).
- 65 WT/L/160/Rev. 1 (26 July 1996).
- 66 *Indonesia—Certain Measures Affecting the Automobile Industry*, Report of the Panel, WT/DS 54, 55, 59, 64/R (2 July 1998) (98–2505).

- 67 E.-U.Petersmann, 'The Dispute Settlement System of the World Trade Organization and the Evolution of the GATT Dispute Settlement System Since 1948' (1994) 31 *Common Market Law Review* 1157, reprinted in Howse (ed.), *op. cit.*, pp. 278–80.
- 68 Appellate Body—*Working Procedures for Appellate Review*, WT/AB/WP/3 (28 February 1997) (97–0847).
- 69 Petersmann, 'How to Promote the International Rule of Law?', *op. cit.*, p. 39.
- 70 European Communities—*Measures Affecting Asbestos and Asbestos-containing Products*, Report of the Appellate Body, WT/DS135/AB/R (12 March 2001) (01–1157), AB-2000–11; Additional Procedure Adopted Under Rule 16(1) of the *Working Procedures for Appellate Review*, WT/DS135/9 (8 November 2000) (00–4729).
- 71 Chile—*Price Band System and Safeguard Measures Relating to Certain Agricultural Products*, Report of the Arbitrator, WT/DS207/13 (17 March 2003) (03–1520), para. 34.
- 72 See *United States—Import Prohibition of Certain Shrimp and Shrimp Products—Recourse to Article 21.5 of the DSU by Malaysia*, Report of the Appellate Body, WT/DS58/AB/R (12 October 1998) (98–3899), AB-1998–4, para. 88.
- 73 European Communities—*Measuring Concerning Meat and Meat Hormones—Recourse to Arbitration by the European Communities under Article 22.6 of the Dispute Settlement Understanding*, WT/DS26/ARB (12 July 1999) (99–2855).
- 74 European Communities—*Regime for the Importation, Sale and Distribution of Bananas—Recourse to Arbitration by the European Communities under Article 22.6 of the DSU*, WT/DS/27/ARB/ ECU (24 March 2000) (00–1207).
- 75 European Communities—*Measuring Concerning Meat and Meat Hormones—Recourse to Arbitration by the European Communities under Article 22.6 of the Dispute Settlement Understanding*, WT/ DS26/ARB (12 July 1999) (99–2855).
- 76 Petros C.Mavroidis, 'Remedies in the WTO System—Between a Rock and a Hard Place' (2000) 11 *European Journal of International Law* 763.
- 77 *United States—Import Measures on Certain Products from the EC*, Report of the Panel, WT/DS165/R (17 July 2000) (00–2868).
- 78 *United States—Import Measures on Certain Products from the EC*, Report of the Appellate Body, WT/DS165/AB/R (11 December 2000) (00–5330) AB-2000–9.
- 79 See the discussion of the NAFTA Agricultural Tariffication panel in Chapter 11 on agriculture.
- 80 Argentina—*Definitive Antidumping Duties on Poultry from Brazil*, Report of the Panel, WT/DS241/R (22 April 2003) (03–1961).
- 81 Panel Report, *European Economic Community—Payments and Subsidies Paid to Processors and Producers of Oilseeds and Related Animal-Feed Proteins*, adopted 25 January 1990, BISD 37S/86, para. 144.
- 82 The following section draws extensively from Susan Esserman and Robert Howse, 'The WTO on Trial', *Foreign Affairs*, January /February 2003.
- 83 K.Leitner and S.Lester, 'WTO Dispute Settlement 1995–2002: A Statistical Analysis' (2003) 6 *Journal of International Economic Law* 251.
- 84 See most notably Claude Barfield, *Free Trade, Sovereignty, Democracy: The Future of the World Trade Organization* (Washington DC: American Enterprise Institute, 2001).
- 85 For instance, J.Bhagwati, 'After Seattle: Free Trade and the WTO', in R.Porter, P.Sauvé, A.Subramanian and A.Beviglia (eds) *Efficiency, Equity, and Legitimacy: The Multilateral Trading System at the Millennium* (Washington DC: Brookings Institution, 2001) pp. 50, 60–1.
- 86 See the discussion of standard of review in antidumping cases in Chapter 8 on antidumping.
- 87 For a comprehensive overview of proposals, see the website of the Institute of International Economic Law, at Georgetown Law Center, <http://www.iiel.org/> Also, see the various contributions in E.-U.Petersmann (ed.), *Preparing the Doha Development Round*:

- Improvements and Clarifications of the WTO Dispute Settlement Understanding*, conference report (Robert Schuman Centre for Advanced Studies, European University Institute, 2003).
- 88 In particular, the FTA is very explicit about setting out detailed schedules for the panel review process.
- 89 Canada, Department of External Affairs, *The Canada—US Free Trade Agreement* (Ottawa: Minister of Supply and Services, 1988) at Article 1801:1 [hereinafter *FTA*]. Article 1801:2 provides that trade disputes between the two countries can be resolved via either the FTA or the GATT if both Agreements are applicable; but these avenues of redress are mutually exclusive according to Article 1801:3.
- 90 *FTA*, Article 1802:1.
- 91 *FTA*, Article 1803.
- 92 *FTA*, Article 1804.
- 93 *FTA*, Article 1805:1. Article 1805:2 permits the Commission to consult whatever technical advisers it deems necessary, and it allows for the use of mutually acceptable mediators to assist in resolving disputes.
- 94 If the matter involves an action taken under Chapter II.
- 95 *FTA*, Article 1806:1.
- 96 *FTA*, Article 1807:2.
- 97 *FTA*, Article 1807:1.
- 98 *FTA*, Article 1807:4. GATT panels are not restricted to the parties' submissions in reaching their 'verdicts'; their procedures can be much more inquisitorial.
- 99 *FTA*, Article 1807:8.
- 100 *Ibid.*
- 101 *FTA*, Articles 1806:3 and 1807:9. Article 1807:9 requires the Party suspending benefits to consider that its fundamental rights or benefits under the Agreement are/or would be impaired by the measure or proposed measure. There is no such stipulation in 1806:3. Article 1807:9 also provides for the termination of such suspension when the offending measure is removed. Again, 1806:3 has no comparable provision.
- 102 See Canada, Department of External Affairs, *Canadian Trade Negotiations* (Ottawa: Supply and Services Canada, 1986).
- 103 In order for countervailing duties to be applied, there must be a finding that a subsidy in the relevant legal sense exists as well as material injury. In order for antidumping duties to be applied, there must be a finding of dumping (usually selling at a cost which is lower in the importing country market than in the exporting country market, or selling below cost) as well as of material injury. The ITA determines the existence of subsidies in the countervail cases and of dumping in antidumping cases, while the ITC makes determinations of injury in both kinds of cases. A similar bifurcation of function exists in Canada between the Minister of National Revenue and the Canadian International Trade Tribunal.
- 104 This is obviously only a brief summary of the procedure.
- 105 A good, brief discussion of the standard of review is to be found in C.M.Castle and J.-G. Castel, 'Should the North American Free Trade Agreement Dispute Settlement Mechanism in Antidumping and Countervailing Duty Cases be Reformed in the Light of *Softwood Lumber III*?' (1995) 26 *Law and Policy in International Business* 823.
- 106 See Gastle and Castel, *op. cit.*, pp. 837–46.
- 107 National Corn Growers Association v. Canada (Import Tribunal) [1990] 2 S.C.R. 1320; *Bell Canada v. Canada (C.R.T.C.)* [1989] 1 S.C.R. 1722.
- 108 North American Free Trade Agreement, Annex 1904.13.
- 109 NAFTA Implementation Act, H.R. Rep. No. 361, 103d Cong., 1st Sess. 75–76 (1993), as quoted in Gastle and Castel, *op. cit.*, p. 838.
- 110 As W.J.Davey notes, 'The principal explanation for the favourable reviews of the panel process, and, in particular, the high quality of the panel opinions, is that the panels were composed largely of active international trade law experts. While it may be helpful to

expand the use of non trade law practitioners, it would likely be a mistake to severely curtail the use of trade law practitioners as panellists.' *Pine and Swine* (Ottawa: Carleton University Centre for Trade Policy and Law, 1996) p. 279.

5

Trade, exchange rates and the balance of payments

- 1 See R.Gilpin, *The Political Economy of International Relations* (Princeton NJ: Princeton University Press, 1987) p. 121.
- 2 This is an extremely simplified presentation of the understanding in contemporary finance theory of equilibrium exchange rates. For a clear elaboration of the complexities, see C.Fred Bergsten and John Williamson, 'Exchange Rates and Trade Policy', in C.Fred Bergsten and William R.Cline (eds) *Trade Policy in the 1980s* (Washington DC: Institute for International Economics, 1983).
- 3 J.E.Spero, *The Politics of International Economic Relations* (New York: St. Martin's Press, 1990) pp. 33–4.
- 4 These arrangements are usefully summarized in S.Fischer, 'International Macroeconomic Policy Coordination', in M.Feldstein (ed.) *International Economic Cooperation* (Chicago: University of Chicago Press, 1988) pp. 25–7. See also R.Solomon, *The International Monetary System, 1945–1981* (New York: Harper & Row, 1982) and P.B.Kenen, *The International Economy* (Cambridge: Cambridge University Press, 3rd ed., 1994) ch. 19, 'Evolution of the Monetary System'.
- 5 P.Volcker, *Changing Fortunes: The World's Money and the Threat to American Leadership* (New York: Times Books, 1992) p. 20.
- 6 For a helpful discussion of the evolution of the international monetary system during this period, see J.C.Pool, *International Economic Policy* (New York: Lexington, 1989) pp. 4–22.
- 7 Fischer, *op. cit.*, p. 15.
- 8 V.Riches, 'Quarante-cinq ans de commerce mondial; régionalisation ou globalisation?', in J.Doyère and S.Marti (eds) *Bilan économique et social 1993* (Paris: Le Monde Dossiers et Documents, 1994) p. 45.
- 9 See, particularly, S.Strange, *Casino Capitalism* (Oxford: Basil Blackwell, 1984) Ch. 1.
- 10 Pool, *op. cit.*, pp. 17–18.
- 11 See W.J.McKibbin and J.D.Sachs, *Global Linkages: Macroeconomic Interdependence and Cooperation in the World Economy* (Washington DC: Brookings Institution, 1991).
- 12 For instances of their use, see R.Roessler, 'Selective Balance-of-Payments Adjustment Measures Affecting Trade: The Roles of the GATT and the IMF (1975) 9 *Journal of World Trade Law* 238.
- 13 See, for example, United Kingdom Temporary Import Charges: Report of the Working Party adopted on 17 November 1966, L/2675, BISD 15S/113.
- 14 *Declaration on Trade Measures taken for Balance-of-Payment Purposes*, adopted on 28 November 1979, BISD 26S/205.
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- 25 Report to the General Council, WT/WGTDF/2, 11 July 2003.
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- 31 Roessler, *op. cit.*, p. 39.
- 32 *Ibid.*
- 33 See *Liberalization of Capital Movements and Financial Services in the OECD Area* (Paris: OECD, 1990).
- 34 See Bergsten and Williamson, *op. cit.*
- 35 See Strange, *op. cit.*; see also Gilpin, *op. cit.*
- 36 Spero, *op. cit.*, p. 50.
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- 44 See, generally, B.DeLong, C.DeLong and S.Robinson, 'The Mexican Peso Crisis: In Defense of U.S. Policy Toward Mexico', *Foreign Affairs*, March 1996.
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- 47 Robert E.Rubin and Jacob Weisberg, *In an Uncertain World: Tough Choices from Wall Street to Washington* (New York: Random House, 2003) pp. 255–7.
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- 53 Here it should be recalled that when capital flows into a country, that country's currency is purchased and the currency in which the capital was originally held is sold, placing downward pressure on the latter. However, when, say, German imports increase and exports decrease, there is the opposite effect on other currencies: since relatively more Deutschmarks are sold for other currencies (i.e. to purchase imports from abroad) than are bought by foreigners to pay for German exports, other currencies rise in value as against the Deutschmark.
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6

Tariffs, rules of origin and regional trading arrangements

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- 12 For a detailed description of current and past valuation systems, see M.Irish, *Customs Valuation in Canada* (Montreal: CCH, 1985).
- 13 J.H.Jackson, *The World Trading System* (Cambridge MA: MIT Press, 2nd ed., 1997) p. 151.
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- 15 Jackson, *op. cit.*, p. 152.
- 16 BISD 268/116(1980).
- 17 M.Stark, 'Valuation Principles: Canadian Customs Duties and Sales Tax' (1988) 36 *Canadian Tax Journal* 1261 at p. 1262.
- 18 Agreement on Implementation of Article VII of the GATT, 15 December 1993.
- 19 Article VII:2(a).
- 20 Under the BDV, value was based on a notional concept of valuation, that is a price at which goods *ought* to be sold under a specified set of circumstances. Because it was not based on any real price, it did not achieve a truly uniform valuation standard. G.Winham, *International Trade and the Tokyo Round Negotiations* (Princeton NJ: Princeton University Press, 1986) p. 179.
- 21 55 U.N.T.S. 308 (1947).
- 22 R.E.Smith, *Customs Valuation in the United States: A Study in Tariff Administration* (Chicago: University of Chicago Press, 1948) p. 141. The ASP provided for the assessment of duty based on the value of 'like or similar goods' produced domestically. This made it possible for domestic producers to inflate their prices and thereby relieve import pressure on a wide range of functionally related products (Winham, *op. cit.*, pp. 67–8). The ASP was only applied to a few imports but its impact on those exporters was substantial. According to W.M.Snyder, 'the ASP...led to protection equal to more than a 100% rate of duty' ('Customs Valuation in the European Economic Community' (1981) 11 *Georgia Journal of International Company Law* 79 at p. 83).
- 23 Winham, *op. cit.*, pp. 180–1.
- 24 Two aspects of the Canadian system were considered inconsistent with these GATT rules: value was based on 'fair market value' in the country of export; and value could be

- established by ministerial prescription when fair market value could not be determined. These rules directly conflict with GATT Article VII, which states: 'value for customs purposes...should not be based on the value of merchandise of national origin or on arbitrary or fictitious values'. See G.E. Salembier, A.R.Moroz and F.Stone, *The Canadian Import File: Trade, Protection and Adjustment* (Montreal: Institute for Research on Public Policy, 1987) ch. 5, pp. 111–12 [hereinafter *Canadian Import File*].
- 25 An attempt was made during the Kennedy Round to abolish the ASP and adopt more uniform standards, but the US Congress refused to ratify the agreement.
 - 26 There were many difficulties with the BDV Even in countries that applied the system in a non-protectionist manner there were large variations in the value assigned to a particular good (Winham, *op. cit.*, p. 179).
 - 27 Twenty-eight countries (including the EC as one) have accepted the Code, including five developing countries. Developing countries were of the view that the Code would make unreasonable demands on their administration systems. As a result, a Protocol was added making allowances for special treatment of developing countries (BISD 26S/151 (1980)). There are also quite extensive interpretive notes with the Code, making it more precise than other GATT codes.
 - 28 The effective date of the EC legislation was 1 July 1980, and the legislation is in Council Regulation 1224/80 of 28 May 1980, (1980) 23 O.J. L134/1; the USA implemented the Code on 1 July 1980, and the current legislation is the Trade Agreements Act of 1979, Pub.L. 96–39, 93 U.S. Statutes at Large 144–19 U.S.C. 1401a; in Canada, the Code became law on 1 January 1985 and is found in Part III (ss.44–53) of the Customs Act, SC 1986, Ch. 1.
 - 29 For detailed descriptions of the provisions of the Tokyo Round Code, see S.L.Sherman and H. Glashoff, *Customs Valuation: Commentary on the GATT Customs Valuation Code* (Deventer: Kluwer, 1988), and D.A.Wyslobicky and J.H.Warnock, 'Customs Valuation: Overview and Problem Areas in Determining Transaction Value', in *Customs and Trade Law Development* (Toronto: Canadian Institute of International Affairs, 1989).
 - 30 Article 1.1(a) of the Uruguay Round Customs Valuation Agreement.
 - 31 Article 1.2. 'Related persons' are defined in Article 15.4.
 - 32 The order of the last two methods may be reversed by the importing country.
 - 33 The last proscription is aimed primarily at the ASP (Snyder, *op. cit.*, p. 82). The Canadian legislation does not prohibit any methods of valuation.
 - 34 Jackson cites the example of the 1904 Swiss-German Treaty reducing German tariffs on the imports of 'large dapple mountain cattle or brown cattle reared at a spot at least 300 meters above sea level and having at least one month's grazing each year at a spot at least 800 meters above sea level [footnote omitted]' (*op. cit.*, p. 127).
 - 35 *Canadian Import File*, *op. cit.*, p. 115.
 - 36 The system became law in Canada on 1 January 1988 and in the USA in September of that year. In addition to Canada and the USA, there are over 50 signatories to the system, including the EC and Japan. In addition, nearly 30 other countries use the system but have not signed the convention. See Maureen Irish, *The Harmonized System and Tariff Classification in Canada* (D.C.L. thesis, McGill Law School, 1992).
 - 37 The details of the system are drawn from T.Lindsay, *Outline of Customs in Canada* (Calgary: Erin, 8th ed., 1991) [unpublished].
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 - 41 WorldTradeLaw.net, 'Dispute Settlement Commentary: Panel Report—*European Communities—Customs Classification of Certain Computer Equipment*', 6 February 2003, available online at www.worldtradelaw.net, p. 2.

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- 44 Raj Bhala and Kevin Kennedy, *World Trade Law: The GATT- WTO System, Regional Arrangements, and U.S. Law* (Charlottesville VA: Lexis Law Publishing, 1998) p. 278.
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- 47 This provision applies to all rules of origin used in non-preferential commercial policy instruments including application of: MFN treatment, antidumping and countervailing duties, safeguard measures, origin-marking requirements and any discriminatory quantitative restrictions.
- 48 A Technical Committee was established to develop a definition of this and other terms.
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- 50 See Philippe G.Nell, 'WTO Negotiations on the Harmonization of Rules of Origin' (1999) 33 *Journal of World Trade* 45.
- 51 Bernard Hoekman and Michel Kostecki, *The Political Economy of the World Trading System* (Oxford: Oxford University Press, 1995) p. 104, cited in Moshe Hirsch, 'International Trade Law, Political Economy and Rules of Origin: A Plea for a Reform of the WTO Regime on Rules of Origin' (2002) 36 *Journal of World Trade* 171 at p. 184. See also Stefano Inama, A Comparative Analysis of the Generalized System of Preferences and Non-Preferential Rules of Origin in the Light of the Uruguay Round Agreement: Is it a Possible Avenue for Harmonization or Further Differentiation?' (1995) 29 *Journal of World Trade* 77.
- 52 Hirsch, *op. cit.*, p. 178.
- 53 Jagdish Bhagwati, *Protectionism* (Cambridge MA: MIT Press, 1988) p. 53, cited in Hirsch, *op. cit.*, p. 182.
- 54 Arye L.Hillman, *The Political Economy of Protection* (Chur: Harwood Academic, 1989) pp. 73–4, cited in Hirsch, *op. cit.*, p. 182.
- 55 Hirsch, *op. cit.*, p. 184.
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- 57 WTO, *United States—Rules of Origin for Textiles and Apparel Products* (20 June 2003) WTO Doc. WT/DS243/R (Panel Report). Note that the EU previously challenged US rules of origin for textiles, but the dispute never reached the panel stage: see WTO Doc. WT/DS85 and, for discussion, Dehousse *et al.*, *op. cit.*
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- 60 Danielle Goldfarb, 'The Road to a Canada-U.S. Customs Union: Step-by-Step or in a Single Bound?', C.D.Howe Institute Commentary (Toronto: 2003) p. 4.
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- 63 Goldfarb, *op. cit.*, p. 8.
- 64 *Ibid.*, p. 28.
- 65 Kenneth Dam, *The GATT: Law and International Economic Organization* (Chicago: University of Chicago Press, 1970) p. 183.

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- 77 Peter Drucker, *Frontiers of Management* (New York: Harper & Row, 1987) p. 65.
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7

Trade policy and domestic health and safety regulation and standards

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- 4 See Sylvia Ostry, ‘Beyond the Border: The New International Policy Arena’, in E. Kantzenbach, H. Sharrer and L. Waverman (eds) *Competition Policy in an Interdependent World Economy* (Baden-Baden: Nomos, 1993) p. 261.
- 5 David Vogel, *Trading Up: Consumer and Environmental Regulation in a Global Economy* (Cambridge MA: Harvard University Press, 1995) p. 3.
- 6 See Vogel, *op. cit.*; Kym Anderson, ‘Environmental Standards and International Trade’, in Michael Bruno and Bruno Pleskovic (eds) *Annual World Bank Conference on Development Economics 1996* (Washington DC: World Bank 1997) p. 317; see also Chapter 14 of this book.
- 7 See Chapter 1.
- 8 Barry N. Rosen, ‘Environmental Product Standards, Trade and European Consumer Goods Marketing: Processes, Threats and Opportunities’ (1995) 30 *Columbia Journal of World Business* 1 at p. 74.
- 9 Peter W. B. Phillips, ‘Biotechnology, the Consumer and the Marketplace: The Role of Labeling in the Canola Industry’, *Policy Commentary* 3, Department of Agriculture, University of Saskatchewan, July 1997.
- 10 National Research Council, International Standards, Conformity Assessment and US Trade Policy Project Committee, *Standards, Conformity Assessment and Trade: Into the 21st Century* (Washington DC: National Academy Press, 1995) p. 111 [hereafter *Standards, Conformity Assessment and Trade*].
- 11 US Department of Agriculture, *SPS Accomplishments Report: Fiscal Year 1996* (Washington DC: APHIS, 1997).

- 12 OECD Guiding Principles Concerning the International Economic Aspects of Environmental Policies.
- 13 David A. Wirth, 'The Role of Science in the Uruguay Round and NAFTA Trade Disciplines' (1994) 27 *Cornell International Law Journal* 817.
- 14 Agreement on Technical Barriers to Trade, 12 April 1979, 1186 U.N.T.S. 276, BISD 26S/8 [hereinafter Standards Code]. Earlier works on the Standards Code include Nusbaumer, 'The GATT Standards Code in Operation' (1984) 18 *Journal of World Trade Law* 542, R.W. Middleton, 'The GATT Standards Code' (1980) 14 *Journal of World Trade Law* 201 and J. Bourgeois, 'The Tokyo Round Agreement on Technical Barriers and on Government Procurement in International and EEC Law' (1982) 19 *Common Market Law Review* 5, as noted in John H. Jackson and William J. Davey, *Legal Problems of International Economic Relations* (St Paul MN: West Publishing Co., 2nd ed., 1986) p. 534.
- 15 Wirth, *op. cit.*
- 16 Standards Code, Article 1.
- 17 *Ibid.*, Article 2.
- 18 *Ibid.*, Article 2.3.
- 19 *Ibid.*, Article 2.2.
- 20 *Ibid.*, Article 2.4.
- 21 Suppose country A is a large producer of lawnmowers and would like to protect its market from cheaper, foreign-made imports. Standards relating to the lawnmower's maximum allowable noise level in decibels differ from standards which mandate exact technological specifications of how that lawnmower must achieve the reduced noise level. One could imagine a situation where country A could draft such regulations to favour a specific domestically patented technology in noise reduction, thereby favouring its own producers.
- 22 Standards Code, Article 2.5.
- 23 *Ibid.*, Article 5.
- 24 *Ibid.*, Article 5.2.
- 25 R.W. Middleton, 'The GATT Standards Code' (1980) 14 *Journal of World Trade Law* 201 at p. 206.
- 26 Agreement on the Application of Sanitary and Phytosanitary Measures, GATT Doc. MTN/FA II-AIA-4 (15 December 1993) [hereinafter SPS Agreement] in Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations [hereinafter the Uruguay Round], GATT Doc. MTN/FA (15 December 1993), 33 I.L.M. 9 (1994).
- 27 Agreement on Technical Barriers to Trade, GATT Doc. MTN/FA II-AIA-6 (15 December 1993) [hereinafter TBT Agreement] in Uruguay Round, *op. cit.*
- 28 As noted in Chapter 1 of this book, the Uruguay Round eliminated for the most part the 'à la carte' style of picking and choosing which agreements to adopt. For a comprehensive list of the precise obligations of Members, see Edmond McGovern, *International Trade Regulation* (Exeter: Globefield Press, 1995), Issue 1, §1.121.
- 29 *Standards, Conformity Assessment and Trade, op. cit.*, p. 113. See also note 27 stating that the calculation was made using 1991 World Bank and IMF data on imports, total signatories to the Tokyo Standards Code and new signatories to the Uruguay Round Agreement.
- 30 *Standards, Conformity Assessment and Trade, op. cit.*, p. 108.
- 31 *Ibid.*
- 32 One commentator suggested that the SPS Agreement was motivated in part by the US—EU dispute regarding the safety of hormone-treated beef (addressed later in this chapter). Wirth, *op. cit.*; see also Donna Roberts, 'Preliminary Assessment of the WTO Agreement on Sanitary and Phytosanitary Regulations' (1998) *Journal of International Economic Law* 377.
- 33 Annex A, SPS Agreement.
- 34 *Measures Concerning Meat and Meat Products (Hormones)*.

- 35 The text of Article 3.2 of the SPS Agreement does not make it clear whether the presumption established is an irrefutable one.
- 36 *Japan—Measures Affecting the Importation of Apples*.
- 37 See, for example, Ellen K. Silbergeld, 'Risk Assessment and Risk Management: An Uneasy Divorce', in Deborah G. May and Rachelle D. Hollander (eds) *Acceptable Evidence: Science and Values in Risk Management* (New York: Oxford University Press, 1991).
- 38 Cass Sunstein and Rick Pildes, 'Experts, Economists, and Democrats', in Sunstein (ed.) *Free Markets and Social Justice* (New York: Oxford University Press, 1997) p. 133.
- 39 See *Japan—Measures Affecting Agricultural Products*, Panel Report, WT/DS76/R (27 October 1998).
- 40 *Japan—Measures Affecting Agricultural Products*, Report of the Appellate Body, WT/DS76/AB/R (22 February 1999), para. 125.
- 41 See *European Communities—Measures Concerning Meat and Meat Products (Hormones)*, Complaint by the United States, Report of the Panel, WT/DS26/R/USA (18 August 1997).
- 42 *European Communities—Measures Concerning Meat and Meat Products (Hormones)*, Report of the Appellate Body, WT/DS26/AB/R (16 January 1998).
- 43 See *Australia—Measures Affecting Importation of Salmon*, Report of the Appellate Body, WT/DS18/AB/R (20 October 1998).
- 44 WTO Doc. WT/DS231/AB/R of 26 September 2002.
- 45 This was due to the fact that the Agreements were negotiated virtually at the same time with many of the less powerful nations in the case of NAFTA and perhaps the same players. For example, the same Canadian government negotiators responsible for the SPS Agreement under the WTO were at the table for NAFTA's SPS provisions. See John Kirton and Julie Soloway, 'Assessing NAFTA's Environmental Effects: Dimensions of a Framework and the NAFTA Regime', Trade and Environment Working Paper Series, No. 1 (Montreal: North American Commission for Environmental Cooperation, 1996).
- 46 See Kirton and Soloway, *op. cit.*
- 47 Pierre Marc Johnson and André Beaulieu, *The Environment and NAFTA* (Washington DC: Island Press, 1996).
- 48 Jon R. Johnson, *The North American Free Trade Agreement: A Comprehensive Guide* (Aurora: Canada Law Book, 1994) p. 245.
- 49 TBT Agreement, Article 2.5. See also Johnson, *op. cit.*, p. 246.
- 50 *Tuna/Dolphin case*.
- 51 In 1994, the United States exported over \$3.1 billion in agricultural products to Mexico and imported over \$2.8 billion of agricultural products from Mexico. In the same year, the United States exported \$5.1 billion of agricultural products to Canada and imported about \$5.3 billion from Canada. Canada-Mexico trade was significantly smaller: Canadian agricultural exports to Mexico in 1994 were worth about \$157 million and Canadian imports from Mexico were worth roughly \$159 million.
- 52 Johnson, *op. cit.*, p. 238.
- 53 *In the Matter of: Puerto Rico Regulations on the Import, Distribution and Sale of U.H.T. Milk from Quebec*, USA-93-1807-01, 3 June 1993. UHT milk is produced by heating milk to 138 degrees Celsius for a minimum of two seconds. The milk is then cooled and packaged in hermetically sealed boxes. UHT milk has a shelf-life of between six and twelve months at room temperature.
- 54 William J. Davey, *Pine and Swine, Canada—United States Trade Dispute Settlement: The FTA Experience and NAFTA Prospect* (Ottawa: Carleton University Centre Trade Policy and Law, 1996) p. 58.
- 55 Canada found it impossible to comply with the regulations because (a) the regulations required an FDA-certified inspection but the FDA refused to certify any Canadian or Quebec inspectors carrying out such inspections; (b) the regulations required not equivalency, but an

- identical regime to that found in the [Q4] PMO; and (c) the regulations required that Canada join the [Q4] NCIMS. §4.9.
- 56 §§4.7, 4.8.
- 57 §4.20 and on.
- 58 Armand de Mestral, 'Dispute Avoidance: Weighing the Values of Trade and the Environment Under the NAFTA and the NAAEC', Environment and Trade Series, No. 3 (Montreal: North American Commission for Environmental Cooperation, 1996) p. 16.
- 59 *Ibid.*
- 60 J.Kirton and R.Fernandez, 'NAFTA's Institutions: The Environmental Potential and Performance of the NAFTA Free Trade Commission and Related Bodies', Environment and Trade Series, No. 5 (Montreal: North American Commission for Environmental Cooperation, 1997).
- 61 See ISO website: <http://www.iso.ch/>
- 62 McGovern, *op. cit.*, Issue 2, §7.23.
- 63 John Audley, *Green Politics and Global Trade: NAFTA and the Future of Environmental Politics* (Washington DC: Georgetown University Press, 1997) p. 131.
- 64 *Ibid.*
- 65 Conference Proceedings from Trilateral Meeting, ISO 14000 (Montreal: North American Commission for Environmental Cooperation, 1998).
- 66 *Ibid.*, p. 23.
- 67 *Ibid.*, p. 21.
- 68 Jeffrey Atik, 'Science and International Regulatory Convergence' (1996–97) 17 *Northwestern Journal of International Law and Business* 736.
- 69 See FAO website: <http://www.fao.org/>
- 70 See, 'Regulatory Reform in the Agro-Food Sector', ch. 5 in OECD, *The OECD Report on Regulatory Reform, Volume I: Sectoral Studies* (Paris: OECD, 1997) p. 251.
- 71 Patti Goldman and Richard Wiles, *Trading Away Food Safety*, Occasional Report (Washington DC: Public Citizen, 1994), cited in Dan Esty, *Greening the GATT* (Washington DC: Institute for International Economics, 1994) p. 173.
- 72 Wirth, *op. cit.*, p. 825, citing Roger W. Miller, *This Is Codex Alimentarium* (1993).
- 73 Steve Charnovitz, 'The World Trade Organization, Meat Hormones and Food Safety', *International Trade Reporter*, 15 October 1997.
- 74 OECD, *The OECD Report on Regulatory Reform, Volume I: Sectoral Studies* (Paris: OECD, 1997) and OECD, *The OECD Report on Regulatory Reform, Volume II: Thematic Studies* (Paris: OECD, 1997).
- 75 OECD, *The OECD Report on Regulatory Reform, Volume I: Sectoral Studies*, *op. cit.*, p. 3.
- 76 *Ibid.*, ch. 6, 'Product Standards, Conformity Assessment and Regulatory Reform', pp. 275–328.
- 77 *Ibid.*, p. 285.
- 78 Alan O. Sykes, *Product Standards for Internationally Integrated Goods Markets* (Washington DC: The Brookings Institution, 1995) p. 117.
- 79 There is some evidence that this process has begun in Canada. A meeting of selected Canadian business leaders and Ambassador John Weekes, Canadian permanent representative to the WTO, was held at the Faculty of Management, University of Toronto, in March 1998. At that meeting, Ambassador Weekes emphasized the need for greater private-sector participation in all WTO processes, beyond periodic negotiating rounds.
- 80 OECD, *The OECD Report on Regulatory Reform, Volume I: Sectoral Studies*, *op. cit.*, p. 21.
- 81 *Ibid.*, ch. 6, 'Product Standards, Conformity Assessment and Regulatory Reform', Box 1, p. 292.
- 82 *Ibid.*, pp. 289–91.
- 83 *Ibid.*

- 84 See Agreement on Mutual Recognition Between the United States of America and the European Community.
- 85 OECD, *The OECD Report on Regulatory Reform, Volume I: Sectoral Studies*, op. cit., ch. 6, 'Product Standards, Conformity Assessment and Regulatory Reform', pp. 289–91.
- 86 See Alan M. Rugman and Julie A. Soloway, 'An Environmental Agenda for APEC: Lessons from NAFTA (1997) 39 *International Executive* 735; OECD, *The OECD Report on Regulatory Reform, Volume I: Sectoral Studies*, op. cit., ch. 6, 'Product Standards, Conformity Assessment and Regulatory Reform', pp. 289–91.
- 87 *Ibid.*
- 88 *Ibid.*, p. 291.
- 89 *Ibid.*, p. 292.

8

Antidumping laws

- 1 For further data illustrating the widespread use of antidumping measures, see David Palmeter, *The WTO as a Legal System: Essays on International Trade Law and Policy* (London: Cameron May, 2003) p. 62.
- 2 WTO, *Report (2002) of the Committee on Antidumping Practices*, WTO Doc. G/L/581, paras 5–6.
- 3 Data sources: WTO, AD Initiations: By Affected Country—01/01/95 to 31/12/02; WTO, AD Initiations: By Reporting Member—01/01/95 to 31/12/02. Available online at <http://www.wto.org/>
- 4 For further data, see Jorge Mirandes, Raul Torres and Mario Ruiz, 'The International Use of Anti-dumping 1987–1997' (1998) 32 *Journal of World Trade* 5; Thomas Prusa and Susan Skeath, 'The Economic and Strategic Motives for Antidumping Filings' (2002) 138 *Review of World Economics* 389.
- 5 See Cliff Stevenson, 'Global Trade Protection Report Update 2003', available online at <http://www.mayerbrownerowe.com/>, for a detailed overview of the incidence of antidumping investigations and actions broken down by WTO Member, as well as an explanation of the decline in 2003.
- 6 In the alternative, according to Article VI, the normal value can be based on either the highest comparable price for the like product for export to any third country in the course of trade, or the cost of production of the product in the country of origin plus a reasonable addition for the selling cost and profit.
- 7 Both countries used the grandfather clause, contained in the Protocol of Provisional Application governing accessions of countries to membership of the GATT, to retain their own legislation with respect to these duties. For more details on this and other aspects of the development of the GATT antidumping regime, see J.F. Beseler and A.N. Williams, *Antidumping and Antisubsidy Law: The European Communities* (London: Sweet & Maxwell, 1986) p. 3.
- 8 The actual status of the Code, both then and as revised, is more substantive than merely interpretive. See R.M. Bierwagen, *GATT Article VI and the Protectionist Bias in Antidumping Law* (Deventer: Kluwer, 1990) p. 23.
- 9 Article 8(a).
- 10 Article 3(a).
- 11 This Act requires 'a causation link but...not...that dumped imports must be a principal cause, or a major cause, or a substantial cause of injury caused by all factors contributing to overall injury to an industry' (S. Rep. No. 1298, 93rd Cong., 2nd Sess. 180 (1974); brackets omitted).

- 12 U.S.C. 160 note (1970).
- 13 See Beseler and Williams, *op. cit.*, p. 11.
- 14 Article 3(4).
- 15 Article 3(3).
- 16 For excellent reviews of the Agreement, see Mitsuo Matsushita, Thomas J. Shoenbaum and Petros C. Mavroidis, *The World Trade Organization: Law, Practice, and Policy* (New York: Oxford University Press, 2003) pp. 301–9; David Palmeter, A Commentary on the WTO Anti-Dumping Code' (1996) 30 *Journal of World Trade* 43; and Gary Horlick and Eleanor Shea, 'The World Trade Organization Antidumping Agreement' (1995) 29 *Journal of World Trade* 5, including its negotiating history.
- 17 See M. Koulen, 'Some Problems of Interpretation and Implementation of the GATT Antidumping Code', in J. H. Jackson and E. A. Vermulst (eds) *Antidumping Law and Practice: A Comparative Study* (Ann Arbor: University of Michigan Press, 1989) p. 366.
- 18 See WTO, *Guatemala—Anti-Dumping Investigation Regarding Portland Cement from Mexico* (1998) WTO Doc. WT/DS60/AB/R (Appellate Body Report).
- 19 WTO, *US—Anti-Dumping Measures on Certain Hot-Rolled Steel Products from Japan* (2001) WTO Doc. WT/DS184/AB/R (Appellate Body Report) [US Steel].
- 20 WTO, *European Communities—Anti-Dumping Duties on Imports of Cotton-Type Bed Linen from India* (2001) WTO Doc. WT/DS141/AB/R (Appellate Body Report).
- 21 WTO, *European Communities—Anti-Dumping Duties on Malleable Cast Iron Tube or Pipe Fittings from Brazil* (22 July 2003) WTO Doc. WT/DS219/AB/R (Appellate Body Decision) [EC Pipe].
- 22 WTO, *Argentina—Definitive Anti-Dumping Measures on Imports of Ceramic Floor Tiles from Italy* (2001) WTO Doc. WT/DS189/R (Panel Report).
- 23 WTO, *Thailand—Anti-Dumping Duties on Angles, Shapes and Sections of Iron or Non-Alloy Steel and H-Beams from Poland* (2001) WTO Doc. WT/DS122/AB/R (Appellate Body Report).
- 24 Note that the close relationship between Article 3.1 and the rest of Article 3 may allow a violation of Article 3.1 to result from violation of another Article 3 provision. In one case, the AB upheld panel reasoning finding a violation of Article 3.1 as a consequence of violations of Articles 3.4 and 3.7. See WTO, *Mexico—Anti-Dumping Investigation of High Fructose Corn Syrup (HFCS) from the United States—Recourse to Article 21.5 of the DSU by the United States* (2001) WTO Doc. WT/DS132/AB/RW at paras 123–4 (Appellate Body Report) ['Mexico Corn Syrup'].
- 25 WTO, *European Communities—Anti-Dumping Duties on Imports of Cotton-Type Bed Linen from India—Recourse to Article 21.5 of the DSU by India* (2003) WTO Doc. WT/DS141/AB/RW (Appellate Body Report).
- 26 EC Pipe, *op. cit.*, para. 119.
- 27 Mexico Corn Syrup, *op. cit.*
- 28 For a list of these factors, see *US Steel, op. cit.*, para. 85.
- 29 WTO, *Implementation-Related Issues and Concerns* (2001) WTO Doc. WT/MIN(01)/17 (Ministerial Conference, Fourth Session).
- 30 WTO, *Ministerial Declaration* (2001) WTO Doc. WT/MIN(01)/DEC/1 (Ministerial Conference, Fourth Session).
- 31 WTO, *Report (2002) of the Committee on Antidumping Practices, op. cit.*, para. 17.
- 32 United Nations Development Programme, Heinrich Boll Foundation, Rockefeller Brothers Fund, The Rockefeller Foundation, and Wallace Global Fund, *Making Global Trade Work for People* (New York: Earthscan Publications Ltd, 2003) pp. 185–93.
- 33 Thomas Prusa, *On the Spread and Impact of Anti-dumping*, NBER Working Paper 7404 (Cambridge MA: National Bureau of Economic Research, 1999), cited in United Nations Development Programme *et al.*, *op. cit.*

- 34 WTO, *Report (1997) of the Committee on Antidumping Practices*, WTO Doc. G/L/204, para. 15.
- 35 WTO, *Report (2002) of the Committee on Antidumping Practices*, *op. cit.*, para. 22.
- 36 Richard O. Cunningham and Troy H. Cribb, 'Dispute Settlement Through the Lens of "Free Flow of Trade": A Review of WTO Dispute Settlement of US Anti-Dumping and Countervailing Duty Measures' (2003) 6 *Journal of International Economic Law* 155 at p. 163; see also Daniel K. Tarullo, 'The Hidden Costs of International Dispute Settlement: WTO Review of Domestic Anti-Dumping Decisions' (2002) 34 *Law and Policy in International Business* 109.
- 37 Robert Howse and Damien J. Neven, 'Argentina: Definitive Anti-dumping Measures on Imports of Ceramic Floor Tiles from Italy', in Henrik Horn and Petros C. Mavroidis (eds) *The WTO Case Law of 2001* (Cambridge: Cambridge University Press, 2004).
- 38 See M. Oesch, 'Standards of Review in WTO Dispute Resolution' (2003) 6 *Journal of International Economic Law* 635, and Tarullo, *op. cit.*, pp. 109–81, for further discussion of the concerns raised, especially in the United States, over the standard of review as applied by panels and the AB. The authors review the outcome of cases under the 17.6(ii) standard and note that neither a panel nor the AB has ever explicitly recognized the existence of a less desirable but equally 'permissible' interpretation. Oesch finds that the standard applied is thus intrusive but WTO-legal, while Tarullo argues that the AB has completely disregarded the 17.6(ii) standard.
- 39 United States General Accounting Office, Report to the Ranking Minority Member, Committee on Finance, U.S. Senate. World Trade Organization: Standard of Review and Impact of Trade Remedy Rulings, GAO-03–824, July 2003. Available online at <http://www.gao.gov/> (search by report number).
- 40 Oesch, *op. cit.*, pp. 635–9, and Tarullo, *op. cit.*, pp. 109–81.
- 41 WTO, *United States—Anti-Dumping Act of 1916*, WTO Docs WT/DS136/AB/R and WT/DS162/AB/R ['US 1916'].
- 42 WTO, *United States—Continued Dumping and Subsidy Offset Act of 2000*, WTO Docs WT/DS217/AB/R and WT/DS234/AB/R ['US Byrd Amendment'].
- 43 Act of 8 September 1916, 39 Stat. 756 (1916); 15 U.S.C. 72.
- 44 Matsushita, Shoenbaum and Mavroidis, *op. cit.*, pp. 335–6.
- 45 United States Tariff Act of 1930, Section 754(a).
- 46 The constituent elements of dumping are defined in GATT 1994, Article VI:1 and elaborated in the Antidumping Agreement, Article 2. See *US Byrd Amendment*, *op. cit.*, para. 240.
- 47 Details of the Canadian regime are drawn from R.K. Paterson, *Canadian Regulation of International Trade and Investment* (Toronto: Carswell, 1986) p. 106; P.A. Magnus, 'The Canadian Antidumping System', in Jackson and Vermulst (eds), *op. cit.*, p. 167; J. Buchanan, 'Antidumping Law and the *Special Import Measures Act* (1985) 11 *Canadian Business Law Journal* 2; and M. Dutz, 'Enforcement of Canadian Trade Remedy Laws: The Case for Competition Policies as an Antidote for Protection', in J.M. Finger, *Antidumping* (Ann Arbor: University of Michigan Press, 1993). The US regime is described in G. Horlick, 'The United States Antidumping System', in Jackson and Vermulst (eds), *op. cit.*; G. Bryan, *Taxing Unfair International Trade Practices* (Lexington MA: Lexington, 1980) chs 1–7; and J.M. Finger and T. Murray, 'Antidumping and Countervailing Duty Enforcement in the United States', in Finger, *op. cit.* For the USA and Canada, see Presley Warner, 'The Canada-US. Free Trade Agreement: The Case for Replacing Antidumping with Antitrust' (1992) 23 *Law and Policy in International Business* 791. The description of the EC draws primarily on J.-F. Bellis, 'The EEC Antidumping System', in Jackson and Vermulst (eds), *op. cit.*, p. 41. For a more detailed account, see I. Van Bael and J.-F. Bellis, *Antidumping and Other Trade Protection Laws of the EEC* (Bicester: CCH, 1990). For a critical review of the experience under EC dumping laws, see P. Messerlin, 'The Antidumping Regulations of the European Community: The Privatization of Administered Protection', in M.J. Trebilcock and

- R.C.York (eds) *Fair Exchange: Reforming Trade Remedy Laws* (Toronto: C.D.Howe Institute, 1990), and A.Eymann and L.Schuknecht, 'Antidumping Enforcement in the European Community', in Finger, *op. cit.*
- 48 An Act to Amend the Customs Tariff, 1897, S.C. 1904, Ch. 11.
- 49 R.S.C. 1985, Ch. S-15.
- 50 15 U.S.C. 71–2 (1988).
- 51 *US 1916* (2000) at paras 2.14–2.16 (Panel Report).
- 52 19 U.S.C. 1673 *et seq.* (1988).
- 53 Council Regulation 2423/88, (1988) O.J. L209/1, governs the EC antidumping system. For a detailed description of the development of the EC antidumping regulations, see Beseler and Williams, *op. cit.*, p. 21.
- 54 SIMA, ss 38–41.
- 55 SIMA, s. 45.
- 56 The Financial Administration Act, R.S.C. 1985, ch. F11, gives the Minister this authority.
- 57 House of Commons Subcommittee on Import Policy, *Report on the Special Import Measures Act*, Issue No. 31, 1st Sess., 32nd Parl., 1980–1–2, 9 June 1982; referred to in Paterson, *op. cit.*, pp. 125–6.
- 58 See, for instance, Surgical Adhesive Tapes and Plasters, Excluding Plastic Tapes and Plasters, Originating in or Exported from Japan (CIT-8–85) 4 December 1985; Grain Corn Originating in or Exported from the United States of America (CIT-7–86) 6 March 1987; Fresh Whole Yellow Onions, Originating in or Exported From the United States of America (CIT-1–87) 30 April 1987. (These cases include countervailing duty cases.)
- 59 'Report to the Minister of Finance: Public Interest Investigation into Certain Prepared Baby Foods Originating in or Exported from the United States of America', *Report of the Canadian International Trade Tribunal*, 30 November 1998; see also Inquiry No. NQ-97–002, statement of reasons, 14 May 1998 (CITT), cited in Michael Trebilcock, Ralph A.Winter, Paul Collins and Edward M.Iacobucci, *The Law and Economics of Canadian Competition Policy* (Toronto: University of Toronto Press, 2003) p. 660 [hereinafter *Canadian Competition Policy*].
- 60 *Certain Prepared Baby Foods Originating in or Exported from the United States of America* (RR-2002–02) 28 April 2002, 22. For comment thereon, see Andrew Tepperman and Michael Trebilcock, "The CITT's Baby Food Devision," *Canadian Competition Policy Record*, September 2004.
- 61 Articles 11(1) and 12(1).
- 62 Beseler and Williams, *op. cit.*, p. 169; Michael Trebilcock, Marsha Chandler and Robert Howse, *Trade and Transitions* (London: Routledge, 1990) pp. 200, 201.
- 63 SIMA, s. 76(1).
- 64 *Ibid.*, s. 76(2).
- 65 Federal Court Act, R.S.C. 1985, Ch. F7, s. 28.
- 66 *Ibid.*, s. 31. See Paterson, *op. cit.*, pp. 126–30, for a discussion of the various appeal provisions.
- 67 28 U.S.C. 1581 *et seq.* (1988).
- 68 I.Van Bael, 'Lessons for the EC: More Transparency, Less Discretion, and, at Last a Debate', in Jackson and Vermulst (eds), *op. cit.*, p. 407; Messerlin, *op. cit.*
- 69 FTA, Article 1907 contemplates the creation of a working group to propose new legal norms to govern government subsidies and unfair cross-border pricing.
- 70 NAFTA, Article 1902:2.
- 71 *Ibid.*
- 72 NAFTA, Article 1903:1. Article 1903:2 requires that the panel conduct itself in accordance with the procedures set out in Annex 1903.2, which provides for procedures very similar to those used in Chapter 20. The Annex also allows the panel to make recommendations about how an offending provision can be brought into conformity with Article 1902.

- 73 NAFTA, Article 1903:3. Article 1907 requires each Party to designate one or more officials who are to be responsible for ensuring that consultations are as expeditious as possible.
- 74 NAFTA, Article 1904:10 provides that the Agreement is not to affect judicial review of other than 'final determinations'. 'Final determination' is a technical term defined by Article 1911—it includes determinations made by administrative tribunals under the Special Import Measures Act (Canada) and the Tariff Act of 1930 (USA). See also Article 1904:15(f) regarding amendments to the Special Import Measures Act deeming certain determinations as final for the purposes of the Agreement. For a description of the relevant provisions, as well as the administrative procedures to which they relate, see Jon Johnson and Joel Schacter, *The Free Trade Agreement: A Comprehensive Guide* (Toronto: Canada Law Book, 1988) Ch. 9.
- 75 NAFTA, Article 1904:1–2. 'Law' here includes 'statutes, legislative history, regulations, administrative practice, and judicial precedents to the extent that a court of the importing Party would rely on such materials' (Article 1904:2). Article 1904:9 makes a panel decision binding on both Parties; Article 1904:11 precludes judicial review of a final determination if either Party has requested panel review; and Article 1904:11 also forbids either Party from allowing its courts to hear an appeal from a decision of the panel.

Article 1904:13 provides for the 'extraordinary' challenge of panel decisions if a Party alleges that: (a) a panel member was guilty of gross misconduct; (b) the panel flouted procedural rules; or (c) substantive limitations on panel powers were ignored; and any of these transgressions materially affected the panel decision and threatens the integrity of binational panel review. The challenge is heard by a panel of three chosen from a roster of ten judges. They will use the criteria of Article 1904:13 to decide the case (see Annex 1904:13). Article 1909 contemplates an exchange of letters by the two Parties which will establish a code of conduct for panellists and committee members operating under Articles 1903 and 1904.

- 76 NAFTA, Article 1904:3. The relevant statutes are set out in Annex 1911: they are, in Canada, the Federal Court Act (s. 28(1)); in the United States, the Tariff Act of 1930 (s. 516A(b)(1)(A) and 516A(b)(1)(B)); and in Mexico, the Federal Fiscal Code (Article 238).
- 77 NAFTA, Article 1904:4. 'Publication' means publication in either the *Canada Gazette*, the *Federal Register* or the *Diario Oficial*. If there is no publication of the determination, then the Party whose tribunal made it must notify the other Party, which then has 30 days to request a panel.

The Agreement is not as detailed as it might be about procedure; details are left to be worked out by the Parties at a later date (see Article 1904:14). However, the Agreement (Article 1904:14) is very clear about the time limits to be allocated to each phase of the panel process, and it sets an overall limit of 315 days, beginning from the date when a request for a panel is made, for the completion of dispute resolution.

- 78 NAFTA, Article 1904:15 sets out a number of amendments that had to be made to existing legislation to give persons standing so that they could ask a Party to request a panel. Thus, s.

- 28(4) of the Federal Court Act had to be modified, and rules added such that persons could ask Canada to request a panel if they were entitled to pursue judicial review.
- 79 NAFTA, Article 1904:7.
- 80 NAFTA, Annex 1901.2:5.
- 81 NAFTA, Article 1904:8. This provision also requires the panel to establish as brief a time as possible given the nature of the case for the administrative body to take action 'not inconsistent' with the panel's decision. In no case can the time given be any longer than that provided by the relevant statute for a final determination by the relevant authority.
- 82 NAFTA, Article 1908:1–2.
- 83 NAFTA, Article 1908:3–4.
- 84 NAFTA, Annex 1901.2:1.
- 85 NAFTA, Annex 1901.2:1.
- 86 *Ibid.*
- 87 NAFTA, Annex 1901.2:3.
- 88 NAFTA, Annex 1901.2:4.
- 89 For a discussion of this literature, see T.M.Boddez and M.J.Trebilcock, *Unfinished Business: Reforming Trade Remedy Laws in North America* (Toronto: C.D.Howe Institute, 1993).
- 90 John Mercury, 'Chapter 19 of the United States—Canada Free Trade Agreement 1989–95: A Check on Administered Protection?' (1995) 15 *Northwestern Journal of International Law & Business* 525.
- 91 William J.Davey, *Pine & Swine—Canada-U.S. Trade Dispute Settlement: The FTA Experience and NAFTA Prospects* (Ottawa: Centre for Trade Policy and Law, 1996).
- 92 US General Accounting Office, *Issues in Binational Panel Review in the Canada—U.S. FTA*, GAO/GGD-95-175 BR, June 1995.
- 93 Davey, *op. cit.*, p. 134.
- 94 *Ibid.*, p. 287.
- 95 NAFTA, Article 1504.
- 96 NAFTA, Article 1907.
- 97 For an overview of antidumping literature and current issues, see Gunnar Neils, 'What is Antidumping Policy Really About?' (2000) 14 *Journal of Economic Surveys* 467.
- 98 J.Viner, *Dumping: A Problem in International Trade* (Chicago: University of Chicago Press, 1933) p. 86.
- 99 A US Congressional subcommittee remarked: '[Antidumping laws are] designed to free US imports from unfair price discrimination practices [by foreign exporters]'. S. Rep. No. 93–1298, 93rd Cong., 2nd Sess. 179, cited in W.Caine, 'A Case for Repealing the Antidumping Provisions of the Tariff Act of 1930' (1981) 13 *Law and Policy in International Business* 681 at p. 682.
- 100 Competition Act, R.S.C. 1985, ch. C-34, s. 50(1)(a), (b).
- 101 Clayton Act, as amended by the Robinson-Patman Act, ss 2, 3; 15 U.S.C. 13 (1988).
- 102 Trebilcock *et al.*, *Canadian Competition Policy*, *op. cit.*, Ch. 5.
- 103 Price discrimination is impossible under perfect competition because sellers who charge a price which is higher or lower than the competitive price will be forced out of the market.
- 104 See Trebilcock *et al.*, *Canadian Competition Policy*, *op. cit.*, Ch. 5.
- 105 Since a monopolist has complete market power, any losses from price discrimination will be highest if the discriminator is a monopolist.
- 106 Richard Posner, 'The Social Costs of Monopoly and Regulation' (1975) 83 *Journal of Political Economy* 807.
- 107 The conflicting views are summarized in M.J.Trebilcock, *The Common Law of Restraint of Trade* (Toronto: Carswell, 1986) pp. 364–5.
- 108 Joan Robinson showed that the output effects of price discrimination depend on the shape of consumer demand curves. See *The Economics of Imperfect Competition* (London: Macmillan, 1933) pp. 188–93. R.Schmalensee, in 'Output and Welfare Implications of

- Monopolistic Third-degree Price Discrimination' (1981) 71 *American Economic Review* 242, and H. Varian, in 'Price Discrimination and Social Welfare' (1985) 75 *American Economic Review* 870, find that welfare effects also depend on the shape of consumer demand curves. Hence, generalizations about the output and welfare effects of price discrimination are impossible.
- 109 It is not 'dumping' for the seller to charge lower prices in its home market than in its export market and this practice is not prohibited by current legislation. See Deardorff, 'Economic Perspectives on Antidumping Law', in Jackson and Vermulst (eds), *op. cit.*, p. 26.
- 110 M.J. Trebilcock and J. Quinn, 'The Canadian Antidumping Act: A Reaction to Professor Slayton' (1979) 2 *Canada-US. Law Journal* 101.
- 111 See Michael P. Gallaway, Bruce A. Blonigen and Joseph E. Flynn, 'Welfare Costs of the U.S. Antidumping and Countervailing Duty Laws' (1999) 49 *Journal of Economics* 211, estimating the collaborative net economic welfare cost in 1993 of US AD/CVD orders to be \$4 billion; James M. Dévault, 'The Welfare Effect of U.S. Antidumping Duties' (1996) 7 *Open Economics Review* 19, finding US welfare is reduced by about \$275 million annually, with the estimated annual cost to US consumers between \$500 and \$800 million, and the estimated gain to US producers between \$90 and \$375 million; US International Trade Commission, 'The Economic Effects of Antidumping and Countervailing Duty Orders and Suspension Agreements', Investigation Nos 332-44, June 1995, estimating that the removal of AD and CVD orders in 1991 would have created a welfare gain of \$1.59 billion in that year; Anderson, 'Antidumping Laws in the United States: Use and Welfare Consequences' (1993) 27 *Journal of World Trade* 99, analysing eight antidumping measures and estimating the average consumer cost per dollar of increased profit to be \$8.00.
- 112 See Jorge Miranda, 'Should Antidumping Laws Be Dumped?' (1996) 28 *Law and Policy in International Business* 255; Clarisse Morgan, 'Competition Policy and Anti-Dumping: Is it Time for a Reality Check?' 30 (1998) *Journal of World Trade* 61.
- 113 See *Cars Produced By or on Behalf of Hyundai Motor Co.*, Canadian Import Tribunal, 1987; Mathew Kronby, 'Kicking the Tires: Assessing the Hyundai Anti-Dumping Decision From a Consumer Welfare Perspective' (1991) 18 *Canadian Business Law Journal* 95.
- 114 For proposals along these lines, see Bernard Hoekman and Petros Mavroidis, 'Dumping, Antidumping and Antitrust' (1996) 30 *Journal of World Trade* 27.
- 115 Trebilcock *et al.*, *Canadian Competition Policy*, *op. cit.*, Ch. 5. See, generally, J.A. Ordover and R.D. Willig, 'An Economic Definition of Predation: Pricing and Product Innovation' (1981) 91 *Yale Law Journal* 8.
- 116 The original US antidumping law, the Antidumping Act of 1916, 19 U.S.C. 1673, made evidence of predatory intent an element of the dumping offence.
- 117 Competition Act, R.S.C. 1985, Ch. C-34, ss 50(1)(b), 50(1)(c) and 79.
- 118 Sherman Act, 15 U.S.C. 2 (1988). Occasionally, predatory pricing is challenged under para. 2 of the Clayton Act, as amended by the Robinson-Patman Act. See Herbert Hovenkamp, *Economics and Federal Antitrust* (West Publishing Co., 1985) pp. 188-90.
- 119 Articles 85 and 86 of the Treaty of Rome set out the basis for EC competition law.
- 120 This is not to say that predatory pricing will never occur. See Trebilcock *et al.*, *Canadian Competition Policy*, *op. cit.*, ch. 5; Richard Posner, *Antitrust Law* (Chicago, IL: University of Chicago Press, 2nd ed., 2001) p. 214; R.H. Bork, *The Antitrust Paradox* (New York: Basic Books, 1978) pp. 144-60; and Hovenkamp, *op. cit.*, pp. 172-84.
- 121 See e.g. B.S. Yamey, 'Predatory Price Cutting: Notes and Comments' (1972) 15 *Journal of Law & Economics* 129; F. Easterbrook, 'The Limits of Antitrust' (1984) 63 *Texas Law Review* 1 at p. 26, and 'Predatory Strategies and Counterstrategies' (1981) 48 *University of Chicago Law Review* 263 at p. 268; and J. McGee, 'Predatory Pricing Revisited' (1980) 23 *Journal of Law & Economics* 289 at pp. 295-7.
- 122 Hovenkamp and Silver-Westrick, 'Predatory Pricing and the Ninth Circuit' (1983) *Arizona State Law Journal* 443 at pp. 460-5.

- 123 McGee, *op. cit.*
- 124 P.Areeda and D.F.Turner, 'Predatory Pricing and Related Practices Under Section 2 of the Sherman Act' (1975) 88 *Harvard Law Review* 697 at p. 698.
- 125 The marginal cost of one unit of output is the amount by which the seller's total costs (for all units of output) increase when that one additional unit of output is produced. Since accountants typically report average costs, not marginal costs, marginal cost is extremely difficult to calculate.
- 126 The seller's total costs are the sum of its fixed costs and its variable costs. Variable costs vary with the level of output; fixed costs do not. By definition, average variable costs are lower than average total costs.
- 127 For the Canadian approach, see Trebilcock *et al.*, *Canadian Competition Policy*, *op. cit.*, and R.J. Roberts, *Anticompetitive and Antitrust* (Toronto: Butterworths, 1980) pp. 218–29. For the US approach, see Bork, *op. cit.*, pp. 144–60, and Hovenkamp, *op. cit.*, pp. 172–84.
- 128 Deardorff, *op. cit.*, p. 36.
- 129 For further support for this view, see J.Barceló, 'Antidumping Laws as Barriers to Trade—The United States and the International Antidumping Code' (1972) *Cornell Law Review* 491 at pp. 501–3.
- 130 S.Hutton and M.J.Trebilcock, 'An Empirical Study of the Application of Canadian Antidumping Laws: A Search for Normative Rationales' (1990) 24 *Journal of World Trade* 123 at p. 128.
- 131 See Attack on Antidumping Law Sparks OECD Row', *Financial Times*, 21 September 1995, p. 16, referring to a study by a team led by Robert Willig.
- 132 For a mathematical proof of this result, see S.W.Davies and A.J.McGuinness, 'Dumping at Less Than Marginal Cost' (1982) 12 *Journal of International Economics* 169 at pp. 171–6; see also P.Nicolaides, 'The Competition Effects of Dumping' (1990) 24 *Journal of World Trade* 115 at pp. 119, 120.
- 133 Antidumping duties were imposed in each case. Hutton and Trebilcock, *op. cit.*, p. 128.
- 134 Deardorff, *op. cit.*
- 135 This practice is widespread. Bulk mail, for example, often contains free samples. Sellers provide samples hoping that customers will be willing to purchase goods after 'experiencing' samples.
- 136 It may be objected that dumped goods cannot be characterized as 'learning by doing' goods because any technological learning would have the same effect on both the home market and the export market. However, if home market sales were 'insufficient' within the meaning of antidumping legislation, antidumping investigations would examine only the 'fully allocated costs' of the exporter. If those costs exceeded the export market price, there would be a positive finding of dumping even if the exporter were merely pricing below-cost (in both markets) to gain technological know-how.
- 137 In the USA, the legality of aggressive pricing policies to increase market share has been upheld: *Telex Corp. v. IBM*, 510 F.2d 894 (10th Cir. 1975), cert. dismissed, 423 U.S. 802 (1975); *Berkey Photo v. Eastman Kodak Co.*, 603 F.2d 263 (2d Cir. 1979). Canadian courts have also recognized the legitimacy of promotional sales: *R.v.Hoffman-La Roche Ltd* (1981), 28 O.R. (2d) 164 at 196; 109 D.L.R. (3d) 5 at 37 (Ont. C.A.).
- 138 See Morgan, *op. cit.*
- 139 See Miranda, *op. cit.*
- 140 Viner, *op. cit.*, pp. 30–1.
- 141 For a fuller discussion of intermittent dumping, see F.Lazar, 'Antidumping Rules Following the Canada-US Free Trade Agreement' (1989) 23 *Journal of World Trade* 45.
- 142 Four of the 30 cases studied exhibited indications of intermittent dumping (Hutton and Trebilcock, *op. cit.*, p. 61).
- 143 *Ibid.*
- 144 See Trebilcock and Quinn, *op. cit.*, pp. 108–11.

145 *Ibid.*

146 Several studies have shown that the cost of capital in markets with strong import competition and demand fluctuation exceeds its cost in markets with constant demand and weak import competition: see W. Wares, *The Theory of Dumping and American Commercial Policy* (Lexington MA: Lexington, 1977) pp. 67–73; Agnar Sandomo, ‘On the Theory of the Competitive Firm under Price Uncertainty’ (1971) 61 *American Economic Review* 65; and Albert Zucker, ‘On the Desirability of Price Instability: An Extension of the Discussion’ (1965) 22 *Econometrica* 437.

147 Hutton and Trebilcock, *op. cit.*, p. 130.

148 See e.g. Barceló, *op. cit.*

149 S. Rep. No. 249, 96th Cong., 1st Sess. 37 (1980); cited in Palmetier, *op. cit.*, p. 191.

150 *Bingham and Taylor Div. Va. Industries, Inc. v. United States*, 815 F.2d 1482, 1485 (Fed. Cir. 1987). See also *Matsushita Electric Industrial Co. v. United States*, 823 F.2d 505, 509 (Fed. Cir. 1987).

151 For a useful discussion of both the economic and the political elements of unfairness claims, see R.E. Hudec, ‘Mirror, Mirror on the Wall: The Concept of Fairness in United States Foreign Trade Policy’, in 1990 *Proceedings of the Canadian Council on International Law*.

152 Jagdish Bhagwati, *Protectionism* (Cambridge MA: MIT Press, 1988) p. 50.

153 *Ibid.*, sp. 68.

154 For a brief and incisive discussion of the welfare effects of low-priced imports, see J.A. Ordover, A.O. Sykes and R.D. Willig, ‘Unfair International Trade Practices’ (1983) 15 *International Law & Policy* 323 at pp. 330–4.

155 Hutton and Trebilcock, *op. cit.*, p. 124. The issue that is raised is whether antidumping laws are the appropriate tool for vindicating these concerns. Compared to antidumping actions, safeguard actions and domestic adjustment assistance policies are preferable policy instruments to address those impacts. This is discussed further in Chapter 10.

156 See e.g. John Rawls, *A Theory of Justice* (Cambridge MA: Belknap Press, 1971).

157 While shareholders often include pension plans and employee shareholders (and therefore workers), it is likely that pension plans would diversify their assets so that import competition would not significantly erode workers’ savings.

158 See e.g. Michael Sandel, *Liberalism and the Limits of Justice* (New York: Cambridge University Press, 1982).

159 Hutton and Trebilcock, *op. cit.*, p. 143.

160 For discussion in the US context, see Brink Lindsey, ‘The US Antidumping Law: Rhetoric versus Reality’ (2000) 34 *Journal of World Trade* 1.

161 Hutton and Trebilcock, *op. cit.*, p. 143.

162 Alan Sykes, ‘The Economics of Injury in Antidumping and Countervailing Duty Cases’ (1996) 16 *International Review of Law and Economics* 5.

163 See also Ronald Cass and Michael Knoll, ‘The Economics of “Injury” in Anti-Dumping and Countervailing Duty Cases: A Reply to Professor Sykes’, in J.S. Bhandari and A.O. Sykes (eds) *Economic Dimensions in International Law: Comparative and Empirical Perspectives* (Cambridge: Cambridge University Press, 1997) p. 126.

164 See Nicolaides, *op. cit.*; B.M. Hoekman and M.P. Leidy, ‘Dumping, Antidumping and Emergency Protection’ (1989) 23 *Journal of World Trade* 27.

165 For a more detailed discussion, see the following UNCTAD report: Anti-Dumping and Countervailing Procedures—Use or Abuse? Implications for Developing Countries’, UNCTAD/ITCD/TAB/10, E.OI.II.D.6 (2001).

166 See *United Brands v. E.C. Commission* [1978] E.C.R. 207; 1 C.M.L.R. 429, C. Ct of Justice.

167 Warner, *op. cit.*

168 See Hoekman and Leidy, *op. cit.*

169 See, more generally, Boddez and Trebilcock, *op. cit.*

170 For further discussion, see Peter D. Ehrenhaft, 'Is Interface of Antidumping and Antitrust Possible?' (2002) 34 *George Washington International Law Review* 363; Gunnar Niels and Adriaan ten Kate, 'Trusting Antitrust to Dump Antidumping: Abolishing Antidumping in Free Trade Agreements without Replacing it with Competition Law' (1997) 31 *Journal of World Trade* 29; Hoekman and Mavroidis, *op. cit.*

9

Subsidies, countervailing duties and government procurement

- 1 This is not the case among member countries of some free trade-common market arrangements, like the EC, where countervailing duties have been abolished.
- 2 P. Messerlin, 'Antidumping', in J. J. Schott (ed.) *Computing the Uruguay Round: A Results-Oriented Approach to the GATT Trade Negotiations* (Washington DC: Institute for International Economics, 1990) p. 110.
- 3 Data sources: WTO, CV Initiations: By Affected Country—01/01/95 to 31/12/03; WTO, CV Initiations: By Reporting Member—01/01/95 to 31/12/03. Available online at <http://www.wto.org/>
- 4 Gerd Schwartz and Benedict Clements, 'Government Subsidies' (1999) 13 *Journal of Economic Surveys* 119.
- 5 J.-F. Bence and M. G. Smith, 'Subsidies and the Trade Laws: The Canada-U.S. Dimension', *International Economic Issues*, May-June 1989.
- 6 *Ibid.*, pp. 31–2. OECD, *Economic Survey: United States (1991–1992)* (Paris: OECD, 1991) p. 148.
- 7 Industrial subsidies as a percentage of GDP at market prices in Canada were 2.6% in 1980–84 and 2.2% in 1985–88. In the United States, the same measures show a 0.5% contribution for 1980–84 and 0.7% for 1985–88.
- 8 E. Fry, *Subsidies and International Trade: The Provincial and State Dimension* (Halifax: Institute for Research and Public Policy, 1990).
- 9 *Ibid.*; M. G. Smith, 'Overview of Provincial and State Subsidies: Their Implications for Canada-U.S. Trade', in *International Economic Issues* (Halifax: Institute for Research on Public Policy, April 1990).
- 10 Article VI, GATT Part V of the Uruguay Round Subsidies Code also governs countervailing duties.
- 11 In the USA, retaliation against certain unfair foreign producers is authorized under s. 301 of the Omnibus Trade and Competition Act, 1988.
- 12 Of course, if domestic producers in country C were being harmed, then from the perspective of country C this situation is like the first.
- 13 There is some evidence that early commentators on trade were concerned about unfair trade and did not sharply distinguish the concepts of dumping and subsidization: J. H. Jackson, *The World Trading System: Law and Policy of International Economic Relations* (Cambridge MA: MIT Press, 2nd ed., 1997) p. 285 [hereinafter *World Trading System*]. Even now, because of the overlap between countervailing duty and antidumping complaints, US producers will often initiate both actions against an exporter.
- 14 This distinction leads some commentators to conclude that countervailing duty actions are more legitimate: these duties offset distortions caused by government interference in a free market, while antidumping duties compound the distortion created by a producer with market power by forcing domestic consumers to pay monopoly prices. See, for example, K. Dam, *The GATT: Law and International Economic Organization* (Chicago: University of Chicago Press, 1970) pp. 177–9.

- 15 Paragraph 4 of Article VI of the GATT.
- 16 Paragraph 7 of Article VI of the GATT
- 17 R.R.Rivers and J.D.Greenwald, 'The Negotiation of a Code on Subsidies and Countervailing Measures: Bridging Fundamental Policy Differences' (1979) 11 *Law and Policy in International Business* 1447 at p. 1460.
- 18 Section B is entitled 'Additional Provisions on Export Subsidies'. However, there is no definition of export subsidies in the section or Article.
- 19 Seventeen developed countries accepted the new section. G.Horlick, R.Quick and E.Vermulst, 'Government Actions Against Domestic Subsidies: An Analysis of the International Rules and an Introduction to United States' Practice' (1986) 12 *Legal Issues of European Integration* 1.
- 20 See Jackson, *World Trading System*, *op. cit.*, p. 286.
- 21 See J.Jackson, *Legal Problems of International Economic Relations* (St Paul MN: West Publishing Co., 1977) p. 756. This list was updated during the Tokyo Round Subsidies Code negotiations.
- 22 G.Winham, *International Trade and the Tokyo Round Negotiations* (Princeton NJ: Princeton University Press, 1986) p. 116.
- 23 *Ibid.*, p. 119.
- 24 The nature of the policy differences and the way in which these differences were resolved is discussed in detail in Rivers and Greenwald, *op. cit.* In large part, the conflict on subsidies can be linked to the USA's dissatisfaction with the Common Agricultural Policy of the EC.
- 25 Article 4, Subsidies Code.
- 26 Jackson, *World Trading System*, *op. cit.*, p. 288.
- 27 J.J.Barceló III, 'The Two Track Subsidies Code—Countervailing Duties and Trade Retaliation', in J.Quinn and P.Slayton (eds) *Non-Tariff Barriers After the Tokyo Round* (Montreal: Institute for Research on Public Policy, 1982) [hereinafter 'Trade Retaliation'] p. 121.
- 28 As was the case in the GATT, there is no definition of export subsidies. There is a revised 'Illustrative List of Export Subsidies' in the Annex to the Code which is intended as an aid to interpretation. There is some debate about whether the list is relevant to Track I or only Track II of the Code. According to Jackson: 'The U.S. has taken the position that [it] is only useful in interpreting a definition of subsidies for purposes of Track 2 of the Code and does not in any way constrain national sovereigns in their definition of "subsidy" for purposes of Track 1' (*World Trading System*, *op. cit.*, pp. 259–60).
- 29 Article 11(1).
- 30 *Ibid.*
- 31 Article 11(2).
- 32 According to Jackson: 'It is not surprising that the Subsidies Code has had a very difficult history subsequent to the completion of the Tokyo Round, since its very language reflects considerable ambivalence about its obligations' (*World Trading System*, *op. cit.*, p. 259).
- 33 Article 12(3).
- 34 The Committee comprises a representative from each signatory to the agreement.
- 35 For reviews of the Uruguay Round Subsidies Agreement, see Mitsuo Matsushita, Thomas J. Shoenbaum and Petros C.Mavroidis, *The World Trade Organization: Law, Practice, and Policy* (New York: Oxford University Press, 2003) pp. 259–301; Terry Collins-Williams and Gerry Salembier, 'International Disciplines on Subsidies: The GATT, the WTO, and the Future Agenda' (1996) 30 *Journal of World Trade* 5; Americo Zampetti, 'The Uruguay Round on Subsidies: A Forward-Looking Assessment' (1995) 29 *Journal of World Trade* 5; and Jeffrey Schott, *The Uruguay Round: An Assessment* (Washington DC: Institute for International Economics, 1994) pp. 86–93; Marc Benitah, *The Law of Subsidies under the GATT/WTO system* (The Hague: Kluwer Law International, 2002). For an economic assessment of the usefulness of Uruguay Round rules on subsidies and countervailing

- measures, see Alan O.Sykes, 'The Economics of WTO Rules on Subsidies and Countervailing Measures', University of Chicago Law and Economics, Olin Working Paper No. 186 (June 2003).
- 36 WTO, *Brazil—Measures Affecting Desiccated Coconut* (1997) WTO Doc. WT/DS22/AB/R (Appellate Body Report).
- 37 WTO, *United States—Tax Treatment for 'Foreign Sales Corporations'* (2000) WTO Doc. WT/DS108/AB/R (Appellate Body Report).
- 38 For more detailed discussion of the background and implications of WTO disputes concerning US built-in fiscal subsidies, see Asif H.Qureshi and Roman Grynberg 'United States Tax Subsidies Under Domestic International Sales Corporation, Foreign Sales Corporation and Extraterritorial Income Exclusion Act Legislation within the Framework of the World Trade Organization' (2002) 36 *Journal of World Trade* 979.
- 39 WTO, *United States—Tax Treatment for 'Foreign Sales Corporations'—Recourse to Article 21.5 of the DSU by the European Communities* (2002) WTO Doc. WT/DS108/AB/RW
- 40 WTO, *Canada—Certain Measures Affecting the Automotive Industry* (2000) WTO Docs WT/DS139/AB/R and WT/DS142/AB/R (Appellate Body Report).
- 41 WTO, *Canada—Measures Affecting the Export of Civilian Aircraft—Recourse by Brazil to Article 21.5 of the DSU* (2000) WTO Doc. WT/DS70/AB/RW (Appellate Body Report).
- 42 WTO, *Canada—Measures Affecting the Export of Civilian Aircraft* (1999) WTO Doc. WT/DS70/AB/R (Appellate Body Report).
- 43 WTO, *United States—Countervailing Measures Concerning Certain Products from the European Communities* (2002) WTO Doc. WT/DS212/AB/R (Appellate Body Report).
- 44 WTO, *United States—Final Countervailing Duty Determination with Respect to Certain Softwood Lumber from Canada* (29 August 2003) WTO Doc. WT/DS257/R (Report of the Panel).
- 45 McGuire argues that careful subsidy design and panels' attention to the circumstances of each case mean that these three categories need not bar national industrial policies. See Steven McGuire, 'Between Pragmatism and Principle: Legalization, Political Economy, and the WTO's Subsidy Agreement' (2002) 16 *International Trade Journal* 319.
- 46 The application of the assistance must be limited to the following costs: personnel; instruments, equipment, land and buildings used exclusively and permanently for the research activity; consultancy and other similar services used exclusively for the research activity; other overhead costs; and running costs incurred directly as a result of the research activity.
- 47 WTO, *Brazil—Export Financing Programme for Aircraft* (1999) WTO Doc. WT/DS46/AB/R (Appellate Body Report) ['Brazil Aircraft'].
- 48 WTO, *Brazil—Export Financing Programme for Aircraft—Recourse by Canada to Article 21.5 of the DSU* (2000) WTO Doc. WT/DS46/AB/RW (Appellate Body Report).
- 49 WTO, *Australia—Subsidies Provided to Producers and Exporters of Automotive Leather* (1999) WTO Doc. WT/DS126/R (Panel Report).
- 50 Ivan Krympotic, 'Symposium Issue on WTO Dispute Settlement Compliance: Brazil Aircraft: Qualitative and Temporal Aspects of "Withdrawal" Under SCM Article 4.7' (2002) 33 *Law and Policy in International Business* 463. For discussion of remedies in *Brazil Aircraft*, see M.J.Trebilcock, 'Brazil-Canada Aircraft Subsidies Dispute: The Definition of Export Subsidies and Remedies' (2000) 20 *Canadian Competition Record* 32.
- 51 For a discussion of this conceptual issue in the context of US—UK Steel, see Gene M.Grossman and Petros Mavroidis, 'United States—Imposition of Countervailing Duties on Certain Hot-Rolled Lead and Bismuth Carbon Steel Products Originating in the United Kingdom: Here Today, Gone Tomorrow? Privatization and the Injury Caused by Non-Recurring Subsidies', in H.Horn and P.C. Mavroidis (eds) *The WTO Case Law of 2001* (Cambridge: Cambridge University Press, 2004).

- 52 WTO, *United States—Continued Dumping and Subsidy Offset Act of 2000* (2003) WTO Docs WT/DS217/AB/R and WT/DS234/AB/R.
- 53 WTO, *United States—Imposition of Countervailing Duties on Certain Hot-Rolled Lead and Bismuth Carbon Steel Products Originating in the United Kingdom* (2000) WTO Doc. WT/DS138/AB/R (Appellate Body Report).
- 54 WTO, *United States—Countervailing Duties on Certain Corrosion-Resistant Carbon Steel Flat Products from Germany* (2002) WTO Doc. WT/DS213/AB/R (Appellate Body Report).
- 55 WTO, *Ministerial Declaration* (2001) WTO Doc. WT/MIN(01)/DEC/1 (Ministerial Conference, Fourth Session) [Doha Declaration].
- 56 WTO, *Implementation-Related Issues and Concerns* (2001) WTO Doc. WT/MIN(01)/17 (Ministerial Conference, Fourth Session).
- 57 United Nations Development Programme, Heinrich Boll Foundation, Rockefeller Brothers Fund, The Rockefeller Foundation and Wallace Global Fund, *Making Global Trade Work for People* (New York: Earthscan Publications Ltd, 2003) pp. 195–200.
- 58 For a detailed description of the administration of countervailing duty laws in the USA, see T. Boddez and M. Trebilcock, *Unfinished Business: Reforming Trade Remedy Laws in North America* (Toronto: C.D. Howe Institute, 1993); R. Diamond, 'A Search for Economic and Financial Principles in the Administration of United States Countervailing Duty Law' (1990) 21 *Law and Policy in International Business* 507; and T. V. Vakerics, D. I. Wilson and K. G. Weigel, *Antidumping, Countervailing Duty and Other Trade Actions* (New York: Practising Law Institute, 1987) pp. 218–19.
- 59 The Tariff Act, 19 U.S.C. 702(a) and 732(a), authorizes the ITA to initiate investigations. It rarely does so. Most investigations are initiated by complaints from domestic producers.
- 60 Tariff Act, 19 U.S.C. 1671.
- 61 Jackson, *World Trading System*, *op. cit.*, p. 293.
- 62 A. O. Sykes, 'Countervailing Duty Law: An Economic Perspective' (1989) 89 *Columbia Law Review* 199 at p. 203 [hereinafter 'Countervailing Duty Law'].
- 63 See Vakerics *et al.*, *op. cit.*, pp. 218–19.
- 64 G. C. Hufbauer and J. Erb, *Subsidies in International Trade* (Washington DC: Institute for International Economics, 1984).
- 65 Vakerics *et al.*, *op. cit.*, p. 221.
- 66 Tariff Act, §1677(5)(B).
- 67 See J. Bello and W. Homer, 'Subsidies and Natural Resources: Congress Rejects a Lateral Attack on the Specificity Test' (1984) 18 *George Washington Journal of International Law and Economics* 297; Panzarella, 'Is the Specificity Test Generally Applicable?' (1986) 18 *Law and Policy in International Business* 417; and Sussman, 'Countervailing Duties and the Specificity Test: An Alternative Approach to the Definition of "Bounty or Grant"' (1986) 18 *Law and Policy in International Business* 475.
- 68 564 F.Supp. 834 (Ct Int'l Trade 1983).
- 69 620 F.Supp. 722 (Ct Int'l Trade 1985).
- 70 54 Fed. Reg. 30774, 30777 (1989).
- 71 These aspects are highlighted in Vakerics *et al.*, *op. cit.*, p. 222.
- 72 The rationale for this rule is that in a non-market economy, there is no valid distinction between government and industry. See, for example, *Carbon Steel Wire Rod from Czechoslovakia*, 49 Fed. Reg. 55014 (1983).
- 73 Upstream subsidies are defined in 19 U.S.C. 1671–1(a)(1) as subsidies paid or bestowed by a foreign government with respect to an input that is used in the manufacture, in the same country, of merchandise that is the subject of a countervailing duty proceeding.
- 74 See, for example, *Prestressed Concrete Steel Wire Strands from Spain*, 47 Fed. Reg. 28723, 28726 (1982).
- 75 Details of the approach of the ITA to these cases can be found in Vakerics *et al.*, *op. cit.*, p. 230.

- 76 See, for example, *Certain Iron-Metal Castings from India*, 45 Fed. Reg. 34946 (1980).
- 77 19 U.S.C. 1671(a)(1)(B). An example of this is found in *Certain Steel Products from the Republic of Korea*, 47 Fed. Reg. 57535 (1982).
- 78 J.Terry, 'Sovereignty, Subsidies and Countervailing Duties in the Context of the Canada-US Trading Relationship' (1988) 46 *University of Toronto Faculty of Law Review* 48 at p. 69.
- 79 G.N.Horlick, 'Subsidies and Suspension Agreements in Countervailing Duty Cases' in *The Commerce Department Speaks on Dumping and Countervailing Duties* (New York: Practising Law Institute, 1982) p. 31.
- 80 *Certain Textile Products from Mexico*, 50 Fed. Reg. 10824 (1985).
- 81 Diamond, *op. cit.*, pp. 541–2.
- 82 See 19 U.S.C. 1677(b).
- 83 Vakerics *et al.*, *op. cit.*, p. 221.
- 84 See *ibid.*, p. 239, for details on this aspect of US countervailing duty law.
- 85 Thus, many of the same problems arise that were discussed in Chapter 8.
- 86 Article 16.1.
- 87 19 U.S.C. 1677(4)(A).
- 88 19 U.S.C. 1677(4)(C).
- 89 19 U.S.C. 1677(10).
- 90 In *Certain Carbon Steel Products from Argentina, Australia, Finland, South Africa and Spain*, Investigation No. 701-TA-212, USITC Publication No. 1510 (1984), there were five separate like products.
- 91 Article 15.4.
- 92 Tariff Act, 19 U.S.C. 1677(7)(A).
- 93 19 U.S.C. 1677(7)(C).
- 94 *Ibid.*
- 95 M.S.Knoll, 'An Economic Approach to the Determination of Injury Under United States Antidumping and Countervailing Duty Law' (1990) 22 *Journal of International Law and Politics* 37 at p. 52.
- 96 For a detailed criticism of ITC methodology, see Boddez and Trebilcock, *op. cit.*, p. 57.
- 97 Article 15.5.
- 98 Knoll, *op. cit.*, p. 54; and R.Cass and A.Schwartz, 'Causality, Coherence, and Transparency in the Implementation of International Trade Law', in M.J.Trebilcock and R.C.York (eds) *Fair Exchange: Reforming Trade Remedy Laws* (Toronto: C.D.Howe Institute, 1990) p. 43.
- 99 Cass and Schwartz, *op. cit.*, p. 43.
- 100 *Ibid.*, p. 33.
- 101 See, for example, *Matsushita Electric Industrial Co. v. United States*, 750 F.2d 927 (1984).
- 102 *Ceramica Regiomontana, S.A. v. United States*, 810 F.2d 1137 at 1139 (Fed. Cir. 1987).
- 103 See Boddez and Trebilcock, *op. cit.*, Ch. 3, for a detailed analysis of binational panel decisions in antidumping and countervailing duty cases. See also John Mercury, 'Chapter 19 of the United States—Canada Free Trade Agreement 1989–1995: A Check on Administered Protection?' (1995) 15 *Northwestern Journal of International Law and Business* 525, and Robert Howse, 'Settling the Trade Remedy Disputes: When the WTO Forum is Better than the NAFTA, C.D.Howe Institute Commentary (1998).
- 104 Boddez and Trebilcock, *op. cit.*, Ch. 3. See also Chapter 8 of the present volume.
- 105 Boddez and Trebilcock, *op. cit.*, pp. 43–50.
- 106 For a similar proposal, see C.Gastle and J.-G.Castel, 'Should the North American Free Trade Agreement Dispute Settlement Mechanism in Antidumping and Countervailing Duty Cases be Reformed in Light of *Softwood Lumber III*?' (1995) 26 *Law and Policy in International Business* 823.
- 107 Department of Foreign Affairs and International Trade, 'Softwood Lumber—Learn More—Canada-US. Softwood Lumber Trade Relations (1982–2002)', available online at www.dfait-maeci.gc.ca/trade/eicb/softwood/chrono-en.asp (accessed 20 June 2003).

- 108 *Review of Department of Commerce Final Affirmative Countervailing Duty Determination and Final Negative Critical Circumstances Determination Re Certain Softwood Lumber Products from Canada* (Decision 16 July 2003) USA-CDA-2002-1904-03 (Chapter 19 Panel).
- 109 WTO, *United States—Final Countervailing Duty Determination with Respect to Certain Softwood Lumber from Canada—Request for the Establishment of a Panel by Canada* (19 August 2002) WTO Doc. WT/DS257/3.
- 110 WTO, *United States—Preliminary Determinations with Respect to Certain Softwood Lumber from Canada* (27 September 2002) WTO Doc. WT/DS236/R (Report of the Panel).
- 111 WTO, *United States—Final Countervailing Duty Determination with Respect to Certain Softwood Lumber from Canada* (29 August 2003) WTO Doc. WTO/DS257/R (Report of the Panel).
- 112 USITC, *Softwood Lumber from Canada—Investigations Nos. 701-TA-414 and 731-TA-928 (Final)* (May 2002) Publication No. 3509 (Determinations and Views of the Commission).
- 113 *Review of USITC Final Injury Determination Re Certain Softwood Lumber Products from Canada* (Canada v. United States) (Decision due 10 September 2003) USA-CDA-2002-1904-07 (Chapter 19 Panel).
- 114 WTO, *United States—Investigation of the International Trade Commission in Softwood Lumber from Canada—Request for the Establishment of a Panel by Canada* (4 April 2003) WTO Doc. WT/DS277/2.
- 115 WTO, *United States—Measures Treating Export Restraints as Subsidies* (29 June 2001) WTO Doc. WT/DS194/R (Report of the Panel).
- 116 Department of Foreign Affairs and International Trade, 'Softwood Lumber—Canada's Legal Actions—WTO Challenges', available online at www.dfait-maeci.gc.ca/eicb/softwood/wto_challenges-en.asp (accessed 20 June 2003).
- 117 For a discussion of how the uncertain causal relationship between subsidy and prejudice has led to a legally indeterminate text not dealt with by case law, see Marc Benitah, 'From Economic Complexity to Legal Indeterminacy: Causality Between Subsidy and Injury' (1999) 33 *Journal of World Trade* 87.
- 118 Terry, *op. cit.*, p. 51; and W.Schwartz and E.W.Harper Jr, 'The Regulation of Subsidies Affecting International Trade' (1972) 70 *Michigan Law Review* 831.
- 119 Schwartz and Harper, *op. cit.*, p. 844.
- 120 For an economic model providing a rationale for multilateral agreements that prohibit export subsidies, see David R.Collie A Rationale for the WTO Prohibition of Export Subsidies: Strategic Export Subsidies and World Welfare' (2000) 11 *Open Economics Review* 229. The author explains the unilateral incentive for welfare-maximizing governments to provide export subsidies and shows how the multilateral prohibition of export subsidies may increase world welfare.
- 121 See Sykes, 'Countervailing Duty Law', *op. at.*
- 122 Schwartz and Harper, *op. cit.*, pp. 834–5. Predatory pricing and international price discrimination are discussed in detail in Chapter 6.
- 123 Robert Hudec, 'Mirror, Mirror on the Wall: The Concept of Fairness in United States Foreign Trade Policy', in 1990 *Proceedings of the Canadian Council on International Law*, p. 88.
- 124 See (1990) 21 *Law and Policy in International Business*, Countervailing Duty Law Symposium issue.
- 125 See Jagdish Bhagwati, 'Fair Trade, Reciprocity, and Harmonization: The New Challenge to the Theory and Policy of Free Trade', in A.Deardorff and R.Stein (eds) *Analytical and Negotiating Issues in the Global Trading System* (Ann Arbor: University of Michigan Press, 1993); Bhagwati, 'Challenges to the Doctrine of Free Trade' (1993) 25 *International Law and Politics* 219.
- 126 See Hudec, *op. cit.*, note 127.

- 127 J.Bhagwati, *The World Trading System at Risk* (Princeton NJ: Princeton University Press, 1991) pp. 21–2; see also James Bovard, *The Fair Trade Fraud* (New York: St. Martin's Press, 1991).
- 128 This group would include unskilled, immobile or low-income workers. See J.Rawls, *A Theory of Justice* (Cambridge MA: Belknap Press, 1971).
- 129 For an extensive comparative evaluation of attempts to regulate subsidies in international trade, see R.Behboodi, *The Regulation of Subsidies in International Trade* (London: Routledge, 1995).
- 130 Diamond, *op. cit.*; M.J.Trebilcock, 'Is the Game Worth the Candle? Comments on Diamond, "A Search for Financial and Economic Principles in the Administration of Countervailing Duty Law"' (1990) 21 *Law and Policy in International Business* 723; Trebilcock, 'Throwing Deep: Trade Remedies in a First-Best World', in Trebilcock and York (eds), *op. cit.*; and M.Hart, 'Idealism versus Pragmatism: Policy and the Academic Analyst', in Trebilcock and York (eds), *op. cit.*
- 131 Diamond, *op. cit.*, pp. 158–9.
- 132 Diamond, *op. cit.*
- 133 C.Goetz, L.Granet and W.Schwartz, 'The Meaning of "Subsidy" and "Injury" in the Countervailing Duty Law' (1986) 6 *International Review of Law and Economics* 17; see also R.Diamond, 'Economic Foundations of Countervailing Duty Law' (1989) 29 *Virginia Journal of International Law* 767.
- 134 Identifying predatory pricing or setting a reasonable rate of return for a natural monopoly are prominent examples.
- 135 These would include, for example, cases of inefficiency or mismanagement of domestic firms as well as threats from more efficient third-country exporters. At the same time, the subsidy in question may have been conferred principally for home-market reasons.
- 136 See Goetz *et al.*, *op. cit.*, pp. 26–9; see also Alan Sykes, 'Second-Best Countervailing Duty Policy: A Critique of the Entitlement Approach' (1990) 21 *Law and Policy in International Business* 699 [hereinafter 'Second-Best Countervailing Duty Policy'].
- 137 J.J.Barceló, 'Subsidies and Countervailing Duties: Analysis and a Proposal' (1977) 9 *Law and Policy in International Business* 779.
- 138 See Barceló, 'Trade Retaliation', *op. cit.*, and Sykes, 'Second-Best Countervailing Duty Policy', *op. cit.*
- 139 See, for example, Richard Harris, *Trade, Industrial Policy and International Competition*, Royal Commission on the Economic Union and Development Prospects for Canada, Collected Research Studies 13 (Toronto: University of Toronto Press, 1985).
- 140 See H.Milner and D.Yoffie, 'Between Free Trade and Protectionism: Strategic Trade Policy and a Theory of Corporate Trade Demands' (1989) 43 *International Organization* 238.
- 141 The Commission has, however, employed some common-sense *de minimis* tests to dispose of cases where the aid in question could have little plausible impact on trade; see, in general, C. Quigley 'The Notion of a State Aid in the EEC' (1988) 13 *European Law Review* 242, and R. Howse, *Economic Union, Social Justice, and Constitutional Reform: Towards a High but Level Playing Field* (Toronto: York Centre for Public Law and Public Policy, 1992) Appendix III.
- 142 See A.Evans and S.Martin, 'Socially Acceptable Distortion of Competition: Community Policy on State Aid' (1991) 16 *European Law Review* 80.
- 143 See, more generally, Boddez and Trebilcock, *op. cit.*
- 144 These panels hear disputes between Canada and the USA that are unrelated to unfair trade law.
- 145 T.L.McDorman, 'Using the Dispute Settlement Regime of the Free Trade Agreement: The West Coast Salmon and Herring Problem' (1991) 4 *Canada-U.S. Business Law Review* 117 at p. 179.
- 146 See, especially, *R.v.Oakes* (1986) 26 D.L.R. (4th) 200 (S.C.C.).

- 147 For a similar set of proposals, see Terry Collins-Williams and Gerry Salembier, 'International Disciplines on Subsidies: The GATT, the WTO and the Future Agenda' (1996) 1 *Journal of World Trade* 5.
- 148 For an extensive review of government procurement under international agreements, see Arie Reich, *International Public Procurement Law: The Evolution of International Regimes on Public Purchasing* (The Hague: Kluwer Law International, 1999) [hereinafter *International Public Procurement Law*].
- 149 S.Arrowsmith, *Government Procurement and Judicial Review* (Toronto: Carswell, 1988) p. 1.
- 150 For examples of this 'secondary' use, see W.F.Leimkuhler, 'Enforcing Social and Economic Policy through Government Contracts', in *Annual Survey of American Law* (1980) p. 539.
- 151 C.McCrudden, 'International Economic Law and the Pursuit of Human Rights: A Framework for Discussion of the Legality of "Selective Purchasing" Laws Under the WTO Government Procurement Agreement' (1999) 2 *Journal of International Economic Law* 3 at p. 47.
- 152 A WTO panel was requested to address Massachusetts state legislation prohibiting procurement from Myanmar, or any person doing business with Myanmar, by state agencies, authorities and entities. However, the panel's work was suspended at the request of the complainants. See Massachusetts Act of 25 June 1996, ch. 130, §1, 1996 Mass. Acts 210, codified at Mass. Gen. Laws, Ch. 7, §§22G-22M; WTO, *United States—Measure Affecting Government Procurement—Lapse of Authority for Establishment of the Panel* (2000) WTO Docs WT/DS88/6, WT/DS95/6 (Note by the Secretariat).
- 153 McCrudden, *op. cit.*, pp. 6–7.
- 154 For this topic, see US General Accounting Office, *Government Buy-National Practices of the United States and Other Countries—An Assessment* (Washington DC, 1976). On the discriminatory procurement practices of various governments, see R.Baldwin, *Nontariff Distortions of International Trade* (Washington DC: Brookings Institution, 1970) pp. 59–70; M.Krauss, *The New Protectionism: The Welfare State and International Trade* (New York: New York University Press, 1978) pp. 54–6.
- 155 For example, the Canadian Content Premium (see Deputy Minister of Supply and Services Directive 637 (10/02/89) Annex A-1) and the Buy American Policy (see the Buy American Act (41 U.S.C., 1976)).
- 156 See *Selling to Government, A Guide to Government Procurement in Canada* (Ottawa: Minister of Supply and Services Canada, 1989) pp. 48–50.
- 157 See Olivier Long, *The Tokyo Round of Multilateral Trade Negotiations*, Report by the Director-General of GATT (Geneva, April 1979).
- 158 The Agreement on Government Procurement (the Code), published in BISD 26S/33. The amendments to the Code enacted in 1987 were published as 'Protocol Amending the Agreement on Government Procurement', BISD 34S/12.
- 159 This threshold was lowered from SDR 150,000 (Article I:1(b)) by the 1987 amendments. SDR stands for Special Drawing Rights, the International Monetary Fund's monetary units. The value of the threshold in the currency of each signatory is determined by the Committee established by the Agreement, in consultation with the signatory in question, and applies throughout a two-year period until next determination. SDR 150,000 is approximately US\$181,000.
- 160 See Article I:1(a). Note that this has been changed under the Uruguay Round negotiations.
- 161 See Article 11:4.
- 162 See Article V.
- 163 See Article V:2, V:6 and V:7.

- 164 Article V:16 limits circumstances for 'single tendering'. On collusion in tendering, see United Nations Conference on Trade and Development, *Collusive Tendering* (New York, 1985).
- 165 See Article V:15(f).
- 166 See Article VI:6. Usually, no effective remedy is provided. See US International Trade Commission, *Review of the Effectiveness of Trade Dispute Settlement Under the GATT and the Tokyo Round Agreements* (Washington DC: USITC, 1985).
- 167 See Article VII:14.
- 168 Norway—*Procurement of Toll Collection Equipment for the City of Trondheim*, Report of the Panel adopted by the Committee on Government Procurement on 13 May 1992.
- 169 *Ibid.*, para. 1.3.
- 170 For reviews of the Uruguay Round Government Procurement Agreement, see Arie Reich, 'The New GATT Agreement on Government Procurement: The Pitfalls of Plurilateralism and Strict Reciprocity' (1997) 31 *Journal of World Trade* 125 [hereinafter 'The New GATT Agreement'], and Schott, *op. cit.*, pp. 66–76. See also *Report (1998) of Working Group on Transparency in Government Procurement to the WTO General Council*.
- 171 Mission of Canada Geneva, '(draft) GATT Agreement on Government Procurement' (15/12/93).
- 172 *Ibid.*, Article I.
- 173 *Ibid.*, Article XVI.
- 174 *Ibid.*, Article XX.
- 175 As of 17 June 2003, signatories: Austria, Belgium, Canada, Denmark, the European Communities, Finland, France, Germany, Greece, Hong Kong China, Iceland, Ireland, Israel, Italy, Japan, Korea, Liechtenstein, Luxembourg, the Netherlands, the Netherlands with respect to Aruba, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, the United Kingdom, the United States; negotiating accession: Bulgaria, Estonia, Jordan, Kyrgyz Republic, Latvia, Panama, Chinese Taipei; observers: Argentina, Australia, Bulgaria, Cameroon, Chile, Colombia, Croatia, Czech Republic, Estonia, Georgia, Jordan, Kyrgyz Republic, Latvia, Lithuania, Malta, Moldova, Mongolia, Oman, Panama, Poland, Slovak Republic, Slovenia, Turkey.
- 176 See Reich, 'The New GATT Agreement', *op. cit.*
- 177 United Nations Development Programme *et al.*, *op. cit.*, pp. 299–300.
- 178 Sue Arrowsmith, 'Reviewing the GPA: The Role and Development of the Plurilateral Agreement After Doha' (2002) 5 *Journal of International Economic Law* 761 at pp. 786–7.
- 179 For additional suggestions, see Paul J. Carrier, 'Sovereignty Under the Agreement on Government Procurement' (1997) 6 *Minnesota Journal of Global Trade* 67.
- 180 Hoekman and Mavroidis, 'The WTO's Agreement on Government Procurement: Expanding Disciplines, Declining Membership' (1995) 4 *Public Procurement Law Review* 3 at p. 76, cited in Arrowsmith, *op. cit.*
- 181 See also Reich, *International Public Procurement Law*, *op. cit.*, p. 353, cited in Arrowsmith, *op. cit.*
- 182 WTO, *Korea—Measures Affecting Government Procurement* (2000) WTO Doc. WT/DS163/R (Panel Report).
- 183 Doha Declaration, *op. cit.*, para. 26.
- 184 WTO, *Singapore Ministerial Declaration* (1996) WTO Doc. WT/MIN(96)/DEC.
- 185 Vinod Rege, 'Transparency in Government Procurement: Issues of Concern and Interest to Developing Countries' (2001) 35 *Journal of World Trade* 489 at p. 497.
- 186 *Ibid.*, pp. 500, 505–7.
- 187 Treasury Board of Canada, Ottawa, *Administrative Policy Manual*, Ch. 305, 'Procurement Review' (March 1980).
- 188 See Minister of Supply and Services, *The Canada-U.S. Free Trade Agreement and Government Procurement: An Assessment* (Hull, Canada, 1989).

- 189 Most Favourable Treatment obligation under Article 1305:1 of the FTA.
- 190 Compare Annex 1002.1 of NAFTA with Annex 1304.3 of the FTA.
- 191 See NAFTA Article 1006.
- 192 For a review of European public procurement law and policy, see Reich, *International Public Procurement Law*, *op. cit.*, and Christopher Bovis, 'An Impact Assessment of the European Public Procurement Law and Policy' (1999) *Journal of Business Law* 126.
- 193 See Council Directive 71/305/EEC, (1971) O.J. L185/5 ('the Works Directive') and Council Directive 77/62/EEC, (1977) O.J. L13/1 ('the Supplies Directive'). See also Council Directive 88/295/EEC, (1988) O.J. L127 (Amending Supplies Directive') and Council Directive 89/440/EEC, (1989) O.J. L210 (Amending Works Directive'). For a recent study on public sector procurement in Europe, see *The 'Cost of Non-Europe' in Public Sector Procurement*, Research on the 'Cost of Non-Europe', Basic Findings, vol. 5, by W.S. Atkins Management Consultants (Commission of the European Communities, 1988).
- 194 For a list of these circumstances, see Article 9 in the Works Directive, and Article 6 in the Supplies Directive.
- 195 Council Directive 89/665/EEC, (1989) O.J. 395/33–5.
- 196 Reich, *International Public Procurement Law*, *op. cit.*, p. 224.
- 197 *Ibid.*, pp. 224–6.
- 198 Council Directive 90/531/EEC, (1990) O.J. 297.
- 199 Reich, *International Public Procurement Law*, *op. cit.*, pp. 237, 241–3.
- 200 Council Directive 92/13/EEC, (1992) O.J. 76/14.
- 201 Reich, *International Public Procurement Law*, *op. cit.*, p. 250.

10

Safeguard regimes and domestic adjustment policies

- 1 For discussion of the special safeguard provisions in the Agreement on Agriculture, the General Agreement on Trade in Services, and the Agreement on Textiles and Clothing, see Chapters 11, 12 and 15 respectively.
- 2 Article XIX:1 lays out the grounds for invocation, XIX:2 the notification requirement and XIX:3 the right to compensation.
- 3 Compensation usually takes the form of other trade concessions. In the absence of agreement on compensation, the exporting countries can impose import restraints of substantially equivalent value.
- 4 Data sources: WTO, Report (2002) of the Committee on Safeguards to the Council for Trade in Goods, WTO Doc. G/L/583, Annex 2; WTO, Report (2001) of the Committee on Safeguards to the Council for Trade in Goods, WTO Doc. G/L/494, Annex 2; WTO, Report (2000) of the Committee on Safeguards, WTO Doc. G/L/409, Annex 2.
- 5 J.M.Finger, and P.Schuler, 'Implementation of Uruguay Round Commitments: The Development Challenge' (2000) 23 *World Economy* 511, cited in Bernard M.Hoekman and Michel M.Kostecki, *The Political Economy of the World Trading System* (Oxford: Oxford University Press, 2001) p. 307.
- 6 Period of 2001:10 November 2000 to 29 October 2001; and of 2002:30 October 2001 to 28 October 2002.
- 7 *Ibid.*
- 8 Data sources: WTO, AD Initiations: By Affected Country—01/01/95 to 31/12/02; WTO, AD Initiations: By Reporting Member—01/01/95 to 31/12/02. Available online at <http://www.wto.org/>

- 9 Data sources: WTO, CV Initiations: By Affected Country—01/01/95 to 31/12/02; WTO, CV Initiations: By Reporting Member—01/01/95 to 31/12/02. Available online at <http://www.wto.org/>
- 10 23 December 1942, Article XI, 57 Stat. 833 (1943); E.A.S. No. 311 (effective 30 January 1943).
- 11 William L. Clayton, *GATT: An Analysis and Appraisal of the General Agreement on Tariffs and Trade* (US Council of the International Chamber of Commerce, 1955) p. 36, n. 8.
- 12 J.H. Jackson, *World Trade and the Law of GATT* (Ann Arbor: Bobbs-Merrill, 1969) p. 554 [hereinafter *World Trade*].
- 13 The historical description that follows draws primarily on G. Winham, *International Trade and the Tokyo Round Negotiations* (Princeton: Princeton University Press, 1986).
- 14 Jackson, *World Trade*, *op. cit.*, p. 557.
- 15 According to Sampson, Article XIX has rarely, if ever, been interpreted in a way that would appear to be consistent with the text.' See G. Sampson, 'Safeguards', in J.M. Finger and A. Olechowski (eds) *The Uruguay Round: A Handbook on the Multilateral Trade Negotiations* (Washington DC: The World Bank, 1987) p. 143.
- 16 Winham, *op. cit.*
- 17 According to Winham, the USA adopted a middle ground. It was sympathetic to the view of developing countries, but also saw itself as vulnerable to sudden import increases from low-cost suppliers (*op. cit.*, p. 199).
- 18 Winham, *op. cit.*, pp. 243–4.
- 19 GATT Secretariat, *The Tokyo Round of Multilateral Trade Negotiations: Supplementary Report* (Geneva, 1980) p. 42.
- 20 Winham, *op. cit.*, p. 358.
- 21 J. Zietz, 'Negotiations on GATT Reform and Political Incentives' (1989) 12 *World Economy* 39.
- 22 A.O. Sykes, 'Protectionism as "Safeguard": A Positive Analysis of the GATT "Escape Clause" with Normative Speculations' (1991) 58 *University of Chicago Law Review* 255 at p. 288 [hereinafter 'Protectionism']; and Sykes, 'GATT Safeguards Reform: The Injury Test' [hereinafter 'The Injury Test'], in M.J. Trebilcock and R.C. York (eds) *Fair Exchange: Reforming Trade Remedy Laws* (Toronto: C.D. Howe Institute, 1990) p. 203.
- 23 G.C. Hufbauer and H.F. Rosen, *Trade Policy for Troubled Industries* (Washington DC: Institute for International Economics, 1986) p. 60.
- 24 M.J. Trebilcock, 'Reforming the GATT Safeguards Regime' (1989) 15 *Canadian Business Law Journal* 234 at p. 238; J.D. Richardson, 'Safeguards Issues in the Uruguay Round', in R.E. Baldwin and J.D. Richardson (eds) *Issues in the Uruguay Round* (Cambridge MA: NBER, 1988) p. 33.
- 25 *Ibid.*
- 26 For a review of the Agreement, see Mitsuo Matsushita, Thomas J. Shoenbaum and Petros C. Mavroidis, *The World Trade Organization: Law, Practice, and Policy* (New York: Oxford University Press, 2003) pp. 181–216. For an overview of WTO case law on safeguards, see Debra Steger, 'Appellate Body Jurisprudence Relating to Trade Remedies' (2001) 35 *Journal of World Trade* 799.
- 27 WTO, *Agreement on Safeguards in Argentina—Safeguard Measures on Imports of Footwear* (1999) WTO Doc. WT/DS121/AB/R (Appellate Body Report).
- 28 For discussion of this decision, see Yong-Shik Lee, 'The WTO Agreement on Safeguards: Improvement on the GATT Article XIX?' (2000) 14 *International Trade Journal* 283. For a discussion of the relationships between GATT 1994 and Annex 1A Agreements, see Elisabetta Montaguti and Maurits Lugard, 'The GATT 1994 and Other Annex 1A Agreements: Four Different Relationships?' (2000) 3 *Journal of International Economic Law* 473.

- 29 This interpretation of 'increased' was adopted at the Second Session of the GATT Contracting Parties in 1948 (GATT, 2 BISD 39, pp. 44–5 (1952)). The allowance of safeguard actions when imports have not increased absolutely is controversial since it shifts the burden of an economic downturn to foreign producers (Jackson, *World Trade, op. cit.*, p. 558).
- 30 For further discussion of 'unforeseen developments', see Henrik Horn and Petros C.Mavroidis, 'US—Lamb: United States—Safeguard Measures on Imports of Fresh, Chilled or Frozen Lamb Meat from New Zealand and Australia: What Should Be Required of a Safeguard Investigation?', in H.Horn and P.C.Mavroidis (eds) *The WTO Case Law of 2001* (Cambridge: Cambridge University Press, 2004).
- 31 WTO, *United States—Safeguard Measures on Imports of Fresh, Chilled or Frozen Lamb Meat from New Zealand and Australia* (2001) WTO Docs WT/DS177/AB/R and WT/DS178/AB/R (Appellate Body Report) ['US Lamb'].
- 32 Horn and Mavroidis, *op. cit.*, argue that the Safeguards Agreement could create a moral hazard problem because it allows safeguards to be imposed where imports are the proximate, though not ultimate, cause of injury.
- 33 WTO, *United States—Definitive Safeguard Measures on Imports of Circular Welded Carbon Quality Line Pipe from Korea* (2002) WTO Doc. WT/DS202/AB/R (Appellate Body Report) ['US Line Pipe'], para. 208.
- 34 WTO, *United States—Definitive Safeguard Measures on Imports of Wheat Gluten from the European Communities* (2000) WTO Doc. WT/DS166/AB/R (Appellate Body Report) ['US Wheat Gluten'].
- 35 These cases are *US Wheat Gluten* and *US Lamb*.
- 36 See above, note 33.
- 37 Alan O.Sykes, 'The Safeguards Mess: A Critique of WTO Jurisprudence', (2003) 2 *World Trade Review* 261.
- 38 WTO, *Korea—Definitive Safeguard Measure on Imports of Certain Dairy Products* (1999) WTO Doc. WT/DS98/AB/R (Appellate Body Report).
- 39 GATT L/76 (1953). The interpretation was developed as part of the negotiations on the International Trade Organization which was never realized, so it has only persuasive value.
- 40 The legal and practical requirement of non-discrimination is the subject of some controversy. See J.H.Jackson, *The World Trading System: Law and Policy of International Economic Relations* (Cambridge MA: MIT Press, 2nd ed., 1997) [hereinafter *The World Trading System*] pp. 195–9; M. Bronckers, 'The Nondiscriminatory Application of Article XIX GATT: Tradition or Fiction?' (1981/2) *Legal Issues of European Integration (LIEI)* 35, 'Reconsidering the Nondiscrimination Principle as Applied to GATT Safeguard Measures' (1983/2) *LIEI* 113, and *Selective Safeguard Measures in Multilateral Trade Relations* (Deventer: Kluwer, 1985); and Koulen, 'The Nondiscriminatory Interpretation of GATT Article XIX(1): A Reply' (1983/2) *LIEI* 89.
- 41 *US Lamb, op. cit.*, indicated that 'establish explicitly' requires competent authorities to provide 'a reasoned and adequate explanation of how the facts support their determination' (para. 103).
- 42 J.Tumlrir, 'A Revised Safeguard Clause for GATT?' (1973) 7 *Journal of World Trade Law* 404.
- 43 See Jackson, *The World Trading System, op. cit.*, p. 194.
- 44 A.W.Wolff, 'The Need for New GATT Rules to Govern Safeguard Actions', in W.R.Cline (ed.) *Trade Policy in the 1980s* (Washington DC: Institute for International Economics, 1983) p. 380.
- 45 Trebilcock, *op. cit.*, p. 238.
- 46 WTO, *United States—Definitive Safeguard Measures on Imports of Certain Steel Products* (11 July 2003) WTO Docs WT/DS248/R, WT/DS249/R, WT/DS251/R, WT/DS252/R, WT/DS253/R, WT/DS254/R, WT/DS258/R and WT/DS259/R (Reports of the Panel).

- 47 These were: certain carbon flat-rolled steel (CCFRS), tin mill, hot-rolled bar, cold-finished bar, rebar, welded pipe, fittings, flanges and tool joints (FFTJ), stainless steel bar, stainless steel rod, and stainless steel wire.
- 48 The WTO panel and the AB made findings for each of the ten measures. In the end, all were found to be inconsistent with the GATT and WTO obligations, but not all for the same reasons.
- 49 Appellate Body Report, *United States—Definitive Safeguard Measures on Imports of Certain Steel Products*, AB-2003–3, WT/DS/248–259/AB, adopted 10 December 2003, para. 288.
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- 52 *The Canada-US. Free Trade Agreement* (Toronto: CCH Canadian, 1988) 364. For a discussion of the FTA provisions, see Trebilcock, *op. cit.*
- 53 Article 1101. Once the transition period is over, bilateral emergency action can only be taken with consent of the other country.
- 54 These measures contrast with ERAs which typically allow exporters to reap monopoly profits at the expense of domestic consumers.
- 55 NAFTA, *In the Matter of the U.S. Safeguard Action Taken on Corn Brooms from Mexico* (1998) USA-97–2008–01 (Chapter 20 Panel).
- 56 19 U.S.C. 2252.
- 57 Kenneth Dam, *The GATT: Law and International Economic Organization* (Chicago: University of Chicago Press, 1970) p. 106.
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- 59 Sykes, ‘The Injury Test’, *op. cit.*
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- 62 Jackson, *The World Trading System*, *op. cit.*, p. 176.
- 63 Hufbauer and Rosen, *op. cit.*
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- 66 R.W. Crandall, ‘Import Quotas and the Automobile Industry: The Costs of Protectionism’ (1983) 2 *Brookings Review* 4 at p. 8.
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- 68 See Trebilcock, Chandler and Howse, *op. cit.*
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- 70 *Ibid.*, p. xvii.
- 71 L. Kaplow, ‘An Economic Analysis of Legal Transitions’ (1986) 99 *Harvard Law Review* 509.

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Trade in agriculture

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Trade in services

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- 16 See Howse *et al.*, *op. cit.*
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- 18 *Ibid.*
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- 23 The US effort to put services on the international trade agenda began to take shape in the OECD Trade Committee at the end of the 1970s. As early as the Autumn 1982 GATT Ministerial Meeting, the USA was pressing for GATT-based negotiations on services. See W.J.Drake and K.Nicolaidis, 'Ideas, Interests and Institutions: "Trade in Services" and the Uruguay Round' (1992) 46 *International Organization* 45.
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- 26 B.M.Hoekman, 'Services-Related Production, Employment, Trade and Factor Movements', in Messerlin and Sauvart (eds), *op. cit.*, p. 32.
- 27 *Ibid.* This was the case for Cameroon, Chile, Colombia, Egypt, India, Kenya, Mexico, Morocco, the Philippines, Senegal, Singapore, South Korea, Sudan, Tanzania and Thailand.
- 28 A.Mattoo and S.Wunsch, 'Securing Openness of Cross-Border Trade in Services: A Possible Approach', World Bank, Washington DC, December 2003, pp. 5–6, 8.
- 29 For a brief explanation of the purported conceptual basis of this distinction, see 'The nature of services' (this chapter).
- 30 See Howse *et al.*, *op. cit.* See also R.Howse, 'Reform, Retrenchment or Revolution? The Shift to Incentives and the Future of the Regulatory State' (1993) 31 *Alberta Law Review* 455; and R.Daniels and R.Howse, 'Reforming the Reform Process: A Critical Analysis of Privatization Proposals in Central and East Europe' (1992) 25 *New York University Journal of International Law and Politics* 27.
- 31 See Marconini, *op. cit.*, pp. 20–1.
- 32 Feketekuty *op. cit.*
- 33 It should be noted that some Members have, pursuant to the Understanding on Commitments in Financial Services, already inscribed in their schedules commitments to permit temporary entry of certain specialized personnel in connection with the provision of financial services.
- 34 That is, applicable even in the absence of specific multilateral disciplines based on the criteria, as contemplated in Article VI:4.
- 35 Since the National Treatment obligation applies only to sectors subject to specific commitments in Members' schedules, it appears in Part III of the GATS, to be discussed in the next section.
- 36 B.Hoekman, 'Assessing the General Agreement on Trade in Services', in L.Martin and A.Winters (eds) *The Uruguay Round and Developing Countries* (Cambridge: Cambridge University Press, 1996) pp. 88–124.
- 37 *Ibid.*, p. 105.
- 38 P.Sauve, 'Assessing the General Agreement on Trade in Services: Half-Full or Half-Empty?' (1996) 29 *Journal of World Trade* 125 at p. 142.
- 39 Note on Scheduling Limitations to National Treatment.
- 40 *Canada—Certain Measures Concerning Periodicals*, WTO Doc. WT/DS31/AB/R of 30 June 1997.
- 41 *EC—Regime for the Importation, Sale and Distribution of Bananas*, WTO Doc. WT/DS27/AB/R of 9 September 1997.
- 42 Guidelines and Procedures for the Negotiations on Trade in Services, S/L/93.
- 43 See the authoritative study by Markus Krajewski, 'Public Services and Trade Liberalization Mapping the Legal Framework' (2003) *Journal of International Economic Law*.
- 44 See, in general, M.Kennett, J.Neumann and E.Tuerk, 'Second-Guessing National Level Policy Choices: Necessity, Proportionality and Balance in the WTO Services Negotiations', Center for International Environmental Law, Geneva, August 2003.

- 45 WTO Secretariat, 'GATS Fact and Fiction', Geneva, 2002.
- 46 This issue is discussed *in extenso* by Krajewski, *op. cit.*
- 47 International Centre for Trade and Sustainable Development, 'Trade in Services' (2003) 2:3 *Doha Round Briefing Series* 3.
- 48 See 'ICTSD Roundtable on Trade in Services and Sustainable Development: Towards Pro-Sustainable Development Rules for Subsidies in Trade in Services: Synthesis Report of the Discussions of the Meeting', International Centre for Trade and Sustainable Development, Geneva, 10 March 2003.
- 49 International Centre for Trade and Sustainable Development, 'Services Council Approves Modalities for Autonomous Liberalisation' (13 March 2003) 6:9 *Bridges*.
- 50 See M.Masayekhi and M.Juisaint, 'Assessment of Trade in Services in the Context of the GATS 2000 Negotiations', Working Paper No. 13, South Centre, London, December 2002.
- 51 S.Chaudhuri, A.Mattoo and R.Self, 'Liberalizing Mode 4: A Possible Approach', World Bank, December 2003.
- 52 Organization for Economic Cooperation and Development, Code of Liberalisation of Capital Movements, November 1990.
- 53 See P.A.Messerlin, 'The European Community', in Messerlin and Sauvart (eds), *op. cit.*, pp. 132–49.
- 54 'Large risk' commercial insurance. Messerlin, *ibid.*, p. 147.
- 55 T.Kim, *International Money and Banking* (London: Routledge, 1993) pp. 318–21. The following discussion draws extensively on Ch. 14 of this work, 'The EC Framework for Banking Services'.
- 56 See G.Hufbauer, 'An Overview', in G.Hufbauer (ed.) *Europe 1992: An American Perspective* (Washington DC: Brookings Institution, 1990).
- 57 Second Council Directive of 15 December 1989 on the Co-ordination of Laws, Regulations and Administrative Provisions Relating to the Taking Up and Pursuit of the Business of Credit Institutions and Amending Directive 77/80/EEC.
- 58 Kim, *op. cit.*, p. 319.
- 59 The following discussion of banking regulation in Canada and the USA draws on J.F.Chant, 'Free Trade in the Financial Sector: Expectations and Experience', Centre for International Studies/Fraser Institute Conference, 'How is Free Trade Progressing?', University of Toronto, 18–19 November 1991.
- 60 A clear and comprehensive presentation of Mexico's commitments under the financial services chapter of NAFTA is to be found in B.Gonzalez-Hermosillo and P.Sauvé, 'Financial Services and NAFTA: Implications for Canadian Financial Institutions', paper presented at Conference on NAFTA, C.D.Howe Institute, Toronto, 5–6 December 1992.
- 61 'Negotiators Clear Path to GATT Pact by Sweeping Away Remaining Differences' (1993) 10 *International Trade Reporter* 2106 (15 December 1993) at p. 2107.
- 62 World Trade Organization, 'The Results of the Financial Services Negotiations under the General Agreement on Trade in Services (GATS)', available online at <http://www.wto.org/wto/>
- 63 'Non-attributable Summary of the Main Improvements in the New Financial Services Commitments', 26 February 1997, available online at www.wto.org/english/news_e/news98_e/finsum.htm.
- 64 *Ibid.*, p. 51.
- 65 M.Kono, P.Low, M.Luanga, A.Mattoo, M.Oshikawa and L.Schuknecht, *Opening Markets in Financial Services and the Role of the GATS* (Geneva: World Trade Organization, 1997) pp. 23–35.
- 66 Some of these proposals are summarized and discussed in R.Haas and R.Litan, 'Globalization and its Discontents' (1998) 77 *Foreign Affairs* 2, and in 'Towards a New Financial System', *The Economist*, 11 April 1998, pp. 52–4.

- 67 The Honourable Paul Martin, 'Statement Prepared for the Interim Committee of the International Monetary Fund', 16 April 1998.
- 68 P.Sauve and K.Steinfaß, 'Financial Services and the WTO: What Next?', in *GATS 2000* (Washington DC: Brookings Institution, 2002) pp. 359–60.
- 69 Nico Valckx, 'WTO Financial Services Commitments: Determinants and Impact on Financial Stability', International Monetary Fund, June 2002.
- 70 S.Globerman, H.N.Janisch, R.J.Schultz and W.T.Stanbury, 'Canada and the Movement towards Liberalization of the International Telecommunications Regime', in A.C.Cutler and M.W.Zacher (eds) *Canadian Foreign Policy and International Economic Regimes* (Vancouver: UBC Press, 1992) pp. 262–4.
- 71 J.Aronson, 'Telecom Agreement Tops Expectations', unpublished manuscript, School of International Relations, University of Southern California, 1997.
- 72 *Ibid.*, p. 6.
- 73 M.Bronckers and P.Larouche, 'Telecommunications Services and the World Trade Organization' (1997) *Journal of World Trade*, pp. 21–2.
- 74 Damien Neven and Joseph Weiler, work in progress.
- 75 Ellen Gould "Panel Strips WTO of Another Fig Leaf," Briefing Paper, Candian Center for Policy Alternatives, July 2004.
- 76 James Hodge, 'WTO Telecommunications Negotiations: How Should the SADC Countries Respond?', SATRN, No. 2, Cape Town, January 2003, p. 1.
- 77 Howse *et al.*, *op. cit.*

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Trade-related intellectual property (TRIPs)

- 1 See R.A.Epstein, *Takings: Private Property and the Power of Eminent Domain* (Cambridge MA: Harvard University Press, 1985), and R.Nozick, *Anarchy, State and Utopia* (New York: Basic Books, 1974).
- 2 For an excellent discussion about the centrality and limits of the idea of private property in liberal democratic theory, in the American context, see J.Nedelsky, *Private Property and the Limits of American Constitutionalism* (Chicago: University of Chicago Press, 1990) pp. 216–64.
- 3 See the discussion of monopoly power and coercion in M.J.Trebilcock, *The Limits of Freedom of Contract* (Cambridge MA: Harvard University Press, 1993) Ch. 4.
- 4 A good survey is to be found in C.Primo Braga, 'Guidance from Economic Theory', in W.E.Siebeck (ed.) *Strengthening Protection of Intellectual Property in Developing Countries: A Survey of the Literature* (Washington DC: World Bank, 1990).
- 5 *Ibid.*, p. 22.
- 6 William Landes and Richard Posner, *The Economic Structure of Intellectual Property Law* (Cambridge MA: Harvard/Belknap, 2003) pp. 320–4.
- 7 See C.Primo Braga, 'The Developing Country Case For and Against Intellectual Property Protection', in Siebeck (ed.), *op. cit.*, pp. 77–8.
- 8 A.Deardorff, 'Should Patent Protection be Extended to all Developing Countries?' (1990) 13 *World Economy* 497.
- 9 Everson suggests that, with respect to developing countries, 'the literature does not show strong correlations between direct foreign investment and the strength of IPRs'. 'Global Intellectual Property Rights Issues in Perspective', in M.B.Wallerstein, M.E.Mogee and R.A.Schoen (eds) *Global Dimensions of Intellectual Property Rights* (Washington DC: National Academy Press, 1993) p. 366.

- 10 Binley challenges the link between strong intellectual property protection and higher levels of foreign investment. She notes: 'Korea benefited from technology transfer in numerous industries via licensing arrangements, sub-contracting agreements and the location of foreign subsidiaries during a period in which its intellectual property laws were as weak as any of the other LDCs'. M.Binley, 'Intellectual Property Rights: A Strategic Instrument of Developing Nations', International Business and Trade Law Programme, Working Paper No. 46, Faculty of Law, University of Toronto, 1992, p. 25.
- 11 See L.Davis, 'Technology Intensity of US, Canadian and Japanese Manufactures Output and Exports', in J.Niosi (ed.) *Technology and National Competitiveness* (Kingston and Montreal: McGill-Queens, 1991).
- 12 See M.Borrus, 'Macroeconomic Perspectives on the Use of Intellectual Property Rights in Japan's Economic Performance', in F.Rushing and C.Brown (eds) *Intellectual Property Rights in Science, Technology and Economic Performance: International Comparisons* (Washington DC: US Chamber of Commerce, 1990) pp. 261–7.
- 13 See J.Niosi, *Canada's Multinationals*, trans. R.Chodos (Toronto: Between the Lines, 1983).
- 14 Deardorff, *op. cit.*, p. 497.
- 15 K.Maskus, 'Normative Concerns in the International Protection of Intellectual Property Rights' (1991) 14 *World Economy* 403.
- 16 G.Grossman and E.Helpman, *Innovation and Growth in the Global Economy* (Cambridge MA: MIT Press, 1991) Ch. 11, 'Imitation'.
- 17 For a good discussion of this controversy, see J.H.Jackson, 'Remarks of Professor John H. Jackson' (1989) 22 *Vanderbilt Journal of Transnational Law*, pp. 343–4.
- 18 This case is discussed more extensively below.
- 19 Paris Convention for the Protection of Industrial Property, 20 March 1883, 828 U.N.T.S. 107.
- 20 Commission of the European Communities, *Green Paper on Copyright and the Challenge of Technology: Copyright Issues Requiring Immediate Attention* (Brussels: European Commission, 1988) p. 233 [hereinafter *EC Green Paper*].
- 21 Some commentators, however, read an MFN principle into the National Treatment obligation on the basis of the history and general purposes of the Convention. See, for instance, J.Reichman, 'Intellectual Property in International Trade: Opportunities and Risks of a GATT Connection' (1989) 22 *Vanderbilt Journal of Transnational Law* 747 at pp. 843–53.
- 22 W.Lesser, 'An Overview of Intellectual Property Systems', in Siebeck (ed.), *op. cit.*, p. 11.
- 23 M.Borrus, 'Macroeconomic Perspectives on the Use of Intellectual Property Rights in Japan's Economic Performance', in F.Rushing and C.Brown (eds) *Intellectual Property Rights in Science, Technology and Economic Performance: International Comparisons* (Washington DC: US Chamber of Commerce, 1990) p. 267.
- 24 Primo Braga, 'The Developing Country Case For and Against Intellectual Property Protection', in Siebeck (ed.), *op. cit.*, p. 75.
- 25 Berne Convention for the Protection of Industrial Property, 20 March 1883, 828 U.N.T.S. 107.
- 26 An exhaustive study of the evolution and contents of the Berne Convention is S.Ricketson, *The Berne Convention for the Protection of Literary and Artistic Works: 1886–1986* (London: Kluwer, 1986). The following section owes much to this work.
- 27 Hence, 'The expression "literary and artistic works" shall include every production in the literary, scientific and artistic domain, whatever may be the mode or form of its expression' (Article 2(1)).
- 28 See *EC Green Paper*, see also D.Llewellyn, 'Computers, Software and International Protection' (1986) 11 *VLA Journal of Law and the Arts* 183.
- 29 T.Stewart, 'Trade-Related Aspects of Intellectual Property Rights', in T.Stewart (ed.) *The Uruguay Round: A Negotiating History*, vol. III (Boston: Kluwer, 1994) pp. 2247–8.

- 30 Convention Establishing the World Intellectual Property Organization, 14 July 1967, 828 U.N.T.S. 3.
- 31 See E.Wolfhard, 'International Trade in Intellectual Property: The Emerging GATT Regime' (1991) 49 *University of Toronto Faculty Law Review* 106. See also F.-K.Beier and G.Schricker (eds), *GATT or WIPO? New Ways in the Protection of Intellectual Property* (VCH: Weinheim, 1989).
- 32 International Convention for the Protection of Performers, Procurers of Phonograms and Broadcasting Organizations, 26 October 1961, 495-6 U.N.T.S. 44.
- 33 For a discussion of the rationale for the protection of intellectual property rights in the genetic material of plants, see R.L.Margulies, 'Protecting Biodiversity: Recognizing International Intellectual Property Rights in Plant Genetic Resources' (1993) 14 *Michigan Journal of International Law* 322.
- 34 World Intellectual Property Organization: Treaty on Intellectual Property in Respect of Integrated Circuits, 26 May 1989, 28 I.L.M. 1477 (1989).
- 35 According to Goldberg, 'Chief among the problems that the United States found with the Washington Treaty were the inadequate terms of protection, the lack of specific protection for mask works incorporated in a finished product, broad provisions for compulsory licenses and excessively permissive treatment of so-called innocent infringers.' M.D.Goldberg, 'Semiconductor Chip Protection as a Case Study', in Wallerstein *et al.* (eds), *op. cit.*, pp. 335-6.
- 36 But see W.Lesser, 'An Overview of Intellectual Property Systems', in Siebeck (ed.), *op. cit.* WIPO has an extensive website where the texts of and detailed information about these agreements and their administration can be found: <http://www.wipo.int/>
- 37 See the discussion of US aggressive unilateralism in Chapter 9.
- 38 See VanGrasstek Communications, 'Trade-Related Intellectual Property Rights: Developing Countries and the Uruguay Round', in United Nations Conference on Trade and Development, *Uruguay Round: Further Papers on Selected Issues* (New York: United Nations, 1990) pp. 79-128.
- 39 Peter Drahos and John Braithwaite, *Information Feudalism: Who Owns the Knowledge Economy?* (New York: New Press, 2003) pp. 106-7.
- 40 GATT, *United States—Section 337 of the Tariff Act of 1930*, L 6439 (16 January 1989).
- 41 See VanGrasstek Communications, *op. cit.*, pp. 103-4.
- 42 The instrument does not appear, however, to specify explicitly the nature or level of the retaliation contemplated.
- 43 See J.Bourgeois and C.Laurent, 'Le "nouvel instrument de la politique commerciale": un pas en avant vers l'élimination des obstacles aux échanges internationaux', *Revue trimestrielle de droit européen* (January-March 1985).
- 44 EC *Green Paper*, *op. cit.*, p. 235.
- 45 W.Brueckmann, 'Intellectual Property Protection in the European Community', in Rushing and Brown (eds), *op. cit.*, pp. 291-310.
- 46 As Stewart notes, the Conventions and WIPO offer the possibility of accepting the jurisdiction of the International Court of Justice with respect to settlement of disputes, and WIPO itself has attempted to achieve some dispute settlement through the appointment of special informal committees of experts to address particular disagreements about the functioning of the Conventions. T.Stewart, 'Trade-Related Aspects of Intellectual Property Rights', in Stewart (ed.), *op. cit.*, pp. 2247-8.
- 47 Primo Braga, 'The Developing Country Case For and Against Intellectual Property Protection', in Siebeck (ed.), *op. cit.*, pp. 73-5.
- 48 Indeed, extensive written reasons for a judicial decision are atypical of most legal systems in the world, which are based on the civilian approach to the role of courts in decision-making. The court is viewed as applying rules in a code and not as making law from case to case.

- 49 See G.B.Rathmann, 'Biotechnology Case Study', in Wallerstein *et al.* (eds), *op. cit.*, pp. 319ff.
- 50 See W.Lesser, 'Seeds and Plants', in Siebeck (ed.), *op. cit.*, pp. 65–8.
- 51 United Nations Environmental Programme, Framework Convention on Biodiversity, 5 June 1992, Articles 15(1) and 16(2). The United States refused to sign the Convention. See Margulies, *op. cit.*, pp. 333–4.
- 52 These are discussed above.
- 53 See P.Samuels, 'A Case Study on Computer Programs', in Wallerstein *et al.* (eds), *op. cit.*, pp. 309–18.
- 54 An example would be a mark deemed obscene or associated with racial or religious hatred.
- 55 For a discussion of the nature of these exemptions and some concrete examples to which they might apply, see International Bureau of Intellectual Property, *The Paris Convention for the Protection of Intellectual Property from 1883 to 1983* (Geneva: WIPO, 1983) pp. 41–5.
- 56 See the above discussion of the Canada-USA FTA.
- 57 For instance, the Convention permits member states to make exceptions to protection with regard to private and some journalistic use of recorded material, as well as use for purposes of teaching and scientific research (Article 15).
- 58 See, on these concerns, Stewart (ed.), *op. cit.*, pp. 2299–30.
- 59 See C.M.Correa, *Integrated Circuits: Trends in Intellectual Property Protection*, United Nations Industrial Development Organization (UNIDO) Doc. IPCT, 24 October 1989, pp. 21–3.
- 60 There are certain differences of wording between the Washington Treaty provisions and the applicable TRIPs Agreement provisions, but they are not major. For instance, where the TRIPs Agreement requires that 'adequate' remuneration be paid for a compulsory licence, the Washington Treaty uses the expression 'equitable remuneration' (compare TRIPs Agreement, Article 31(h) and Washington Treaty, Article 6.3(a)).
- 61 Some adjustment costs may occur in developed countries as well where the Agreement requires extending protection (e.g. in the generic drug industry in Canada). However, no transitional or adjustment provision is available to them.
- 62 R.Eisenberg, 'Patents and the Progress of Science: Exclusive Rights and Experimental Use' (1989) 56 *University of Chicago Law Review* 1017.
- 63 Drahos and Braithwaite, *op. cit.*, pp. 7–8.
- 64 Carlos Correa, 'Access to Drugs under TRIPS: A Not So Expeditious Solution', *Bridges*, International Centre for Trade and Sustainable Development, January 2004, p. 21.
- 65 See R.M.Sherwood, 'Intellectual Property and Free Trade in North America', unpublished paper, Centre for International Studies/Fraser Institute Conference, University of Toronto, 18–19 November 1991.
- 66 See J.Dillon, 'Intellectual Property', in *Analysis of NAFTA Proposals and the Impact on Canada* (Toronto: Ecumenical Coalition for Economic Justice, 1992).
- 67 Document IP/C/2, November 1995.
- 68 Document IP/C/3, November 1995.
- 69 World Trade Organization, Council for Trade-Related Aspects of Intellectual Rights, *Annual Report (1997) of the Council for TRIPS*, 28 November 1997, IP/C/12, p. 5.
- 70 World Intellectual Property Organization Provisional Treaty on Protection of Literary and Artistic Works (1996).
- 71 Basic Proposal for the Substantive Provisions of the Treaty on Intellectual Property in Respect of Databases, WIPO Document CRNR/DC/6 (1996).
- 72 J.Boyle, 'A Politics of Intellectual Property: Environmentalism for the Net?' (1997) 47 *Duke Law Journal* 87 at pp. 101–2.
- 73 CRNR/DC/95 (20 December 1996).
- 74 See R.F.Martin, 'The WIPO Performances and Phonograms Treaty: Will the U.S. Whistle a New Tune?' (1997) 44 *Journal of the Copyright Society of America* 157.

- 75 M.Bacchetta, P.Low, A.Mattoo, L.Schuknecht, H.Wager and M.Wehtens, *Electronic Commerce and the Role of the WTO* (Geneva: World Trade Organization, 1998) p. 62.
- 76 United States Trade Representative, Press Release, 'Trade Preferences for Honduras Suspended', 30 March 1998, citing 'widespread, blatant copyright piracy'.
- 77 R.Pechman, 'Seeking Multilateral Protection for Intellectual Property: The United States "TRIPs" over Special 301' (1998) 7 *Minnesota Journal of Global Trade* 179 at pp. 202–4.
- 78 Bacchetta *et al.*, *op. cit.*, p. 64.
- 79 Keith Maskus, 'TRIPs: The Key Issues', in *The World Trade Brief* (London: Agenda Publishing, 2003) p. 67.
- 80 'Environment and TRIPs', WT/CTE/W/8 (8 June 1995), paras 76–8.
- 81 'Intellectual Property Rights: Doha Round Briefing Series', International Institute for Sustainable Development and International Centre for Trade and Sustainable Development, Geneva, February 2003, p. 4.
- 82 See Kal Raustiala and David G.Victor, 'The Regime Complex for Plant Genetic Resources' (2004) 58 *International Organization* 277, and R.Lettington and K.Nnadozie, A Review of the Intergovernmental Committee on Genetic Resources, Traditional Knowledge and Folklore at WIPO', Occasional Paper No. 12, South Centre, London, December 2003.
- 83 UNCTAD-ICTSD Project on IPRs and Sustainable Development, *Intellectual Property Rights: Implications for Development* (Geneva: ICTSD and UNCTAD, 2003) Ch. 8.

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Trade and investment

- 1 N.Grimwade, *International Trade: New Patterns of Trade, Production and Investment* (London: Routledge, 1989) p. 144.
- 2 T.Stewart, 'Trade-related Investment Measures', in T.Stewart (ed.) *The GATT Uruguay Round: A Negotiating History* (Boston: Kluwer, 1994) p. 2003.
- 3 UNCTAD Investment Report, 1998.
- 4 UNCTAD Investment Report, 2002.
- 5 UNCTAD, PRESS/PR/2004/001, 12 January 2004.
- 6 See E.Graham and M.Ebert, 'Foreign Direct Investment and U.S. National Security: Fixing Exon-Florio' (1991) 14 *World Economy* IP. 245; see also R.Kuttner, *The End of Laissez-Faire: National Purpose and the Global Economy After the Cold War* (New York: Knopf, 1991).
- 7 See S.Ostry, 'Globalization, Domestic Policies and the Need for Harmonization', Centre for the Study of Business and Public Policy, University of California (Santa Barbara), January 1993, pp. 12–18.
- 8 S.Strange, *States and Markets* (Cordar: Pinter, 1988).
- 9 See A.Rugman, *Inside the Multinational: The Economics of Internal Markets* (New York: Columbia University Press, 1981).
- 10 Recent empirical evidence, surveyed by Jenkins, suggests that a major effect of foreign direct investment in many sectors in developing countries is to make local enterprises more competitive, rather than making them fail for inability to compete with multinationals. In some instances, competition may have resulted in domestic enterprises adopting practices that were arguably regressive or distributively unjust—i.e. with respect to labour and employment practices. Here, foreign investment itself could hardly be considered the root problem as opposed to inadequate labour or other social regulation to which both multinationals and domestic firms operating in the jurisdiction would be subject. See R.Jenkins, 'The Impact of Foreign Investment on Less Developed Countries: Cross-Section

- Analysis versus Industry Studies', in P. Buckley and J. Clegg (eds) *Multinational Enterprise in Less-Developed Countries* (London: Macmillan, 1991) especially pp. 123–30.
- 11 See A. J. Easson, 'The Design of Tax Incentives for Direct Investment: Some Lessons from the ASEAN Countries', International Business and Trade Law Programme, University of Toronto, 1993.
 - 12 OECD, *Investment Incentives and Disincentives* (Paris: OECD, 1989).
 - 13 See, especially, D. Greenaway, 'Why Are We Negotiating on TRIMs?', in D. Greenaway, R. C. Hine, A. P. O'Brien and R. J. Thornton (eds) *Global Protectionism* (London: Macmillan, 1991).
 - 14 For a discussion of the rationale for singling out export subsidies and its dubious merits, see Chapter 9.
 - 15 See A. Barnea, R. Haughen and W. Senbet, 'Market Imperfections, Agency Problems, and Capital Structure: A Review' (1981) 10 *Financial Management*, Summer. See also R. Caves, *Multinational Enterprise and Economic Analysis* (New York: Cambridge University Press, 1982). Gilpin notes that the application of the theory of the firm to explain foreign investment is relatively recent; before the 1980s, explanations of foreign investment depended upon assumptions about oligopolistic competition or invoked the 'product cycle' theory of production (according to which countries at different levels of development have a comparative advantage at different stages in the life history of a product, from research and invention downwards to standardized mass production). R. Gilpin, *The Political Economy of International Relations* (Princeton NJ: Princeton University Press, 1987) p. 237. However, foreign investment has increasingly occurred in sectors not characterized by oligopolistic competition, and the 'product cycle' theory cannot explain the existence of increasing foreign investment flows from developed countries to other developed countries.
 - 16 Grimwade, *op. cit.*, pp. 178–92.
 - 17 On the globalization of production through increasing use of international external contracting mechanisms such as subcontracting, licensing and inter-firm agreements, see OECD, *Globalisation of Industrial Activities: Four Case Studies: Auto Parts, Chemicals, Construction and Semiconductors* (Paris: OECD, 1993).
 - 18 P. Nicolaides, 'Investment Policies in an Integrated World Economy' (1992) 15 *World Economy* 123.
 - 19 Although, of course, where a firm decided to choose the instrument of foreign direct investment, it may encounter substantial agency costs in enforcing the various internal contracts in the jurisdiction in which it invests. The problem of the security of investors' assets and of expropriation will be discussed briefly later in this chapter.
 - 20 See Grimwade, *op. cit.*, pp. 170–3.
 - 21 R. Gilpin, *Global Political Economy: Understanding the International Economic Order* (Princeton: Princeton University Press, 2001) p. 284.
 - 22 K. Maskus, 'Encouraging International Technology Transfer', UNCTAD and ICTSD, Geneva, 2003.
 - 23 J. Dunning, *Explaining International Production* (London: Unwin Hyman, 1988) especially ch. 2, 'The Eclectic Paradigm of International Production: A Restatement and Some Possible Extensions'. See also Dunning, *Multinationals, Technology and Competitiveness* (London: Unwin Hyman, 1988).
 - 24 M. Porter, *The Competitive Advantage of Nations* (New York: Free Press, 1990).
 - 25 Transfer prices are the prices at which the firm buys and sells goods and services from and to itself.
 - 26 See, for instance, J. Knubley, W. Krause and Z. Sadeque, 'Canadian Acquisitions Abroad: Patterns and Motivations', in L. Waver man (ed.) *Corporate Globalization through Mergers and Acquisitions* (Calgary: University of Calgary Press, 1991).
 - 27 In general, recent economic literature seems to support the view that the consumer welfare losses from protection in these circumstances are likely to outweigh any gains to domestic

- welfare from rent-shifting. See A.E.Safarian, *Multinational Enterprise and Public Policy: A Study of the Industrial Countries* (Aldershot: Edward Elgar, 1993) p. 499.
- 28 See Safarian, *op. cit.*, pp. 467–70.
- 29 Indeed, Graham argues that protection-induced investment may actually result in a net loss to domestic economic development, where the foreign firm's access to a protected market reduces the pressure for it to invest in highly competitive production facilities in the host country. E.Graham, 'Strategic Trade Policy and the Multinational Enterprise in Developing Countries', in Buckley and Clegg (eds), *op. cit.*, pp. 89–91. Hence, the economic development case for protection-induced investment depends upon capturing and channelling the rents from protection into directions that are beneficial to economic development.
- 30 A clear and balanced discussion of these and related concerns about foreign investment and multinationals can be found in Gilpin, *The Political Economy of International Relations*, *op. cit.*, Ch. 6, 'Multinational Corporations and International Production'.
- 31 N.Machiavelli, *The Prince*, trans. M.Musa (New York: St. Martin's Press, 1964) Chs 6–7.
- 32 Stewart, 'Trade-related Investment Measures', *op. cit.*, pp. 2036–7. See also UN Centre on Transnational Corporations, *National Legislation and Regulations Relating to Transnational Corporations*, UN Doc. ST/CTC/91 (1989).
- 33 50 U.S.C. App. 2170(a) (1990).
- 34 Stewart, 'Trade-related Investment Measures', *op. cit.*, p. 2038.
- 35 Nance and Wasserman note, for instance, a case where US industry interests complained to the CFIUS about the sale to a West German concern of a US company involved in manufacturing raw material for semiconductors. The transaction was eventually approved, but not before the German acquirer had sent a letter of intent to the US government, undertaking, *inter alia*, to continue production in the USA for at least five years and to make its products available to the US semiconductor industry. D.S.Nance and J.Wasserman, 'Regulation of Imports and Foreign Investment in the United States on National Security Grounds' (1990) 11 *Michigan Journal of International Law* 926 at pp. 973–4. The CFIUS process is particularly suited to the exertion of pressure on foreign investors and to the striking of such deals or bargains because, as Nance and Wasserman also remark, the process is characterized by a 'complete lack of transparency': there are no hearings, there are no public submissions and there is no administrative record (p. 961).
- 36 Graham and Ebert, *op. cit.*
- 37 See, in general, A.L.C.de Mestral and T.Gruchalla-Wesierski, *Extraterritorial Application of Export Control Legislation: Canada and the United States* (Boston: Martinus Nijhoff, 1990).
- 38 See M.Leigh and P.Lichtenbaum, 'Law Without Borders: The Cuban Democracy Act of 1992' (1993) *Canadian Law Newsletter* 13.
- 39 See R.S.Whitt, 'The Politics of Procedure: An Examination of the GATT Dispute-Settlement Panel and the Article XXI Defense in the Context of the U.S. Embargo of Nicaragua' (1987) 19 *Law and Policy in International Business* 63.
- 40 See J.G.Castel, A.L.C.de Mestral and W.C.Graham, *International Business Transactions and Economic Relations* (Toronto: Carswell, 1991) Ch.10, 'Extraterritorial Application of Canadian and Foreign Laws Prohibiting Restrictive Business Practices'.
- 41 OECD, *Decision of the Council: Conflicting Requirements* (Paris: OECD, June 1991).
- 42 See Chapter 18 on trade and competition policy.
- 43 For a discussion of these various options, see N.Campbell and M.Trebilcock, 'International Merger Review: Problems of Multi-Jurisdictional Conflict', in E.Kautzenbach, H.-E.Scharrer and L.Waverman (eds) *Competition Policy in an Interdependent World Economy* (Baden-Baden: Nomos Verlagsgesellschaft, 1993); see also Chapter 18 of the present volume. For a somewhat more sceptical view of the possibility of establishing common rules to govern these inter-jurisdictional disputes, see S.Ostry, 'Globalization, Domestic Policies

- and the Need for Harmonization', Competition Policy in a Global Economy Project, University of California (Santa Barbara), January 1993 (unpublished).
- 44 These and related concerns are summarized and discussed in M.J. Trebilcock, *Public Enterprises in Papua New Guinea* (Port Moresby: Institute of National Affairs, 1982).
- 45 See, generally, for recent work, Buckley and Clegg (eds), *op. cit.*
- 46 See J. Stopford and S. Strange, *Rival States, Rival Firms: Competition for World Market Shares* (Cambridge: Cambridge University Press, 1991).
- 47 B. Emmott, 'Multinationals: Back in Fashion', *The Economist*, 27 March-2 April 1993, p. 19.
- 48 N. Klein, *NO LOGO: Taking Aim at the Brand Bullies* (New York: Picador, 1999).
- 49 A. Chua, *World on Fire: How Exporting Free Market Democracy Breeds Ethnic Hatred and Global Instability* (New York: Doubleday, 2003).
- 50 *Ibid.*, pp. 278-85.
- 51 Canada: Administration of the Foreign Investment Review Act (FIRA), BISD 30S/140 (1984).
- 52 See D. Greenaway, 'Trade Related Investment Measures: Political Economy Aspects and Issues for GATT' (1992) 15 *World Economy* 375.
- 53 An exhaustive discussion of the various conflicting perspectives that emerged in the Uruguay Round TRIMs negotiations can be found in Stewart, 'Trade-related Investment Measures', *op. cit.*
- 54 Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations (MTN/FA), Geneva, 15 December 1993, II.7 Agreement on Trade-Related Investment Measures' [hereinafter Agreement on TRIMs].
- 55 *India—Measures Affecting the Automotive Sector*, Report of the Panel, WT/DS146/R (21 December 2001).
- 56 See *EC—Bananas III*, Report of the Panel, para. 7.186.
- 57 *Canada—Certain Measures Affecting the Automotive Industry*, WT/DS139/R (11 February 2000).
- 58 What follows draws heavily on work in progress on the MAI by Robert Howse and Jonathan Feldman and a brief article by Feldman and Howse, 'A Brief Critical Overview of the MAI', *Canada Watch*, Winter 1988.
- 59 M. Hart, A Multilateral Agreement on Foreign Direct Investment: Why Now?', in P. Sauve and D. Schwanen (eds) *Investment Rules for the Global Economy: Enhancing Access to Markets* (Toronto: C.D. Howe Institute, 1996) p. 82. See also the essay in the same volume by A. Rugman and M. Gestrin, 'A Conceptual Framework for a Multilateral Agreement on Investment: Learning from the NAFTA'. This volume also contains some more subtle and cautious but still positive assessments of the whole MAI project, including by the editors and Ed Graham.
- 60 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 (CMIT), OECD, Paris, May 1995.
- 61 This overview is based on the Negotiating Text as of 24 April 1998, as posted on the OECD website, <http://www.oecd.org/>
- 62 Multilateral Agreement on Investment: Report by the MAI Negotiating Group, OECD, Paris, May 1997.
- 63 T. Clarke and M. Barlow, *MAI: The Multilateral Agreement on Investment and the Threat to Canadian Sovereignty* (Toronto: Stoddart, 1997) pp. 4-5.
- 64 *Ibid.*, pp. 5-6.
- 65 Khavajjit Singh, Agenda', *Financial Times*, 7 July 2003.
- 66 P. Sauve and M. Robert, 'Investment Issues and their Interface with Service: The Road to Cancun', Pacific Economic Cooperation Council, 15th General Meeting, Brunei, 1 September 2003; and see also International Institute for Sustainable Development, 'The

Singapore Issues: Investment, Competition Policy, Transparency in Government Procurement and Trade Facilitation' (August 2003) 2:6 *Doha Round Briefing Series*.

67 See M.Gestrin and A.M.Rugman, 'The NAFTA's Impact on the North American Investment Regime' (1993) 42 *C.D.Howe Institute Commentary* 1 at p. 8.

68 There may be some difficult definitional problems as well. For instance, although public healthcare exists throughout Canada, for purposes of Canadian constitutional law, hospitals, although publicly funded and regulated, are not viewed as part of government. Therefore, an argument could be made that they are not even covered by Article 1104.1.

69 J.Johnson, *International Trade Law* (Concord: Irwin Law, 1998) p. 223.

70 See D.Schneiderman, 'NAFTA's Takings Rule: American Constitutionalism Comes to Canada' (1996) 46 *University of Toronto Law Journal* 499.

71 Johnson, *op. cit.*, p. 223, footnote 16.

72 *Ibid.*

73 The investor-state dispute settlement process in NAFTA, which is described immediately below, is based on commercial arbitration arrangements which allow for the particulars of proceedings to remain secret except by consent of both parties. Ethyl has not consented to public release of any documents in the proceedings and so accounts of this matter rely on anecdotes. This account is from Clarke and Barlow, *op. cit.*, pp. 90–1.

74 With the exception of the Treaty of Rome, which is much more than a trade treaty and which may be rightly viewed as establishing the outlines of a supranational government that in many matters can act directly on individual citizens.

75 The following discussion owes much to Barry Appleton, *Navigating NAFTA*, 2nd ed., forthcoming, 'Chapter 11, Investment'; see also Chris Tollefson, 'Games Without Frontiers: Investor Claims and Citizen Submissions Under the NAFTA Regime' (2002) 27 *Yale Journal of International Law* 141.

76 The Loewen Group, Inc. v. United States of America, para. 68.

77 *Ibid.*, para. 132.

78 Mondev International Ltd v. United States of America, para. 127.

79 Annexed to OECD, Declaration on International Investment and Multinational Enterprises, Paris, 1976.

80 For a good discussion of the various codes and guidelines and their perceived impact, see R.Grosse, 'Codes of Conduct for Multinational Enterprises' (1982) 16 *Journal of World Trade Law* 414; see also M.A.Kwaw, 'Trade Related Investment Measures in the Uruguay Round: Towards a GATT for Investment?' (1991) 16 *North Carolina Journal of International Law and Commercial Regulation* 309 at pp. 315–16.

81 See OECD (Committee on International Investment and Multinational Enterprises), *The OECD Declaration and Decisions on International Investment and Multinational Enterprises: 1991 Review* (Paris: OECD, 1992) pp. 42–54. See also B.Blanpain, *The OECD Guidelines for Multinational Enterprises and Labour Relations 1982–1984: Experience and Review* (Boston: Kluwer, 1985).

82 The provisions of these Codes are discussed in the context of trade in financial services in Chapter 12 above.

83 OECD (Committee on International Investment and Multinational Enterprises), *National Treatment for Foreign-Controlled Enterprises* (Paris: OECD, 1993) p. 23.

84 OECD Council, National Treatment: Third Revised Decision of the Council (1991), Article 2(c).

85 *Ibid.*, Article 3.

86 OECD, Declaration on International Investment and Multinational Enterprises, *op. cit.*, Article II.1.

87 See P.E.Bondzi-Simpson, *The Legal Relationship Between Transnational Corporations and Host States* (New York: Quorum, 1990).

- 88 See, for example, H.W.Baade, 'The Legal Effects of Codes of Conduct for Multinational Enterprises', in N.Horn (ed.) *Legal Problems of Codes of Conduct for Multinational Enterprises* (Deventer: Kluwer, 1980) pp. 32–7.
- 89 575 U.N.T.S. 159.
- 90 On the various theories concerning the ICSID's very limited impact, see O.Unegbu, 'Dispute Settlement in International Investment: A Study of the ICSID Arbitral Regime', unpublished L.L.M. thesis, Faculty of Law, University of Toronto, 1991.
- 91 M.Hallward-Driemeier, 'Do Bilateral Investment Treaties Attract FDI? Only a Bit... And They Could Bite', World Bank, Washington DC, 2003.
- 92 *Ibid.*
- 93 See Dirk Willem te Velde and M.Fahnbulleh, 'Investment Provisions in Regional Trade Agreements', Overseas Development Institute, October 2003.
- 94 See, especially on the first point, Maskus, *op. cit.*
- 95 For creative thinking that might be a basis for such an approach, see Konrad von Moltke, A Roadmap for Cotonou Investment Negotiations', The Commonwealth Secretariat, London, April 2003.

15

Trade and developing countries

- 1 There is no GATT or WTO definition of developed or developing country, and developing-country status is determined primarily by self-selection. The WTO recognizes as least-developed countries (LDCs) those countries recognized as such by the UN. There are currently 49 LDCs. See <http://www.unctad.org/>
- 2 Constantine Michalopoulos, *Developing Countries in the WTO* (New York: Palgrave, 2001) pp. 7–16, cited in Mitsuo Matsushita, Thomas J.Schoenbaum and Petros C.Mavroidis, *The World Trade Organization: Law, Practice, and Policy* (New York: Oxford University Press, 2003) p. 373.
- 3 These were Burma, Ceylon, Chile, Cuba, India, Pakistan, Southern Rhodesia, South Africa and Syria.
- 4 R.Hudec, *Developing Countries in the GATT Legal System* (London: Gower, 1987) [hereinafter *Developing Countries*].
- 5 See B.Balassa, 'The Importance of Trade for Developing Countries', in *New Directions in the World Economy* (New York: NYU Press, 1989) p. 17 [hereinafter *New Directions*].
- 6 See J.Whalley (ed.), *The Uruguay Round and Beyond: The Final Report from the Ford Foundation Project on Developing Countries in the Global Trading System* (Ann Arbor: University of Michigan Press, 1989).
- 7 See Balassa, *op. cit.*
- 8 See R.Gilpin, *The Political Economy of International Relations* (Princeton NJ: Princeton University Press, 1987) pp. 298–302.
- 9 See, in general, M.Kelly and A.K.McGuirk *et al.*, *Issues and Developments in International Trade Policy* (Washington DC: International Monetary Fund, 1992) pp. 41–3.
- 10 See, for example, E.Fukuyama, *The End of History and the Last Man* (New York: Free Press, 1992) pp. 98–101.
- 11 B.Balassa, 'Liberalizing Trade Between Developed and Developing Countries', in Balassa, *New Directions*, *op. cit.*, p. 360.
- 12 See Hudec, *Developing Countries*, *op. cit.*, pp. 24–5. See also OECD (Centre for Cooperation with the European Economies in Transition), *Exchange Control Policy* (Paris: OECD, 1993) pp. 11–15.

- 13 Developing countries are defined, rather generally or imprecisely, as 'contracting parties the economies of which can only support low standards of living and are in the early stages of development' (XVIII:1).
- 14 Hudec, *Developing Countries*, *op. cit.*, Ch. 2.
- 15 See Kelly and McGuirk *et al.*, *op. cit.*, Appendix I ('The GATT System', pp. 74–5).
- 16 Hudec, *Developing Countries*, *op. cit.*, Ch. 4.
- 17 See B.Balassa, 'The Extent and Cost of Protection in Developed-Developing Country Trade', in Balassa, *New Directions*, *op. cit.*
- 18 Hudec, *Developing Countries*, *op. cit.*, p. 83.
- 19 J.H.Jackson, *The World Trading System: Law and Policy of International Economic Relations* (Cambridge MA: MIT Press, 1988) p. 99.
- 20 Robert E.Hudec, 'The New WTO Dispute Settlement Procedure: An Overview of the First Three Years' (1999) 8 *Minnesota Journal of Global Trade* 1 at p. 23.
- 21 *Ibid.*, p. 24.
- 22 Marc. L.Busch and Eric Reinhardt, "Developing Countries and General Agreement on Tariffs and Trade/World Trade Organization Dispute Settlement," (2003) 37 *Journal of World Trade* 719–735.
- 23 See Jackson, *op. cit.*, pp. 278–9.
- 24 See Decision of 28 November 1979 on Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries [hereinafter referred to as the Enabling Clause].
- 25 See Lomé I (1975) 14 I.L.M. 595; Lomé II (1980) 19 I.L.M. 327; Lomé III (1985) 24 I.L.M. 571.
- 26 See J.-G.Castel, A.L.C.DeMestral and W.C.Graham, *International Business Transactions and Economic Relations* (Toronto: Emond Montgomery, 1986) p. 35.
- 27 Decision of the CONTRACTING PARTIES, Doc. L/7604 of 19 December 1994, available online at <http://docsonline.wto.org/> See also the Appellate Body report considering the status of the waiver and the Lomé preferences: *Report of the Appellate Body on the European Communities—Regime for the Importation, Sale and Distribution of Bananas*, WT/DS27/AB/R (9 September 1997), available online at <http://www.wto.org/>
- 28 See Joseph McMahon, 'The EC Banana Regime, the WTO Rulings and ACP—Fighting for Economic Survival?' (1998) 32 *Journal of World Trade* 101.
- 29 European Communities—Regime for the Importation, Sale and Distribution of Bananas, WT/DS27.
- 30 'U.S. Seeks Talks on EU Banana Regime as WTO Confirms U.S. Win', *Inside U.S. Trade*, 12 September 1997.
- 31 WTO, European Communities—Conditions of Tariff Preferences to Developing Countries: Request for the Establishment of a Panel by India, WTO Doc. WT/DS246/4 (9 December 2002).
- 32 R.Howse, 'India's WTO Challenge to Drug Enforcement Conditions in the European Community Generalized System of Preferences: A Little Known Case with Major Repercussions for "Political" Conditionality in US Trade Policy.' *Chi. J. Int'l L.* 4, no.2 (2003): 385–405.
- 33 J.H.Jackson, *The World Trading System* (Cambridge MA: MIT Press, 2nd ed., 1997) p. 324 [hereinafter *World Trading System* 2].
- 34 Trade and Tariff Act of 1984, Section 505(b).
- 35 See R.E.Moore, 'The Level of Development and GSP Treatment' (1992) 26 *Journal of World Trade* 21.
- 36 R.I.Meltzer, 'U.S.Renewal of the GSP' (1986) 20 *Journal of World Trade Law* 507.
- 37 See Jackson, *World Trading System* 2, *op. cit.*, p. 325.
- 38 With respect to textiles, see the discussion below on the MFA.

- 39 B.Balassa, 'Liberalizing Trade Between Developed and Developing Countries', in Balassa, *New Directions*, *op. cit.*, p. 359.
- 40 See Kelly and McGuirk *et al.*, *op. cit.*, Table A11 in Statistical Appendix.
- 41 For a recent critique of the benefits of the GSP system to developing countries, see C.Ozden and E.Reinhardt, 'The Perversity of Preferences: GSP and Developing Country Trade Policies, 1976–2000', World Bank Working Paper, 13 January 2003. Available online at http://econ.worldbank.org/files/23188_wps2955.pdf.
- 42 B.Balassa, 'The Extent and Cost of Protection in Developed—Developing Country Trade', in Balassa, *New Directions*, *op. cit.*, p. 335.
- 43 See M.Wolf, 'Managed Trade in Practice: Implications of the Textile Arrangements', in W.R.Cline (ed.) *Trade Policy in the 1980s* (Washington DC: Institute for International Economics, 1983) pp. 457–9.
- 44 See Jackson, *World Trading System 2*, *op. cit.*, p. 207.
- 45 See Wolf, *op. cit.*, p. 457.
- 46 The nature of these competitive pressures and the costs and benefits to the restricting countries of import controls in the textile and clothing sectors are analysed in M.J.Trebilcock, M.A.Chandler and R.Howse, *Trade and Transitions: A Comparative Analysis of Adjustment Policies* (London: Routledge, 1990) pp. 50–9.
- 47 Jackson, *World Trading System 2*, *op. cit.*, p. 181.
- 48 G.C.Dao, 'The Developing World and the Multifiber Arrangement', in J.Whalley (ed.) *Developing Countries and the Global Trading System*, vol. II (London: Macmillan, 1989) p. 85.
- 49 M.de P.Abreu and W.Fritsch, 'Market Access for Manufactured Exports from Developing Countries: Trends and Prospects', in J.Whalley (ed.) *Developing Countries and the Global Trading System*, vol. I (London: Macmillan, 1989) p. 117. These estimates are based on UNCTAD, *Protectionism and Structural Adjustment* (Geneva: UNCTAD, 1986).
- 50 UNCTAD, *op. cit.*
- 51 Dao, *op. cit.*, pp. 87–8.
- 52 See N.A.Adams, *Worlds Apart: The North South Divide and the International System* (Atlantic Highlands NJ: Zed, 1993) especially Chs 4–5.
- 53 See A.O.Krueger, 'Trade Policy and Economic Development: How We Learn' (1997) 87 *American Economic Review* 1.
- 54 Hudec, *Developing Countries*, *op. cit.*, pp. 39–40.
- 55 See, particularly, *Charter of Economic Rights and Duties of States*, U.N.G.A. Res. 3281 (XXIX) (1974).
- 56 See M.Agarwal, 'South—South Trade: Building Block or Bargaining Chip?', in Whalley (ed.), *op. cit.*, pp. 196–9.
- 57 R.E.Hudec, 'The Structure of South-South Trade Preferences in the 1988 GSTP Agreement: Learning to Say MFMFN', in Whalley (ed.), *op. cit.*, p. 211.
- 58 *Ibid.*, pp. 213–14.
- 59 *Ibid.*, pp. 223–9. Space does not permit a discussion of the law of these regional South-South arrangements in this chapter. They include CARICOM (the Caribbean), the Latin American Free Trade Area, the East African Community, the West African Economic Community and the Arab Common Market. For a survey of these arrangements and a detailed bibliography, see Agarwal, *op. cit.* In general, they account only for a small percentage of the total trade of the member countries. This limited potential for South-South economic integration may reflect similarity of endowments among many of the countries concerned.
- 60 See H.D.B.H.Gunasekera, D.Parsons and M.G.Kirby, 'Liberalizing Agricultural Trade: Some Perspectives for Developing Countries', in Whalley (ed.), *op. cit.*, pp. 253–4.
- 61 T.A.Oyejide, 'Primary Commodities in the International Trading System', in Whalley (ed.), *op. cit.*, p. 104.
- 62 *Ibid.*, pp. 105–6.

- 63 As Ruggie notes, according to Ricardo's presentation of the theory of comparative advantage in the *Principles of Political Economy and Taxation*, 'specialization entailed no important dynamic implications for growth or development, but simply provided static gains from trade that made both parties better off than they would be in its absence'. J.G.Ruggie, 'Introduction: International Interdependence and National Welfare', in Ruggie (ed.) *The Antinomies of Interdependence: National Welfare and the International Division of Labor* (New York: Columbia University Press, 1983) p. 6. The neo-classical trade theorists launched their analysis from this account of comparative advantage, with little attention to other work of Ricardo and his fellow classical political economists, that emphasized dynamic effects of trade liberalization. See R.Findlay, 'Growth and Development in Trade Models', in P.B.Kenen and R.W.Jones (eds) *Handbook of International Economics* (Amsterdam: North-Holland, 1984). Milner, as well, emphasizes renewed attention to the work of the classical political economists on the dynamics of growth and development. C.Milner, 'Trade Strategies and Economic Development: Theory and Evidence', in D.Greenaway (ed.) *Economic Development and International Trade* (London: Macmillan, 1988) pp. 64–5.
- 64 See, for example, G.M.Grossman and E.Helpman, *Innovation and Growth in the Global Economy* (Cambridge MA: MIT Press, 1991).
- 65 See Gilpin, *op. cit.*, pp. 270–90.
- 66 R.Vernon, 'International Investment and International Trade in the Product Cycle' (1966) 80 *Quarterly Journal of Economics* 190.
- 67 Grossman and Helpman, *op. cit.*, p. 310.
- 68 See Kelly and McGuirk *et al.*, *op. cit.*, p. 404.
- 69 See A.O.Krueger, *Trade Policies and Developing Nations* (Washington DC: Brookings Institution, 1995) [hereinafter *Trade Policies*].
- 70 For a more recent elaboration of the theory, see P.Evans, *Dependent Development: The Alliance of Multinational, State and Local Capital in Brazil* (Princeton: Princeton University Press, 1979).
- 71 See particularly the 1974 UN Charter of Economic Rights and Duties of States. Article 1 states that 'Every State has the sovereign and inalienable right to choose its economic system as well as its political, social and cultural systems in accordance with the will of its people, without outside interference, coercion or threat in any form whatsoever', and Article 2(1) that 'Every State has and shall freely exercise free permanent sovereignty, including possession, use and disposal over all its wealth, natural resources and economic activities.'
- 72 For the empirical evidence, see J.Bhagwati, 'Export-Promoting Trade Strategy: Issues and Evidence', in D.Irwin (ed.) *Political Economy and International Economics* (Cambridge MA: MIT Press, 1991); B.Balassa, 'The Cambridge Group and the Developing Countries', in Balassa, *New Directions*, *op. cit.*; G.Feder, 'On Exports and Economic Growth' (1983) *Journal of Development Economics* 59; V.Thomas, K.Matin and J.Nash, *Lessons in Trade Policy Reform* (Washington DC: World Bank, 1990) p. 5.
- 73 B.Balassa, 'The Importance of Trade for Developing Countries', in Balassa, *New Directions*, *op. cit.*; Krueger, *Trade Policies*, *op. cit.*
- 74 B.Balassa, 'The Importance of Trade for Developing Countries', in Balassa, *New Directions*, *op. cit.*
- 75 J.Bhagwati, 'Export-Promoting Trade Strategy', in Irwin (ed.), *op. cit.*
- 76 *Ibid.*
- 77 See Kelly and McGuirk *et al.*, *op. cit.*, pp. 48–9.
- 78 Hong Kong is the only one of these countries that actually adopted a thoroughgoing *laissez-faire* approach. See Milner, *op. cit.*, pp. 72–3. The most dramatic contrast with Hong Kong is perhaps Korea, where systematic and pervasive industrial policy measures (including sectoral targeting) went hand in hand with liberalization of the external trade regime (i.e. tariffs and exchange rates). On the Korean case, see S.Haggard and C.-I.Moon, 'The South

- Korean State in the International Economy: Liberal Dependent, or Mercantile?', in Ruggie (ed.), *op. cit.*, pp. 147–52.
- 79 World Bank, *The East Asian Miracle: Economic Growth and Public Policy* (Oxford: Oxford University Press, 1993).
- 80 See *Canada, the International Financial Institutions and the Debt Problem of Developing Countries*, Report of the Standing Senate Committee on Foreign Affairs, Parliament of Canada, Ottawa, 1987.
- 81 Gilpin, *op. cit.*, pp. 318–19.
- 82 W.R.Rhodes, 'Third-World Debt: The Disaster That Didn't Happen', *The Economist*, 12 September 1992, pp. 21–3.
- 83 Rhodes, *op. cit.*, p. 22.
- 84 J.I. Levinson, 'A Perspective on the Debt Crisis' (1989) 4 *American University Journal of International Law and Policy* 489 at pp. 509–12.
- 85 Rhodes, *op. cit.*, p. 23.
- 86 Kelly and McGuirk *et al.*, *op. cit.*, pp. 41–7.
- 87 Thomas *et al.*, *op. cit.*, p. 17.
- 88 Very recently, however, there are some signs of a change in outlook, although less in the context of assistance to LDCs than in the context of support for the reform process in Central and Eastern Europe. Thus, the World Bank has approved a \$100 million loan for labour adjustment in Poland.
- 89 See D. Papagerogiou, A. Choksi and M. Michaeli, *Liberalizing Foreign Trade in Developing Countries: Lessons of Experience* (Washington DC: World Bank, 1990).
- 90 J. Stiglitz, *Globalization and its Discontents* (New York: W.W. Norton & Co., 2003) pp. 59–67, 73–8.
- 91 B. Balassa, 'Interests of Developing Countries in the Uruguay Round' (1988) 11 *World Economy* 50.
- 92 For detailed reviews of different features of the Uruguay Round results for developing countries, see W. Martin and L.A. Winters (eds), *The Uruguay Round and the Developing Countries* (Cambridge: Cambridge University Press, 1996) especially introductory essay by Martin and Winters.
- 93 *Ibid.*, Ch. 1.
- 94 L.A. Winters, 'The LDC Perspective', in K.A. Ingersent, A.J. Rayner and R.C. Hine (eds) *Agriculture in the Uruguay Round* (New York: St. Martin's Press, 1994) p. 159.
- 95 *Ibid.*
- 96 For descriptions and evaluations of the Uruguay Round Agreement on Textiles and Clothing, see M. Smeets, 'Main Features of the Uruguay Round Agreement on Textiles and Clothing and Implications for the Trading System' (1995) 29 *Journal of World Trade* 97; N. Blokker and J. Deelstra, 'Towards a Termination of the Multifibre Arrangement?' (1994) 28 *Journal of World Trade* 97.
- 97 *United States—Restrictions on Imports of Cotton and Man-made Fibre Underwear*, WT/DS24/AB, p. 3.
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- 99 'WTO Panel Rules Against U.S. on Shirts, Sidesteps Broader Issues', *Inside U.S. Trade*, 10 January 1997.
- 100 Judicial economy refers to, in this instance, the panel's refusal to rule on certain issues when rendered unnecessary by earlier decisions within the Panel Report.
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- 102 Dani Rodrik, 'The Global Governance of Trade as if Development Really Mattered', United Nations Development Programme, background paper for Trade and Sustainable Human Development Project, October 2001, pp. 14–15.

- 103 WTO, *Ministerial Declaration* (2001) WTO Doc. WT/MIN(01)/DEC/1 (Ministerial Conference, Fourth Session) [Doha Declaration].
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- 105 Asoke Mukerji, 'Developing Countries and the WTO: Issues of Implementation' (2000) 34 *Journal of World Trade* 33 at pp. 70–1; Peter Lichtenbaum, 'Reflections on the WTO Doha Ministerial: "Special Treatment" vs. "Equal Participation": Striking a Balance in the Doha Negotiations' (2002) 17 *American University International Law Review* 1003 at pp. 1032–3. For further context, see also Sylvia Ostry, 'The Uruguay Round North-South Bargain: Implications for Future Negotiations', in Daniel L.M.Kennedy and James D.Southwick (eds) *The Political Economy of International Trade Law: Essays in Honor of Robert E.Hudec* (Cambridge: Cambridge University Press, 2002) pp. 285–300; and J.Michael Finger, 'The Uruguay Round North-South Bargain: Will the WTO Get Over It?', in Kennedy and Southwick (eds), *op. cit.*, pp. 301–10.
- 106 WTO, *Implementation-Related Issues and Concerns* (2001) WTO Doc. WT/MIN(01)/17 (Ministerial Conference, Fourth Session).
- 107 Mukerji, *op. cit.*, pp. 39–40.
- 108 *Ibid.*, p. 69.
- 109 See, further, G.Edward Schuh, 'Developing Country Interests in WTO Agricultural Policy', in Kennedy and Southwick (eds), *op. cit.*, pp. 435–49.
- 110 ICTSD, 'Agriculture' (2003) 1:2 *Doha Round Briefing Series: Developments Since the Fourth WTO Ministerial Conference*, available online at <http://www.ictsd.org/>
- 111 WTO, 'Draft Elements of Modalities for Negotiations on Non-Agricultural Products' (2003) WTO Doc. TN/MA/W/35.
- 112 WTO, *Guidelines and Procedures for the Negotiations on Trade in Services* (2001) WTO Doc. S/L/93 (Special Session of the Council for Trade in Services on 28 March 2001).
- 113 ICTSD, 'Trade in Services' (2003) 1:3 *Doha Round Briefing Series: Developments Since the Fourth WTO Ministerial Conference*, p. 2, available online at <http://www.ictsd.org/>
- 114 For further discussion, see Chapter 13.
- 115 TRIPs is discussed in much greater detail in Chapter 13.
- 116 Matsushita *et al.*, *op. cit.*, p. 408.
- 117 UN, *Convention on Biological Diversity* (1992) UN Doc. UNEP/Bio.Div/CONF/L.2.
- 118 WTO, *Declaration on the TRIPs Agreement and Public Health* (20 November 2001) WTO Doc. WT/MIN(01)/DEC/2. For further discussion, see Fredrick M.Abbott, 'The Doha Declaration on the TRIPs Agreement and Public Health: Lighting a Dark Corner at the WTO' (2002) 5 *Journal of International Economic Law* 469; Haochen Sun, 'Reshaping the TRIPs Agreement Concerning Public Health: Two Critical Issues' (2003) 37 *Journal of World Trade* 163.
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- 120 For an excellent overview, see Constantine Michalopoulos, 'The Role of Special Differential Treatment for Developing Countries in GATT and the World Trade Organization', World Bank Working Paper 2388, July 2000.
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- 122 WTO, Preparations for the Fourth Session of the Ministerial Conference: Proposal for a Framework Agreement on Special and Differential Treatment (2001) WTO Doc. WT/GC/W/442.
- 123 *Ibid.*, para. 7.
- 124 Gustavo Olivares, 'The Case for Giving Effectiveness to GATT/WTO Rules on Developing Countries and LDCs' (2001) 35 *Journal of World Trade* 545.

- 125 Bernard Hoekman, 'Economic Development and the WTO After Doha', World Bank Working Paper 2851, June 2002, p. 25.
- 126 Michalopoulos, *op. cit.*, pp. 29, 33–6; see also Stiglitz, *op. cit.*, Edwards, 'Openness, Trade Liberalisation and Growth in Developing Countries' (1993) 31 *Journal of Economic Literature* 1358, and Rodrik, 'The Limits of Trade Policy Reform in Developing Countries' (1992) 6 *Journal of Economic Perspectives*, all cited in Michalopoulos, *op. cit.*
- 127 These include: 'eradicating extreme poverty and hunger, achieving universal primary education, promoting gender equality and empowering women, reducing child mortality, improving maternal health, combating HIV/AIDS, malaria, and other diseases, ensuring environmental sustainability and developing a global partnership for development'. United Nations Development Programme, Heinrich Boll Foundation, Rockefeller Brothers Fund, The Rockefeller Foundation and Wallace Global Fund, *Making Global Trade Work for People* (New York: Earthscan Publications Ltd, 2003), p. xxvi.
- 128 *Ibid.*, p. 74.
- 129 ICTSD, 'Special and Differential Treatment' (2003) 1:13 *Doha Round Briefing Series: Developments Since the Fourth WTO Ministerial Conference*, pp. 2–4, available online at <http://www.ictsd.org/>
- 130 US Government, 'Summary of AGOA I', available online at <http://www.agoa.gov/> (accessed 17 July 2003).
- 131 Paul Brenton, 'Integrating the Least Developed Countries into the World Trading System: The Current Impact of EU Preferences under Everything but Arms', World Bank Working Paper 3018, 2003, p. 3.
- 132 Department of Foreign Affairs and International Trade, 'Least Developed Countries (LDCs) Market Access Initiative', available online at <http://www.dfait-maeci.gc.ca/> (accessed 15 July 2003).
- 133 Elena Ianchovichina, Aaditya Mattoo and Marcelo Olarreaga, 'Unrestricted Market Access for Sub-Saharan Africa: How Much is it Worth and Who Pays?', World Bank Working Paper 2595, 2001, p. 21.
- 134 Rubens Ricupero, Secretary-General of UNCTAD, Statement at the Ministerial Round Table on Trade and Poverty in LDCs, London, 19 March 2001, available online at www.unctad.org/Templates/webflyer.asp?docid=2587&intItemID==2054&lang==1.
- 135 Aaditya Mattoo, Devesh Roy and Arvind Subramanian, 'The Africa Growth and Opportunity Act and its Rules of Origin: Generosity Undermined?', World Bank Policy Research Working Paper 2908, 2002, pp. 3, 6.
- 136 Brenton, *op. cit.*, p. 20.
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- 138 WTO, *Work Programme for the Least Developed Countries* (2002) WTO Doc. WT/COMTD/LDC/11.
- 139 Integrated Framework, 'About Integrated Framework', online at <http://www.integratedframework.org/> (accessed 16 July 2003).
- 140 ICTSD, 'Technical Assistance and Capacity-building' (2003) 1:12 *Doha Round Briefing Series: Developments Since the Fourth WTO Ministerial Conference*, p. 4, available online at <http://www.ictsd.org/>
- 141 UNDP *et al.*, *op. cit.*, p. 336; B. Hoekman, 'Strengthening the Global Trade Architecture for Development: The Post Doha Agenda', World Bank Working Paper 2757, 2002, p. 32.
- 142 UNDP *et al.*, *op. cit.*, pp. 336–8.
- 143 ICTSD, 'Technical Assistance and Capacity-building', *op. cit.*, p. 2.
- 144 Hoekman, 'Strengthening the Global Trade Architecture for Development', *op. cit.*, pp. 28, 32.

- 145 T.Hertel, K.Anderson, J.Francois and W.Martin, 'Agriculture and Non-agricultural Liberalization in the Millennium Round', paper presented at Conference on Agriculture and the New Trade Agenda on the WTO 2000 Negotiations, WTO, Geneva, 1–2 October 1999, cited in Hertel and Martin, 'Liberalising Agriculture and Manufactures in a Millennium Round: Implications for Developing Countries' (2000) 23 *World Economy* 455 at p. 456.
- 146 *Ibid.*, pp. 465–6.
- 147 T.N.Srinivasan, 'Developing Countries and the Multilateral Trading System After Doha', Yale University Economic Growth Center Discussion Paper No. 842, 2002, p. 22.
- 148 Paragraph derived from UNDP *et al.*, *op. cit.*, pp. 41–2, 63–70, 74.
- 149 Paragraph 44 of the Doha Declaration requires the Committee on Trade and Development to identify which current S&DT provisions are mandatory, and to consider the legal and practical implications of making mandatory those which are currently non-binding. The Committee is also instructed to consider ways in which developing countries, particularly the LDCs, may be assisted to make the best use of special and differential treatment. See www.wto.org/english/tratop_e/dev_e/dev_special_differential_provisions_e.htm.
- 150 The DDA places a special emphasis on the interests of developing countries, noting that the majority of WTO Members are developing countries and affirming that their needs and interests shall be at the heart of the work programme for this round of negotiations.
- 151 In December 2002, WTO Member governments failed to meet the year-end deadlines for agreement in negotiations on special and differential treatment for developing countries and access to essential medicines for poor countries. In July 2002, the Committee on Trade and Development recommended the extension of the deadline for final recommendations, given the complexity and volume of proposals for S&DT on the table. There were over 100 proposals specific to S&DT submitted pre-Cancun, although by April 2003, the number still being considered had been narrowed down to 88.
- 152 For a chronicle of other missed deadlines in previous rounds, illustrating the nature of multilateral negotiations, see J.-M.Metzger, 'Mapping the Bumpy Road to Cancun', *OECD Observer* 237, 28 May 2003, p. 24. But see also D.Horovitz, 'Looking Ahead to the Cancun Ministerial' (2003) 9 *International Trade Law Review* 123, for a less optimistic view of the significance of missed deadlines in this particular round.
- 153 *Ibid.*
- 154 J.E.Stiglitz, 'Whither Reform? Ten Years of the Transition', World Bank Annual Bank Conference on Development Economics, Washington DC, 28–30 April 1999.
- 155 J.Weekes, 'Doha Development News: Monthly Reporting on Developments for Commonwealth Governments', August 2002, p. 5, available online at <http://www.thecommonwealth.org/>
- 156 See M.Trebilcock, 'What Makes Poor Countries Poor? The Role of Institutional Capital in Economic Development', in E.Buscaglia, W.Ratliff and R.Cooter (eds) *The Law and Economics of Development* (Connecticut: JAI Press, 1997).

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Trade and the environment

- 1 See, generally, D.Esty, *Greening the GATT* (Washington DC: Institute for International Economics, 1994).
- 2 North American Agreement on Environmental Cooperation, 1993.
- 3 O.Young, *International Governance: Protecting the Environment in a Stateless Society* (Ithaca: Cornell University Press, 1994) p. 20.
- 4 G.Hardin, 'The Tragedy of the Commons', in G.Hardin and J.Baden (eds) *Managing the Commons* (San Francisco: W.H.Freeman, 1977).

- 5 Young, *op. cit.*, p. 21.
- 6 G.Hufbauer, J.Schott and K.Elliott, *Economic Sanctions Reconsidered: History and Current Policy* (Washington DC: Institute for International Economics, 2nd ed., 1990). See also M.Miyagawa, *Do Economic Sanctions Work?* (New York: St. Martin's Press, 1992), and D.Baldwin, *Economic Statecraft* (Ithaca: Cornell University Press, 1985).
- 7 Hufbauer *et al.*, *op. cit.*, p. 93.
- 8 This is consistent with more recent work by Nossal, which found that sanctions by 'middle powers' such as Canada and Australia have been largely ineffective. See K.R.Nossal, *Rain Dancing: Sanctions in Canadian and Australian Foreign Policy* (Toronto: University of Toronto Press, 1994).
- 9 In some cases such sanctions might, however, be aimed at goals that imply very significant regime change, for instance, in the case of China, sanctions aimed at inducing respect for the right of labour to organize and bargain freely.
- 10 S.Charnovitz, 'Encouraging Environmental Cooperation Through Trade Measures: The Pelly Amendment and the GATT', paper delivered at the Institute on Global Conflict and Cooperation (1993), cited in Chang, *op. cit.*, pp. 58–60.
- 11 GATT Secretariat, *Trade and the Environment*, GATT Doc. 1529 (3 February 1992).
- 12 Chang, *op. cit.*, pp. 19–25.
- 13 K.A.Rodman, 'Public and Private Sanctions against South Africa' (1994) 109 *Political Science Quarterly* 313 at p. 334.
- 14 There may also be a further alternative, akin to labelling, through which individual consumers by their investment choices can attempt to discipline socially irresponsible corporate behaviour. The phenomenon of socially responsible investing (SRI) refers to the 'making of investment choices according to both financial and ethical criteria'. For instance, individuals can choose to put their investments in firms that act in a manner consistent with their ethical values or they may choose to refrain from investing in those firms believed to be behaving in a socially unacceptable fashion. The two primary claims advanced by SRI adherents, that distinguish it from other strategies of investment, are: (1) that social screening does not entail a financial sacrifice (i.e. that advancing one's social agenda can be as profitable as investment for purely financial gain), and (2) that SRI can alter corporate behaviour insofar as it seeks to channel funds away from firms acting in a socially unacceptable way. While this phenomenon has become quite popular, there is good reason to be sceptical about its ability to deliver on its claims. Specifically, Knoll has suggested that, at best, only one of the claims can be true because each implies the negation of the other. As he explains, '[i]f markets are efficient, the first might be true but the second is false. If markets are inefficient, the second might be true but the first is false.' With respect to the second claim, Knoll found that 'regardless of the efficiency or inefficiency of the market, the impact of an investor's decision not to invest in a company will have little or no impact on the firm's ability to raise capital and therefore on its activities'. For a more thorough discussion, see Michael S.Knoll, 'Socially Responsible Investment and Modern Financial Markets', 18 March 1994, unpublished.
- 15 On environmental labelling, see R.Howse, 'Reform, Retrenchment or Revolution? The Shift to Incentives and the Future of the Regulatory State' (1993) 31 *Alberta Law Review* 486; D.Cohen, 'Procedural Fairness and Incentive Programs: Reflections on the Environmental Choice Program' (1993) 31 *Alberta Law Review* 554.
- 16 J.Bhagwati and T.N.Srinivasan suggest that environmental values, if sound, 'will spread because of their intrinsic appeal'. 'Trade and the Environment: Does Environmental Diversity Detract from the Case for Free Trade?', unpublished manuscript, July 1994. The fact that moral principles such as those prohibiting murder and theft are inherently sound does not, however, obviate the need to sanction non-compliance with them.
- 17 See R.Stewart, 'Environmental Regulation and International Competitiveness' (1993) 102 *Yale Law Journal* 2039.

- 18 See B.A.Langille, 'General Reflections on the Relationship of Trade and Labour (Or: Fair Trade is Free Trade's Destiny)', in J.Bhagwati and R.E.Hudec (eds) *Fair Trade and Harmonization: Prerequisites for Free Trade?* (Cambridge MA: MIT Press, 1996).
- 19 See B.A.Langille, 'A Day at the Races': A Reply to Professor Revesz on the Race for the Bottom', unpublished manuscript, Faculty of Law, University of Toronto, 18 March 1994; R. Revesz, 'Rehabilitating Interstate Competition: Rethinking the "Race to the Bottom" Rationale for Federal and Environmental Competition' (1992) 62 *New York University Law Review* 1216.
- 20 Laura Tyson, *Who's Bashing Whom?* (Washington: Institute for International Economics, 1992).
- 21 C.Rhodes, *Reciprocity, U.S. Trade Policy and the GATT Regime* (Ithaca: Cornell University Press, 1993).
- 22 See GATT Secretariat, *Trade and the Environment* (Geneva: GATT Secretariat, 1992) p. 7; see also E.-U.Petersmann, 'Trade Policy, Environmental Policy and the GATT: Why Trade Rules and Environmental Rules Should be Mutually Consistent' (1991) 46 *Aussenwirtschaft* 197.
- 23 S.Shrybman, 'International Trade and the Environment: An Environmental Assessment of the General Agreement on Tariffs and Trade' (1990) 20 *Ecologist* 33.
- 24 S.Charnovitz, 'Exploring the Environmental Exceptions in the GATT' (1991) 25 *Journal of World Traded*.
- 25 The equivalent provision in the Uruguay Round Agreement on Technical Barriers to Trade, Article 2.2, contains identical wording.
- 26 Panel Report, *Canada—Measures Affecting Exports of Unprocessed Herring and Salmon*, 22 March 1988, BISD 35S/98.
- 27 Canada also argued (unsuccessfully) that the exemption in Article XI:2(b) applied, since quality control with respect to the marketing of processed fish required assuring access of the Canadian processing industry to unprocessed fish that were subject to Canadian quality control, implying the need to limit flight of these Canadian quality-controlled unprocessed fish to the US markets.
- 28 Panel Report, *Canada—Measures Affecting Exports of Unprocessed Herring and Salmon*, 22 March 1988, BISD 35S/98, op. cit. p. 108.
- 29 *Ibid.*, p. 114.
- 30 *Thailand: Restrictions on Importation of and Internal Taxes on Cigarettes*, BISD 37S/200 (1990).
- 31 *In the Matter of Canada's Landing Requirement for Pacific Coast Salmon and Herring*, Final Report of the Panel, 16 October 1989.
- 32 Panel Report, *Canada—Measures Affecting Exports of Unprocessed Herring and Salmon*, 22 March 1988, BISD 35S/98, op. cit.
- 33 *Lobster From Canada*, Final Report of the Panel (25 May 1990) 3 T.C.T. 8182.
- 34 Of course, since it was exports and not imports that were affected in the *Salmon and Herring Landing Requirement* case, the panel could not have dealt with the matter under Article III, which applies only to internal measures affecting imports. However, the fact that the panel had a choice as to whether to apply Article III or Article XI in the *Lobster* case whereas it had no choice in *Salmon and Herring* does not go very far in reconciling the rather different views of Article XI itself that underlie these two decisions.
- 35 It should be noted, however, that while the panel found that Article XI did not apply to the ban on undersized Canadian lobster, it did not determine whether in fact the ban violated the National Treatment obligation in Article III. This is because the explicit terms of reference of the panel did not include the issue of National Treatment.
- 36 *Canada—Import, Distribution and Sale of Certain Alcoholic Drinks by Provincial Marketing Agencies* (1992) 5 T.C.T. 8003.
- 37 *Ibid.*, p. 8045.

- 38 *United States—Restrictions on Imports of Tuna* (1991) 30 I.L.M. 1594. The panel ruling was not formally adopted by the GATT Council, by mutual agreement of the USA and Mexico.
- 39 *Ibid.*, p. 1618.
- 40 *Ibid.*, p. 1620.
- 41 See GATT Secretariat, *Trade and the Environment*, *op. cit.*
- 42 See Ted McDorman, 'The 1991 US-Mexico GATT Panel Report on Tuna and Dolphin: Implications for Trade and Environmental Conflicts' (1991) 17 *North Carolina Journal of International Law and Commercial Regulation* for a defence of the decision.
- 43 *United States—Restrictions on Imports of Tuna*, Report of the Panel, DS29/R (16 June 1994), *op. cit.*, pp. 1622–3.
- 44 See Charnovitz, 'Exploring the Environmental Exceptions in the GATT', *op. cit.*, and accompanying text.
- 45 See, for instance, the Canadian Cultural Property Export and Import Act S.C. 1974–75–76, c 50.
- 46 See J.W. Kindt, *Marine Pollution and the Law of the Sea*, vol. IV (Buffalo NY: Hein & Co., 1986) pp. 2130–44.
- 47 In the *Nicaraguan Contra* case, the International Court of Justice found that there was no rule of customary international law prohibiting the use of economic measures, including a trade embargo, to influence the internal policies of another state. *Case Concerning Military and Paramilitary Activities in and against Nicaragua (Nicaragua v. United States of America) (Merits)* (1986) I.C.J. Rep. 14, 244.
- 48 (1994) 33 I.L.M. 936 (known as the LaJolla Agreement).
- 49 *United States—Restrictions on Imports of Tuna: Report of the Panel* (1994) GATT Doc. DS29/R.
- 50 *Case Concerning Military and Paramilitary Activities in and against Nicaragua*, *op. cit.*
- 51 In exceptional circumstances, it might be possible to compensate for the loss of the US market by lowering the price of dolphin-unfriendly tuna in other markets to increase sales there; however, this would only be possible if tuna had been priced above marginal cost in these markets, which is a highly unlikely scenario.
- 52 *United States—Taxes on Automobiles*, Report of the Panel (29 September 1994) unadopted, DS31 /R, 1–124.
- 53 Of course, with globalization of automobile production and extensive cross-ownership between foreign and American automakers, the whole basis for the distinction would have to be rethought. See Petrus van Bork, 'Victory in Europe: A Discussion of Future Implications for Article III of the GATT', Discussion Paper, Nomos Corporation Consultants.
- 54 A recent OECD document appears to take this view of the meaning of product-related PPMs. Thus, it claims that where the environmental damage is caused by the way in which the product is produced and not the product itself, the PPM is 'non-product related'. This analysis appears to be based on confused economic reasoning that non-product-related PPMs do not address consumption externalities. Yet the kind of measure at stake in *Tuna/Dolphin*, at least the embargo, does address consumption externalities. It is the consumption of dolphin-unfriendly tuna that leads to the dolphins in question being killed—the loss of dolphins is an externalized cost of consuming such tuna. By contrast, a trade ban on, let us say, straw hats produced by countries that allow tuna to be caught in a dolphin-unfriendly way does not address any consumption externality with respect to straw hats. OECD, *Processes and Production Methods (PPMs): Conceptual Framework and Considerations on Use of PPM-Based Trade Measures*, OCDE/GD(97)137, p. 15.
- 55 *United States—Standards for Reformulated and Conventional Gasoline*, Report of the Panel, WT/DS32/R (29 January 1996) (96–0236).
- 56 *United States—Import Prohibitions of Certain Shrimp and Shrimp Products*, Report of the Panel, WT/DS58/R (15 May 1998) (98–1710) [hereinafter 'Turtles'].
- 57 See note 55 above and accompanying text.

- 58 The following draws on R.Howse, 'The Appellate Body Ruling in the Shrimp/Turtle Case: A New Legal Baseline for the Trade and Environment Debate' (2002) 27 *Columbia Journal of Environmental Law* 491.
- 59 First AB ruling, paras 115–16; emphasis in original unless otherwise noted.
- 60 Second AB *Turtles* ruling, para. 138.
- 61 Panel 21.5 report, para. 5.106.
- 62 Original AB report, para. 165.
- 63 A point that was first grasped fully by M.Bronckers and N.McNellis, 'Rethinking the Like Product Definition in GATT 1994', in T.Cottier and P.Mavroidis (eds) *Regulatory Barriers and the Principle of Non-Discrimination in World Trade Law* (Ann Arbor: University of Michigan Press, 2000); see also the discussion of the product/process distinction in the excellent J.Wiers, *Trade and Environment in the EC and the WTO: A Legal Analysis* (Amsterdam: Europa Law Publishing, 2002). Readers who seek a more detailed account of the jurisprudential issues discussed in this chapter would do well to turn to Wiers's treatise.
- 64 J.H.Jackson, 'The Limits of International Trade: Workers' Protection, the Environment and Other Human Rights' (2000) 94 *American Society of International Law Proceedings* 222.
- 65 The following draws on R.Howse and E.Tuerk, 'The WTO Impact on Internal Regulation: A Case Study of the Canada—EC Asbestos Dispute', in G.de Burca and J.Scott (eds) *The EU and the WTO: Legal and Constitutional Issues* (Oxford: Hart Publishing, 2001).
- 66 *Korea—Measures Affecting Imports of Fresh, Chilled and Frozen Beef*, Report of the Appellate Body, WT/DS161/AB/R (11 December 2000) (00–5347), AB-2000–8.
- 67 *European Communities—Measures Affecting Asbestos and Asbestos-Containing Products*, Report of the Appellate Body, WT/DS135/AB/R (12 March 2001) (01–1157), (AB-2000–11), para. 162.
- 68 Panel Report, *Thailand—Restriction on Importation of and Internal Taxes on Cigarettes* ('*Thai Cigarettes*'), adopted on 7 November 1990, BISD 37S/200, para. 8.184.
- 69 *European Communities—Measures Affecting Asbestos and Asbestos-Containing Products*, Report of the Appellate Body, WT/DS135/AB/R (12 March 2001) (01–1157), (AB-2000–11), para. 163.
- 70 *European Communities—Measures Affecting Asbestos and Asbestos-Containing Products*, Report of the Appellate Body, WT/DS135/AB/R (12 March 2001) (01–1157), (AB-2000–11), para. 165.
- 71 *Ibid.*, para. 168.
- 72 One of the clearest textual indicators of such a hierarchy is the general operative clause of Article XX, stipulating that '*Nothing* in this Agreement shall prevent' measures for the purposes indicated in the various heads of Article XX (emphasis added).
- 73 'We think it is unlikely that Korea intended to establish a level of protection that *totally eliminates* fraud with respect to the origin of beef (domestic or foreign) sold by retailers. The total elimination of fraud would probably require a total ban of imports. Consequently we assume Korea intended to *reduce considerably* the number of cases of fraud occurring with respect to the origin of beef sold by retailers' (*Korea—Beef*, para. 178). As this passage indicates, and as the AB reiterates in *Asbestos*, the level of protection need not be articulated in quantitative terms.
- 74 *European Communities—Measures Affecting Asbestos and Asbestos-Containing Products*, Report of the Appellate Body, WT/DS135/AB/R (12 March 2001) (01–1157), (AB-2000–11), para. 168.
- 75 *Korea—Measures Affecting Imports of Fresh, Chilled and Frozen Beef*, Report of the Appellate Body, WT/DS161/AB/R (11 December 2000) (00–5347), AB-2000–8, para. 161.
- 76 *Ibid.*, para. 164.
- 77 Here, it is important to be clear on the precise language in *Korea-Beef*, especially since the AB in paragraph 172 of *Asbestos* refers to balancing in *Korea-Beef* in a rather loose way that could mislead the reader into thinking it is going to go on to balance in *Asbestos*. The AB

- said in *Korea-Beef*: ‘in sum, determination of whether a measure, which is not “indispensable”, may be “necessary” within the contemplation of Art. XX (d), involves in every case a process of weighing and balancing’ (emphasis added).
- 78 One frequent criticism of the AB rulings in *Gasoline* and *Shrimp/Turtle*, which held that the language ‘relating to (exhaustible natural resources)’ in Article XX(g) implied a looser fit than the necessity language in Article XX(b), was that the AB was actually saying, apparently perversely, that it is easier to justify protecting turtles or dolphins than protecting human lives. One could see the introduction of levels of scrutiny into the analysis of whether a measure is necessary under Article XX, with especially deferential scrutiny for measures to protect human life from deadly risks, as an indirect answer to this criticism. Of course, the criticism is not in itself very well taken—it ignores the fact that there is an additional hurdle under Article XX(g) that does not exist under Article XX(b), namely that the measures must be taken in conjunction with restrictions on domestic consumption or production. See *United States—Standards for Reformulated and Conventional Gasoline*, *op. cit.*
- 79 An alternative interpretation of what the AB is doing here is that it is saying that there are some interests that are so vital that we simply ignore the distinction between ‘indispensable’ and ‘necessary’ in the looser sense, and simply proceed to the analysis of alternative measures, without balancing, but with a lower or relaxed level of scrutiny. The AB’s observation that ‘France could not reasonably be expected to employ any alternative measure if that measure would involve a continuation of the very risk that the Decree seeks to “halt”’ indicates that no balancing or proportionality analysis is being undertaken here, whether because of the importance of the interest at stake or because this is in essence a claim for indispensability within the meaning of *Korea-Beef*, para. 174.
- 80 *European Communities—Measures Affecting Asbestos and Asbestos-Containing Products*, Report of the Appellate Body, WT/DS135/AB/R (12 March 2001) (01–1157), (AB-2000–11), para. 114.
- 81 *Report of the (1996) WTO Committee on Trade and Environment*, PRESS/TE 014, 14 November 1996, p. 7.
- 82 *Ibid.*, pp. 7–8.
- 83 See International Centre for Trade and Sustainable Development, ‘Trade and Environment’ (August 2003) 2:9 *Doha Round Briefing Series: Cancun Update*.
- 84 ‘The Role of Public International Law in the WTO: How far Can we go’, (2001)/95, *American Journal of International Law* 535–78.
- 85 International Centre for Trade and Sustainable Development, ‘Trade and Environment’, *op. cit.*, p. 3.
- 86 And see on this issue, Tobias Bender, ‘Unilaterale Exportverbote von Domestically prohibited goods zum Umwelt- der Gesundheitsschutz im Ausland und ihre Rechtmäßigkeit nach dem GATT ein Beitrag zur Dogmatik der Article XI und XX GATT’, *Zeitschrift für ausländisches öffentliches Recht und Völkerrecht* (2003), 4, p. 1007–1034.
- 87 This interpretation is also suggested by W.G. Watson, *Environmental and Labor Standards in the NAFTA* (Toronto: C.D. Howe Institute, 1994) p. 14.
- 88 For a clear presentation of the nature of this paradigm, its limits, and some of the developments in international legal theory and practice that are putting into question traditional notions of sovereignty, see K. Knop, ‘Re/Statements: Feminism and State Sovereignty in International Law’ (1993) 3 *Transnational Law and Contemporary Problems* 294.
- 89 See *Eco Region 1:1* (Summer 1995), newsletter of the Secretariat of the Commission for Environmental Cooperation.
- 90 The amounts specified for these projects range from US\$77,000 for a plant biodiversity Inventory and Information Network to US\$522,000 for a project on the sound management of chemicals. ‘Record of Council Session 96–1’, 25 January 1996. One can have little

confidence that comprehensive and competent technical work, as opposed to consultants' reports full of generalities, can be done for these amounts.

- 91 See 'Three Additional Chemicals Targeted for Joint Action by Canada, the U.S. and Mexico', CEC Press Release, 11 April 1996.
- 92 Submission No. SEM-95-001, 30 June 1995.
- 93 Determination of the Secretariat, 21 September 1995, p. 3.
- 94 Submission No. SEM-95-002, 31 August 1995.
- 95 Determination of the Secretariat concerning Submission SEM-95-002, 8 December 1995, p. 3.
- 96 Submission No. SEM-96-001, 18 January 1996.
- 97 *Final Factual Record of the Cruise Ship Pier Project in Cozumel, Quintana Roo*, Commission for Environmental Cooperation, 1997.
- 98 *Ibid.*, Annex II.
- 99 CEC Secretariat Report on the Death of Migratory Birds at the Silva Reservoir, October 1995.

17

Trade, labour standards and human rights

- 1 See S.Charnovitz, "The Influence of International Labour Standards on the World Trading System: An Historical Overview", *International Labour Review* 126 (1987), 565-584; V.Leary, "Workers' Rights and International Trade: The Social Clause", in J.Bhagwati and R.Hudec (eds.), *Fair Trade and Harmonization*, Vol. 2, Cambridge, MA 1996, 177-230; B.Molatlhegi, *Trade and Labour Interference in the Context of Economic Integration: The Case of the Southern African Development Community*. Doctoral Thesis, University of Toronto Faculty of Law 2000.
- 2 For an excellent review of the surrounding debates, see B.Langille, 'Eight Ways to Think about International Labour Standards' (1997) 31 *Journal of World Trade* 27.
- 3 See B.Molatlhegi (2000) Chap. 3; P.Stirling, "The Use of Trade Sanctions as an Enforcement Mechanism for Basic Human Rights: Proposal for Additions at the World Trade Organization", *American University Journal of International Law and Policy* 11 (1996), N. 1, 1-46.
- 4 See C.McCruden and A.Davies, "A Perspective on Trade and Labour Rights", *Journal of International Economic Law* 3 (2000), No. 1, 43-62; H.Cullen, "The Limits of International Trade Mechanisms in Enforcing Human Rights: The Case of Child Labour", *The International Journal of Children's Rights* 7 (1999), 1-29.
- 5 Doha Ministerial Declaration, 14 November 2001.
- 6 Molatlhegi, *op. cit.*, Ch. 2.
- 7 For a useful review of the evolution of labour standards in US trade policy legislation, see D. Brown, A.Deardorff, and R.Stein, "International Labour Standards and Trade: A Theoretical Analysis", in J.Bhagwati and R.Hudec (eds.), *Fair Trade and Harmonization*, Vol. 1, Cambridge, MA 1996, 236-266.
- 8 Molatlhegi, *op. cit.*, Ch. 2; Cullen, *op. cit.*
- 9 See D.Rodrik, *Labour Standards in International Trade: Do They Matter and What to do About Them*", in R.Lawrence *et al.* (eds.), *Emerging Agenda for Global Trade: High Stakes for Developing Countries*, Policy Essay No. 20, Overseas Development Council, Washington, DC 1996, 35-79; A.Blackett, "Whither Social Clause? Human Rights, Trade Theory and Treaty Interpretation", *Columbia Human Rights Law Review* 31 (1999), No. 1, 1-80.

- 10 For extensive reviews of the empirical literature, see D.Brown, "International Trade and Core Labour Standards: Survey of the Recent Literature", OECD Occasional Papers No. 43, Paris 2000; K.E.Maskus, "Should Core Labour Standards Be Imposed Through International Trade Policy?", Policy Research Working Paper 1817, World Bank, Washington, DC 1997.
- 11 P.Krugman, "Competitiveness: A Dangerous Obsession", in *Pop Internationalism*, (Cambridge, MA 1997).
- 12 D.Rodrik, *Has Globalization Gone Too Far?*, Washington, DC 1997; Robert Flanagan, "Labour Standards and International Competitive Advantage", Working Paper, Stanford Business School, November, 2002.
- 13 See Brown *et al.*, *op. cit.*; see also Brown, *op. cit.*, and Maskus, *op. cit.*
- 14 OECD, *Trade, Employment and Labour Standards: A Study of Core Workers' Rights and International Trade* (Paris: OECD, 1996); Rodrik (1996), *op. cit.*
- 15 See Brown, *op. cit.*; Maskus, *op. cit.*
- 16 ILO, International Programme on the Elimination of Child Labour, *Investing in Every Child: An Economic Study of the Costs and Benefits of Eliminating Child Labour* (Geneva: ILO, 2003).
- 17 P.Morici and E.Schultz, *Labor Standards in the Global Trading System* (Washington DC: Economic Strategy Institute, 2001).
- 18 See E.Alben, "GATT and the Fair Wage: A Historical Perspective", *Columbia Law Review* 101 (2001), No. 6, 1410–1447.
- 19 See Brown, *op. cit.*; Maskus, *op. cit.*
- 20 See K.E.Maskus (1997); K.Basu, "The View from the Tropics, in New Democracy Forum: Stepping Up Labour Standards", *Boston Review*, February/March 2001.
- 21 See A.Sen, *Development as Freedom*, New York, 1999.
- 22 See B.Molatlhegi (2000) Ch. 3; C.McCrudden, A.Davies (2000); S.Cleveland, "Human Rights Sanctions and International Trade: A Theory of Compatibility", *Journal of International Economic Law* 5 (2002), No. 1, 133–189.
- 23 P.Stirling "The Use of Trade Sanctions as an Enforcement Mechanism for Basic Human Rights", 11 *American University Journal of International Law and Policy* 16 (1996).
- 24 Economist Magazine, August 18, 2001, "The Politics of Human Rights" 9; "Human Rights" 18 et seq; M.Ignatieff, *Human Rights as Politics and Idolatry*, (Princeton, NJ 2001).
- 25 See R.Freeman, "A Hard-Headed Look at Labour Standards", in US Department of Labour, Bureau of International Labour Affairs (ed.), *International Labour Standards and Global Economic Integration*; Proceedings of a Symposium, Washington, DC 1994.
- 26 A.Fung, D.O'Rourke and C.Sabel, 'Realizing Labor Standards', *Boston Review*, February/March 2001; see the critical responses by, among others, Mark Levinson and Ian Ayres, in the same issue of *Boston Review*.
- 27 See J.Diller, "A Social Conscience in the Global Marketplace? Labour Dimensions of Codes of Conduct, Social Labelling and Investor Initiatives", in *International Labour Review* 138 (1999), No. 2, 99–129; A.Blackett, "Global Governance, Legal Pluralism and the Decentered State: A Labour Law Critique of Codes of Corporate Conduct", *Indiana Journal of Global Legal Studies* 8 (2001), No. 2, 401–447; D.Brown, "Can Consumer Product Labels Deter Foreign Child Labour Exploitation?", Discussion Paper 99–19, Department of Economics, Tufts University, Medford, MA 1999.
- 28 See Debate, 'New Democracy Forum: Stepping Up Labour Standards', *Boston Review*, February/March 2001.
- 29 World Bank Group, Corporate Social Responsibility Practice, *Strengthening Implementation of Corporate Social Responsibility in Global Supply Chains* (Washington DC: World Bank, 2003).
- 30 See D.Brown (2000); P.Morici, "Labour Standards in Global Trading System", Economic Strategy Institute, Washington, DC 2001.

- 31 See H.Chang, "Carrots, Sticks, and International Externalities", *International Review of Law and Economics* 17 (1997), No. 3, 309–324.
- 32 See T.N.Srinivasan, "International Trade and Labour Standards from an Economic Perspective", in P.van Dijk and G.Faber (eds.), *Challenges to the New World Trade Organization*, Den Haag/Boston 1996, 219–224
- 33 See Chapter 4 of the present volume.
- 34 Under Annex 39 of NAFTA, any monetary enforcement assessment shall be no greater than US\$1 million for the first year of the Agreement and thereafter no greater than 0.007% of total trade between the Parties during the most recent year for which data are available and must be paid into a fund to improve or enhance labour law enforcement in the Party complained against.
- 35 Charnovitz, *op. cit.*
- 36 Appellate Body report on European Communities—Conditions For the Granting of Tariff Preferences To Developing Countries (WT/DS246/AB/R/of 7 April 2004).
- 37 C.T.Feddersen, 'Focusing on Substantive Law in International Economic Relations: The Public Morals of GATT's Article XX(a) and "Conventional" Rules of Interpretation' (1998) 7 *Minnesota Journal of Global Trade* 75 at pp. 76ff. See C.T.Feddersen, *Der Ordre Public in der WTO: Auslegung und Bedeutung des Art. XX. Lit. a) GATT im Rahman der WTO-Stretbeileugung* (Berlin: Duncker and Humbolt, 2002); also, in early 2004, the Office of the UN High Commissioner for Human Rights was preparing a study on 'public morals' and human rights. See, further, S.Charnovitz, 'The Moral Exception in Trade Policy' (1998) 38 *Journal of International Law* 68; G.Marceau, 'WTO Dispute Settlement and Human Rights' (2002) 13 *European Journal of International Law* 753.
- 38 For a detailed examination of India's initial claim concerning the labour and environmental preferences, see R.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' (2003) 18 *American University International Law Review* 1333.
- 39 Omnibus Trade and Competitiveness Act of 1988, Pub. L. 100–418, 102 Stat. 1107 (1988, 1101(b)(14)).
- 40 See Chapter 13 for an explanation of the GSP.
- 41 Section 503, General System of Preferences Renewal Act of 1984.
- 42 OECD, *op. cit.*, p. 185.
- 43 *Ibid.*
- 44 S.Dufour, *Les droits des travailleurs et les accords commerciaux* (Sherbrooke: Presses de l'Universite de Sherbrooke, 1998) p. 60.
- 45 K.A.Elliott, 'Preferences for Workers? Worker Rights and the US Generalized System of Preferences', Institute for International Economics, Washington DC, 8 May 2000, available online at www.iie.com/publications/papers/elliott0598.htm; see also L.Compa and J.S.Vogt, 'Labor Regulation and Trade: Labor Rights in the Generalized System of Preferences: A 20-Year Review' (2001) 22 *Comparative Labor Law and Policy Journal* 199.
- 46 Dufour, *op. cit.*, pp. 49–54.
- 47 See Weintraub and Gilbreath, *op. cit.*, pp. 66–8.
- 48 *Ibid.*
- 49 See P.Morici, 'Implications of a Social Charter for the NAFTA, in Lemco and Robson (eds), *op. cit.*, pp. 137–8.
- 50 L.Compa, 'NAFTA's Labor Side Accord: A Three-Year Accounting', *NAFTA: Law and Business Review of the Americas*, Summer 1997, pp. 19–21.
- 51 L.Compa, *Justice for All: The Struggle for Worker Rights in Mexico* (Washington DC: Solidarity Center, 2003) p. 41.
- 52 See R.Abrami, 'Workers Rights and Global Trade: The US-Cambodia Bilateral Textile Trade Agreement', Harvard Business School Case Study, Cambridge MA, August 2003;

- K.Kolben, 'Trade, Monitoring and the ILO: Working to Improve Conditions in Cambodia's Garment Factories', *Yale Human Rights and Development Law Journal*, forthcoming.
- 53 The following section draws extensively on R.Howse and M.Matua, *Protecting Human Rights in a Global Economy: Challenges for the World Trade Organization* (Montreal: Rights & Democracy, 2000).
- 54 Louis Henkin, *The Age of Rights* ix (1990); Philip Alston, *Making Space for New Human Rights: the Case of the Right to Development*, 1 Harv. Hum. Rts. Y.B. 3, 3 (1988); Henry J.Steiner, *Political Participation as a Human Right*, 1 Harv. Hum. Rts. Y.B. 77, 79 (1988).
- 55 Article 64, Vienna Convention on the Law of Treaties, opened for signature May 23, 1969, UN Doc. A/CONF.39/27, reprinted in 63 Am. J. Int'l L. 875 (1969)
- 56 *The Case Concerning the Barcelona Traction, Light and Power Company, Limited* (New Application 1962) (Belgium v. Spain), [1970] I.C.J. Rep. 4, at ¶ 33–4.
- 57 See Thomas Buergenthal, *International Human Rights* 29–38 (1995).
- 58 Mary Ann Glendon, *Knowing the Universal Declaration of Human Rights*, 73 Notre Dame L. Rev. 1153 (1998).
- 59 A.Sen, *Development as Freedom*, New York, 1999.
- 60 A.O.Sykes, 'International Trade and Human Rights: An Economic Perspective', University of Chicago Law and Economics, Olin Working Paper No. 188 (May 2003).
- 61 C.McCrudden, *International Economic Law and the Pursuit of Human Rights: A Framework for Discussion of 'Selective Purchasing' Laws under the WTO Government Procurement Agreement*, 3 Journal of International Economic Law 8 (1999).
- 62 'Human Rights and Intellectual Property', UN Doc. E/C. 12/2001/15, 21 November 2001, para. 4.
- 63 'Access to Medication in the Context of Pandemics such as HIV/AIDS', Commission on Human Rights resolution 2002/32, 22 April 2002.
- 64 'Human Rights and Intellectual Property', *op. cit.*
- 65 Report of the High Commissioner to the Sub-Commission on the Promotion and Protection of Human Rights, 'Liberalization of Trade in Services and Human Rights', E/CN.4/Sub.2/2002/9.

18

Trade and competition policy

- 1 For a useful introduction to the basic economics of antitrust, see Michael Trebilcock, Ralph Winter, Paul Collins and Edward Iacobucci, *The Law and Economics of Canadian Competition Policy* (Toronto: University of Toronto Press, 2002) Ch. 2.
- 2 See, generally, W.Landes and R.Posner, 'Market Power in Antitrust Cases' (1991) 94 *Harvard Law Review* 937.
- 3 The monopolist restricts output to the point where the marginal cost and marginal revenue curves intersect because, assuming it is able to charge only a single price for whatever output it produces (i.e. it cannot discriminate between price sensitive and price insensitive customers), lowering the price below PM in Figure 18.1 in order to capture further sales means foregoing some of the profits on all sales up to that point. (This assumption is relaxed below.)
- 4 The extent to which the monopolist is able to price above PC is a function of the elasticity of demand which it faces. The more inelastic the demand at the competitive price, the greater the capacity to increase price above this level without losing large numbers of profitable sales.
- 5 See Richard Posner, *Antitrust Law: An Economic Perspective* (Chicago: University of Chicago Press, 2nd ed., 2001) pp. 13, 14.

- 6 However, it is not clear how these concerns can be rendered justiciable under competition law, and it seems likely that other public policies can better address inequalities of political influence: see B.Dunlop, D.McQueen and M.Trebilcock, *Canadian Competition Policy* (Toronto: Canada Law Book, 1987) pp. 67–8.
- 7 To return to Figure 18.1, if the monopolist were to raise the price for inelastic customers on the demand curve above PM and then set a separate price for more elastic customers on the demand curve below PM and above PC (i.e. set two prices), sales to the inelastic customers are likely to decline, while sales to the more elastic customers are likely to increase, with the net effect on output being unclear as a matter of logic (although in most cases it is likely to be positive).
- 8 See O.Williamson, 'Economies as an Antitrust Defence: The Welfare Trade-Offs' (1968) 48 *American Economic Review* 18.
- 9 We do not consider here the case of so-called 'natural monopoly' where scale effects are so large that for a single firm in an industry, average total costs are falling in the region of total industry demand. Here some form of price regulation is more appropriate than a competition policy response, although it should be noted that in recent years, industries or segments of industries traditionally viewed as natural monopolies (e.g. telecommunications, transportation, electricity, gas) are now widely viewed as contestable, leading to deregulation, privatization and the application of competition policy to their contestable elements.
- 10 For a detailed overview of the issues for trade and competition being considered in the Doha Round of negotiations, see OECD, *Trade and Competition: From Doha to Cancun* (Paris: OECD, 2003). Note that there is little discussion over whether competition should be addressed at the WTO in the first place, but rather an assertion that 'there is rather wide agreement to recognize that the WTO is the relevant place to raise trade and competition issues' (pp. 67–8).
- 11 Sylvia Ostry, *The Post-Cold War Trading System: Who's On First?* (Chicago: University of Chicago Press, 1997).
- 12 For a more detailed review of the range of situations where this concern arises, see WTO Annual Report, 1997, Section IV; see also Report (1998) of the Working Group on the Interaction Between Trade and Competition Policy to the WTO General Council.
- 13 See Mitsuo Matsushita, Thomas J.Shoenbaum and Petros C.Mavroidis, *The World Trade Organization: Law, Practice, and Policy* (New York: Oxford University Press, 2003) Ch. 20, 'Competition Policy and Trade', at pp. 541–5.
- 14 See Americo Zampetti and Pierre Sauvé, 'New Dimensions of Market Access: An Overview', in OECD, *New Dimensions of Market Access in a Globalizing World Economy* (Paris: OECD, 1995) pp. 19–20 [hereinafter *New Dimensions*]; see also Eleanor Fox and Janusz Ordover, 'The Harmonization of Competition and Trade Law' (1995) 19 *World Competition* 5.
- 15 For a detailed review of the history of international efforts at cooperation, coordination and harmonization with respect to domestic competition policy, see Kevin Kennedy, *Competition Law and the World Trade Organization: The Limits of Multilateralism* (London: Sweet & Maxwell, 2001) Chs 2–4.
- 16 See Olivier Long, *Law and its Limits in the GATT Multilateral Trade System* (London: Graham and Trotman-Martinus Nijhoff, 1987) pp. 1–2; Kenneth Dam, *The GATT* (Chicago: University of Chicago Press, 1970) Ch. 2; Frank Stone, *Canada, GATT, and the International Trade System* (Montreal: Institute for Research on Public Policy, 1987) pp. 52–3; John Jackson, *The World Trading System* (Cambridge MA: MIT Press, 1989) Ch. 2; Eleanor Fox, 'Competition Law and the Next Agenda for the WTO', in OECD, *New Dimensions*, *op. cit.*, p. 169.

- 17 See George N. Addy, *International Co-ordination of Competition Policies*, in E. Kantzenbach, H. Scharrer and L. Waverman (eds) *Competition Policy in an Interdependent World Economy* (Baden-Baden: Nomos Verlagsgesellschaft, 1993) p. 292.
- 18 The Set of Multilaterally Agreed Principles and Rules for the Control of Restrictive Business Practices, 5 December 1980, UNCTAD Doc. TD/RBP/Conf. 10/Rev. 1.
- 19 See P. Ebow Bondzai Simpson, *Legal Relationships Between Transnational Corporations and Host States* (New York: Quorum Books, 1990) Ch. 5.
- 20 Fox, *op. cit.*, p. 170.
- 21 See Edward Glynn, *International Agreements to Allocate Jurisdiction Over Mergers*, in Barry Hawk (ed.) *International Mergers and Joint Ventures* (New York: Fordham Corporate Law Institute, 1991) pp. 38–43; George N. Addy, 'International Co-ordination of Competition Policies', in Kantzenbach *et al.* (eds), *op. cit.*, pp. 292–4.
- 22 See E.-U. Petersmann, 'International Competition Rules for Governments and Private Business' (1996) 30 *Journal of World Trade* 5; see also Matsushita *et al.*, *op. cit.*, pp. 545–50.
- 23 For an overview of these agreements, see draft report by the International Chamber of Commerce, *Competition and Trade in the Global Arena* (February 1998), pp. 17–25.
- 24 Memorandum of Understanding Between the Government of Canada and the Government of the United States of America as to Notification, Consultation and Co-operation with Respect to the Application of National Antitrust Laws, 23 I.L.M. 275 (1984); see also the Treaty Between the Government of Canada and the Government of the United States of America on Mutual Legal Assistance in Criminal Matters, 24 I.L.M. 1092 (18 March 1985). See, generally, Lawson Hunter and Susan Hutton, 'Where There is a Will There is a Way: Co-operation in Canada-US. Antitrust Relations', paper presented at the American Conference Institute on Multinational Antitrust Enforcement, New York, 7 March 1994; Neil Campbell, Jeffrey Roode and William Rowley, 'The Proper Framework for Co-operation Among National Antitrust Agencies', paper presented at Roundtable on Competition Policy Reform, University of Toronto, 8 December 1995.
- 25 See *Notes* for an address by George Addy, Director of Investigation and Research, Canadian Bureau of Competition Policy, to ABA Section of Antitrust Law Annual Meeting, 6 August 1995.
- 26 Agreement Between the Government of the United States of America and the Government of Australia Relating to Co-operation on Antitrust Matters, 20 I.L.M. 702 (1982) (renegotiated in 1995).
- 27 Agreement Between the Government of the United States of America and the Government of the Federal Republic of Germany Relating to Mutual Co-operation Regarding Restrictive Business Practices, 1976.
- 28 Agreement Between the Commission of the European Communities and the Government of the United States of America Regarding the Application of their Competition Laws, Washington DC, 23 September 1991. This Agreement was held invalid by the European Court of Justice as *ultra vires* the Commission's powers, but was subsequently approved by the Council.
- 29 See OECD, Revised Recommendation of the Council Concerning Co-operation between Member Countries on Restrictive Business Practices Affecting International Trade, C(86)44(Final) (1986), and predecessor versions referenced therein.
- 30 See Glynn, *op. cit.*, pp. 39–43.
- 31 See Valentine Korah, *An Introductory Guide to EC Competition Law and Practice* (London: Sweet & Maxwell, 6th ed., 1997); Richard Whish and Brenda Sufrin, *Competition Law* (London: Butterworths, 3rd ed., 1993); Vivien Rose (ed.), *Bellamy and Child: Common Market Law of Competition* (London: Sweet & Maxwell, 4th ed., 1993); Ivo Van Bael and Jean-Francois Bellis, *Competition Law of the EEC* (Bicester: CCH Editions, 2nd ed., 1990).
- 32 These provisions are similar to the state trading provisions in Article XVII of the GATT.

- 33 The balance of this chapter is drawn from Michael Trebilcock and Edward Iacobucci, 'National Treatment and Extraterritoriality: Defining the Domains of Trade and Antitrust Policy', in Richard Epstein and Michael Greve (eds) *Competition Laws in Conflict: Antitrust Jurisdiction in the Global Economy* (Washington DC: American Enterprise Institute, 2004).
- 34 See James S. Venit and William J. Kolasky, 'Substantive Convergence and Procedural Dissonance in Merger Review', in Simon J. Evenett, Alexander Lehmann and Benn Steil (eds) *Antitrust Goes Global: What Future for Transatlantic Cooperation?* (Washington DC: Brookings Institution Press, 2000) p. 97. See also William E. Kovacic, 'Merger Enforcement in Transition: Antitrust Controls on Acquisitions in Emerging Economies' (1998) 66 *University of Cincinnati Law Review* 1075 (discussing the proliferation of competition laws in transition economies).
- 35 See David Leebron, 'Lying Down with Procrustes: An Analysis of Harmonization', in Jagdish Bhagwati and Robert Hudec (eds) *Fair Trade and Harmonization: Prerequisites for Free Trade?*, vol. 1 (Cambridge MA: MIT Press, 1966); Alan Sykes, 'Regulatory Protectionism and the Law of International Trade' (1999) 66 *University of Chicago Law Review* 1; Michael Trebilcock and Robert Howse, 'Trade Liberalization and Regulatory Diversity: Reconciling Competitive Markets with Competitive Politics' (1998) *European Journal of Law and Economics* 5.
- 36 The United States has applied its antitrust laws extraterritorially since *United States v Aluminum Co. of America (Alcoa)*, 148 F.2d 416 (2d Cir. 1945).
- 37 See Edward Iacobucci, 'The Interdependence of Trade and Competition Policies' (1997) 21 *World Competition Law and Economics Review* 5 at pp. 16–17.
- 38 *Ibid.*, p. 17.
- 39 Kovacic expresses concern with the transition economies' attempts to apply regulatory frameworks based on Western models in environments that lack the institutional preconditions that are essential to the effectiveness of such frameworks in the West. Kovacic, *op. cit.*, p. 1078. See also Michal S. Gal, 'Size Does Matter: The Effects of Market Size on Optimal Competition Policy' (2001) 74 *Southern California Law Review* 1437 (discussing the distinct needs of small economies with respect to antitrust policy).
- 40 *Ibid.*, pp. 1472–4.
- 41 'A central purpose of competition policy is to maximize the sum of producer and consumer surplus in the economy... Where there is autarky, both the consumer surplus and the producer surplus are realized in the same nation. To maximize welfare, the domestic authorities would use a competition policy designed to promote activity that maximizes the sum of consumer and producer surplus in that nation. In the two-country autarky model, global welfare is maximized by each country independently maximizing its domestic welfare. The maximum of a sum is the sum of the maxima of the sum's constituents. In this model, there is no beggar-thy-neighbour reason for divergence in competition policies or their application...

'Where there is trade, locally optimal competition policy may fail to maximize global welfare. Country A permits anticompetitive practices in order to extract consumer surplus from Country B. This, as with any anticompetitive practice that raises price, serves to reduce quantity and results in a deadweight loss to global welfare. The gains to Country A from "beggar" its neighbours are smaller than the loss to the neighbour; it is a negative sum game.' Iacobucci, *op.cit.*, pp. 20–1.

- 42 According to Iacobucci, under certain circumstances (in particular, where competition involves strategic substitutes, such as in the case of Cournot (quantity) oligopoly competition) countries will maximize their welfare by having several local firms, rather than one, participate in international markets. Having more than one domestic firm compete reduces the total amount of profit in an international market, but, in the case of strategic substitutes, increases the domestic country's share of those rents, thus potentially increasing total domestic producer welfare. In addition, competition will be beneficial to domestic consumers. The combination of these factors could result in countries racing to the top with their competition policies in an attempt to shift rents to the home country. Unlike beggar-thy-neighbour reasons for the divergence of competition policy, the race to the top may be global welfare enhancing. Iacobucci, *op. cit.*, pp. 24–6. We further discuss these issues, which could be described as the implications for international approaches to competition policy of strategic trade theory, below.
- 43 We return below to the question of dealing with non-discriminatory laws whose substantive content is nevertheless distorted by international trade.
- 44 Competition Act, R.S.C. 1985, c. C-34.
- 45 *Ibid.*, Section 96(2).
- 46 By 'divergent policies' we mean policies that would treat the same matter differently even where there is full agreement on the facts. Even if two countries have exemptions for export cartels, there is divergent policy since the importing country may object to conduct that the exporting country permits.
- 47 Andrew T. Guzman, 'Antitrust and International Regulatory Federalism' (2001) 76 *New York University Law Review* 1142 at p. 1142 [hereinafter 'Antitrust and International Regulatory Federalism']; Guzman, 'Global Governance and the WTO', Working Paper, 2003.
- 48 'Antitrust and International Regulatory Federalism', *op. cit.*, p. 1147.
- 49 *Ibid.*, p. 1155.
- 50 See Special Supplement, 64 *BNA Antitrust & Trade Regulation Report*, 19 August 1993 (Special Supplement, No. 1628). For a review of the Code, see W.F. Kentscher, 'Competition Rules for Private Agents in the GATT/WTO System' (1994) 49 *Aussenwirtschaft* 281 (Code annexed).
- 51 See Iacobucci, *op. cit.*; Trebilcock *et al.*, *op. cit.*, ch. 10; Neil Campbell and Michael J. Trebilcock, 'International Merger Review: Problems of Multi-Jurisdictional Conflict', in Kantzenbach *et al.* (eds), *op. cit.*, p. 129. Also, against harmonization, see Eleanor M. Fox, 'Antitrust and Regulatory Federalism: Races Up, Down, and Sideways' (2000) 75 *New York University Law Review* 1781 at p. 1801 [hereinafter 'Antitrust and Regulatory Federalism']; Karl M. Meessen, 'Competition of Competition Laws' (1989) 10 *Northwestern Journal of International Law and Business* 17 at p. 21; Douglas H. Ginsburg and Scott H. Ansstreich, 'Multinational Merger Review: Lessons from our Federalism' (2000) 68 *Antitrust Law Journal* 219 at p. 237.
- 52 We set aside another potentially significant drawback of international harmonization: the potential lack of accountability of international bodies and thus the vulnerability of rule-making to pernicious political influences. See Paul B. Stephan, 'Accountability and International Lawmaking: Rules, Rents, and Legitimacy' (1996–97) 17 *Northwestern Journal of International Law and Business* 681 at p. 706.
- 53 Although the National Treatment principle is not a centrepiece in Guzman's model to deal with international competition problems, in Guzman's view, an international antitrust agreement should contain a National Treatment principle. According to Guzman, although this principle 'would not address the strategic choice of domestic law by trading nations, it would prevent the most explicit attempts to favor locals over foreigners such as exemptions for export cartels'. 'Antitrust and International Regulatory Federalism', *op. cit.*, p. 1162.
- 54 See chapter 3 in this volume.

- 55 See Daniel Tarullo, 'Norms and Institutions in Global Competition Policy' (2000) 94 *American Journal of International Law* 478 at p. 479.
- 56 *Ibid.*, p. 483.
- 57 *Hartford Fire Insurance Co. v California*, 509 U.S. 764 (1993). For discussions of this case, see Kenneth Dam, 'Extraterritoriality in an Age of Globalization: The Hartford Case' (1993) *Supreme Court Review* 289; Alan Swan, 'The Hartford Insurance Company Case: Antitrust in the Global Economy—Welfare Effects and Sovereignty', in Jagdeep S. Bhandari and Alan O. Sykes (eds) *Economic Dimensions in International Law: Comparative and Empirical Perspectives* (Cambridge: Cambridge University Press, 1997).
- 58 Japan—Measures Affecting Consumer Photographic Film and Paper (Complaint by the United States) (1998) WTO Doc. WT/DS44/R (Panel Report).
- 59 *Canada (Commissioner of Competition) v Superior Propane Inc.* [2001] EC J. No. 455, online: QL (FCJ) [hereinafter *Superior Propane*].
- 60 *Brown Shoe Co. v United States*, 370 U.S. 294, 320 (1962).
- 61 Mario Monti, 'Europe's Merger Monitor', *The Economist*, 9 November 2002, p. 71.
- 62 See Tarullo, *op. cit.*
- 63 See Robert Anderson and Peter Holmes, 'Competition Policy and the Future of the Unilateral Trading System' (2002) 5 *Journal of International Economic Law* 531 at pp. 541–4; Report of the WTO Working Group on the Interaction Between Trade and Competition Policy to the WTO General Council, 9 December 2002, pp. 17, 18.
- 64 See Paul Crampton, 'The 1995 U.S. Antitrust Enforcement Guidelines for International Operations: A Foreign Perspective' (1996) 1 *International Business Law* 99; for similar reasons, we oppose the assertion of jurisdiction by the US in *United States v Pilkington*, 59 F.R. 30604 (1994), alleging that Pilkington established a web of restrictive distribution arrangements impeding effective market access by US competitors to the UK and other glassware markets around the world.
- 65 Japan—Measures Affecting Consumer Photographic Film and Paper (Complaint by the United States), *op. cit.*
- 66 For a similar example, see Frank Easterbrook, 'Antitrust and the Economics of Federalism' (1982) 26 *Journal of Law and Economics* 23.
- 67 See Chapter 8 of the present volume.
- 68 See Tarullo, *op. cit.*
- 69 The Canadian Competition Bureau approved the merger without providing written reasons.
- 70 *Aerospatiale-Alenia/de Havilland*, (1991) O.J. L334/42.
- 71 See *In Re The Proposed Acquisition of McDonnell Douglas Corp. by the Boeing Co.*, FTC File No. 971–005 (1 July 1997). For a comment on the case, see Thomas L. Boeder, 'The Boeing-McDonnell Douglas Merger', in Evenett *et al.* (eds), *op. cit.*, p. 139.
- 72 See *In Re Vitamins Antitrust Litigation*, 2000–1 Trade Cas. (CCH) P 72,914 (D.D.C. 2000).
- 73 'Is International Antitrust Possible?' (1998) 73 *New York University Law Review* 1501 at p. 1524; 'Antitrust and International Regulatory Federalism', *op. cit.*, pp. 1159–60.
- 74 Campbell and Trebilcock, *op. cit.*, pp. 149–55.
- 75 *Ibid.*, p. 150.
- 76 Trebilcock *et al.*, *op. cit.*, p. 684; Campbell and Trebilcock, *op. cit.*, p. 153.
- 77 Competition Act, *op. cit.*, Section 96(2).
- 78 See *Superior Propane*, *op. cit.* (requiring consideration of a transfer from producers to consumers as potentially harmful).
- 79 'Antitrust and International Regulatory Federalism', *op. cit.*, p. 1154.
- 80 Iacobucci, *op. cit.*, p. 21.
- 81 'Antitrust and International Regulatory Federalism', *op. cit.*, pp. 1154–5.
- 82 'Is International Antitrust Possible?', *op. cit.*, p. 1524.
- 83 'Antitrust and International Regulatory Federalism', *op. cit.*, p. 1155.
- 84 'Is International Antitrust Possible?', *op. cit.*, p. 1524.

85 Iacobucci, *op. cit.*, p. 13.

86 *Ibid.*, p. 20.

87 As discussed in note 43 above, Iacobucci, *op. cit.*, emphasizes the strategic domestic incentives to adopt vigorous competition policies, but acknowledges that rent-shifting concerns could result in lax policies.

88 Derived by dividing gross receipts in international trade of goods and services less gross payments in 2001 (which difference was C\$55.6 billion in 2001; see Statistics Canada, 'Canada's Balance of International Payments', available online at www.statcan.ca/english/Pgdb/econ01a.htm (accessed 12 November 2002)) by Canadian GDP in 2001 (which was C\$1.1 trillion; see Statistics Canada, 'Gross Domestic Product, Expenditure-based', available online at www.statcan.ca/english/Pgdb/econ04.htm (accessed 12 November 2002)).

89 9 December 2002.

90 See William Kovacic, 'Creating New Competition Policy Institutions in Transition Economies' (1997) 23 *Brooklyn Journal of International Law* 403.

91 See Hunter Nottage, 'Trade and Competition in the WTO: Pondering the Applicability of Special and Differential Treatment' (2003) *Journal of International Economic Law* 23.

92 On the difficulties of drawing this distinction, see Presley Warner and Michael Trebilcock, 'Rethinking Price-Fixing Law' (1993) 38 *McGill Law Journal* 679.

93 See Konrad Von Finckenstein, Chair, International Competition Network Steering Group, 29th Annual Conference on International Antitrust Law and Policy, Fordham Corporate Law Institute, New York, 31 October 2002; see also Tarullo, *op. cit.*, pp. 495, 496.

94 See Chapter 13 of the present volume.

95 Guzman, 'Antitrust and International Regulatory Federalism', *op. cit.*, pp. 1142–3, 1155–8. The Canadian Competition Bureau outlined the possible elements of a multilateral agreement on trade-related aspects of anti-competitive measures (TRAMs) in 'Options for the Internationalization of Competition Policy: Defining Canadian Interests', available online at <http://competition.ic.gc.ca/epic/internet/incb-bc.nsf/en/ct01519e.html#Sec6> (accessed 21 July 2004). Against the idea of negotiating a comprehensive multilateral competition policy agreement in the WTO, see Merit E. Janow, 'Transatlantic Cooperation on Competition Policy', in Evenett *et al.* (eds), *op. cit.*, p. 54; Merit E. Janow and Cynthia R. Lewis, 'International Antitrust and the Global Economy: Perspectives on The Final Report and Recommendations of the International Competition Policy Advisory Committee to the Attorney General and the Assistant Attorney General for Antitrust' (2001) 24 *Journal of World Competition* 3 at p. 14; Eleanor Fox, 'Competition Law and the Millennium Round' (1999) 2 *Journal of International Economic Law* 665 at pp. 677–8 (Fox argues for a limited role for the WTO; according to her, only market-access competition issues belong in the WTO).

96 See Tarullo, *op. cit.*, pp. 500, 501.

97 See *ibid.*, p. 491.

98 See chapter 3 in this volume.

99 Michael Trebilcock and Robert Howse, 'Trade Liberalization and Regulatory Diversity: Reconciling Competitive Markets with Competitive Politics' (1998) 6 *European Journal of Law and Economics* 5.

19

The international movement of people

1 This chapter is derived from Michael Trebilcock, 'The Law and Economics of Immigration Policy', (2003) 5 *American Law and Economics Review* 271.

- 2 WTO, *International Trade Statistics 2000* (Geneva: WTO, 2000); OECD, *Trends in International Migration—2000 Edition* (Paris: OECD, 2001).
- 3 See Bob Hamilton and John Whalley, 'Efficiency and Distributional Implications of Global Restrictions on Labour Mobility: Calculations and Policy Implications' (1984) 14 *Journal of Development Economics* 61.
- 4 See 'Survey on Immigration', *The Economist*, 2 November 2002, p. 3.
- 5 Hamilton and Whalley, *op. cit.*, pp. 73–4.
- 6 See SCADPlus, 'The Amsterdam Treaty: A Comprehensive Guide', 17 July 2001, available online at <http://europa.eu.int/scadplus/leg/en/lvb/al1000.htm>.
- 7 *Ibid.*
- 8 See European Commission, 'The Free Movement of Workers in the Context of Enlargement', 6 March 2001, available online at http://europa.eu.int/comm/enlargement/docs/pdf/migration_enl.pdf, p. 29.
- 9 *Ibid.*, p. 32.
- 10 *Ibid.*
- 11 See International Labour Organization, 'World Migration Tops 120 Million, says ILO: 67 Countries are Now Major Receivers of Immigrants', 2 March 2000, available online at www.ilo.org/public/english/bureau/inf/pr/2000.htm. Other estimates range from 100 million to 140 million. See Sharon Stanton Russell and Michael S. Teitelbaum, 'International Migration and International Trade', World Bank Discussion Paper No. 160, Washington DC, 1992; and George J. Borjas, 'Introduction', in Borjas (ed.) *Issues in the Economics of Immigration* (Chicago: University of Chicago Press, 2000) p. 1.
- 12 See World Bank, 'Overview', *The World Development Report 2000/2001: Attacking Poverty*, p. 3, available online at www.worldbank.org/poverty/wdrpoverty/report/overview.pdf.
- 13 *Ibid.*
- 14 These effects are clear when one considers the background fact that Third World labour employed in the first world is much more productive, valuable and efficient than it is at home. This is largely attributed to the much better legal, financial and political institutions of the developed world, but is probably also due to a much larger pool of managerial talent. See Mancur Olson, 'Big Bills Left on the Sidewalk: Why Some Nations are Rich, and Others Poor' (1996) 10 *Journal of Economic Perspectives* 3 at pp. 19–20.
- 15 See, for example, Teresa Hayter, *Open Borders: The Case Against Immigration Controls* (London: Pluto Press, 2000).
- 16 This is plainly the case given that the modern welfare state provides materially for its own indigent very generously compared to those facing far graver famine and poverty in the Third World. Adam Smith long ago recognized the tendency to care more strongly for those closest to us and less strongly for those more removed. See Adam Smith, *The Theory of Moral Sentiments* (Amherst NY: Prometheus Books, 2000); see especially Part VI, Section II, Chapter I, entitled 'Of the Order in which Individuals are recommended by Nature for our care and attention'.
- 17 See, for example, Howard F. Chang, 'The Economic Analysis of Immigration Law', in Caroline Brettell and James Hollifield (eds) *Migration Theory: Talking Across Disciplines* (New York: Routledge, 2000) p. 206; and Chang, 'Migration as International Trade: The Economic Gains from the Liberalized Movement of Labor' (1998) 3 *UCLA Journal of International Law and Foreign Affairs* 371.
- 18 See George Borjas, *Heaven's Door: Immigration Policy and the American Economy* (Princeton NJ: Princeton University Press, 1999) p. 8 [hereinafter *Heaven's Door*].
- 19 In a study co-authored with colleagues Richard Freeman and Lawrence Katz, Borjas argues that adverse labour market impacts of immigration on wages are concentrated primarily on highschool dropouts. See George Borjas, Richard Freeman and Lawrence Katz, 'How Much

- Do Immigration and Trade Affect Labor Market Outcomes?' (1997) 1 *Brookings Papers on Economic Activity* 1 at pp. 62–3.
- 20 See NPG, 'Immigration Polls: Why doesn't Congress Listen to the American People?' (July 2001), available online at www.npg.org/facts/immpolls.htm.
- 21 See Julian Simon, *The Economic Consequences of Immigration* (Ann Arbor: University of Michigan Press, 2nd ed., 1999) pp. 377–84.
- 22 See Noel Gaston and Douglas Nelson, 'Immigration and Labour-Market Outcomes in the United States: A Political Economy Puzzle' (2000) 16 *Oxford Review of Economic Policy* 104; see also Gaston and Nelson, *The Wage and Employment Effects of Immigration: Perspectives from Labour and Trade Economics* (Murphy Institute of Political Economy, 2000).
- 23 See James Smith and Barry Edmonston (eds), *The New Americans: Economic, Demographic, and Fiscal Effects of Immigration* (Washington DC: National Academy Press, 1997).
- 24 *Ibid.* Quoted by Borjas *et al.*, *op. cit.*, p. 63.
- 25 Borjas *et al.*, *op. cit.*
- 26 See Gaston and Nelson, 'Immigration and Labour-Market Outcomes in the United States', *op. cit.*
- 27 *Ibid.*, p. 108.
- 28 *Ibid.*
- 29 A recent study of US data suggests that immigrants benefit disproportionately from the Social Security Program relative to the US-born. However, like the US-born, immigrants pay more into the system than they receive in benefits, thereby benefiting the US-born taken as a whole. See Alan L. Gustman and Thomas L. Steinmeier, 'Social Security Benefits of Immigrants and U.S. Born', in Borjas (ed.), *op. cit.*, pp. 309–50.
- 30 The 'NRC study' is Smith and Edmonston (eds), *op. cit.*
- 31 *Ibid.*, p. 334.
- 32 See Borjas *et al.*, *op. cit.*, p. 125.
- 33 *Ibid.*
- 34 For example, is the public education system paid for by current taxpayers, or are students assumed to 'pay back' the cost of their education once they enter the labour market? Similarly, is the range of existing public infrastructure (such as bridges and roads) already considered 'paid for', or are the costs associated with it amortized over time? If it is amortized, over what time period?
- 35 Simon's actual estimate of the benefits of each immigrant is between \$15,000 and \$20,000 (constant 1975). See Simon, *op. cit.*, pp. 206–19, 371. For comparability, however, we have converted this range into 1996 dollars using GDP deflator data available from the US Bureau of Economic Accounts. In the data, 1975 is given an index value of 40.027, whereas 1996 is assigned an index value of 100, generating a factor of approximately 2.5 necessary to compare benefits between the periods. See US Bureau of Economic Accounts, 'National Accounts Data: Historical Data for Chain-type Indexes Accurate to 3 Decimal Places (31 Files in Plain Text Format), Quarterly and Annual, 1929:I–1997:IV' (August 2001).
- 36 See Michael Trebilcock, 'The Case for a Liberal Immigration Policy', in Warren F. Schwartz (ed.) *Justice in Immigration* (Cambridge: Cambridge University Press, 1995) pp. 233–4. See also Jagdish Bhagwati, 'Behind the Green Card', in Bhagwati (ed.) *A Stream of Windows: Unsettling Reflections on Trade, Immigration, and Democracy* (Cambridge MA: MIT Press, 1998) pp. 320–4.
- 37 See Borjas *et al.*, *op. cit.*, pp. 90–2.
- 38 See Economic Council of Canada, *Economic and Social Impacts of Immigration* (Ottawa: Supply and Services, 1991) p. 25.
- 39 According to Statistics Canada census figures, there were 4,971,070 immigrants living in Canada in 1996. See Statistics Canada, 'Immigrant Population by Place of Birth and Period

- of Immigration (1996 Census)', available online at <http://www.statcan.ca/english/Pgdb/demo25a.htm>.
- 40 Canada's per capita GDP in 1999 in US dollars was approximately \$23,300. See *The World Factbook 2000 Online*, available at www.bartleby.com/151/45.html.
- 41 Some commentators believe that the point where the costs of immigration exceed its benefits may be close to being attained, that is if the point has not been exceeded already. See, for example, Vernon M. Briggs, *Mass Immigration and the National Interest* (Armonk NY: M.E. Sharpe, 1992), and Roy H. Beck, *The Case Against Immigration: The Moral, Economic, Social, and Environmental Reasons for Reducing US Immigration to Traditional Levels* (New York: W.W. Norton & Co., 1996). See also Christopher Jencks, 'Who Should Get In?', *New York Review of Books*, 29 November 2001, and Jencks, 'Who Should Get In? Part II', *New York Review of Books*, 20 December 2001. Jencks argues that one of the major problems associated with current levels of immigration is the lack of successful integration of many second-generation immigrants—especially Latinos—into US society. For similar Canadian perspectives, see Diane Francis, *Immigration: The Economic Case* (Toronto: Key Porter Books, 2002); Martin Collacott, 'Canada's Immigration Policies: The Need for Major Reform', *Public Policy Sources* 64, Fraser Institute, Vancouver, September 2002; and Daniel Stoffman, *Who Gets In: What's Wrong with Canada's Immigration Program, and How to Fix It* (Toronto: Macfarlane Walter & Ross, 2002).
- 42 Borjas, *Heaven's Door*, *op. cit.*
- 43 Jeffrey Reitz, 'Immigrant Success in the Knowledge Economy: Institutional Change and the Immigrant Experience in Canada 1970–1975' (2001) 57 *Journal of Social Issues* 579.
- 44 See, for example, Simon, *op. cit.*, p. 296. The examples of employees who might not capture their full marginal product in their wages are adapted from Simon.
- 45 Some might object that these externalities are really just examples of consumer surplus brought about by competition in reducing prices of the services provided. The distinction is largely semantic, and in any case the loss of these types of consumer surplus still represents a loss to the country of origin if the skilled worker emigrates.
- 46 See Augustine Oyowe, 'Brain Drain Colossal Loss of Investment for African Countries' (1996) 159 *Courier ACP-EU*, pp. 59–60.
- 47 See IMF, *Balance of Payments Statistics Yearbook 1998* (Washington DC: IMF, 1998).
- 48 Oyowe, *op. cit.*
- 49 Robert Goldfarb, Oli Havrylyshyn and Stephen Magnum, 'Can Remittances Compensate for Manpower Outflows: The Case of Philippine Physicians' (1984) 15 *Journal of Development Economics* 1.
- 50 See A. Mountford, 'Can a Brain Drain Be Good for Growth in the Source Economy?' (1997) 53 *Journal of Development Economics* 287; O. Stark, C. Helmenstein and A. Prskawetz, 'A Brain Gain with a Brain Drain' (1997) 55 *Economics Letters* 227; and J.P. Vidal, 'The Effect of Emigration on Human Capital Formation' (1998) 11 *Journal of Population Economics* 4. See also David Dollar and Paul Collier, *Globalization, Growth and Poverty: Building an Inclusive World Economy* (World Bank and Oxford University Press, 2001) p. 82.
- 51 See Michel Beine, Frederic Docquier and Hillel Rapoport, 'Brain Drain and Economic Growth: Theory and Evidence' (2001) 64 *Journal of Development Economics* 275.
- 52 Health-based exclusions are not self-defining. Consider Section 19(1) of the Canadian Immigration Act, R.S.C. 1985, c. I–2, which provides (in part) that:

(1) No person shall be granted admission who is a member of any of the following classes:

- (a) persons who are suffering from any disease, disorder, disability or other health impairment as a result of the nature, severity or probable

duration of which, in the opinion of a medical officer concurred in by at least one other medical officer,

- (i) they are or are likely to be a danger to public health or to public safety, or
- (ii) their admission would cause or might reasonably be expected to cause excessive demands on health or social services.

Exactly what constitutes ‘a danger to public health or to public safety’ or what might ‘reasonably be expected to cause excessive demands on health or social services’ is often far from clear.

53 See Alan O.Sykes, ‘The Welfare Economics of Immigration Law’, in Schwartz (ed.), *op. cit.*

54 Criminality-based exclusions, like health-based exclusions, are not self-defining. See Section 19(1) of the Canadian Immigration Act, R.S.C. 1985, c. I-2, which (in part) provides that:

(1) No person shall be granted admission who is a member of any of the following classes:

(c.1) persons who there are reasonable grounds to believe:

- (i) have been convicted outside Canada of an offence that, if committed in Canada, would constitute an offence that may be punishable under any Act of Parliament by a maximum term of imprisonment of ten years or more, or
- (ii) have committed outside Canada an act or omission that constitutes an offence under the laws of the place where the act or omission occurred and that, if committed in Canada, would constitute an offence that may be punishable under any Act of Parliament by a maximum term of imprisonment of ten years or more,

except persons who have satisfied the Minister that they have rehabilitated themselves and that at least five years have elapsed since the expiration of any sentence imposed for the offence or since the commission of the act or omission, as the case may be.

55 The US alone spends over \$100 billion per year on law enforcement. See Peter H.Schuck and John Williams, ‘Removing Criminal Aliens: The Promises and Pitfalls of Federalism’ (1999) 22 *Harvard Journal of Law & Public Policy* 367 at p. 382.

56 Arnold De Silva has found that earnings of refugees and economic immigrants differ initially but converge rather quickly in the Canadian labour market. De Silva argues that in Canada, the single most important determinant of labour market success is age and that skills-based screening may be largely ineffectual. See Arnold De Silva, ‘Earnings of Immigrant Classes in the Early 1980s in Canada: A Reexamination’ (1997) 23 *Canadian Public Policy* 179.

57 See, for example, Alan Green and David Green, ‘Canadian Immigration Policy: The Effectiveness of the Point System and other Instruments’ (1995) 28 *Canadian Journal of Economics* 1006, and Paul Miller, ‘Immigration Policy and Immigrant Quality: The Australian Points System’ (1999) 89 *American Economic Review Papers and Proceedings* 192.

58 The Australian policy of demanding pledge bonds probably increases the desirability of family sponsored immigration, all else being the same, and is likely a much more effective means of ensuring independence from social programmes than the simple promises to

support family members elicited in the context of family sponsored immigrants to Canada. See the discussion of these policies below.

- 59 This discussion draws heavily on earlier work. See Trebilcock, 'The Case for a Liberal Immigration Policy', *op. cit.*, pp. 219–44.
- 60 For a discussion, see Peter Schuck, 'Immigration Law and the Problem of Community', in Nathan Glazer (ed.) *Clamor at the Gates* (San Francisco: Institute for Contemporary Studies, 1985) pp. 285–307. See also Schuck, *Citizens, Immigrants and In-Betweens: Essays on Immigration and Citizenship* (Boulder CO: Westview Press, 1998).
- 61 See, for example, Howard F. Chang, 'Immigration Policy, Liberal Principles, and the Republican Tradition' (1997) 85 *Georgetown Law Journal* 2105.
- 62 Pursuant to Australia's 'White Australia' immigration policy, it was very difficult for nonEuropeans to be admitted to Australia prior to the mid-1970s. See, for example, Nancy Viviani (ed.), 'The Abolition of the White Australia Policy: The Immigration Reform Group Revisited', Centre for the Study of Australia-Asia Relations, Working Paper No. 65, Faculty of Asian and International Studies, Griffith University, Queensland, June 1992. For a historical account of racial and ethnic discrimination in the Canadian immigration policy context, see Ninette Kelley and Michael Trebilcock, *The Making of the Mosaic: A History of Canadian Immigration Policy* (Toronto: University of Toronto Press, 1998).
- 63 This occurs to the greatest extent in the USA because a large majority of the immigrants—72 per cent—are admitted based on family ties. See United States Immigration and Naturalization Service, *1998 Statistical Yearbook of the Immigration and Naturalization Service* (Washington, DC: U.S. Government Printing Office, 2000) at 17.
- 64 See Christian Joppke, *Immigration and the Nation-State: The United States, Germany and Great Britain* (Oxford: Oxford University Press, 1999) p. 26.
- 65 *Ibid.*
- 66 See Peter Brimelow, *Alien Nation: Common Sense About America's Immigration Disaster* (New York: Random House, 1995) p. xv.
- 67 *Ibid.*, p. 10.
- 68 For an expanded discussion and analysis of Brimelow's attack on those in favour of increased immigration, see Schuck, *Citizens, Immigrants and In-Betweens*, *op. cit.*, Ch. 14.
- 69 See Michael Walzer, *Spheres of Justice* (New York: Basic Books, 1983).
- 70 *Ibid.*, pp. 61–2.
- 71 See Arthur M. Schlesinger Jr, *The Disuniting of America* (New York: W.W. Norton & Co., 1992) pp. 17–18.
- 72 See Joseph Carens, Aliens and Citizens: The Case for Open Borders' (1987) 47 *Review of Politics* 251.
- 73 See Robert Nozick, *Anarchy, State and Utopia* (Oxford: Basil Blackwell, 1974).
- 74 See John Rawls, *A Theory of Justice* (Cambridge MA: Harvard University Press, 1971).
- 75 See Carens, *op. cit.*, p. 256.
- 76 Alan Sykes has argued, however, that open borders may be the first-best solution if such a policy were coupled with changes to social programmes making them inaccessible to non-citizens. Sykes acknowledges, however, that the political process may not accommodate these restrictions with ease, and that these modifications may not be legally feasible. See Sykes, *op. cit.*, p. 176.
- 77 This has recently changed in Canada. On 15 December 2001, the new Immigration and Refugee Protection Regulations—which took effect as of 28 June 2002—were introduced. Among the changes are a new points system that scores prospective immigrants on six criteria, including age, education, experience, language ability, arranged employment and adaptability, eschewing previously scored categories such as occupation which granted points to immigrants seeking to work in areas perceived to have the greatest labour demand. For the full text of the proposed regulations, see Immigration and Refugee Protection Regulations, *Canada Gazette*, 2001.I.4477.

- 78 Jagdish Bhagwati has long advocated a liberal approach to encouraging foreign students to stay on in the United States after they have completed their formal education. See, for example, Jagdish Bhagwati, 'The False Alarm of Too Many Scientists', in Bhagwati (ed.) *A Stream of Windows: Unsettling Reflections on Trade, Immigration, and Democracy* (Cambridge MA: MIT Press, 1998) p. 363. At p. 368, Bhagwati remarks that the 'intelligent and highly motivated foreign students who come to this country for scientific education and then "stay on" in large numbers assimilate readily, becoming indistinguishable from native-born Americans. The scientific eminence of the United States thus reflects a virtuous circle: the best and brightest from around the world are attracted to our universities, and they in turn help make our universities world class.'
- 79 See Chang, 'The Economic Analysis of Immigration Law', *op. cit.*, p. 220.
- 80 See De Silva, *op. cit.*
- 81 See CIC, *Planning Now for Canada's Future* (Ottawa: Minister of Public Works and Government Services Canada, 2001) Appendix B, p. 29.
- 82 *Ibid.*, p. 21.
- 83 According to the Ontario government, in the year 2000 there were approximately 17,000 defaulted sponsors in Ontario alone and immigrants whose sponsors defaulted collected approximately \$125 million of social assistance. See Ontario Ministry of Community and Social Services, 'Baird Condemns Federal Liberals for Promoting World Wide Welfare', 5 April 2000.
- 84 For the full details, see Australian Department of Immigration and Multicultural Affairs, 'DIMA Fact Sheet 27: Family Stream Immigration—An Overview', 13 December 2000.
- 85 See Gary Becker and Guity Nashat Becker, *The Economics of Life* (McGraw-Hill, 1997) pp. 58–9; Simon, *op. cit.*, pp. 357–63; and Simon, 'The Price of Citizenship—Auctioning Immigration Visas Helps Foreigners and Americans Alike' (1987) 39 *Policy Review* 71.
- 86 See Michael Porter, 'Clusters and Competition: New Agendas for Companies, Governments and Institutions', in Porter (ed.) *On Competition* (Boston MA: Harvard Business School Publishing, 1998).
- 87 See Jeffrey Reitz, *Warmth of the Welcome* (Boulder CO: Westview Press, 1998).

20

Concluding postscript

- 1 See Christoph Beat Graber, 'Audiovisual Media and the Law of the WTO', in Christoph Beat Graber, Michael Girsberger and Mira Nenova (eds), *Free Trade versus Cultural Diversity* (Zürich: Schulthess, 2004) pp. 15–64. See also Graber, *Handel und Kultur im Audiovisionsrecht der WTO. Völkerrechtliche, ökonomische und kulturpolitische Grundlagen einer globalen Medienordnung* (Bern: Stämpfli Verlag, 2003). Professor Graber is becoming the leading scholar in the area of trade and culture, and what follows draws extensively from his work, along with the outstanding work also of Mary Footer. See Footer and Graber, 'Trade Liberalization and Cultural Policy' (2000) *Journal of International Economic Law* 115. See also the excellent article B. de Witte, 'Trade in Culture: International Legal Regimes and EU Constitutional Values', in Grainne de Burca and Joanne Scott (eds) *The EU and the WTO: Legal and Constitutional Values* (Oxford: Hart, 2001) pp. 237–56, and Peter Grant and Chris Wood, *Blockbusters and Trade Wars: Popular Culture in Globalized World* (Toronto: Douglas & M'Intyre, 2004).
- 2 See Footer and Graber, *op. cit.*, p. 117.
- 3 See Rosemary Coombe, *The Cultural Life of Intellectual Properties* (Durham NC: Duke University Press, 1998).

- 4 See I. Bernier, 'A UNESCO Convention on Cultural Diversity', in Graber *et al.* (eds), *op. cit.*, pp. 65–76.
- 5 J. Pauwelyn, 'WTO Compassion or Superiority Complex? What to Make of the WTO Waiver for Conflict Diamonds' (2003–04) 24 *Michigan Journal of International Law* 1177.
- 6 See R. Keohane, 'The Club Model of Multilateral Cooperation and the World Trade Organization: Problems of Democratic Legitimacy', in Roger B. Porter, Pierre Sauvé, Arvind Subramanian and Americo Beviglia Zampetti (eds) *Efficiency, Equity, and Legitimacy: The Multilateral Trading System at the Millennium* (Washington DC: Brookings Institution, 2001).
- 7 S. Ostry, 'Civil Society: Consultation in Negotiations and Implementation of Trade Liberalization and Integrated Agreements: An Overview of the Issue', paper presented at Good Practices on Social Inclusion: A Dialogue Between Europe and the Caribbean and Latin America, IDB seminar, Milan, March 2003, p. 4. Robert Howse is grateful to Ostry for discussions of these issues on various occasions.

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