

A Study on WTO Consistency, Relevance of other International Agreements,
Economic Effectiveness and Impact on Developing Countries of Measures
concerning Non-Product-Related Processes and Production Methods

UNILATERAL MEASURES ADDRESSING NON-TRADE CONCERNS

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Foreword

Who could be against compliance with basic labour standards, the prevention of child labour, the promotion of sustainable development and the protection of biodiversity, the environment and animal welfare? If the question is posed in these terms, any right-thinking person is of course in favour of all these things. The next relevant questions for policy makers are: what is the best way to take account of these societal concerns and values, especially when it comes to promoting them in other countries? And how will developing countries be affected if their exports are denied access to the markets of developed countries in an effort to enforce compliance with rules and standards that are designed to meet these concerns and values? These are complex and sensitive questions, particularly when one considers that such rules and standards are often intimately related to a country's standard of living and general level of development.

Societal concerns like those mentioned above are often referred to as non-trade concerns (NTCs). They are at the centre of a debate within the World Trade Organization (WTO) and the European Union (EU), and with many third countries, including developing countries. Attempts to meet non-trade concerns through domestic regulation in the form of rules and standards almost always have repercussions and unintended side effects on world trade and its continued liberalisation, as well as on poverty alleviation and sustainable development. How can we deal with this challenge? It is the position of the Dutch government that non-trade concerns deserve attention, because of their intrinsic importance and because ignoring them would undermine public support for the multilateral trading system. This view is shared by many members of parliament who have been urging the government to take an active role in the matter. The Dutch government is eager to examine to what extent it is possible and desirable to address non-trade concerns while ensuring the achievement of the Millennium Development Goals, what role it can (and should) play in that process and what policy instruments are best suited for the job. It is important to bear in mind that any measure designed to achieve non-trade concern objectives should meet Dutch and European WTO obligations without having a discriminatory or trade distorting effect.

These considerations are, however, only a first step; there is no national or international consensus on what non-trade concerns entail, which of them are truly global or cross-border in nature, what measures are permitted under current WTO rules and what instruments will actually work in practice. As regards the WTO's legal framework, it is uncertain where the grey area lies in the interpretation of treaties, how WTO case law evolves and what the relationship is to other international treaties containing trade-related provisions. Governments, legal experts, and representatives of non-governmental organisations (NGOs) and the private sector have widely divergent views on the WTO conformity and the

effectiveness of different instruments in the mounting debate on addressing non-trade concerns.

As demand continues to grow for some kind of public intervention, non-trade concerns have already left their mark in various areas of policy. We see evidence of this in the form of sustainability requirements for products such as biofuels, timber and fish and requirements related to improved working conditions and animal welfare. Where these societal concerns manifest themselves in unilateral, mandatory instruments, the link to trade can sometimes generate tension with the legally binding framework of the WTO. It is not always clear to what extent such a link is possible and/or desirable in policy terms.

Given this lack of clarity, a study was conducted under the auspices of the Ministry of Foreign Affairs by three leading experts on international economic and public law, economics and non-trade concerns. The study focused on unilateral measures that lay down rules for production processes and methods in the producing country that do not or hardly affect the properties of the product or the market and the environment in the importing country. The study also examined a number of specific measures to assess their (potential) economic impact on developing countries.

I am pleased to have been given the opportunity to write this foreword to the report you are now reading, which was published by my Ministry. In my opinion it is a unique study that will make an important contribution to the academic and public debate and the development of public-sector policy (especially trade policy), both here and abroad. It also offers guidance on the possible roles that society and the private sector can play. For the record, I should point out that the analyses and conclusions presented in this book do not necessarily represent the opinion of the Dutch government.

Obviously, this study is not the last word on the subject. The Dutch government intends to reflect further on its stance on non-trade concerns. At the start of 2008 we plan to release a new position paper which will be debated with parliament. Prior to this, the Ministry of Economic Affairs will organise a broad-based, public dialogue on non-trade concerns in which all relevant ministries will participate. That dialogue will solicit input from all other relevant stakeholders and involve the present study as well.

Of course, I will continue to support every initiative that seeks to improve the environment, working conditions and animal welfare, whether here or in developing countries. I do recognise the sense of urgency that some feel with regard to certain non-trade concerns. As Minister for Development Cooperation, I also see it as my duty to ensure that Dutch and EU policies on non-trade concerns

respect the sovereignty and the priorities of the developing countries without reverting to neo-protectionism. I share their suspicion that some trade measures ostensibly aimed at rectifying non-trade concerns are actually prompted by protectionist motives. Certain unilateral measures are being presented as socially responsible, even though they have the effect of providing unfair protection to European or Dutch producers.

I have always been an advocate of dialogue and the pursuit of joint solutions that offer opportunities for all parties involved. These opportunities may come in the form of voluntary partnerships and customised multilateral frameworks that could contain effective trade measures. But there is no sense in unilaterally shutting out products from developing countries that do not accommodate or meet our societal concerns. Not only will this not solve the problems in question; by taking this drastic step, we would also be depriving these countries of the chance to trade and grow towards a workable solution. Only by working together to develop international standards that take account of common but differentiated responsibilities, different circumstances and capacity, we can achieve sustainable development on a global scale, reduce poverty and raise the level of labour standards, environmental protection and animal welfare.

I hope this book contributes to a broad-based international dialogue, in which the participants carry out careful analyses and listen to one another, and where the discussion results in a balanced outcome that does justice to all interests and interested parties.

Bert Koenders
Minister for Development Cooperation

Preface

This study on *Unilateral Measures addressing Non-Trade Concerns* was carried out at the request of the Netherlands Ministry of Foreign Affairs by Peter Van den Bossche, Professor of International Economic Law at the Faculty of Law of the Universiteit Maastricht, Nico Schrijver, Professor of Public International Law at the Faculty of Law of the Universiteit Leiden and Gerrit Faber, Associate Professor in International Economics at the Utrecht School of Economics of the Universiteit Utrecht.

The Introduction and Part 1 of this report (on the consistency with the obligations under the *WTO Agreement*) were written by Peter Van den Bossche. Part 2, on the relevance of other international agreements and measures, was written by Nico Schrijver, and Part 3, on economic efficiency and effectiveness, as well as the impact on developing countries, was written by Gerrit Faber. The Executive Summary and the Conclusions were prepared by all three authors.

Peter Van den Bossche wishes to thank Lorin van Nuland and Marieke van Overveld and Denise Prévost for their invaluable assistance during the research and in the writing of this report. Likewise, Nico Schrijver wishes to thank Daniëlla Dam.

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Acronyms and abbreviations

ACP	African, Caribbean and Pacific countries
AMS	aggregate measurement of support
AW	animal welfare
CAP	Common Agricultural Policy (EU)
CCC	Customs Cooperation Council
CENELEC	European Committee for Electrotechnical Standardization
CFC	chlorofluorocarbon
CITES	Convention on International Trade in Endangered Species of Wild Fauna and Flora
COMESA	Common Market of Eastern and Southern Africa
CSR	corporate social responsibility
CTE	Committee on Trade and Environment (WTO)
DDA	Doha Development Agenda
DFQF	duty-free quota-free
DSB	Dispute Settlement Body (WTO)
DSU	Dispute Settlement Understanding (WTO)
EAC	East African Community
EBA	Everything but Arms initiative (EU)
EC	European Communities
EEA	European Environment Agency
EU	European Union
EurepGAP	Euro Retailer Working Group (EUREP) Good Agricultural Practices
FAO	United Nations Food and Agriculture Organization
FICCI	Federation of Indian Chambers of Commerce and Industry
FDI	foreign direct investment
FSC	Forest Stewardship Council
FTA	free trade agreement
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GHG	greenhouse gas
GMO	genetically modified organism
GSP	Generalized System of Preferences
HS	Harmonized Commodity Description and Coding System
IBB	<i>Subsidieprogramma CO₂-reductie Innovatieve Biobrandstoffen</i> programme
ICFTU	International Confederation of Free Trade Unions
ICTSD	International Centre for Trade and Sustainable Development
IEA	International Energy Agency
IECEE	Worldwide System for Conformity Testing and Certification of Electrical Equipment
IFA	International Accreditation Forum
ILO	International Labour Organization
ISO	International Organization for Standardization
LDC	least developed country

LEI	Agricultural Economics Research Institute (the Netherlands)
LTO	
Nederland	<i>Land- en Tuinbouworganisatie Nederland</i>
NGO	non-governmental organization
nPR PPMs	non-product-related processes and production methods
NTCs	non-trade concerns
MEA	multilateral environmental agreement
MEP	<i>Subsidieregeling Milieukwaliteit van de Elektriciteitsproductie</i> programme
Mercosur	Common Market of the South
MFN	Most Favoured Nation
ODS	ozone-depleting substance
OECD	Organisation for Economic Co-operation and Development
OIE	World Organization for Animal Health
PCG	polyvinyl alcohol (PVA), cellulose and glass fibres
PPM	processes and production methods
PR PPMs	product-related processes and production methods
SADC	Southern Africa Development Community
SAN	Sustainable Agriculture Network
SCM	Subsidies and Countervailing Measures (Agreement)
SMEs	small and medium enterprises
SPS	Sanitary and Phytosanitary (Agreement)
TBT	Technical Barriers to Trade (Agreement)
TCDA	Trade, Cooperation and Development Agreement
TRIMs	trade-related investment measures
UKR	<i>Unieke Kansenregeling</i> programme
UNCTAD	United Nations Conference on Trade and Development
UNESCO	United Nations Educational, Scientific and Cultural Organization
WCO	World Customs Organization
WHO	World Health Organization
WTO	World Trade Organization

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EXECUTIVE SUMMARY

Introduction

The Netherlands is highly dependent on international trade for its economic prosperity. Successive Dutch governments have, therefore, always supported the further liberalization of international trade. At the same time, the public debate on economic globalization and international trade reveals that citizens as well as policy makers fear the corrosive impact of international trade on the core societal values on which Dutch society is founded. They fear that international trade, in particular a further liberalization thereof, may undermine or put at risk policies and measures for the protection of public health, the environment, labour rights, social welfare, good governance, national security, cultural identity, food safety, access to knowledge, consumer interests and animal welfare. There is a general consensus in the Netherlands that these *non-trade concerns* (NTC's), which cover very different societal aspirations and fears, must be addressed in Dutch government policy and measures relating to international trade.

Many of the trade measures introduced by developed countries to address *non-trade concerns* have been met by developing countries with much suspicion and opposition. Developing countries often suspect that such measures are inspired by protectionist motives and intentions, rather than genuine non-trade concerns. Moreover, developing countries perceive these measures as an attempt by developed countries to impose their social, ethical or cultural values and preferences on exporting developing countries.

Over the last two years, the debate in the Netherlands on trade measures addressing *non-trade concerns* has focused on two important and politically sensitive issues, namely:

- the sustainability of the large-scale production of biomass as an alternative source of energy; and
- the production of livestock products in a manner that is consistent with animal welfare requirements.

With regard to the first issue – sustainable biomass production – in February 2007 the Project Group *Duurzame Productie van Biomassa*, a commission established by the government and chaired by Jacqueline Cramer (hereinafter the 'Cramer Commission'), issued a report on the *Toetsingskader voor Duurzame Biomassa* (hereinafter the 'Cramer Report'). This report discusses the risks associated with large-scale biomass production and establishes a list of criteria for the sustainable production of biomass. These criteria (hereinafter the 'Cramer sustainability criteria') reflect a broad range of non-trade concerns, including environmental protection, global warming, food security, biodiversity, economic prosperity and social welfare. The Cramer Report invites the Dutch government to give effect to the Cramer sustainability criteria by incorporating them into relevant policy

instruments. The report recognizes, however, that the implementation of the Cramer sustainability criteria (including the establishment of a certification system) will require careful consideration of the obligations of the Netherlands under EU and WTO law.

With regard to the second issue – animal welfare – modern methods of intensive agricultural production have generated, especially in Europe, increased concern about the treatment of farm animals, in particular with regard to their housing, nutrition, transportation and slaughter. Individual EU Member States, including the Netherlands, as well as the EU itself, have adopted wide-ranging animal welfare legislation.

Governments called upon to address non-trade concerns may do so by using different types of measures. Prominent among these are measures concerning processes and production methods of products. These measures may concern either:

- *product-related* processes and production methods (PR PPMs), i.e. measures that prescribe processes and production methods that affect the characteristics of products (e.g. measures prohibiting the use of growth hormones for cattle in the production of meat, or prohibiting the use of pesticides in the production of vegetables); or
- *non-product-related* processes and production methods (nPR PPMs), i.e. measures that prescribe processes and production methods that do *not*, or in a negligible manner only, affect the characteristics of the products (e.g. a measure requiring that tuna fishing vessels use dolphin-friendly nets).

The second type of measure, i.e. measures concerning nPR PPMs, is – much more than measures concerning PR PPMs – the subject of controversy. Pursuant to its terms of reference, this study therefore focuses on three main issues relating to unilateral *non-product-related* PPM measures addressing non-trade concerns, namely:

- the consistency of unilateral nPR PPM measures addressing non-trade concerns with the obligations under the *WTO Agreement* (see Part 1);
- the relevance of other international agreements for unilateral nPR PPM measures addressing non-trade concerns (see Part 2); and
- the economic effectiveness and efficiency, as well as the impact on developing countries, of unilateral nPR PPM measures addressing non-trade concerns (see Part 3).

In the present study, these issues are examined primarily with regard to existing, proposed or still purely hypothetical measures for implementing the Cramer criteria for the sustainable production of biomass, or measures for the protection and promotion of animal welfare.

Part 1 WTO Consistency of Unilateral nPR PPM Measures addressing Non-Trade Concerns

Part 1 of this study deals with the consistency with WTO law of unilateral measures concerning non-product-related processes and production methods (nPR PPMs) addressing non-trade concerns (NTCs). In WTO law, four categories of basic substantive rules can be distinguished:

- rules on non-discrimination, including the Most Favoured Nation (MFN) treatment obligation and the national treatment obligation;
- rules on market access, including rules on tariff and non-tariff barriers to trade;
- rules on ‘unfair’ trade, including rules on anti-dumping duties, subsidies and countervailing duties; and
- rules on conflicts between trade liberalization and other societal values and interests, including the general public policy exceptions, the national and international security exceptions; the economic emergency exception; the regional integration exceptions and the rules on special and differential treatment of developing countries. These exceptions allow WTO members to maintain or adopt otherwise WTO-inconsistent measures in order to address non-trade concerns.

These basic substantive rules (and exceptions) of WTO law are set out in the annexes to the 1994 *Marrakesh Agreement Establishing the World Trade Organization* (the ‘*WTO Agreement*’). These annexes contain in total 19 WTO agreements. In view of the focus of this study on unilateral measures concerning nPR PPMs, not all of the WTO agreements are of relevance. In this study, the focus is on the obligations and exceptions set out in the WTO agreements on trade in goods, and in particular, the *General Agreement on Tariffs and Trade* (‘the GATT 1994’), the *Agreement on Technical Barriers to Trade* (the ‘*TBT Agreement*’), the *Agreement on Subsidies and Countervailing Measures* (the ‘*SCM Agreement*’) and the *Agreement on Agriculture*.

Relevant obligations under the GATT 1994

In examining the consistency with the GATT 1994 of nPR PPM measures addressing non-trade concerns such as the sustainability of biomass production or animal welfare, the most relevant obligations are, first of all, the non-discrimination obligations of the GATT 1994, namely:

- the MFN treatment obligation of Article I:1; and
- the national treatment obligation of Article III.

Article I:1 of the GATT 1994 prohibits discrimination between like products originating in, or destined for, different countries. The principal purpose of the MFN treatment obligation of Article I:1 is to ensure equality of opportunity to import

from, or to export to, all WTO Members. Article III of the GATT 1994 prohibits discrimination against imported products. Generally speaking, it prohibits Members from treating imported products less favourably than like domestic products once the imported products have entered the domestic market. Article III obliges WTO Members to provide equality of competitive conditions for imported products in relation to domestic products. The principal purpose of the national treatment obligation of Article III is to ensure that internal taxes (Article III:2) or internal regulation (Article III:4) 'not be applied to imported or domestic products so as to afford protection to domestic production'. With respect to internal taxes, Article III:2, first sentence, requires that imported products not be taxed in excess of like domestic products, while Article III:2, second sentence, requires that the imported products not be taxed such as to afford protection to directly competitive or substitutable domestic products. With respect to internal regulation, Article III:4 requires that imported products be treated no less favourably than like domestic products.

The present report contains a detailed analysis of the requirements of each of the non-discrimination obligations under Articles I and III of the GATT 1994, and the relevance of these obligations for existing, proposed or still purely hypothetical measures implementing the Cramer criteria for the sustainable production of biomass, or measures for the protection and promotion of animal welfare. This Executive Summary, however, focuses on only three issues that are of particular relevance in the examination of the consistency of nPR PPM measures addressing Non-trade concerns with the GATT non-discrimination obligations.

The first of these issues is whether the process and production method (PPM) by which a product is produced is of relevance in determining whether products are 'like'. Generally speaking, the non-discrimination obligations apply only between 'like products'. Products that are not 'like' may be treated differently. Therefore, the determination of whether products are like (or not), is important. It is debated whether, under current WTO law, the PPM by which a product is produced is relevant in determining whether products are 'like' if that PPM does not affect the physical characteristics of the product.

It is often said that such nPR PPMs are not relevant. This was definitely the conclusion reached by the GATT Panel in the *US – Tuna I (Mexico)* case in 1991. In line with this case law, one might conclude that biomass produced inconsistently with the Cramer sustainability criteria is 'like' biomass produced consistently with these criteria; and that livestock products not produced consistently with animal welfare requirements are 'like' livestock products produced consistently with these requirements. However, the case law on the concept of 'likeness' has evolved since the 1991 *US – Tuna I (Mexico)* case. The question of whether nPR PPMs may be of relevance in the determination of 'likeness' now requires a more nuanced answer

than that given by the Panel in *US – Tuna I (Mexico)*. As the Appellate Body ruled in 2001 in *EC – Asbestos*, the determination of 'likeness' is, fundamentally, a determination about the nature and extent of a competitive relationship between and among products. It should be noted that the manner in which products are made (i.e. PPMs), may have an impact on the preferences and tastes of consumers for these products, and thus on the nature and the extent of the competitive relationship between these products. If carpets made by children are shunned by consumers in a particular market, a situation may arise in which there is in fact no (or only a weak) competitive relationship between these carpets and carpets made by adults. In the light of the nature and the extent of the competitive relationship between them, carpets made by children and carpets made by adults could in such a situation be found not to be 'like'. However, it seems unlikely that this type of situation will often arise as consumers in most markets are in their choice between products primarily guided by the price and other aspects that are not related to the conditions (e.g. environmental, labour or animal welfare conditions) under which the products were produced.

The second issue relating to the non-discrimination obligations of the GATT 1994 to be addressed in this Executive Summary also concerns the concept of 'likeness'. The GATT Panel in the *US – Malt Beverages* case ruled in 1992 that in determining whether two products subject to different treatment are 'like' products, it is necessary to consider whether such product differentiation is being made 'so as to afford protection to domestic production'. According to this case law, products that are treated differently for reasons other than the protection of domestic production (such as the protection of the environment or public health) are not 'like' products. This so-called 'aim-and-effect' test for determining 'likeness' was, however, rejected in 1996 by the Panel in *Japan – Alcoholic Beverages II* and has never been applied by WTO panels or the Appellate Body.

The third issue relating to the non-discrimination obligations of the GATT 1994 to be addressed in this Executive Summary concerns the requirement of 'treatment no less favourable' of Article III:4. The fact that a measure distinguishes between 'like products' does not suffice to conclude that this measure is inconsistent with Article III:4. As the Appellate Body ruled in *Korea – Various Measures on Beef*, the formal difference in treatment between domestic and imported 'like' products is *neither necessary nor sufficient* for a violation of Article III:4. Formally different treatment of imported products does not necessarily constitute less favourable treatment, while the absence of formal difference in treatment did not necessarily mean that there was no less favourable treatment. Whether or not imported products are treated 'less favourably' than like domestic products should be assessed instead by examining whether a measure modifies the *conditions of competition* in the relevant market to the detriment of imported products. However, as the Appellate Body ruled in 2005 in *Dominican Republic –*

Import and sale of Cigarettes, the existence of a detrimental effect on a given imported product resulting from a measure does not necessarily imply that this measure accords less favourable treatment to imports if the detrimental effect is explained by factors or circumstances unrelated to the foreign origin of the product, such as the market share of the importer in this case.

In examining the consistency with the GATT 1994 of nPR PPM measures addressing non-trade concerns such as the sustainability of biomass production or animal welfare, other relevant obligations under the GATT 1994 are

- the obligations regarding tariffs of Article II; and
- the obligations regarding non-tariff barriers of Article XI.

With regard to tariffs, Article II:1(a) and (b), first sentence, of the GATT 1994 prohibit Members to impose customs duties above the maximum level (i.e. the tariff binding) to which they have committed themselves during tariff negotiations. On the tariff classification of products there are no specific GATT rules. Note, however, that, as the GATT Panel in *Spain – Unroasted Coffee* ruled in 1981, the general MFN treatment obligation also applies to tariff classification.

‘Like’ products can, therefore, not be classified differently. Article II:1(b), second sentence, prohibits duties and charges other than ordinary customs duties:

- unless (and then only to the extent that) these other duties and charges have been recorded in the Goods Schedule of the Member concerned; or
- unless the duties and charges fall under one of the three exceptions provided for under Article II:2.

With regard to the first of these exceptions, namely, the exception relating to border tax adjustment, note that through border tax adjustment WTO Members may impose domestic taxes and charges on imports, and exempt or reimburse them on exports. It is quite doubtful, however, that border tax adjustment is permitted for taxes related to nPR PPMs (such as a special domestic tax on non-free-range eggs).

With regard to non-tariff barriers, Article XI:1 of the GATT 1994 provides for a straightforward prohibition of quantitative restrictions on trade in goods. While it is clear that the scope of application of Article XI:1 covers more than bans and quotas, it is unclear how broad is its scope of application. It has been argued that nPR PPM measures are caught under Article XI, and *not* under Article III:4. However, there is little, if any, support for this position in the case law. GATT and WTO panels and the Appellate Body have given Article III:4 a very broad scope of application. Whether Articles III:4 and XI can both be applicable to a specific nPR PPM measure is not clear from the case law to date, but the approach taken by the Panel in *EC – Asbestos* seems to suggest that this is not possible.

Relevant exceptions from obligations under the GATT 1994

The GATT 1994 provides for multiple exceptions from the obligations it imposes on Members. These exceptions allow Members – under certain conditions and within certain limits – to adopt or maintain otherwise GATT-inconsistent measures. With respect to nPR PPM measures addressing non-trade concerns, the most relevant of these exceptions are the general exceptions of Article XX of the GATT 1994, in particular, paragraphs (a), (b), (d) and (g) thereof. The application of Article XX gives rise to a number of interesting issues, which are all discussed in the present report. This Executive Summary, however, focuses on two issues which are of particular importance for the justification of otherwise GATT-inconsistent nPR PPM measures.

The first of these issues is the jurisdictional limitation on the application of Article XX. To date, the Appellate Body has not yet ruled on whether measures that protect, or purport to protect, a societal value or interest *outside* the territorial jurisdiction of the Member taking the measure, can be justified under Article XX. There is no explicit jurisdictional limitation contained in Article XX. As discussed below, the wording of Article XX(b) does not explicitly limit the protection of life and health to the territory of the Member enacting the measure at issue.

Likewise, the wording of Article XX(a) (concerning the protection of public morals) and Article XX(g) (concerning the preservation of exhaustible natural resources) has no such explicit limitation either. However, the question is whether there is an *implied* jurisdictional limitation, in that Article XX cannot be invoked to protect societal values outside the territorial jurisdiction of the Member concerned. The GATT Panels in *US – Tuna I (Mexico)* and *US – Tuna II (EEC)* ruled in 1991 and 1994 that Article XX(b) and (g) cannot justify measures that pursue the protection of public health and environmental policy objectives *outside* the jurisdiction of the Member enacting the measure. However, in 1998 the Appellate Body in *US – Shrimp* explicitly refused to pass upon the question of whether there is an implied jurisdictional limitation in Article XX(g), and if so, on the nature or extent of that limitation.

It merely noted that in the specific circumstances of the *US – Shrimp* case, there was a sufficient nexus between the migratory and endangered sea turtles *and* the United States for the purposes of Article XX(g). Note, however, that the Panel in *EC – Tariff Preferences* found in 2004 that the policy reflected in the EC measure at issue in that case was not one designed for the purpose of protecting human life or health *in the European Communities* and, therefore, this measure was not a measure for the purpose of protecting human life or health under Article XX(b) of the GATT 1994.

The second issue relating to the application of Article XX of particular importance for the justification of otherwise GATT-inconsistent nPR PPM measures, relates to

the chapeau of Article XX. The chapeau requires that a measure that meets the requirements of one of the paragraphs of Article XX (and is thus provisionally justified), is not applied in a manner that constitutes arbitrary or unjustifiable discrimination. As the Appellate Body ruled in 1998 in *US – Shrimp*, when a measure is applied without any regard for the difference in conditions between countries and in a rigid and inflexible manner, the application of the measure may constitute ‘arbitrary discrimination’ within the meaning of the chapeau of Article XX. Conditioning market access on the adoption by the exporting Member of essentially the same regulation as in force in the importing Member constitutes ‘arbitrary discrimination’. However, as the Appellate Body found in 2001 in *US – Shrimp (Article 21.5 – Malaysia)*, authorizing an importing Member to condition market access on exporting Members putting in place regulation *comparable in effectiveness* to that of the importing Member gives sufficient latitude to the exporting Member with respect to the regulation it may adopt to achieve the level of effectiveness required. It allows the exporting Member to adopt regulation that is suitable to the specific conditions prevailing in its territory. According to the Appellate Body, conditioning market access on the adoption of a programme *comparable in effectiveness*, allows for sufficient flexibility in the application of the measure so as to avoid ‘arbitrary discrimination’. It has been noted that the Appellate Body thus seems to introduce in the chapeau of Article XX an ‘embryonic’ and ‘soft’ requirement on Members to recognize the equivalence of foreign measures comparable in effectiveness.

The Appellate Body in *US – Shrimp* also addressed the question of whether the application of the measure at issue in this case constituted an ‘unjustifiable discrimination’ within the meaning of the chapeau. The Appellate Body found that while the United States negotiated with some Members a multilateral agreement for the protection of sea turtles (the *Inter-American Convention for the Protection and Conservation of Sea Turtles*), it did not pursue negotiations with other Members (including the complainants). According to the Appellate Body, this is plainly discriminatory and unjustifiable. The unjustifiable nature of this discrimination emerged clearly when one considered the cumulative effects of the failure of the United States to pursue negotiations for establishing consensual means of protection and conservation of sea turtles. In *US – Shrimp (Article 21.5 – Malaysia)*, the Appellate Body made it clear that, in order to meet the requirement of the chapeau of Article XX, a Member needs to make serious efforts, in good faith, to negotiate a multilateral solution before resorting to unilateral measures. Failure to do so may lead to the conclusion that the discrimination is ‘unjustifiable’.

In addition to the general exceptions of Article XX, the GATT 1994 provides *inter alia* for exceptions from GATT obligations aimed at helping developing-country Members to benefit more from international trade. The most prominent of these

exceptions is the Enabling Clause, which allows *inter alia* that developed-country Members give preferential tariff treatment to developing-country Members. This exception to the MFN treatment obligation is the legal basis for the Generalized System of Preferences (GSP) schemes adopted by many developed-country Members in favour of developing-country Members. The GSP scheme of the European Communities provides, however, for *additional* preferential tariff treatment for developing-country Members that pursue specific domestic policies (with regard to labour standards, the environment and the fight against drug production and trafficking). India contested the GATT consistency of the Drug Arrangements of the EC GSP scheme. As the Appellate Body ruled in 2004 in *EC – Tariff Preferences*, a developed-country Member may grant additional preferential tariff treatment to some, and not to other, developing-country Members, as long as additional preferential tariff treatment is available to all *similarly situated* developing-country Members. *Similarly situated* developing-country Members are all those that have the development, financial and trade needs to which additional preferential tariff treatment is intended to respond.

Relevant obligations under other multilateral agreements on trade in goods

The present report examines the WTO consistency of nPR PPM measures addressing non-trade concerns also with respect to the obligations of Members under the *TBT Agreement* and the WTO agreements providing rules on subsidies. The report contains a detailed discussion of the obligations under the *TBT Agreement*. This Executive Summary focuses on an essential preliminary question, namely, whether nPR PPM measures fall within the scope of application of the *TBT Agreement*. The *TBT Agreement* applies to technical regulations, standards and conformity assessment procedures relating to:

- products (both industrial and agricultural); and
- related processes and production methods.

The issue of the applicability of the *TBT Agreement* to nPR PPM measures was discussed during the negotiations on the *TBT Agreement*, but the negotiators failed to reach agreement. Discussions since 1995 have only highlighted the deep division among the WTO membership on this issue. The definitions in Annex 1, paragraphs 1–3, to the *TBT Agreement* seem to indicate that technical regulations, standards and conformity assessment procedures relating to PR-PPMs do not fall within the scope of application of the *TBT Agreement*. The definitions refer to ‘characteristics for products and *related* processes and production methods’ [emphasis added]. Note, however, that in the last sentence of the definitions of technical regulations and standards, it is stated that technical regulations and standards also include measures that are concerned with ‘terminology, symbols, packaging, marking or labelling requirements *as they apply to a product, process or production method*’ [emphasis added]. Therefore, while there may be

uncertainty and debate about whether technical regulations, standards or conformity assessment procedures relating to nPR PPMs in general fall within the scope of application of the *TBT Agreement*, it is clear that ‘labelling requirements’ relating to nPR PPMs are TBT measures within the meaning of Annex 1 to the *TBT Agreement* and thus fall within the scope of application of the *TBT Agreement*.

The WTO rules on subsidies are primarily contained in two agreements, namely, the *SCM Agreement*, which applies to all subsidies within the meaning of Articles 1 and 2 of that Agreement; and the *Agreement on Agriculture*, which applies, in addition to the *SCM Agreement*, to subsidies on agricultural products. In case of conflict between the rules of the *SCM Agreement* and the *Agreement on Agriculture*, the latter prevails.

The applicability of the *Agreement on Agriculture* to subsidies on biomass or biofuels depends on whether these products are classified as agricultural products, i.e. in the Harmonized Commodity Description and Coding System (HS) Chapters 1–24 (except fish and fish products), plus the HS Headings and Codes listed in Annex 1 to the *Agreement on Agriculture*. In this Executive Summary, it is sufficient to mention that under the *SCM Agreement* import substitution subsidies, i.e. subsidies contingent on the use of domestic products over imported products, are prohibited and must be withdrawn without delay. Subsidies are *de facto* contingent on the use of domestic products over imported products, if the subsidies are granted on the condition to use products that are produced according to nPR PPMs which foreign producers cannot, or can only with great difficulty, apply. Under the *Agreement on Agriculture*, agricultural export subsidies are either subject to reduction commitments or prohibited. Domestic agricultural support measures are also subject to reduction commitments. However, certain domestic agricultural support measures, commonly referred to as ‘green box’ measures, are exempted from the reduction commitments. Note that, as set out in Annex 2 to the *Agreement on Agriculture*, these ‘green box’ measures include certain payments under a government environment or conservation programme that are dependent on the fulfilment of specific conditions under the programme, including conditions related to production methods and inputs. Subsidies to farmers to compensate them for the extra costs associated with meeting animal welfare requirements may constitute ‘green box’ measures.

Part 2 Relevance of other International Agreements for Unilateral nPR PPM Measures addressing Non-Trade Concerns

Environmental, human rights and labour standards are the subject of specific international agreements, which occasionally contain provisions that have a bearing on international trade. Also, the programmes developed by intergovernmental, private or non-governmental organizations setting environmental and social standards often impact on international trade.

International environmental agreements

Out of the 200 multilateral environmental agreements (MEAs) currently in existence, the WTO has identified 14 MEAs containing trade related provisions, mostly concerning product-related PPMs. These include the 1973 *Convention on International Trade in Endangered Species of Wild Fauna and Flora* (CITES); the 1985 *Vienna Convention for the Protection of the Ozone Layer* and its 1987 *Montreal Protocol*; the 1989 *Basel Convention on the Control of Transboundary Movements of Hazardous Wastes and their Disposal*; the 1992 *Convention on Biological Diversity* and its 2000 *Cartagena Protocol on Biosafety*; the 1992 *United Nations Framework Convention on Climate Change* and its 1997 *Kyoto Protocol*; and the 1995 *UN Fish Stocks Agreement*. Common features of most of these agreements include import and/or export restrictions both between Parties and with regard to third states. Also, Parties may choose to adopt unilateral measures addressing non-product-related PPMs in furtherance of the objectives of environmental agreements. Most of these trade restrictions violate the GATT non-discrimination obligations (Articles I and III) or the prohibition on quantitative restrictions (Article XI) and, therefore, must be held against the requirements of the general exceptions and the chapeau of Article XX of the GATT 1994. The present report examines a number of these trade restrictions.

International agreements on human rights and labour standards

Unlike environmental agreements, most human rights treaties do not contain explicit trade-restrictive provisions. Furthermore, it can be observed that whereas Article XX of the GATT 1994 contains an explicit environmental exception, a clear social exception is absent. Also, where trade restrictions under environmental treaties in most cases concern product-related PPMs, the type of human rights measures of concern for the current discussion generally relate to labour standards, a typical example of non-product-related PPMs. Important human rights treaties in this respect include the 1966 *International Covenants on Economic, Social and Cultural Rights and on Civil and Political Rights* as well as the 1965 *International Convention on Discrimination*; the 1979 *Convention on the Rights of Women*; the 1984 *Anti-Torture Convention*; and the 1989 *International Convention*

on the *Rights of the Child*. This study pays particular attention to the core labour standards incorporated in the 1998 *Declaration on Fundamental Principles and Rights at Work* developed by the International Labour Organization (ILO) as an example of the relation between core human rights and WTO law, and to the 2005 *UNESCO Convention on the Protection and Promotion of the Diversity of Cultural Expressions*. The present report concludes that as a result of the absence of explicit trade-restrictive provisions in multilateral human rights agreements and a social clause in Article XX of the GATT 1994, as well as the jurisdictional limitations arguably 'implied' by the WTO dispute settlement bodies, it is extremely difficult – if not impossible – to justify trade restrictions relating to human rights concerns under Article XX of the GATT 1994.

International measures addressing non-trade concerns

An increasing number of regulatory programmes addressing (non-product-related) social and environmentally sound production is being developed at the international level. Examples of such programmes include those adopted by intergovernmental organizations, such as the special incentive arrangements of the EU's Generalized System of Preferences (GSP); by the private sector, such as the Euro Retailer Working Group Good Agricultural Practices (EurepGAP); and by NGOs such as the Forest Stewardship Council (FSC) certification programme for timber, and the Sustainable Agriculture Network (SAN) certification programme. Most of the private and NGO initiatives set standards aimed at certification of products. Since adherence to these programmes is voluntary and does not involve government regulation, they fall outside the scope of the GATT 1994. However, it is not certain whether these programmes are covered by the *TBT Agreement* either, since it is not clear whether non-product-related PPMs (other than labelling) are within the scope of the *TBT Agreement*.

Conflict rules

Most authors regard trade law, human rights law and environmental law as three separate branches of public international law, without an *a priori* hierarchy between these systems. Therefore, a conflict between norms in these fields must be resolved through the rules of treaty interpretation of Article 31 of the *Vienna Convention on the Law of Treaties* – which has attained the status of customary international law – and through the conflict rules of Article 30 of the *Vienna Convention*. Article 31 determines 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'. Article 31(2) specifies what should be understood by the context of a treaty, while Article 31(3) provides *inter alia* for 'any applicable rules of international law applicable in the relations between the parties' to be taken into account.

On several occasions, WTO dispute settlement bodies have used non-WTO law to interpret the terms of the *WTO Agreement*.

As regards the application of Article 31(3) of the *Vienna Convention*, the Appellate Body has taken a narrow approach, defining 'between the parties' as meaning all WTO Members. If a conflict cannot be resolved through interpretation, recourse should be made to the conflict rules contained in Article 30 of the *Vienna Convention* and customary international law. The two main conflict rules, i.e. *lex posterior derogat lex anterior* (a newer rule prevails over an older rule) and *lex specialis derogat lex generalis* (a more specific rule prevails over a more general rule), relate to the aspects of temporality and speciality. There is an interplay between these rules. For the current discussion, the first rule implies that, in principle, environmental or human rights treaties adopted since 1994 shall prevail over the *WTO Agreement*. This is also the case for principles that have attained the status of international customary law since then. Furthermore, more specific international environmental or human rights norms shall, in principle, prevail over general WTO norms. This is of relevance for the analysis of Article XX of the GATT 1994.

Other international agreements: alternative or complementary to WTO law?

A balanced approach to the WTO as a legal system will take into account its place within the wider corpus of international law – as demonstrated by the reference in the Preamble of the *WTO Agreement* to sustainable development, and to the international law in the field of sustainable development, but will also accept its limitations as a consequence of its speciality. Besides using environmental and human rights agreements to determine the ordinary meaning of the terms of the *WTO Agreement*, WTO dispute settlement bodies should use these agreements as a factual reference in their analysis of Article XX of the GATT 1994. The observation that a measure was taken pursuant to a widely ratified environmental or human rights agreement should be considered relevant factual evidence that the measure taken was legitimate. Yet, in the current state of legal doctrine, the direct application of non-WTO norms as 'legal norms' by the WTO dispute settlement bodies is considered a bridge too far.

Finally, the best way to address non-product-related PPM concerns is through the negotiation of multilateral agreements that expressly contain trade measures to further their objectives. These agreements must be open to all WTO Members and must impose equal obligations on countries 'where the same conditions prevail' so as to avoid discrimination.

Part 3 Economic Efficiency and Effectiveness of Unilateral nPR PPM Measures addressing Non-Trade Concerns, and their Impact on Developing Countries

Measures related to the production of biofuels in developing countries

Bioethanol has a high potential as an effective and efficient instrument for climate policy. Using it for more policy objectives, such as energy security or agricultural support in the EU, would undermine the effectiveness and efficiency of climate policy. Many developing countries have a comparative advantage in the supply of biofuels and biomass, and are capable of yielding large reductions in greenhouse gas (GHG) emission, measured over the life cycle of the fuel. Bioethanol from tropical regions is the ideal substitute for mineral gasoline: it is competitive at the current fuel prices, much cheaper than all alternatives that are available now and in the foreseeable future, and ranks highest in reducing GHG emissions (more than 80 per cent). At present, the cost per tonne of GHG reduction using Brazilian ethanol is a fraction (around 5 per cent) of the cost using ethanol from grain produced in the EU. However, the EU does not have a coherent policy with respect to bioethanol. EU import tariffs vary between zero and €19.2 per hectoliter, depending on the exporting country and type of ethanol. At the same time, the EU Common Agricultural Policy subsidizes ethanol production in the EU.

In the near future, the production of bioethanol in developing countries will rise considerably, in response to rising domestic demand for ethanol as a fuel, and to rising import demand from developed countries. On the supply side, the EU market for biofuels is highly distorted by the Common Agricultural Policy, the subsidies for innovative fuels and the EU's common trade policy. As a result, the price of bioethanol in the EU does not reflect its relative scarcity globally. Bioethanol from tropical countries has a high potential to reduce greenhouse gas emissions in the short run in an effective and efficient way. In order to realize this potential, the EU will have to devise a coherent trade policy with respect to bioethanol:

- The difference in preferential tariff arrangements under GSP and the high MFN tariff should be eliminated by gradually lowering the MFN tariff to the level of mineral fuels.
- In order to develop the untapped potential in Africa, support will be necessary to improve the physical infrastructure for export, to finance feasibility studies, and to create a favourable climate for private investment in biomass production.
- It has been proposed by the Cramer Commission to make the import of bioethanol conditional upon meeting certain sustainability criteria. With regard to the criteria on GHG emissions, bioethanol from developing countries could be an effective and efficient instrument, given its efficient reduction of GHG emissions on a well-to-wheels basis.

With regard to the other sustainability criteria, it is questionable whether it would be wise to impose these conditions, apart from the question whether it would be permitted under EU and WTO law, for several reasons.

Firstly, an importing country has a potential impact on part of the production only (the EU currently imports only 1 per cent or less of all bioethanol produced in Brazil). Even if the exporting country meets the sustainability criteria for that small part of the production, little would change in the sector. The exporting country may also respond by shifting its exports to less demanding markets. Thus, trying to encourage an entire economy to adopt more sustainable methods of production by imposing conditions on a tiny part of its production for export, would be a case of the tail wagging the dog.

Secondly, even if the exporter were to adapt the production process throughout the sector, the regulatory situation would differ significantly from the rest of the economy. This may greatly distort relative prices and wages. It cannot be assumed that the sustainability and welfare of the exporting economy as a whole would improve; it might even deteriorate. Research into the issue of child labour has made it clear that import constraints on goods produced using child labour do not necessarily improve the lot of the children in the exporting economy, at least in the short and medium term.

Thirdly, exporting developing countries may perceive these criteria as a form of eco- or labour protectionism. Given the experiences of these countries in the recent past, and the imminent risk that regulatory systems of importing countries are captured by rent-seeking groups, this perception is not without grounds. The practical effect of implementing the criteria will be an increase in the cost of production. Although it is difficult to estimate the precise cost-increasing effect as a simple percentage, it is clear that it could be substantial. For ethanol produced in the São Paulo region (where 60 per cent of Brazilian sugar and ethanol are produced), for example, it is estimated that total production costs could rise by 24–56 per cent, increasing the cost per litre by €0.12. This would come on top of the EU import tariff of €0.19 per litre. On the whole, the impression of disguised protectionism is difficult to refute, and the opportunity to introduce an effective and efficient climate policy based on bioethanol will be lost. There are more effective and efficient ways to achieve these objectives of sustainability: by concluding international agreements, by supporting aspects of sustainable production financially, and via transfer of technology.

Standards and labelling for animal welfare

The modern consumer demands a large choice among differentiated products, adequate information and a guarantee for a few credence attributes, mainly with

respect to health aspects. Credence attributes are product attributes that can not be assessed by the (potential) buyer through inspection of the product in the shop. The supplier does have knowledge over these attributes. This is a matter of information asymmetry. These health attributes have the nature of a public good and should be regulated by mandatory standards and/or labels by the government. It is far from clear, however, whether animal welfare aspects have this public good nature. For credence attributes that do not have a public good nature, voluntary labelling is a sufficient and efficient solution to solve the problem of market failures due to information asymmetry.

Primary producers in developing countries may be able to profit from higher standards as long as they are able to invest in upgrading their production processes, in certification and marketing. However, financial systems in developing countries might not cater to these investment needs as firms may be small and lack collateral, and local banks may not operate along the lines of market incentives. Thus higher standards (including voluntary private sector schemes such as EurepGAP) may favour large production companies and big retailers.

Certification of small firms is relatively expensive; collective certification could be a solution but requires costly organization and monitoring/sanctioning. Again, big firms may be in a more favourable position. Small producers may benefit if the right institutions are in place to provide training, information and certification at reasonable prices.

Given the potential problems developing country exporters have in complying with higher norms and standards, which are increasingly being demanded by private importers in rich countries, and often come on top of high tariffs and restrictive quota, governments should practice utmost restraint in making policy decisions that add to the regulatory barriers to imports from developing countries. International harmonization could prevent the proliferation of different standards, as this will only add to the costs to developing country producers of meeting those standards.

Development cooperation can play an important role in stimulating the export performance of domestic firms in developing countries. Technical and financial support for research, local extension services, monitoring and testing facilities that help small and middle sized firms to set up and improve export ventures, organize small producers for collective initiatives in labelling, certification and marketing are examples in this regard.

INTRODUCTION

1 International trade and non-trade concerns

The economic prosperity of the Netherlands is highly dependent on international trade. In 2006, the openness of the Dutch economy in terms of international trade in goods was equal to 57 per cent of Dutch GDP.¹ It is therefore not surprising that the Netherlands, acting in the context of the European Union or independently, has always pursued a free trade policy and is a strong supporter of further liberalization of international trade. In recent years, however, the liberalization of international trade has encountered growing hostility and resistance from large segments of Dutch civil society. Citizens as well as policy makers fear the corrosive impact of international trade on the core societal values on which Dutch society is built. Many fear that international trade, and in particular its further liberalization, may undermine or put at risk policies and measures aimed at the protection of public health, the environment, labour rights, social welfare, good governance, national security, cultural identity, food safety, access to knowledge, consumer interests and animal welfare. There is a general consensus in the Netherlands that these *non-trade concerns*, which cover very different societal aspirations and fears, must be addressed in Dutch government policy and measures relating to international trade.²

In the Dutch Parliament, the importance of taking into account and addressing non-trade concerns has been repeatedly stressed in debates and motions on trade policy.³ For example, a motion proposed by Kris Douma and Corien Jonker, adopted on 28 June 2005, called upon the Dutch government to plead for an EU

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- 1 Calculated from data in CBS, *Nationale Rekeningen 2006* (Voorburg/Heerlen 2007). The average of exports and imports is expressed as a percentage of GDP.
- 2 Note, for example, that the *Land- en Tuinbouworganisatie Nederland* (LTO Nederland) stated on the eve of the WTO Ministerial Conference in Hong Kong in December 2005: 'Bij de liberalisering van de wereldhandel dient een gelijk speelveld voor alle partijen en uitgangspunt te zijn. Producten die vrij geïmporteerd worden uit landen buiten de EU moeten voldoen aan dezelfde eisen als waar de Europese boeren en tuinders aan moeten voldoen. Het gaat hierbij in het bijzonder om eisen op het gebied van bescherming van voedselveiligheid, traceerbaarheid, arbeidsvoorwaarden, milieu, dierwelzijn, en platteland. Als dit niet het geval is, komt dit neer op aanzienlijke concurrentienadeln'. See Persbericht LTO Nederland, 13 December 2005, *EU moet pas op de plaats maken bij WTO handelsoverleg: LTO Nederland waarschuwt voor 'eenzijdige ontwapening'*.
- 3 See, for example, Kamerstuk 103451, Tweede Kamer, vergaderjaar 2006-2007, 25074, nr. 140; Kamerstuk 104526, Tweede Kamer, vergaderjaar 2006-2007, 30800 XIV, nr. 81; Kamerstuk 105740, Tweede Kamer, vergaderjaar 2006-2007, 25074, nr. 143; Kamerstuk 106074, Tweede Kamer, vergaderjaar 2006-2007, 22112, nr. 509; Kamerstuk 106149, Tweede Kamer, vergaderjaar 2006-2007, 21501-32, nr. 204; Kamerstuk 106156, Tweede Kamer, vergaderjaar 2006-2007, 30800 XIV, nr. 86; Kamerstuk 106173, Tweede Kamer, vergaderjaar 2006-007, 21501-32, nr. 205; Kamervragen 27702, Tweede Kamer, vergaderjaar 2006-2007, Aanhangsel van de Handelingen, 1149.

effort to include non-trade concerns on the agenda for the next round of multilateral trade negotiations in the WTO.⁴

The trade measures introduced by developed countries to address non-trade concerns have been met with much suspicion and opposition on the part of developing countries, who often see trade protectionist intentions, rather than genuine non-trade concerns, behind these measures. From the perspective of developing countries, the emphasis put on non-trade concerns by developed countries is often a means to justify existing forms and levels of protection of domestic production or, worse, a means to introduce new forms of protection. Moreover, developing countries object to trade measures addressing non-trade concerns as an attempt by developed countries to impose their social, ethical or cultural values and preferences on exporting developing countries.

Over the last two years, the debate in the Netherlands on trade measures addressing non-trade concerns has focused on two important and politically sensitive issues, namely:

- the sustainability of the large-scale production of biomass as an alternative source of energy; and
- the production of livestock products in a manner that is consistent with animal welfare requirements.

In view of the relative scarcity of fossil fuels and their adverse effects on the environment, it is expected that over the next decades biomass will become an important alternative source of energy. However, the large-scale production of biomass may itself harm the environment and may have adverse economic and social effects on the people involved in its production or, more generally, on the population of the producing countries. In February 2007 the Project Group *Duurzame Productie van Biomassa*, set up by the Dutch government and chaired by Jacqueline Cramer (hereinafter the 'Cramer Commission'), issued a report entitled *Toetsingskader voor duurzame biomassa* (hereinafter the 'Cramer Report').⁵ This report discussed the risks associated with the large-scale production of biomass and established a list of criteria for the sustainable production of biomass. These criteria (hereinafter the 'Cramer sustainability criteria') relate to a broad range of non-trade concerns, including environmental protection, global warming, food security, biodiversity, economic prosperity and social welfare.

The Cramer sustainability criteria (and related sustainability indicators referred to in parentheses) stipulate that biomass production and use must:

- achieve reductions in **greenhouse gas emissions** throughout the entire lifecycle of biofuels, including the in the production or processing of the biomass from which biofuels are produced (compared with fossil fuels, the net emission reduction for biofuels used for transport, for example, must be at least 30%);
- have no adverse effects on the **availability of food** or the availability of agricultural products for non-food uses such as building materials or medicines (no specific sustainability indicators have yet been established for this purpose);
- ensure the protection of **biodiversity** (no large-scale production of biomass in or in the vicinity of 'gazetted protected areas' or areas of 'high conservation value');
- have no adverse effects on the **local environment** and, in particular, on the quality of the soil, water and air (in compliance with national limits on the use of pesticides and artificial fertilizers, as well as use of 'best practice' production methods);
- contribute to the **economic prosperity** of the local community and have no negative effects on the regional and national economy (no specific sustainability indicators have yet been established for this purpose); and
- contribute to the **welfare** of the workers involved in biomass production and of the local population (in compliance with the relevant requirements established by the International Labour Organization (ILO), i.e. *Social Accountability 8000* and the *Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy*), and the *UN Universal Declaration of Human Rights* and other international agreements).⁶

For the production of biomass to qualify as 'sustainable', it must meet the Cramer sustainability criteria. Note that the Cramer Report explicitly mentions that no distinction is made between imported biomass and biomass produced in the Netherlands. Both have to meet the Cramer sustainability criteria.⁷ The Cramer sustainability criteria for biomass production are similar to those currently under development in the United Kingdom.⁸ The Cramer Report stresses the importance of establishing a certification system for biomass.⁹ Only with such a certification system in place, will it be possible to determine whether the biomass

4 See Ministeriële Conferentie van de Wereldhandelsorganisatie (WTO): Motie van de leden Douma en Jonker, Tweede Kamer, Vergaderjaar 2004-2005, 25074, nr. 92.

5 *Toetsingskader voor duurzame biomassa* (Cramer report). Final report of the project group 'Duurzame productie van biomassa', chaired by Professor Jacqueline Cramer, 2007. Available at www.vrom.nl/docs/20070427-toetsingskader-duurzame-biomassa.pdf.

6 See Cramer Report, p. IV, as well as Tables 1 and 2. Note that the Cramer Report also 'translates' these criteria into nine principles for application at the micro-level (see Box 6.1.1 of the Report, p.32).

7 See Cramer Report, p. II.

8 B. Dehue *et al.*, *Sustainability Reporting within the RTFO: Framework Report* (Utrecht: Ecofys, 2007). Available at www.dft.gov.uk/consultations/open/rtforeporting/sustainabilityreporting.

9 See Cramer Report, pp.IV and 33.

(or the resulting biofuel) used in the Netherlands has been produced in a sustainable manner, i.e. in a manner consistent with the Cramer sustainability criteria.

The sustainability criteria set out in the report resulted from an extensive consultation process involving the most important Dutch stakeholders. Stakeholders in biomass-exporting countries were not consulted, although the importance of such consultations is explicitly recognized.¹⁰

The Cramer Report invites the Dutch government to give effect to the Cramer sustainability criteria by incorporating them into relevant policy instruments. As the report notes, the relevant policy instruments in the short run are, first, the *Regeling Milieukwaliteit Electriciteitsproductie (MEP)*, which concerns the environmentally friendly production of electricity, and, second, the obligation to use biofuels for road transport. In the future, it is expected that the criteria for the sustainable production of biomass will also be implemented in other policy instruments. The report recognizes that the implementation of the Cramer sustainability criteria in policy instruments (as well as the establishment of a certification system) will take time, and that it will also require careful consideration of the obligations of the Netherlands under EU and WTO law.¹¹

In addition to the sustainability of large-scale biomass production, the current debate in the Netherlands on trade measures addressing non-trade concerns also deals with animal welfare. Modern methods of intensive agricultural production have generated – especially in Europe – increasing concern about the treatment of farm animals, in particular with regard to their housing, nutrition, transport and slaughter. Consumer surveys seem to suggest that there is growing demand for animal-welfare friendly products (such as free-range eggs). Individual EU Member States, including the Netherlands, as well the EU itself, have adopted wide-ranging animal welfare legislation. EU animal welfare legislation currently in force relates, *inter alia*, to minimum standards for the husbandry of hens, veal calves and pigs. For other farm animals (e.g. broiler chickens and turkeys), production standards are under consideration. The EU has also adopted legislation on animal welfare regarding the transportation and ‘humane’ slaughter of farm animals. Note that the Council of Europe has adopted several conventions on animal welfare that have been an important source of inspiration for EU and national animal welfare regulations.¹²

¹⁰ See Cramer Report, p.34.

¹¹ See Cramer Report, p. 33.

¹² These conventions elaborate *inter alia* elaborate the five freedoms for animals, namely, the freedom to turn around, the freedom to groom themselves, the freedom to get up, the freedom to lie down and the freedom to stretch their limbs.

The growing concern regarding animal welfare is reflected not only in existing or proposed regulations, but also in private sector standards for the production of livestock products that are being developed and applied by producers and/or retailers.¹³ McDonalds, for example, has instituted animal welfare programmes for its suppliers, requiring that these suppliers meet animal welfare requirements that are much stricter than those set out in national legislation.¹⁴ The World Organization for Animal Health (OIE), in its 2001–2005 strategic plan, identified the development of international standards on animal welfare as a priority, and has formally established a Working Group on Animal Welfare. However, setting international standards for animal welfare – even if this is done on a scientific basis – is difficult due to differences of religious, economic, social and cultural nature between countries. In the context of the Doha Development Round negotiations, the EU has stated that its objective is to ensure that further liberalization of trade in agricultural products does not undermine EU efforts to improve the welfare of animals.¹⁵

2 Measures addressing non-trade concerns

Governments called upon to address non-trade concerns may do so by using different types of measures.¹⁶ A first important distinction to be made among measures to address non-trade concerns is that between international and unilateral measures.

2.1 International measures addressing non-trade concerns

International measures addressing non-trade concerns include bilateral, regional and multilateral agreements, intergovernmental and private international standards, and international codes of conduct. Examples of such international measures are the *Convention on International Trade in Endangered Species of Wild Fauna and Flora*, the *Basel Convention on the Control of Transboundary Movements of Hazardous Wastes and their Disposal*, the *International Covenant on Economic, Social and Cultural Rights*, the *Convention on the Protection and*

¹³ While these private standards are, by their nature, voluntary, compliance with these standards may become the industry norm from which producers can, in practice, not afford to deviate. See D. Blandford, J.C. Bureau, L. Fulponi and S. Henson, ‘Potential implications of animal welfare concerns and public policies in industrialized countries for international trade’, in B. Krissoff, M. Bohman and J. Caswell (eds), *Global Food Trade and Consumer Demand for Quality* (New York: Kluwer, 2002), p.13.

¹⁴ *Ibid.*, p.20.

¹⁵ See the EC’s Comprehensive Negotiating Proposal to the WTO negotiations on agriculture, issue 20, available at http://ec.europa.eu/agriculture/external/wto/document/neg_en.pdf.

¹⁶ Governments will often opt for a combination of the different types of measures available.

Promotion of the Diversity of Cultural Expressions and the Forest Stewardship Council certification programme for timber. These and other international measures addressing non-trade concerns are discussed in Part II of this report.¹⁷ As discussed in Part I of this report, several WTO agreements also contain provisions address non-trade concerns.¹⁸ In many cases, international measures addressing non-trade concerns will allow national governments – *under certain conditions* – to take unilateral measures to address non-trade concerns, as discussed in the next section.

2.2 Unilateral measures addressing non-trade concerns

Unilateral measures addressing non-trade concerns take many different forms and can be distinguished in various ways. First, a distinction can be made between command-and-control measures (e.g. prohibitions or quantitative restrictions) and price-based measures (customs duties and internal taxes (sanctions) or subsidies (incentives)).¹⁹ Second, a distinction can be made between border measures (e.g. customs duties; import bans or import restrictions) and internal measures (internal regulation (including labelling), internal taxes or subsidies). Third, a distinction can be made between measures applicable to imports only (which constitute *de jure* discrimination) and measures applicable to imports and domestic products (which *may* constitute *de facto* discrimination). Fourth, a distinction can be made between measures determining the characteristics of products and measures concerning the processes and production methods of products. Fifth, within the category of measures concerning the processes and production methods of products, a further distinction can be made between:

- measures concerning *product-related* processes and production methods (PR PPMs), i.e. measures that prescribe processes and production methods that affect the characteristics of the products produced (e.g. measures prohibiting the use of growth hormones for cattle in the production of meat, or the use of pesticides in the production of vegetables); and
- measures concerning *non-product-related* processes and production methods (nPR PPMs), i.e. measures that prescribe processes and production methods that do *not*, or in a negligible manner only, affect the characteristics of the products produced (e.g. a measure requiring that tuna fishing vessels use dolphin-friendly nets).

Finally, within the category of measures concerning nPR PPMs, a further distinction can be made between:

- measures concerning nPR PPMs affecting a purely national situation in the country of production (e.g. measures concerning child labour or animal welfare);
- measures concerning nPR PPMs affecting a transboundary situation (e.g. measures concerning air or water pollution across national borders);
- measures concerning nPR PPMs affecting a situation in multiple/undetermined national territories (e.g. measures concerning the protection of migratory species); and
- measures concerning nPR PPMs affecting a global situation (e.g. measures concerning climate change or the depletion of the ozone layer).²⁰

3 Focus of this study

As stated in the terms of reference of this study, measures concerning nPR PPMs are – much more than measures concerning PR PPMs or other measures referred to above – the subject of controversy. At present this is particularly the case with regard to measures addressing concerns relating to the large-scale production of biomass and animal welfare concerns. In view of the policy debates and calls for action referred to above, there is an urgent need for more clarity regarding the kind of measures concerning nPR PPMs that are both legal and effective, and which also take into account the interests of developing countries.

3.1 Measures dealt with in this study

The unilateral measures to give effect to nPR PPMs, such as the sustainability criteria for biomass production or animal welfare requirements, can take many different forms. The following list includes some measures that are already applied; most of those listed, however, are not (yet) in force (and, therefore, still hypothetical) but have been suggested by policy makers and/or stakeholders as appropriate and effective measures for either the Netherlands or the European Union to take:²¹

20 See OECD, *Processes and Production Methods (PPMs): Conceptual Framework and Considerations on Use of PPM-Based Trade Measures*, OECD/GD(97) (Paris: OECD, 1997), p.137.

21 It is clear that under EU law the Netherlands no longer has any competence to introduce a number of the measures discussed below (e.g. granting preferential customs duties to products produced consistently with nPR PPMs).

17 See below, p. 165.

18 See below, p. 13.

19 See WTO Committee on Trade and Environment, *Taxes and Charges for Environmental Purposes – Border Tax Adjustment*, Note by the Secretariat, WT/CTE/W/47, dated 2 May 1997, para. 2.

- An **import prohibition** on products not produced consistently with nPR PPMs (e.g. an import prohibition on biomass not produced consistently with the Cramer sustainability criteria; or an import prohibition on livestock products not produced consistently with animal welfare requirements);
- **Preferential customs duties** for products produced consistently with nPR PPMs (e.g. lower customs duties for biomass produced consistently with the Cramer sustainability criteria; or higher customs duties for meat from animals that have not been kept, fed, transported or slaughtered in accordance with specific animal welfare requirements);
- **Country-specific customs duties** for imports from countries that have national legislation incorporating specific nPR PPMs (e.g. lower customs duties for biomass imported from countries which have been certified as requiring that the production of biomass conforms to the Cramer sustainability criteria and equivalent criteria);
- **Domestic prohibition** of the use or sale of products produced inconsistently with the nPR PPMs (e.g. a prohibition on the use in the production of biofuels from biomass produced inconsistently with the Cramer sustainability criteria; or a prohibition on the sale of *foie gras* from geese that were force-fed);
- **Technical regulations** (mandatory) setting out nPR PPMs for products used or sold (e.g. a technical regulation stipulating that eggs must be produced in conditions where battery cages hold no more than eight laying hens per m²);
- **Government or private standards** (voluntary) setting out nPR PPMs for products used or sold (e.g. a standard agreed upon by oil and electricity companies that the biomass they use must meet the Cramer sustainability criteria; or a standard agreed upon by retailers that they will only sell animal-welfare-friendly products).
- **Compulsory blending requirements** specifying that the products blended must be produced consistently with nPR PPMs (e.g. a regulation excluding from the compulsory blending of fossil and biofuels, biofuels from biomass not produced consistently with the Cramer sustainability criteria);
- **Mandatory or voluntary labelling** regarding nPR PPMs (e.g. labelling on livestock products indicating whether they are produced consistently with specific animal welfare requirements);
- **Voluntary certification programmes or schemes** regarding nPR PPMs (e.g. a government or private organization certifying that specific biomass has been produced consistently with the Cramer sustainability criteria; or that livestock products have been produced consistently with animal welfare requirements);
- **Tax reductions, exemptions or rebates** for products produced consistently with nPR PPMs (e.g. a reduction in excise duties on biofuels made from biomass produced consistently with the Cramer sustainability criteria; or a reduction in the VAT on animal-welfare-friendly products);

- **Border tax adjustments** levied on imported products to offset nPR PPM-based domestic taxation;
- **Government procurement requirements** favouring products produced consistently with nPR PPMs (e.g. a requirement that public buses must use biofuels from biomass produced consistently with the Cramer sustainability criteria; or a requirement that public hospitals and schools may only buy livestock products produced consistently with animal welfare requirements);
- **Direct subsidies** to assist producers with the additional cost incurred in meeting nPR PPMs (e.g. payments to oil or electricity companies to offset the additional costs of using biomass or biofuels from biomass produced consistently with the Cramer sustainability criteria; or payments to farmers to offset the additional costs resulting from complying with animal welfare requirements)
- **Export refunds** to overcome the competitive disadvantage that producers have on the world market as a result of stricter domestic regulation setting out nPR PPMs (e.g. export refunds for meat and livestock products to compensate for the higher production costs resulting from complying with animal welfare requirements); and
- **Reporting requirements** relating to nPR PPMs (e.g. a requirement for industrial users of biomass (oil companies and electricity companies) to report whether the biomass they use is produced consistently with the Cramer sustainability criteria (and subsequently leaving it to the consumers/civil society to act on the basis of this information).

3.2 Issues dealt with in this study

Pursuant to its terms of reference, this study focuses on three main issues, namely:

- the consistency of unilateral nPR PPM measures addressing non-trade concerns with the obligations under the *WTO Agreement* (see Part 1);
- the relevance of other international agreements for unilateral nPR PPM measures addressing non-trade concerns (see Part 2); and
- the economic effectiveness and efficiency as well as the impact on developing countries of unilateral nPR PPM measures addressing non-trade concerns (see Part 3).

These issues will be examined with regard to the existing, proposed or still purely hypothetical measures relating to the sustainable production of biomass or the protection and promotion of animal welfare discussed in the previous section.

PART 1
WTO CONSISTENCY OF
UNILATERAL NPR PPM
MEASURES ADDRESSING
NON-TRADE CONCERNS

Peter Van den Bossche

1 Introduction

The first part of this study deals with the consistency with WTO law of unilateral measures concerning non-product-related processes and production methods (nPR PPMs) addressing non-trade concerns.

1.1 The nature and scope of WTO law

WTO law is a complex and extensive set of international rules dealing with trade in goods, trade in services and the protection of intellectual property rights. It covers a broad spectrum of national measures ranging from customs duties, import quotas and customs formalities to food safety regulations, restrictions on foreign investment and national security measures. In WTO law, four categories of basic substantive rules can be distinguished:

- rules on non-discrimination, including the Most Favoured Nation (MFN) treatment obligation and the national treatment obligation;
- rules on market access, including rules on tariff and non-tariff barriers to trade in goods and rules on market access for services and service suppliers;
- rules on ‘unfair’ trade, including rules on anti-dumping duties, subsidies and countervailing duties; and
- rules on conflicts between trade liberalization and other societal values and interests, including the general public policy exceptions, the national and international security exceptions; the economic emergency exception; the regional integration exceptions, and the rules on special and differential treatment of developing countries.

Very important among the rules of the last category above are the general exceptions of Article XX of the *General Agreement on Tariffs and Trade* (‘GATT 1994’) and Article XIV of the *General Agreement on Trade in Services* (‘GATS’).²² These general exceptions allow WTO Members to adopt or maintain otherwise GATT 1994 or GATS inconsistent measures addressing non-trade concerns, such as public morals, public health and the environment.²³ The term ‘non-trade concern’ does not appear in the basic WTO agreement, the *Marrakesh Agreement on the Establishment of the World Trade Organization* (hereinafter the ‘WTO Agreement’). However, the Preamble to the *WTO Agreement* states that WTO Members, when pursuing the economic objectives of the WTO, should:

²² The texts of the GATT 1994 and the GATS are available at www.wto.org/english/docs_e/legal_e/legal_e.htm.

²³ For an in-depth discussion of Article XX of the GATT 1994, see below, p. 89.

*allow for the optimal use of the world's resources in accordance with the objective of sustainable development.*²⁴ [emphasis added]

The term 'non-trade concern' is applied in the Preamble to the *WTO Agreement on Agriculture*, which states that agricultural trade liberalization commitments should be made:

*in an equitable way among all Members, having regard to non-trade concerns, including food security and the need to protect the environment.*²⁵ [emphasis added]

In Article 20 of the *Agreement on Agriculture*, WTO Members agreed that they would continue negotiations on the further liberalization of trade in agricultural products taking into account, *inter alia*, 'non-trade concerns'.²⁶

With respect to the extent to which non-trade concerns can be considered, and affect the scope of existing WTO obligations and exceptions, it is important to note that the Appellate Body stated in *Japan – Alcoholic Beverages II*:

*WTO rules are not so rigid or so inflexible as not to leave room for reasoned judgements in confronting the endless and ever changing ebb and flow of real facts in real cases in the real world. They will serve the multilateral trading system best if they are interpreted with that in mind.*²⁷

As discussed below in detail, in *US – Shrimp*, when interpreting the scope of application of one of the general exceptions to obligations under the GATT 1994, the Appellate Body stated:

The words of Article XX(g), 'exhaustible natural resources', were actually crafted more than 50 years ago. They must be read by a treaty interpreter in the light of contemporary concerns of the community of nations about the protection and

24 See paragraph 1 of the Preamble to the *Marrakesh Agreement Establishing the World Trade Organization*, available at www.wto.org/english/docs_e/legal_e/legal_e.htm.

25 See paragraph 6 of the Preamble to the *Agreement on Agriculture*, available at www.wto.org/english/docs_e/legal_e/legal_e.htm.

26 Reference to 'non-trade concerns' was also made in paragraph 13 of the Doha Ministerial Declaration of November 2001, and in paragraph 2 of Annex 2 to the Doha Framework Agreement of August 2004. For the EU, the champion of non-trade concerns within the WTO, addressing these concerns in the Doha Development Round is a condition for the further liberalization of trade in agricultural products and the lowering of domestic support. See EC Proposal for Modalities in the WTO Agricultural Negotiations, dated 27 January 2003 (133 Committee, MD:625/02 REV4).

27 Appellate Body Report, *Japan – Alcoholic Beverages II*, 122-3.

conservation of the environment. While Article XX was not modified in the Uruguay Round, the preamble attached to the WTO Agreement shows that the signatories to that Agreement were, in 1994, fully aware of the importance and legitimacy of environmental protection as a goal of national and international policy. ... From the perspective embodied in the preamble of the WTO Agreement, we note that the generic term 'natural resources' in Article XX(g) is not 'static' in its content or reference but is rather 'by definition, evolutionary'.²⁸ [Emphasis added]

Also note that in two prominent disputes involving measures concerning the protection of the environment (*US – Gasoline*, the first dispute before the Appellate Body and *US – Shrimp*, the dispute referred to in the previous paragraph), the Appellate Body added a paragraph at the end of its reports explaining, in straightforward language, the scope of the freedom of WTO Members to adopt trade-restrictive measures addressing non-trade concerns (*in casu* the protection of the environment). In *US – Shrimp*, for example, the Appellate Body stated:

In reaching these conclusions, we wish to underscore what we have not decided in this appeal. We have not decided that the protection and preservation of the environment is of no significance to the Members of the WTO. Clearly, it is. We have not decided that the sovereign nations that are Members of the WTO cannot adopt effective measures to protect endangered species, such as sea turtles. Clearly, they can and should. And we have not decided that sovereign states should not act together bilaterally, plurilaterally or multilaterally, either within the WTO or in other international fora, to protect endangered species or to otherwise protect the environment. Clearly, they should and do.

*What we have decided in this appeal is simply this: although the measure of the United States in dispute in this appeal serves an environmental objective that is recognized as legitimate under paragraph (g) of Article XX of the GATT 1994, this measure has been applied by the United States in a manner which constitutes arbitrary and unjustifiable discrimination between Members of the WTO, contrary to the requirements of the chapeau of Article XX. [...] As we emphasized in **United States – Gasoline**, WTO Members are free to adopt their own policies aimed at protecting the environment as long as, in so doing, they fulfill their obligations and respect the rights of other Members under the WTO Agreement.²⁹*

WTO Members are free to adopt or maintain unilateral measures addressing non-trade concerns as long as, in doing so, they act consistently with their obligations under WTO law.

28 Appellate Body Report, *US – Shrimp*, paras. 129-130. See below, p. 110.

29 Appellate Body Report, *US – Shrimp*, paras. 185-186. See also Appellate Body Report, *US – Gasoline*, pp.29-30.

1.2 Relevant WTO agreements

The basic substantive rules of WTO law, listed above, are set out in the Annexes to the *WTO Agreement*. These Annexes contain in total 19 WTO agreements. In view of the focus of this study on *unilateral measures concerning nPR PPMs*, not all of the WTO agreements are of relevance. In this study, the focus will be on the obligations and exceptions set out in the WTO agreements on trade in goods, and in particular, the GATT 1994, the *Agreement on Technical Barriers to Trade* (the '*TBT Agreement*'), the *Agreement on Subsidies and Countervailing Measures* (the '*SCM Agreement*') and the *Agreement on Agriculture*. This study does not deal with the *Agreement on the Application of Sanitary and Phytosanitary Measures* (the '*SPS Agreement*') as the provisions of this agreement in principle do not apply to measures concerning nPR PPMs.³⁰

2 Relevant obligations under the GATT 1994

This section addresses the most relevant obligations under the GATT 1994, namely, the MFN treatment obligation of Article I, the national treatment obligation of Article III, the obligations regarding tariff barriers to trade of Article II, and the obligations regarding non-tariff barriers of Article XI of the GATT 1994.³¹

2.1 MFN treatment obligation

Article I of the GATT 1994, entitled 'General Most-Favoured-Nation Treatment', states in paragraph 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

³⁰ The scope of application of the *SPS Agreement* is limited to measures addressing risks associated with pests and diseases and measures addressing food borne risks. By definition, therefore, SPS measures are measures concerning PR PPMs. For an in-depth discussion of the provisions of the *SPS Agreement*, see D. Prevost and P. Van den Bossche, 'The Agreement on the Application of Sanitary and Phytosanitary Measures', in P. Macrory, A. Appleton and M. Plummer (eds.) *The World Trade Organization: Legal, Economic and Political Analysis* (Springer, 2005), pp.231-370.

³¹ This section is based on, and in parts further elaborates on and updates, P. Van den Bossche, *The Law and Policy of the World Trade Organization* (Cambridge University Press, 2005, reprinted 2006), pp.309-318 (MFN treatment obligation), pp.377-441 (obligations regarding tariff barriers; and pp.441-480 (except 458-466) (obligations regarding non-tariff barriers). See www.cambridge.org/catalogue/catalogue.asp?isbn=9780521529815.

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 [Member] 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 [Members].

2.1.1 Scope and nature of the MFN treatment obligation

The MFN treatment obligation set out in Article I:1 of the GATT 1994 is a 'cornerstone of the GATT' and 'one of the pillars of the WTO trading system'.³² In *US – Section 211 Appropriations Act*, the Appellate Body ruled:

*For more than fifty years, the obligation to provide most-favoured-nation treatment in Article I of the GATT 1994 has been both central and essential to assuring the success of a global rules-based system for trade in goods.*³³

The importance of the MFN treatment obligation to the multilateral trading system is undisputed. However, the proliferation of customs unions, free trade agreements and other preferential arrangements in the last 15 years has led to a situation in which much of world trade is not conducted in accordance with the MFN treatment obligation. Since 1995, 206 preferential agreements have been notified to the WTO, 180 of which are currently in force.³⁴ Considering this reality of widespread preferential treatment, i.e. non-MFN treatment, in trade relations between WTO Members, the 2005 Sutherland Report on *The Future of the WTO* arrived, not without some pathos and emotion, at the following conclusion regarding the MFN treatment obligation:

*... nearly five decades after the founding of the GATT, MFN is no longer the rule; it is almost the exception. Certainly, much trade between the major economies is still conducted on an MFN basis. However, what has been termed the 'spaghetti bowl' of customs unions, common markets, regional and bilateral free trade areas, preferences and an endless assortment of miscellaneous trade deals has almost reached the point where MFN treatment is exceptional treatment.*³⁵

³² See Appellate Body Report, *EC – Tariff Preferences*, para. 101.

³³ Appellate Body Report, *US – Section 211 Appropriations Act*, para 297. See also Appellate Body Report, *Canada – Autos*, para. 69; and Appellate Body Report, *EC – Tariff Preferences*, para. 101.

³⁴ See WTO website, Regionalism: Friends or Rivals?, at www.wto.org/english/thewto_e/whatis_e/tif_e/bey1_e.htm.

³⁵ Report by the Consultative Board to the Director-General of the WTO, Supachai Panitchpakdi, *The Future of the WTO: Addressing Institutional Challenges in the New Millennium* (the 'Sutherland Report') (WTO, 2005), para. 60.

It is clear that in practice MFN treatment is less prevalent than one might expect of ‘one of the pillars of the WTO trading system’. Nevertheless, MFN treatment is, and remains, a core obligation for WTO Members. Any deviation from this obligation will have to be justified.

Article I:1 of the GATT 1994 prohibits discrimination *between* like products originating in, or destined for, different countries.³⁶ The principal purpose of the MFN treatment obligation is to ensure *equality of opportunity* to import from, or to export to, all WTO Members. In *EC – Bananas III*, the Appellate Body stated, with respect to WTO non-discrimination obligations (such as the obligation set out in Article I:1):

*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.*³⁷

Article I:1 covers not only ‘in law’, or *de jure*, discrimination but also ‘in fact’, or *de facto*, discrimination. A measure may be said to discriminate in law (or *de jure*) in a case in which it is clear from reading the text of the law, regulation or policy that it discriminates. If the measure does not appear on the face of the law, regulation or policy to discriminate, it may still be found to discriminate *de facto* if, on reviewing all the facts relating to the application of the measure, it becomes obvious that it discriminates in practice or in fact. It follows from this that the non-discrimination obligation of Article I:1 applies not only to ‘origin-based’ measures but also to measures which are ‘origin neutral’.³⁸ Measures that appear, on the surface, to be ‘origin-neutral’ can give certain countries more opportunity to trade than others and can, therefore, be in violation of the non-discrimination obligation of Article I:1.

36 Appellate Body Report, *Canada – Autos*, para. 84.

37 Appellate Body Report, *EC – Bananas III*, para. 190. Note that the Appellate Body also referred to the non-discrimination obligations set out in Articles X:3(a) and XIII of GATT 1994 and Article 1.3 of the Import Licensing Agreement.

38 In *Canada – Autos*, the Appellate Body rejected Canada’s argument that Article I:1 does not apply to measures which appear, on the surface, to be ‘origin-neutral’. See Appellate Body Report, *Canada – Autos*, para. 78. See also GATT Panel Report, *EEC – Imports of Beef*, paras. 4.2 and 4.3. In this case, the Panel in this case found that EC regulations making the suspension of an import levy conditional on the production of a certificate of authenticity were inconsistent with the MFN obligation of Article I:1 after it was established that the only certifying agency authorized to produce a certificate of authenticity was an agency in the United States.

2.1.2 Consistency with Article I of the GATT 1994

Article I:1 of the GATT 1994 sets out a three-tier test of consistency. There are three questions which must be answered to determine whether there is a violation of the MFN treatment obligation of Article I:1, namely:

- whether the measure at issue confers a trade ‘advantage’ of the kind covered by Article I:1;
- whether the products concerned are ‘like’ products; and
- whether the advantage at issue is granted ‘immediately and unconditionally’ to all like products concerned.

2.1.2.1 Does the measure at issue confer a trade ‘advantage’?

The MFN treatment obligation concerns any advantage granted by any Member with respect to:

- customs duties, other charges on imports and exports and other customs matters;
- internal taxes; and
- internal regulations affecting the sale, distribution and use of products.

Both panels and the Appellate Body have recognized that Article I:1 clearly casts a very wide net.³⁹ In *Canada – Autos*, the Appellate Body usefully clarified the scope of Article I:1 by ruling:

*Article I:1 requires that ‘any advantage, favour, privilege or immunity granted by any Member 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 Members’. [emphasis added] The words of Article I:1 refer not to some advantages granted ‘with respect to’ the subjects that fall within the defined scope of the Article, but to ‘any advantage’; not to some products, but to ‘any product’; and not to like products from some other Members, but to like products originating in or destined for ‘all other’ Members.*⁴⁰

In other words, the MFN treatment obligation requires that *any* advantage granted by a Member to any product from or for another country be granted to *all* like products from or for *all other* Members.

39 Appellate Body Report, *EC – Bananas III*, para. 206. See GATT Panel Report, *US – MFN Footwear*, para. 6.8; and also GATT Panel Report, *US – Customs User Fee*, para. 122.

40 Appellate Body Report, *Canada – Autos*, para. 79.

2.1.2.2 Are the products concerned 'like products'?

Article I:1 concerns any product originating in or destined for any other country and requires that an advantage granted to such products shall be accorded to 'like products' originating in or destined for the territories of all other Members. It is only between 'like products' that the MFN treatment obligation applies. Products that are not 'like' may be treated differently.

The concept of 'like products' is used not only in Article I:1 but also in Article III:2, first sentence, and Article III:4 of the GATT 1994.⁴¹ This concept plays a very important role in GATT law. Nevertheless, the concept of 'like products' is not defined in the GATT 1994. It is generally accepted that the concept of 'like products' has different meanings in the different contexts in which it is used. In *Japan – Alcoholic Beverages II*, the Appellate Body illustrated the possible differences in the scope of the concept of 'like products' as used in different provisions by evoking 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.*⁴²

The meaning of the concept of 'like products' in Article I:1 was addressed in a number of GATT working party and panel reports.⁴³ In *Spain – Unroasted Coffee*, the Panel had to decide whether various types of unroasted coffee ('Colombian mild', 'other mild', 'unwashed Arabica', 'Robusta' and 'other') were 'like products' within the meaning of Article I:1. Spain applied zero customs duties on 'Colombia mild' and 'other mild', while it imposed a 7 per cent customs duty on the other three types of unroasted coffee. Brazil, which exported mainly 'unwashed Arabica', claimed that the Spanish tariff regime was inconsistent with Article I:1. In examining whether the various types of unroasted coffee were 'like products' to which the MFN treatment obligation applied, the Panel considered:

- the characteristics of the products;
- their end-use; and
- the tariff regimes of other Members.⁴⁴

After careful consideration of these criteria, the Panel concluded that all six types of unroasted coffee were 'like products'.

In addition to the characteristics of the products, their end-use and the tariff regimes of other Members – the criteria used by the GATT Panel in *Spain – Unroasted Coffee* – a WTO panel examining whether products are 'like' within the meaning of Article I:1 would now definitely also consider consumers' tastes and habits, a criterion or factor not yet referred to in *Spain – Unroasted Coffee*. Since the case law on 'likeness' within the meaning of Article I:1 of the GATT 1994 is limited, the case law on 'likeness' within the meaning of Article III of the GATT 1994, discussed below, should be considered even though the scope of the concept of 'likeness' may differ.⁴⁵

It is debatable whether, under current WTO law, the processes or production methods (PPMs) by which products are produced are relevant in determining whether those products are 'like', if the processes or production methods do *not* affect the physical characteristics of the products. It is often said that such non-product-related processes and production methods (nPR PPMs) are not relevant.⁴⁶ Consequently, one might conclude that biomass produced inconsistently with the Cramer sustainability criteria is 'like' biomass produced consistently with these criteria; and that livestock products not produced consistently with animal welfare requirements are 'like' livestock products produced consistently with these requirements. However, as will be discussed below in the context of the national treatment obligation under Article III:4 of the GATT 1994, there may be situations in which it would not be correct to come to these conclusions.⁴⁷

2.1.2.3 Is the advantage at issue granted 'immediately and unconditionally'?

Article I:1 requires that any advantage granted by a WTO Member to imports from any country must be granted 'immediately and unconditionally' to imports from all

41 In addition, the concept of 'like products' is also used in Articles II:2(a), VI:1(a), IX:1, XI:2(c), XIII:1, XVI:4 and XIX:1 of the GATT 1994.

42 Appellate Body Report, *Japan – Alcoholic Beverages II*, 114.

43 See e.g. Working Party Report, *Australian Subsidy on Ammonium Sulphate*, para. 8; and GATT Panel Report *EEC – Animal Feed Proteins*, para. 4.2. In the latter case, the Panel decided, on the basis of 'such factors as the number of products and tariff items carrying different duty rates and tariff bindings, the varying protein contents and the different vegetable, animal and synthetic origin of the protein products', that the various protein products at issue could not be considered as 'like products' within the meaning of Articles I and III of the GATT 1947.

44 GATT Panel Report, *Spain – Unroasted Coffee*, paras. 4.6-4.9.

45 Note the warning by Mavroidis 'against "lock, stock and barrel" transfers of interpretations reached in Article III GATT, into the four corners of Article I GATT.' P. Mavroidis, *The General Agreement on Tariffs and Trade: A Commentary*, Oxford Commentaries on GATT/WTO Agreements (Oxford: Oxford University Press, 2005), p.119.

46 For the meaning of the concept of nPR PPMs, see above, p. 8-9.

47 See below, p. 51.

other WTO Members.⁴⁸ Once a WTO Member has granted an advantage to imports from a country, it cannot make the granting of that advantage to imports of other WTO Members conditional upon those other WTO Members ‘giving something in return’ or ‘paying’ for the advantage.⁴⁹ The granting of an advantage within the meaning of Article I:1 may also not be conditional on whether a Member has certain characteristics, has certain legislation or undertakes certain action. In *Belgium – Family Allowances*, a dispute of 1952 concerning a Belgian law providing for a tax exemption for products purchased from countries which had a system of family allowances similar to that of Belgium, the Panel held that the Belgian law at issue:

*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.*⁵⁰

The Panel concluded that the advantage – the exemption from a tax – was not granted ‘unconditionally’ and that the Belgian law was, therefore, inconsistent with the MFN treatment obligation of Article I:1.

In *Indonesia – Autos*, the Panel found in its report of 1998 with respect to the requirement under Article I:1 that advantages shall be granted ‘unconditionally and immediately’, as follows:

*under the February 1996 car programme the granting of customs duty benefits to parts and components is conditional to 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’.*⁵¹

According to the Panel in *Indonesia – Autos* under Article I:1 of the GATT 1994, trade advantages – *in casu* tax and customs duty benefits – could not:

*be made conditional on any criteria that is not related to the imported product itself.*⁵²

In support of this statement, the Panel referred to the Report in *Belgian Family Allowances*.⁵³ Note, however, that the Panel in *Canada – Autos* found in its report of 2000 as follows:

*... we believe that the panel decisions and other sources referred to by Japan do not support the interpretation of Article I:1 advocated by Japan in the present case according to which the word ‘unconditionally’ in Article I:1 must be interpreted to mean 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. Rather, they accord with the conclusion from our analysis of the text of Article I:1 that whether conditions attached to an advantage granted in connection with the importation of a product offend Article I:1 depends upon whether or not such conditions discriminate with respect to the origin of products.*⁵⁴

The Panel in *Canada – Autos* found that the term ‘unconditionally’ does not mean that all conditions are prohibited. According to the Panel, ‘unconditionally’ refers to the obligation that MFN treatment towards another WTO Member shall not be conditional on reciprocal conduct by that other Member. The Panel stated:

... it appears to us that there is an important distinction to be made between, on the one hand, the issue of whether an advantage within the meaning of Article I:1 is subject to conditions, and, on the other hand, whether, an advantage, once it has been granted to the products of any country, is accorded ‘unconditionally’ to the like product of all other Members.

48 Note that Article I:1 also requires that any advantage granted by a WTO Member to exports to any country must be accorded ‘immediately and unconditionally’ to exports to all other WTO Members. However, the study focused on the non-discriminatory treatment of imports from different origins.

49 See in the respect, the Working Party Report on the ‘Accession of Hungary’, L/3889, adopted on 30 July 1973, BISD 20S/34, para. 12.

50 GATT Panel Report, *Belgium – Family Allowances*, para. 3.

51 Panel Report, *Indonesia – Autos*, para. 14.146.

52 *Ibid.*, para. 14.143.

53 *Ibid.*, para. 14.144.

54 Panel Report, *Canada – Autos*, para. 10.29.

An advantage can be granted subject to conditions without necessarily implying that it is not accorded 'unconditionally' to the like products of other Members.⁵⁵

The Panel in *EC – Tariff Preferences*, however, opted in its Report of 2003 for a yet another and again stricter meaning of the term 'unconditionally'. The measure at issue in this case was additional tariff preferences granted under the Drug Arrangements of the EC Generalized System of Preferences (GSP) to developing countries that are experiencing grave problems relating to the production of and traffic in illegal drugs. According to India, the complainant, 'the term 'unconditionally' in Article I:1 means that any such advantage must be accorded to like products of all other Members regardless of their situation or conduct'.⁵⁶ According to the European Communities, however, 'unconditionally' should be understood to mean that 'any advantage granted may not be subject to conditions requiring compensation'.⁵⁷ The Panel did not agree with the European Communities, and stated that:

In the Panel's view, moreover, the term 'unconditionally' in Article I:1 has a broader meaning than simply that of not requiring compensation. While the Panel acknowledges the European Communities' argument that conditionality in the context of traditional MFN clauses in bilateral treaties may relate to conditions of trade compensation for receiving MFN treatment, the Panel does not consider this to be the full meaning of 'unconditionally' under Article I:1. Rather, the Panel sees no reason not to give that term its ordinary meaning under Article I:1, that is, 'not limited by or subject to any conditions'.⁵⁸

Consequently, according to the Panel in *EC – Tariff Preferences*, a trade advantage is granted 'unconditionally' as required under Article I:1 of the GATT 1994 when the granting of the advantage is 'not limited by or subject to any conditions'. As the tariff preferences at issue in *EC – Tariff Preferences* were limited by or subject to

conditions the Panel concluded that they were not granted 'unconditionally' and thus were inconsistent with Article I:1.

The strict meaning given to the term 'unconditionally' in 2003 by the Panel in *EC – Tariff Preferences* contrasts with the less exact meaning given to this term in 2000 by the Panel in *Canada – Autos*. This term clearly requires clarification by the Appellate Body. Whether a Member granting a trade advantage, for example a lower customs duty, to biomass produced consistently with the Cramer sustainability criteria, while not granting this advantage to other biomass, acts inconsistently with the MFN treatment obligation of Article I:1 of the GATT 1994, may depend on whether one adopts the strict test of *EC – Tariff Preferences* or the more flexible test of *Canada – Autos*. Under the strict test of *EC – Tariff Preferences*, namely, whether granting of the advantage is 'not limited by or subject to any conditions', preferential tariff treatment of biomass produced consistently with the Cramer sustainability criteria clearly constitutes a violation of Article I:1 of the GATT 1994. Under the more flexible test of *Canada – Autos*, the preferential tariff treatment for biomass produced consistently with the Cramer sustainability requirements constitutes a violation of Article I:1 of the GATT only if this condition discriminates with respect to the origin of the products. Establishing whether such discrimination exists requires a difficult and fact-intensive investigation.

2.2 National treatment obligation

Article III of the GATT 1994, entitled 'National Treatment on Internal Taxation and Regulation', states, in relevant part:

1. *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.*
2. *The products of the territory of any [Member] imported into the territory of any other [Member] shall not be subject, directly or indirectly, to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products. Moreover, no [Member] 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.*
3. *...*
4. *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.*

⁵⁵ *Ibid.*, para. 10.24. Note that the Appellate Body in *Canada – Autos* found: 'The measure maintained by Canada accords the import duty exemption to certain motor vehicles entering Canada from certain countries. These privileged motor vehicles are imported by a limited number of designated manufacturers who are required to meet certain performance conditions. In practice, this measure does not accord the same import duty exemption immediately and unconditionally to like motor vehicles of all other Members, as required under Article I:1 of the GATT 1994. The 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. Accordingly, we find that this measure is not consistent with Canada's obligations under Article I:1 of the GATT 1994'. See Appellate Body Report, *Canada – Autos*, para. 85.

⁵⁶ Panel Report, *EC – Tariff Preferences*, para. 7.55.

⁵⁷ *Ibid.*, para. 7.56.

⁵⁸ *Ibid.*, para. 7.59.

The provisions of Article III, quoted above, should always be read together with the provisions of the *Ad Article III Note* contained in Annex I, entitled 'Notes and Supplementary Provisions', of the GATT 1994.

2.2.1 Scope and nature of the national treatment obligation

Article III of the GATT 1994 prohibits discrimination against imported products. Generally speaking, it prohibits Members from treating imported products less favourably than like domestic products once the imported products have entered the domestic market. In 1958, in *Italy – Agricultural Machinery*, a dispute concerning an Italian law providing special conditions for the purchase on credit of Italian-produced tractors and other agricultural machinery, the Panel stated with regard to Article III:

that the intention of the drafters of the Agreement was clearly to treat the imported products in the same way as the like domestic products once they had been cleared through customs. Otherwise indirect protection could be given.⁵⁹

In *Japan – Alcoholic Beverages II*, the Appellate Body stated with respect to the purpose of the national treatment obligation of Article III:

The broad and fundamental purpose of Article III is to avoid protectionism in the application of internal tax and regulatory measures. More specifically, the purpose of Article III is to ensure that internal measures 'not be applied to imported or domestic products so as to afford protection to domestic producers'. Toward this end, Article III obliges Members of the WTO to provide equality of competitive conditions for imported products in relation to domestic products. '[T]he intention of the drafters of the Agreement was clearly to treat the imported products in the same way as the like domestic products once they had been cleared through customs. Otherwise indirect protection could be given'.⁶⁰

In *Korea – Alcoholic Beverages*, the Appellate Body identified the objectives of Article III as 'avoiding protectionism, requiring equality of competitive conditions and protecting expectations of equal competitive relationships'.⁶¹

Article III of the GATT 1994 covers not only 'in law' or *de jure* discrimination; it also covers 'in fact' or *de facto* discrimination.⁶² In other words, Article III applies not only to 'origin-based' measures, which are discriminatory by definition; it also applies to 'origin-neutral' measures that in spite of their 'origin-neutrality' may nevertheless be discriminatory. An example of an 'origin-based' measure to which the non-discrimination obligation of Article III has been applied is the measure at issue in *Korea – Various Measures on Beef*. In that case, the disputed measure was a dual retail distribution system for the sale of beef under which *imported* beef was, *inter alia*, to be sold in specialist stores selling only imported beef or in separate sections of supermarkets. An example of an 'origin-neutral' measure to which the non-discrimination obligation of Article III has been applied is the measure at issue in *Japan – Alcoholic Beverages II*.⁶³ In that case, the disputed measure was tax legislation that provided for higher taxes on vodka (domestic and imported) than on *shochu* (domestic and imported).

Note that unlike Article I discussed above, Article III only applies to internal measures, and not to border measures. In addition to Article I, Articles II and XI, discussed below, also apply to border measures. It is not always easy to distinguish an internal measure from a border measure when the measure is applied to imported products at the time or point of importation.⁶⁴ Moreover, as the Panel in *India – Autos* noted:

... it ... cannot be excluded a priori that different aspects of a measure may affect the competitive opportunities of imports in different ways, making them fall within the scope either of Article III (where competitive opportunities on the domestic market are affected) or of Article XI (where the opportunities for importation itself, i.e. entering the market, are affected), or even that there may be, in perhaps exceptional circumstances,

59 GATT Panel Report, *Italy – Agricultural Machinery*, para. 11. As discussed below, the Panel in this early GATT case, the Panel in fact erred when it stated that imported products must be treated 'in the same way' as like domestic products. Under Article III:4, the paragraph of Article III at issue, imported products must be treated no less favourably than like domestic products. See below, p. 51.

60 Appellate Body Report, *Japan – Alcoholic Beverages II*, 16. In a footnote, the Appellate Body referred to GATT Panel Report, *US – Section 337*, para. 5.10 (for the first quote); GATT Panel Report, *US – Superfund*, para. 5.1.9; Panel Report, *Japan – Alcoholic Beverages II*, para. 5.5(b); and GATT Panel Report, *Italy – Agricultural Machinery*, para. 11 (for the second quote). See also Appellate Body Report, *Korea – Alcoholic Beverages*, para. 119; and Panel Report, *Indonesia – Autos*, para. 14.108.

61 Appellate Body Report, *Korea – Alcoholic Beverages*, para. 120. In *Canada – Periodicals*, the Appellate Body stated: 'The fundamental purpose of Article III of the GATT 1994 is to ensure equality of competitive conditions between imported and like domestic products.' See Appellate Body Report, *Canada – Periodicals*, 8. See also Panel Report, *Argentina – Hides and Leather*, para. 11.182.

62 On the meaning of the concepts of *de jure* and *de facto* discrimination, see above, p. 8.

63 Another example is the ban on asbestos and asbestos-containing products at issue in *EC – Asbestos*.

64 See *Ad Article III Note*. See also Panel Report, *EC – Asbestos*, paras. 8.89 and 8.91, and Panel Report, *India – Autos*, para. 7.224.

a potential for overlap between the two provisions, as was suggested in the case of state trading.⁶⁵

Of particular importance for the scope of application of Article III:4 of the GATT 1994, is the question of whether nPR PPM measures, i.e. measures regulating the process and production methods of products which do not affect the characteristics or properties of these products, fall within the scope of Article III:4. As discussed below, it has been argued that these nPR PPM measures constitute border measures controlled by Article XI of the GATT 1994, and not by Article III:4.⁶⁶

The general principle that internal measures should not be applied so as to afford protection to domestic production is elaborated in Article III:2 with regard to internal taxation and in Article III:4 with regard to internal regulation. In Article III:2, two non-discrimination obligations can be distinguished: one obligation, set out in the first sentence of Article III:2, relates to internal taxes on 'like products'; and the other obligation, set out in the second sentence of Article III:2, relates to internal taxes on 'directly competitive or substitutable products'. The sections below will discuss:

- the GATT national treatment test of Article III:2, first sentence, for internal taxes on like products;
- the GATT national treatment test of Article III:2, second sentence, for internal taxes on directly competitive or substitutable products; and
- the GATT national treatment test of Article III:4 for internal regulation.

2.2.2 GATT consistency of internal taxes on like products

Article III:2, first sentence, of the GATT 1994 states:

The products of the territory of any [Member] imported into the territory of any other [Member] 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.

This provision sets out a two-tier test of consistency of internal taxation. In *Canada – Periodicals*, the Appellate Body found:

[T]here are two questions which need to be answered to determine whether there is a violation of Article III:2 of the GATT 1994: (a) whether imported and domestic products are like products; and (b) whether the imported products are taxed in excess of the

⁶⁵ *Ibid.*, para. 7.224.

⁶⁶ See below, p. 86.

*domestic products. If the answers to both questions are affirmative, there is a violation of Article III:2, first sentence.*⁶⁷

In brief, the two-tier test of consistency of internal taxation with Article III:2, first sentence, therefore requires the examination of:

- whether the imported and domestic products are *like products*; and
- whether the imported products are *taxed in excess* of the domestic products.

However, before applying the test under Article III:2, first sentence, it has to be determined whether the measure at issue is an 'internal tax or other internal charge of any kind' within the meaning of that provision.

2.2.2.1 Is the measure at issue an 'internal tax on products'?

Article III:2, first sentence, concerns 'internal taxes and other charges of any kind' which are applied 'directly or indirectly' on products. Examples of such internal taxes on products are value added taxes (VAT), sales taxes and excise duties. Income taxes or import duties are not covered since they are not taxes on *products* or are not *internal* taxes.⁶⁸ The words 'applied *directly or indirectly* on products' should be understood to mean 'applied *on or in connection with* products'. It has been suggested that a tax applied 'indirectly' is a tax applied, not on a product as such, but on the processing of the product. VAT or excise duties on biomass or biofuels are definitely internal taxes within the scope of application of Article III:2. Taxes imposed on the processing of biomass into biofuels may also be considered to be internal taxes within the scope of application of Article III:2. Customs duties on biomass or biofuels or income taxes on companies producing biomass or biofuels are not internal taxes within the meaning of Article III:2 of the GATT 1994.

Note that the regulatory objective pursued by the tax measure is of no relevance to the question of whether the measure is an internal tax within the meaning of Article III:2. In *Japan – Alcoholic Beverages II*, the Appellate Body stated that Members may pursue, through their tax measures, any given policy objective provided they do so in compliance with Article III:2. In *Argentina – Hides and Leather*, the Panel rejected Argentina's contention that the tax legislation at issue in that case was designed to achieve efficient tax administration and collection, and as such did not fall under Article III:2.⁶⁹ The fact that a tax measure applicable on biomass or livestock products is adopted to promote the protection of the environment or animal welfare (and not to raise revenue for the government) is of

⁶⁷ Appellate Body Report, *Canada – Periodicals*, 468.

⁶⁸ Note that an income tax regulation can be considered to be an internal regulation and thus fall within the scope of Article III:4 of the GATT 1994, discussed below, p. 51.

⁶⁹ Panel Report, *Argentina – Hides and Leather*, para. 11.144.

no relevance to the question of whether the measure is an internal tax within the meaning of Article III:2 of the GATT 1994.⁷⁰

2.2.2.2 Are the products concerned 'like products'?

Similar to the concept of 'like products' in Article I:1 of the GATT 1994, the concept of 'like products' in Article III:2, first sentence, is not defined in the GATT 1994.

There are, however, a considerable number of GATT and WTO dispute settlement reports that shed light on the meaning of the concept of 'like products' in Article III:2, first sentence.

Under the Japanese tax system at issue in *Japan – Alcoholic Beverages II*, the internal tax imposed on domestic *shochu* was the same as that imposed on imported *shochu*; the higher tax imposed on imported vodka was also imposed on domestic vodka. Identical products (not considering brand differences) were thus taxed identically. However, the question in *Japan – Alcoholic Beverages II* was whether *shochu* and vodka should be considered to be 'like products'. If *shochu* and vodka were found to be 'like', vodka could not be taxed in excess of *shochu*. The Appellate Body in *Japan – Alcoholic Beverages II* addressed the scope of the concept of 'like products' within the meaning of Article III:2, first sentence. The Appellate Body first stated that this concept should be interpreted narrowly because of the existence of the concept of 'directly competitive or substitutable products' used in the second sentence of Article III:2. The Appellate Body ruled:

Because the second sentence of Article III:2 provides for a separate and distinctive consideration of the protective aspect of a measure in examining its application to a broader category of products that are not 'like products' as contemplated by the first sentence, we agree with the Panel that the first sentence of Article III:2 must be construed narrowly so as not to condemn measures that its strict terms are not meant to condemn. Consequently, we agree with the Panel also that the definition of 'like products' in Article III:2, first sentence, should be construed narrowly.⁷¹

70 Note, however, that according to the Panel in *US – Tobacco*, a financial penalty provision for the enforcement of a domestic law is not an 'internal tax or charge of any kind' within the meaning of Article III:2, first sentence. Such a financial penalty provision is an internal regulation with the meaning of Article III:4 of the GATT 1994. See GATT Panel Report, *US – Tobacco*, para. 80. Also, the Panel in *EEC – Animal Feed Proteins* did not consider a security deposit to be a fiscal measure, although this deposit accrued to the EEC when the buyers of vegetable proteins failed to fulfil the obligation to purchase milk powder. The Panel considered the security deposit, including any associated cost, to be only an enforcement mechanism for the purchase requirement and, as such, should be examined with the purchase obligation (which is an international regulation subject to Article III:4 of the GATT 1994). See GATT Panel Report, *EEC – Animal Feed Proteins*, para. 4.4.

71 Appellate Body Report, *Japan – Alcoholic Beverages II*, 112-13.

Subsequently, the Appellate Body expressly agreed with the basic approach for determining 'likeness' set out in the 1970 report of the Working Party on *Border Tax Adjustments*.⁷² This Working Party found that:

the interpretation of the term should be examined on a case-by-case basis. This would allow a fair assessment in each case of the different elements that constitute a 'similar' product. Some criteria were suggested for determining, on a case-by-case basis, whether a product is 'similar': the product's end-uses in a given market; consumers' tastes and habits, which change from country to country; the product's properties, nature and quality.⁷³

This basic approach was followed in almost all later GATT panel reports involving a GATT provision in which the concept of 'like products' was used.⁷⁴ According to the Appellate Body in *Japan – Alcoholic Beverages II*, this approach should be helpful in identifying on a case-by-case basis the range of 'like products' that fall within the limits of Article III:2, first sentence of the GATT 1994. However, the Appellate Body added:

*Yet this approach will be most helpful if decision makers keep ever in mind how narrow the range of 'like products' in Article III:2, first sentence, is meant to be as opposed to the range of 'like' products contemplated in some other provisions of the GATT 1994 and other Multilateral Trade Agreements of the WTO Agreement. In applying the criteria cited in [the report of the Working Group on] *Border Tax Adjustments* to the facts of any particular case, and in considering other criteria that may also be relevant in certain cases, panels can only apply their best judgement in determining whether in fact products are 'like'. This will always involve an unavoidable element of individual, discretionary judgement.⁷⁵*

The criteria listed in the report of the Working Group on Border Tax Adjustments did not include the tariff classification of the products concerned. Yet, tariff classification has been used as a criterion for determining 'like products' in several panel reports.⁷⁶ The Appellate Body acknowledged in *Japan – Alcoholic Beverages II*

72 Report of the Working Party on *Border Tax Adjustments*, BISD 18S/97. The Working Party considered the concept of 'like' or 'similar' products as used throughout the GATT.

73 Report of the Working Party on *Border Tax Adjustments*, BISD 18S/97, para. 18.

74 See e.g. GATT Panel Report, *Australia – Ammonium Sulphate*; GATT Panel Report, *EEC – Animal Feed Proteins*; GATT Panel Report, *Spain – Unroasted Coffee*; GATT Panel Report, *Japan – Alcoholic Beverages I*; and GATT Panel Report, *US – Superfund*.

75 Appellate Body Report, *Japan – Alcoholic Beverages II*, 113.

76 See e.g. GATT Panel in *Spain – Unroasted Coffee*, discussed above in the context of Article I:1 of the GATT 1994.

that uniform classification in tariff nomenclatures based on the Harmonized System can be of help in determining ‘likeness’.⁷⁷

The fact that ‘likeness’ under Article III:2, first sentence, is to be narrowly construed as compared to ‘likeness’ under other provisions, is clearly demonstrated in the 2004 case *Dominican Republic – Import and Sale of Cigarettes*. In that case, the Panel had found that domestic and imported cigarettes were ‘like’ products under Article III:4, before turning to complainant’s claim of inconsistency with Article III:2, first sentence. As provided for in its Selective Consumption Tax legislation, the Dominican Republic increased the taxes on cigarettes. The increase of taxes on *imported* cigarettes was based on the value of the nearest similar product on the domestic market. The Panel noted, firstly, that it was aware of the fact that finding ‘likeness’ under Article III:4 does not guarantee a finding of ‘likeness’ under Article III:2, first sentence. It then went on to state that:

... imported cigarettes can generally be considered as like products to domestic Dominican Republic cigarettes within the meaning of the first sentence of Article III:2 of the GATT. Indeed, the available evidence demonstrates that both imported and domestic cigarettes have similar physical properties; they are made from similar materials; have a similar presentation; they have the same end-use (i.e. they are smoked by consumers); and they are classified under the same tariff heading 24402.20.00. However, for the purpose of the analysis within the first sentence of Article III:2 of the GATT, a narrowly construed interpretation of the likeness requirement, would require the Panel to additionally consider the fact that, within the general product description, cigarettes are presented to consumers distinguished by brands. Under the identification of these brands, cigarettes compete within specific price segments against each other. The distinction between different price segments may be particularly important for the analysis under Article III:2 of the GATT, since the Selective Consumption Tax was applied on an ad valorem basis, i.e. was related to the price of the product.⁷⁸

Honduras, the complainant in this case, contended that the imported Viceroy brand had been treated for tax purposes as similar to higher-priced brands like Marlboro and Kent, rather than to the brand with which it had an equivalent retail price, Líder.⁷⁹ The Dominican Republic responded to this that it had determined that the nearest similar domestic cigarettes to Viceroy were Marlboro, and not Líder, because:

... its custom authorities considered that the Viceroy cigarettes were similar in quality to domestic higher-priced Marlboro and Kent, and not to the lower-priced Líder, since the declared customs value of Viceroy cigarettes was higher than the price of Líder and even of Marlboro and Kent.⁸⁰

The Panel agreed with the respondent that ‘quality is an important factor in the determination of the likeness of products’. However, the Panel then stated that:

... it does not think that values declared by importers for customs purposes can be the only factor used in order to determine the quality of a product. The Dominican Republic admits that the imported Viceroy cigarettes had the same retail selling price as the domestic Líder cigarettes. The Panel believes that, if prices of a product are to be considered as a function of their quality, then the actual price of the product in the marketplace should be in principle more relevant than the value declared in customs.⁸¹

The Panel in *Dominican Republic – Import and Sale of Cigarettes* thus concluded that in examining whether the Selective Consumption Tax was consistent with Article III:2, first sentence, it would consider:

... as products ‘alike’ to the imported cigarettes, those domestic cigarettes that were sold at a similar price and, more specifically, will consider that Viceroy cigarettes imported in the Dominican Republic are alike to domestic Líder cigarettes.⁸²

The actual price at which products are sold on the market of the importing country is thus a factor – in addition to the factors identified in the report of the Working Group on Border Tax Adjustment – to be considered when determining whether products are ‘like’ within the meaning of Article III:2, first sentence.

In *US – Malt Beverages*, the Panel held that national legislation giving special tax credits to products of *small* firms (whether domestic or foreign) would constitute discrimination against products from a *larger* foreign firm and therefore infringed Article III because its products would be treated less favourably than the like products of a small domestic firm.⁸³ The fact that products were produced by small or large firms was irrelevant in the determination of their ‘likeness’. The Panel pointed out that:

77 Appellate Body Report, *Japan – Alcoholic Beverages II*, 114-115.

78 Panel Report, *Dominican Republic – Import and Sale of Cigarettes*, paras. 7.330-331.

79 *Ibid.*, paras.7.321-323.

80 *Ibid.*, para. 7.326.

81 *Ibid.*, para. 7.333.

82 *Ibid.*, para. 7.336.

83 GATT Panel Report, *US – Malt Beverages*, para. 5.19.

... the United States did not assert that the size of the breweries affected the nature of the beer produced or otherwise affected beer as a product.⁸⁴

According to the Panel in *US – Malt Beverages*, processes and production methods that do not affect the nature, quality or property of products, in other words non-product related processes and production methods (nPR-PPMs), are irrelevant in the determination of 'likeness'.

The same Panel also considered, however, with regard to the determination of 'likeness', that:

the like product determination under Article III:2 also should have regard to the purpose of the Article ... The purpose is ... not to prevent contracting parties from using their fiscal and regulatory powers for purposes other than to afford protection to domestic production. Specifically, the purpose of Article III is not to prevent contracting parties from differentiating between different product categories for policy purposes unrelated to the protection of domestic production... Consequently, in determining whether two products subject to different treatment are like products, it is necessary to consider whether such product differentiation is being made 'so as to afford protection to domestic production'.⁸⁵

The Panel found domestic wine containing a particular local variety of grape 'like' imported wine not containing this variety of grape after considering that the purpose of differentiating between the wines was to afford protection to the local production of wine. The Panel noted that the United States did not advance any alternative policy objective for the differentiation. It is clear from the Panel's argumentation that, if the United States had advanced a legitimate (i.e. non-protectionist) policy objective for the product differentiation, the Panel would not have considered the products 'like'. According to the Panel in *US – Malt Beverages*, the reason for the product differentiation was to be considered when deciding on the 'likeness' of products.

In a dispute concerning, *inter alia*, special tax levels for luxury vehicles, *US – Taxes on Automobiles*, the Panel elaborated further this approach of determining 'likeness'.⁸⁶ The United States imposed a retail excise tax on cars over US\$30,000, and the Panel had to determine whether cars with prices above and below US\$30,000 were 'like products'. The complainant in this dispute, the European Communities, argued before the Panel that 'likeness' should be determined on the

basis of factors such as the end-use of the products, their physical characteristics and tariff classification. The United States, however, contended that the key factor in determining 'likeness' should be whether the measure was applied 'so as to afford protection to domestic industry'. The Panel reasoned that the determination of 'likeness' would, in all but the most straightforward cases, have to include an examination of the *aim* and *effect* of the particular tax measure. According to the Panel in *US – Taxes on Automobiles*, 'likeness' should be examined in terms of whether the less favourable treatment was based on a regulatory distinction taken so as to afford protection to domestic production. *In casu*, the Panel decided that the luxury tax was not implemented to afford protection to the domestic production of cars, and that cars above and below US\$30,000 could not, for the purpose of the luxury tax, be considered to be 'like products' under Article III:2, first sentence.⁸⁷

The 'aim-and-effect' test for determining 'likeness' was, however, explicitly rejected in 1996 by the Panel in *Japan – Alcoholic Beverages II*. The Panel explained its rejection of the 'aim-and-effect' test as follows:

... the proposed aim-and-effect test is not consistent with the wording of Article III:2, first sentence. The Panel recalled that the basis of the aim-and-effect test is found in the words 'so as to afford protection' contained in Article III:1. The Panel further recalled that Article III:2, first sentence, contains no reference to those words. Moreover, the adoption of the aim-and-effect test would have important repercussions on the burden of proof imposed on the complainant. The Panel noted in this respect that the complainants, according to the aim-and-effect test, 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. The Panel also noted that very often there is a multiplicity of aims that are sought through enactment of legislation and it would be a difficult exercise to determine which aim or aims should be determinative for applying the aim-and-effect test. Moreover, access to the complete legislative history, which according to the arguments of the parties defending the aim-and-effect test, is relevant to detect protective aims, could be difficult or even impossible for a complaining party to obtain. Even if the complete legislative history is 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 by interested parties) should be primarily determinative of the aims of the legislation.⁸⁸

84 *Ibid.*

85 GATT Panel Report, *US – Malt Beverages*, para. 5.24-25.

86 GATT Panel Report, *US – Taxes on Automobiles*, paras. 5.8ff. Note that this report was never adopted.

87 *Ibid.*

88 Panel Report, *Japan – Alcoholic Beverages II*, para. 6.16.

The United States had argued that the ‘aim-and-effect’ test should be applied only with respect to origin-neutral measures. The Panel noted, however, that neither the wording of Article III:2, nor that of Article III:1 support a distinction between origin-neutral and origin-specific measures.⁸⁹

In support of its rejection of the ‘aim-and-effect’ test in determining ‘likeness’ in the context of Article III:2, the Panel in *Japan – Alcoholic Beverages II* further noted this test would allow Members to circumvent the disciplines of Article XX of the GATT 1994, discussed below, and therefore make this provision redundant.⁹⁰ The Panel considered that:

*... the list of exceptions contained in Article XX of GATT 1994 could become redundant or useless because the aim-and-effect test does not contain a definitive list of grounds justifying departure from the obligations that are otherwise incorporated in Article III. The purpose of Article XX is to provide a list of exceptions, subject to the conditions that they ‘are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction of international trade’, that could justify deviations from the obligations imposed under GATT. Consequently, in principle, a WTO Member could, for example, invoke protection of health in the context of invoking the aim-and-effect test. The Panel noted that if this were the case, then the standard of proof established in Article XX would effectively be circumvented. WTO Members would not have to prove that a health measure is ‘necessary’ to achieve its health objective. Moreover, proponents of the aim-and-effect test even shift the burden of proof, arguing that it would be up to the complainant to produce a *prima facie* case that a measure has both the aim and effect of affording protection to domestic production and, once the complainant has demonstrated that this is the case, only then would the defending party have to present evidence to rebut the claim.⁹¹*

The Panel thus concluded for reasons relating to the wording of Article III as well as its context that the ‘aim-and-effect’ test proposed by Japan and the United States should be rejected.⁹²

The Appellate Body in *Japan – Alcoholic Beverages II* implicitly affirmed the Panel’s rejection of the aim-and-effect test.⁹³

2.2.2.3 Is the tax applied on the imported product ‘in excess’ of the tax on the domestic product?

Pursuant to Article III:2, first sentence, internal taxes on imported products should not be ‘in excess of’ the internal taxes applied to ‘like’ domestic products. In *Japan – Alcoholic Beverages II*, the Appellate Body established a strict benchmark for the ‘in excess of’ requirement. The Appellate Body ruled:

*Even the smallest amount of ‘excess’ is too much. 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.⁹⁴*

On the absence of a ‘trade effects test’, the Appellate Body stated in the same case, *Japan – Alcoholic Beverages II*:

*it is irrelevant that the ‘trade effects’ of the tax differential between imported and domestic products, as reflected in the volumes of imports, are insignificant or even non-existent; Article III protects expectations not of any particular trade volume but rather of the *equal competitive relationship* between imported and domestic products.⁹⁵ [emphasis added]*

With respect to the absence of a *de minimis* standard, note that in *US – Superfund* the Panel had already ruled in 1987:

The rate of tax applied to the imported products is 3.5 cents per barrel higher than the rate applied to the like domestic products... The tax on petroleum is ... inconsistent with the United States’ obligations under Article III:2, first sentence.⁹⁶

89 *Ibid.*, para. 6.17.

90 See below, p. 89.

91 *Ibid.*, para. 6.17.

92 *Ibid.*

93 The Appellate Body stated: ‘With these modifications to the legal reasoning in the Panel Report, we affirm the legal conclusions and the findings of the Panel with respect to “like products” in all other respects’. See Appellate Body Report, *Japan – Alcoholic Beverages II*, 115.

94 *Ibid.* See also Panel Report, *Argentina – Hides and Leather*, para. 11.244.

95 Appellate Body Report, *Japan – Alcoholic Beverages II*, 110.

96 GATT Panel Report, *US – Superfund*, para. 5.1.1. In *Argentina – Hides and Leather*, the Panel rejected Argentina’s argument that the tax burden differential between imported and domestic products would only exist for a thirty-day period and therefore was *de minimis*. See Panel Report, *Argentina – Hides and Leather*, para. 11.245.

In *Argentina – Hides and Leather*, the Panel emphasized that Article III:2, first sentence, requires a comparison of *actual* tax burdens rather than merely of *nominal* tax burdens. The Panel ruled:

It is necessary to recall the purpose of Article III:2, first sentence, which is to ensure 'equality of competitive conditions between imported and like domestic products'. Accordingly, Article III:2, first sentence, is not concerned with taxes or charges as such or the policy purposes Members pursue with them, but with their economic impact on the competitive opportunities of imported and like domestic products. It follows, in our view, that what must be compared are the tax burdens imposed on the taxed products.

We consider that Article III:2, first sentence, requires a comparison of actual tax burdens rather than merely of nominal tax burdens. Were it otherwise, Members could easily evade its disciplines. Thus, even where imported and like domestic products are subject to identical tax rates, the actual tax burden can still be heavier on imported products. This could be the case, for instance, where different methods of computing tax bases lead to a greater actual tax burden for imported products.⁹⁷

With respect to the methods of computing the tax basis, the Panel in *Japan – Alcoholic Beverages I* stated:

in assessing whether there is tax discrimination, account is to be taken not only of the rate of the applicable internal tax but also of the 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 the tax collection (e.g. basis of assessment).⁹⁸

In *Dominican Republic – Import and Sale of Cigarettes*, the importance of the *tax basis* in determining whether a tax measure is consistent with Article III:2 was further illustrated. In that case, the Dominican Republic taxed domestic cigarettes based on the average retail selling price of each brand, whereas, by contrast, the tax basis for imported cigarettes was calculated on the value of the 'nearest similar product on the domestic market.' According to the complainant, Honduras, this difference in tax basis resulted in certain lower-priced imported cigarettes being taxed at a rate higher than the one which would have corresponded according to their actual selling price. Honduras thus contended that the Dominican Republic acted inconsistently with Article III:2, first sentence. The Panel agreed with Honduras. It found that:

According to the available evidence, during the year 2003, the retail selling prices for imported cigarettes under the brand Viceroy and domestic cigarettes under the brand Líder were the same, i.e. RD\$18 per packet. However, these cigarettes were not taxed on the same basis. While each packet of Viceroy cigarettes paid RD\$6.54 in Selective Consumption Tax, a packet of Líder only paid RD\$5.34. That means that, while the actual tax burden for Viceroy cigarettes was 36.33 per cent of its retail selling price, for Líder it was 29.66 per cent.⁹⁹

On the basis of these considerations, the Panel concluded that the Dominican Republic imposed an internal tax on certain imported cigarettes in excess to the tax applied on the like domestic products and therefore acted in a manner inconsistent with Article III:2, first sentence, of the GATT.¹⁰⁰

While it is the *actual* tax burden on the 'like products' which must be examined, it should be noted that the Panel in *EEC – Animal Feed Proteins* ruled that an internal regulation which merely exposed imported products to a risk of discrimination constitutes, by itself, a form of discrimination and therefore less favourable treatment within the meaning of Article III.¹⁰¹

A Member which applies higher taxes on imported products in some situations but 'balances' this by applying lower taxes on the imported products in other situations also acts inconsistently with the national treatment obligation of Article III:2, first sentence. The Panel in *Argentina – Hides and Leather* ruled:

Article III:2, first sentence, is applicable to each individual import transaction. It does not permit Members to balance more favourable tax treatment of imported products in some instances against less favourable tax treatment of imported products in other instances.¹⁰²

If differences in taxes are based upon the nationality of producers or the origin of the parts and components contained in the products, these tax differences are – as the Panel in *Indonesia – Autos* found – necessarily inconsistent with the national treatment obligation of Article III:2, first sentence.¹⁰³ Such instances of *de jure* tax discrimination are usually easy to identify and have become, probably for that reason, uncommon. However, Article III:2, first sentence, also covers origin-neutral

99 Panel Report, *Dominican Republic – Import and Sale of Cigarettes*, para. 7.357

100 *Ibid.*, para. 7.358.

101 GATT Panel Report, *EEC – Animal Feed Proteins*, para. 141. See also GATT Panel Report, *US – Tobacco*, paras. 95-97.

102 Panel Report, *Argentina – Hides and Leather*, para. 11.260. See GATT Panel Report, *US – Tobacco*, para. 98.

103 Panel Report, *Indonesia – Autos*, para. 14.112.

97 Panel Report, *Argentina – Hides and Leather*, paras. 11.182-11.183.

98 GATT Panel Report, *Japan – Alcoholic Beverages I*, para. 5.8.

internal tax measures. Such measures can constitute *de facto* discrimination.¹⁰⁴ An example of *de facto* discrimination under Article III:2, first sentence, can be found in *Dominican Republic – Import and Sale of Cigarettes*. In that case, the Panel first found that the legislation on the basis of which the added tax on cigarettes was determined, was itself not discriminatory.¹⁰⁵ However, when the Panel subsequently examined the manner in which the tax legislation actually applied, it came to the conclusion – as discussed above – that there was sufficient evidence to indicate that imported cigarettes were taxed in excess of Dominican Republic cigarettes, and that the tax measure was therefore inconsistent with Article III:2, first sentence.¹⁰⁶

In 2006, under the ‘umbrella’ of the EC directive on biofuels, EC Directive 2003/30, Belgium adopted a biofuels law which provides, *inter alia*, for a lower excise duty on fuels containing a minimum percentage of bioethanol or biodiesel.¹⁰⁷ However, the relevant requirements are such that *de facto* this bioethanol or biodiesel must be of Belgian origin produced from Belgian biomass. As will be discussed below, such a measure is not only inconsistent with Article III:2, but also with the *SCM Agreement* because the measure – as described above – clearly constitutes a prohibited import substitution subsidy within the meaning of Article 3 of the *SCM Agreement*.¹⁰⁸ Under the ‘umbrella’ of EC Directive 2003/30, the Netherlands currently applies lower excise duties on biofuels produced from three specific vegetable oils than it applies to other biofuels. To the extent that the biofuels produced from these three specific vegetable oils are ‘like’ other biofuels, the higher excise duties on the latter biofuels is inconsistent with Article III:2, first sentence, of the GATT 1994.¹⁰⁹

While it is clear that border tax adjustment is possible for indirect taxes levied on products, the extent to which indirect taxes on inputs, incorporated or exhausted in the production process, to the final product can be adjusted at the border, whether on exports or on imports, remains to be clarified. The GATT Panel in *US – Superfund* considered that taxes on substances entering in the composition

of the final product could be adjusted at the border. However, it is not clear, in this particular case, whether those substances were still physically present in the final product, or whether they had been exhausted in the production process, and the Panel made no distinction to that effect.¹¹⁰

2.2.3 GATT consistency of internal taxes on directly competitive or substitutable products

The second sentence of Article III:2 of the GATT 1994 states:

Moreover, no Member 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.

As discussed above, the relevant leading principle set forth in Article III:1 is that internal taxes and other internal charges ‘should not be applied to imported or domestic products so as to afford protection to domestic production.’

Furthermore, the *Ad Article III Note* provides with respect to Article III:2:

A tax conforming to the requirements of the first sentence of paragraph 2 would be considered to be inconsistent with the provisions of the second sentence only in cases where competition was involved between, on the one hand, the taxed product and, on the other hand, a directly competitive or substitutable product which was not similarly taxed.

The relationship between the first and the second sentence of Article III:2 was addressed by the Appellate Body in *Canada – Periodicals*, a dispute concerning, *inter alia*, the Canadian excise tax on magazines. The Appellate Body considered:

there are two questions which need to be answered to determine whether there is a violation of [the first sentence of] Article III:2 of the GATT 1994: (a) whether imported and domestic products are like products; and (b) whether the imported products are taxed in excess of the domestic products. If the answers to both questions are affirmative, there is a violation of Article III:2, first sentence. If the answer to one question is negative, there is a need to examine further whether the measure is consistent with Article III:2, second sentence.¹¹¹

¹¹⁰ See Committee on Trade and Environment, *Taxes and Charges for Environmental Purposes*. Note by the Secretariat, WT/CTE/W/47, paras. 68-70.

¹¹¹ Appellate Body Report, *Canada – Periodicals*, 486.

¹⁰⁴ See above, p. 28.

¹⁰⁵ Panel Report, *Dominican Republic – Import and Sale of Cigarettes*, para. 7.353.

¹⁰⁶ *Ibid.*, paras. 7.354-358. See also the analysis above, p. 40-41.

¹⁰⁷ Wet betreffende de biobrandstoffen van 10 juni 2006, *Belgisch Staatsblad*, 16 juni 2006, 30632-30637.

¹⁰⁸ See below, p. 158. It is assumed that Article III:8(b) of the GATT 1994 does not apply here since the measure at issue is not the ‘payment of a subsidy exclusively to domestic producers’ within the meaning of that provision. See below, p. 73.

¹⁰⁹ If the biofuels concerned are not ‘like’ within the strict meaning of Article III:2, first sentence, they are at least ‘directly competitive or substitutable’ within the meaning of Article III:2, second sentence and thus fall under the rules of this provision, discussed below, p. 43.

As the Appellate Body stated in *Japan – Alcoholic Beverages II* and again in *Canada – Periodicals*, Article III:2, second sentence, contemplates a ‘broader category of products’ than Article III:2, first sentence.¹¹² Furthermore, Article III:2, second sentence, sets out a different test of inconsistency. In *Japan – Alcoholic Beverages II*, the Appellate Body stated:

Unlike that of Article III:2, first sentence, the language of Article III:2, second sentence, specifically invokes Article III:1. The significance of this distinction lies in the fact that whereas Article III:1 acts implicitly in addressing the two issues that must be considered in applying the first sentence, it acts explicitly as an entirely separate issue that must be addressed along with two other issues that are raised in applying the second sentence. Giving full meaning to the text and to its context, three separate issues must be addressed to determine whether an internal tax measure is inconsistent with Article III:2, second sentence. These three issues are whether:

1. *[t]he imported products and the domestic products are ‘directly competitive or substitutable products’ which are in competition with each other;*
2. *the directly competitive or substitutable imported and domestic products are ‘not similarly taxed’; and*
3. *the dissimilar taxation of the directly competitive or substitutable imported and domestic products is ‘applied ... so as to afford protection to domestic production’.*

Again, these are three separate issues. Each must be established separately by the complainant for a panel to find that a tax measure imposed by a Member of the WTO is inconsistent with Article III:2, second sentence.¹¹³

In brief, the test of consistency of internal taxation with Article III:2, second sentence, thus requires an examination of:

- whether the imported and domestic products are *directly competitive or substitutable*;
- whether these products are *not similarly taxed*; and
- whether the internal tax is *applied so as to afford protection* to domestic production.

However, before this test of consistency of internal taxation can be applied, it must be established that the measure at issue is an ‘internal tax or other internal charge’ within the meaning of Article III:2, second sentence, of the GATT 1994.

2.2.3.1 Is the measure at issue an ‘internal tax on products’?

As is the case with Article III:2, first sentence, Article III:2, second sentence, is concerned with ‘internal taxes or other internal charges’ on products. For a discussion on the meaning and the scope of these concepts, recall the discussion above in the section dealing with Article III:2, first sentence.¹¹⁴ With regard to this element of the test of consistency, there is no difference between the first and second sentence of Article III:2.

2.2.3.2 Are the products concerned ‘directly competitive or substitutable’?

The national treatment obligation of Article III:2, second sentence, applies to ‘directly competitive or substitutable products’. The relevant WTO case law to date provides us with a number of examples of products that panels and/or the Appellate Body have found to be ‘directly competitive or substitutable’ on the market of a particular Member. In *Canada – Periodicals*, the ‘directly competitive or substitutable products’ were the split-run periodicals and non-split-run periodicals at issue in that case.¹¹⁵ In *Japan – Alcoholic Beverages II* and *Korea – Alcoholic Beverages*, *shochu* and *soju*, respectively, were found to be ‘directly competitive or substitutable’ with imported liquors such as whisky, vodka, brandy, cognac, rum and genever.¹¹⁶ In *Chile – Alcoholic Beverages*, the domestically produced *pisco* was considered ‘directly competitive or substitutable’ with imported distilled spirits such as whisky, brandy and cognac.¹¹⁷ In *Mexico – Taxes on Soft Drinks*, the ‘directly competitive or substitutable products’ were domestic soft drinks produced with cane sugar and foreign products produced with high fructose corn syrup.¹¹⁸ Note that in this case, domestic soft drinks produced with cane sugar and imported soft drinks produced with beet sugar were considered ‘like’ under Article III:2, first sentence.

In *Canada – Periodicals*, the Appellate Body ruled that to be ‘directly competitive or substitutable’ within the meaning of Article III:2, second sentence, products do not – contrary to what Canada had argued – have to be perfectly substitutable. The

114 See above, p. 31.

115 Appellate Body Report, *Canada – Periodicals*, 473.

116 Panel Report, *Japan – Alcoholic Beverages II*, para.6.32 (‘whisky, brandy, rum, gin, genever, and liqueurs’, para. 6.28), and Panel Report, *Korea – Alcoholic Beverages*, para. 10.98 (‘vodka, whiskies, rum, gin, brandies, cognac, liqueurs, tequila and ad-mixtures’, para. 10.57).

117 Appellate Body Report, *Chile – Alcoholic Beverages*, para. 7.83

118 Panel Report, *Mexico – Taxes on Soft Drinks*, para. 8.78.

112 *Ibid.*, 470.

113 Appellate Body Report, *Japan – Alcoholic Beverages II*, 116. This part was later cited and endorsed by the Appellate Body, in Appellate Body Report, *Canada – Periodicals*, 470, and in Appellate Body Report, *Chile – Alcoholic Beverages*, para. 47.

Appellate Body noted:

A case of perfect substitutability would fall within Article III:2, first sentence, while we are examining the broader prohibition of the second sentence.¹¹⁹

With regard to the relationship between the concept of ‘like products’ of Article III:2, first sentence, and the concept of ‘directly competitive or substitutable’ products of Article III:2, second sentence, the Appellate Body stated in *Korea – Alcoholic Beverages*:

‘Like’ products are a subset of directly competitive or substitutable products: all like products are, by definition, directly competitive or substitutable products, whereas not all ‘directly competitive or substitutable’ products are ‘like’. The notion of like products must be construed narrowly but the category of directly competitive or substitutable products is broader. While perfectly substitutable products fall within Article III:2, first sentence, imperfectly substitutable products can be assessed under Article III:2, second sentence.¹²⁰

As to the meaning of the concept of ‘directly competitive or substitutable products’, the Appellate Body stated in *Korea – Alcoholic Beverages*:

The term ‘directly competitive or substitutable’ describes a particular type of relationship between two products, one imported and the other domestic. It is evident from the wording of the term that the essence of that relationship is that the products are in competition. This much is clear both from the word ‘competitive’ which means ‘characterized by competition’, and from the word ‘substitutable’ which means ‘able to be substituted’. The context of the competitive relationship is necessarily the marketplace since this is the forum where consumers choose between different products.¹²¹

The Appellate Body considers products to be ‘directly competitive or substitutable’ when they are interchangeable or offer alternative ways of satisfying a particular need or taste.¹²² The Appellate Body also considers that, in examining whether products are ‘directly competitive or substitutable’, an analysis of *latent* as well as *extant* demand is required since ‘competition in the market place is a dynamic,

evolving process’.¹²³ As the Appellate Body in *Korea – Alcoholic Beverages* stated, in justification of its dynamic view of the concept of ‘directly competitive or substitutable products’:

In view of the objectives of avoiding protectionism, requiring equality of competitive conditions and protecting expectations of equal competitive relationships, we decline to take a static view of the term ‘directly competitive or substitutable’. The object and purpose of Article III confirms that the scope of the term ‘directly competitive or substitutable’ cannot be limited to situations where consumers already regard products as alternatives. If reliance could be placed only on current instances of substitution, the object and purpose of Article III:2 could be defeated by the protective taxation that the provision aims to prohibit.¹²⁴

With respect to the factors to be taken into account in establishing whether products are ‘directly competitive or substitutable’, the Appellate Body, in *Japan – Alcoholic Beverages II*, agreed with the Panel in that case that these factors include, in addition to the physical characteristics, common end-use and tariff classification of the products concerned, the competitive conditions in the relevant market.¹²⁵ The Appellate Body held:

The GATT 1994 is a commercial agreement, and the WTO is concerned, after all, with markets. It does not seem 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’.

Nor does it seem inappropriate to examine elasticity of substitution as one means of examining those relevant markets. The Panel did not say that cross-price elasticity of demand is ‘the decisive criterion’ for determining whether products are ‘directly competitive or substitutable’.¹²⁶

The Appellate Body considered an examination of the competitive conditions in the market, and, in particular, the cross-price elasticity of demand in that market, as a means of establishing whether products are ‘directly competitive or substitutable’. In *Korea – Alcoholic Beverages*, the Appellate Body further clarified:

123 *Ibid.*, para. 114.

124 *Ibid.*, para. 120.

125 Appellate Body Report, *Japan – Alcoholic Beverages II*, 117.

126 *Ibid.* In fact, the Panel in *Japan – Alcoholic Beverages II* had found 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 elasticity of substitution.’ See Panel Report, *Japan – Alcoholic Beverages II*, para. 6.22.

119 Appellate Body Report, *Canada – Periodicals*, 473.

120 Appellate Body Report, *Korea – Alcoholic Beverages*, para. 118. In a footnote, the Appellate Body referred to the Appellate Body Report, *Japan – Alcoholic Beverages II* and Appellate Body Report, *Canada – Periodicals*.

121 Appellate Body Report, *Korea – Alcoholic Beverages*, para. 114.

122 *Ibid.*, para. 116.

... studies of cross-price elasticity, which in our Report in *Japan – Alcoholic Beverages* were regarded as one means of examining a market, involve an assessment of latent demand. Such studies attempt to predict the change in demand that would result from a change in the price of a product following, *inter alia*, from a change in the relative tax burdens on domestic and imported products.¹²⁷

However, in that case, *Korea – Alcoholic Beverages*, the Appellate Body was again careful to stress that cross-price elasticity of demand for products is not the decisive criterion in determining whether these products are ‘directly competitive or substitutable’. The Appellate Body agreed with the Panel’s emphasis on the ‘quality’ or ‘nature’ of competition rather than the ‘quantitative overlap of competition’. The Appellate Body shared the Panel’s reluctance to rely unduly on quantitative analyses of the competitive relationship.¹²⁸

Note that in establishing whether products are ‘directly competitive or substitutable’ in the market of one Member, the market situation in *other* Members may be relevant and can be taken into consideration. In *Korea – Alcoholic Beverages*, the Appellate Body stated:

*It is, of course, true that the ‘directly competitive or substitutable’ relationship must be present in the market at issue, in this case, the Korean market. It is also true that consumer responsiveness to products may vary from country to country. This does not, however, preclude consideration of consumer behaviour in a country other than the one at issue. It seems to us that evidence from other markets may be pertinent to the examination of the market at issue, particularly when demand on that market has been influenced by regulatory barriers to trade or to competition. Clearly, not every other market will be relevant to the market at issue. But if another market displays characteristics similar to the market at issue, then evidence of consumer demand in that other market may have some relevance to the market at issue. This, however, can only be determined on a case-by-case basis, taking account of all relevant facts.*¹²⁹

Note that while biofuels and fossil fuels may not be ‘like products’ within the meaning of Article III:2, first sentence, they may be ‘directly competitive or substitutable’ products within the meaning of Article III:2, second sentence, of the GATT 1994.

2.2.3.3 Is the imported product ‘not similarly taxed’ as the domestic product?

The test of consistency of internal taxation with Article III:2, second sentence, subsequently requires an examination of whether the imported and domestic products are *not similarly taxed*. While under Article III:2, first sentence, even the slightest tax differential in favour of the domestic product leads to the conclusion that the internal tax imposed on imported products is inconsistent with the national treatment obligation, under Article III:2, second sentence, the tax differential in favour of the domestic product has to be more than *de minimis* to support a conclusion that the internal tax imposed on imported products is WTO-inconsistent. In *Japan – Alcoholic Beverages II*, the Appellate Body explained:

*To interpret ‘in excess of’ and ‘not similarly taxed’ identically would deny any distinction between the first and second sentences of Article III:2. Thus, in any given case, there may be some amount of taxation on imported products that may well be ‘in excess of’ the tax on domestic ‘like products’ but may not be so much as to compel a conclusion that ‘directly competitive or substitutable’ imported and domestic products are ‘not similarly taxed’ for the purposes of the Ad Article to Article III:2, second sentence.*¹³⁰

Whether any particular differential amount of taxation is *de minimis* or not must be determined on a case-by-case basis.

Note that the ‘not similarly taxed’ requirement is met even if only some imported products are not taxed similarly to domestic products, while other imported products are taxed similarly. The Appellate Body stated in *Canada – Periodicals* that:

*... dissimilar taxation of even some imported products as compared to directly competitive or substitutable domestic products is inconsistent with the provisions of the second sentence of Article III:2.*¹³¹ [emphasis added]

2.2.3.4 Is the internal tax applied ‘so as to afford protection to domestic production’?

The last element of the test under Article III:2, second sentence, is whether the internal taxes are applied ‘so as to afford protection to domestic production’.

127 Appellate Body Report, *Korea – Alcoholic Beverages*, para. 121.

128 *Ibid.*, para. 134.

129 *Ibid.*, para. 137.

130 Appellate Body Report, *Japan – Alcoholic Beverages II*, 118. On the *de minimis* standard, see also Appellate Body Report, *Canada – Periodicals*, 474; Appellate Body Report, *Chile – Alcoholic Beverages*, para. 49; and Panel Report, *Indonesia – Autos*, para. 14.115.

131 Appellate Body Report, *Canada – Periodicals*, 474. To support this conclusion, the Appellate Body referred to GATT Panel Report, *US – Section 337*, para. 5.14.

This element must be distinguished from the previous element ('not similarly taxed').¹³²

As to how to establish whether a tax measure was applied so as to afford protection to domestic production, the Appellate Body noted in *Japan – Alcoholic Beverages II*:

*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.*¹³³

To determine whether the application of a tax measure affords protection to domestic production, it is the application criteria, the structure and the overall application rather than the subjective intent of the legislator or regulator that must be examined. For example, if the tax measure operates in such a way that the lower tax brackets cover predominantly domestic production, whereas the higher tax brackets embrace largely imported products, the implication is that the tax measure is applied so as to afford protection to domestic production.

As the Appellate Body acknowledged in *Japan – Alcoholic Beverages II*, the very magnitude of the tax differential may be evidence of the protective application of a tax measure. Most often, however, other factors will also be considered. The Appellate Body noted in *Japan – Alcoholic Beverages II* that:

*It is irrelevant that protectionism was not an intended objective if the particular tax measure in question is nevertheless, to echo Article III:1, 'applied to imported or domestic products so as to afford protection to domestic production'. This is an issue of how the measure in question is applied.*¹³⁴

In *Chile – Alcoholic Beverages*, Chile argued that the internal taxation on alcoholic beverages at issue in that case was aimed at, among other things, reducing the consumption of alcoholic beverages with a high alcohol content. The Appellate Body held:

We recall once more that, in Japan – Alcoholic Beverages, we declined to adopt an approach to the issue of 'so as to afford protection' that attempts to examine 'the many reasons legislators and regulators often have for what they do'. We called for

132 See Appellate Body Report, *Japan – Alcoholic Beverages II*, 119, criticizing the Panel for failing to make this distinction.

133 *Ibid.*, p.120

134 *Ibid.*, p.119.

*examination of the design, architecture and structure of a tax measure precisely to permit identification of a measure's objectives or purposes as revealed or objectified in the measure itself. Thus, we consider that a measure's purposes, objectively manifested in the design, architecture and structure of the measure, are intensely pertinent to the task of evaluating whether or not that measure is applied so as to afford protection to domestic production.*¹³⁵

As the Appellate Body noted, however, Chile failed to explain the rationale for the structure of the internal tax measure at issue, and, 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. In the absence of an explanation for the structure of the Chilean tax measure, according to the Appellate Body, it was very difficult to reach any other conclusion than that the measure was applied as a protective measure. The Appellate Body emphasized that the mere statement of the four objectives pursued by Chile does not constitute effective rebuttal of the conclusion reached by the Panel that the Chilean tax measure is 'applied so as to afford protection to domestic production'.¹³⁶

Note, however, that in *Canada – Periodicals*, the Appellate Body did seem to give at least some importance to the statements of representatives of the Canadian Government about the policy objectives of the tax measure at issue.¹³⁷

If biofuels and fossil fuels are considered to be 'directly competitive or substitutable products' within the meaning of Article III:2, second sentence, then the Netherlands would act inconsistently with Article III:2, second sentence, when the tax differential between biofuels and fossil fuels would be such as to afford protection to the domestic production of biofuels. This would be the case if the structure, architecture and design of the tax measure are such that the domestic products predominantly fall in the lower tax bracket while the imported products fall in the higher tax bracket.

2.2.4 GATT consistency of internal regulation on like products

The national treatment obligation of Article III of the GATT 1994 does not only concern internal taxation dealt with in Article III:2. Article III also concerns internal regulation, dealt with primarily in Article III:4. Article III:4 states, in relevant part:

135 Appellate Body Report, *Chile – Alcoholic Beverages*, para. 71.

136 *Ibid.*, para. 71.

137 See Appellate Body Report, *Canada – Periodicals*, pp. 475-6.

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.

This provision sets out a three-tier test for the consistency of internal regulation. In *Korea – Various Measures on Beef*, the Appellate Body stated:

For a violation of Article III:4 to be established, three elements must be satisfied: that the imported and domestic products at issue are ‘like products’; that the measure at issue is a ‘law, regulation, or requirement affecting their internal sale, offering for sale, purchase, transportation, distribution, or use’; and that the imported products are accorded ‘less favourable’ treatment than that accorded to like domestic products.¹³⁸

In other words, the three-tier test of consistency of internal regulation with Article III:4 thus requires examination of whether:

- the measure at issue is a *law, regulation or requirement* covered by Article III:4;
- the imported and domestic products are *like products*; and
- the imported products are accorded *less favourable treatment*.

2.2.4.1 Is the measure at issue a ‘law, regulation or requirement affecting internal sale...’?

Article III:4 concerns ‘all laws, regulations and requirements affecting [the] internal sale, offering for sale, purchase, transportation, distribution or use [of products]’.

Broadly speaking, the national treatment obligation of Article III:4 applies to regulations affecting the sale and use of products. In 1958 already, the Panel in *Italy – Agricultural Machinery* interpreted the scope of application of Article III:4 broadly as including all measures that may modify the conditions of competition.¹³⁹ Later GATT panels built on this broad interpretation of the scope of Article III:4. In *US – Section 337*, for example, the Panel ruled that not only *substantive* laws, regulations and requirements, but also *procedural* laws, regulations and requirements can be regarded as ‘affecting’ the internal sale of imported goods.¹⁴⁰

According to GATT case law, Article III:4 applies, *inter alia*, to:

- minimum price requirements applicable to domestic and imported beer;¹⁴¹
- limitations on points of sale for imported alcoholic beverages;¹⁴²

- the requirement that imported beer and wine be sold only through in-state wholesalers or other middlemen;¹⁴³
- a ban on all cigarette advertising;¹⁴⁴
- additional marking requirements such as an obligation to add the name of the producer or the place of origin or the formula of the product;¹⁴⁵
- practices concerning internal transportation of beer;¹⁴⁶ and trade-related investment measures.¹⁴⁷

Note that a requirement for industrial users of biomass (oil companies and electricity companies) to report whether the biomass they use is produced consistently with the sustainability requirements is a requirement affecting the use of biomass and therefore falls within the scope of Article III:4.

In *Mexico – Taxes on Soft Drinks*, the Panel found that ‘the soft drink tax, the distribution tax and the bookkeeping requirements may be considered as measures that affect the internal use in Mexico of non-cane sugar sweeteners ... within the meaning of Article III:4 of the GATT 1994’.¹⁴⁸ Internal taxes are thus not only subject to the disciplines of Article III:2, discussed above. They can also be measures within the meaning of Article III:4 and thus be subject to the disciplines of that provision.

In *Canada – Autos*, the Panel held that a measure can be considered to be a measure affecting, i.e. having an effect on, the internal sale or use of imported products even if it is not shown that under the current circumstances the measure has an impact on the decisions of private parties to buy imported products.¹⁴⁹

While, to date, most cases involving Article III:4 have concerned *generally applicable* ‘laws’ and ‘regulations’, Article III:4 also covers ‘requirements’ that may

138 Appellate Body Report, *Korea – Various Measures on Beef*, para. 133

139 GATT Panel Report, *Italy – Agricultural Machinery*, para. 12.

140 GATT Panel Report, *US – Section 337*, para. 5.10.

141 See GATT Panel Report, *Canada – Provincial Liquor Boards (US)*, para. 5.30.

142 See GATT Panel Report, *Canada – Provincial Liquor Boards (EEC)*, para.4.26.

143 See GATT Panel Report, *US – Malt Beverages*, para. 5.32.

144 See GATT Panel Report, *Thailand – Cigarettes*, para. 77.

145 See Working Party Report, *Certificates of Origin, Marks of Origin, Consular Formalities*, para. 13.

146 See GATT Panel Report, *Canada – Provincial Liquor Boards (US)*, para. 5.12; and GATT Panel Report, *US – Malt Beverages*, para. 5.50.

147 See GATT Panel Report, *Canada – FIRA*, paras. 5.12 and 6.1.

148 Panel Report, *Mexico – Taxes on Soft Drinks*, para. 8.113.

149 Panel Report, *Canada – Autos*, para. 10.84.

apply to *isolated cases* only.¹⁵⁰ Thus Article III:4 covers measures that apply both across the board and in isolated cases only.¹⁵¹

The question has arisen as to whether a ‘requirement’ within the meaning of Article III:4 necessarily needs to be a government-imposed requirement, or whether an action by a private party can constitute a ‘requirement’ to which Article III:4 applies. In *Canada – Autos*, the Panel examined commitments by Canadian car manufacturers to increase the value added to cars in their Canadian plants. These commitments were communicated in letters addressed to the Canadian government. The Panel qualified these commitments as ‘requirements’ subject to Article III:4.¹⁵² According to the Panel, private action can be a ‘requirement’ within the meaning of Article III:4 if, and only if, there is such a *nexus*, i.e. a close link, between that action and the action of a government, that the government must be held responsible for that private action.¹⁵³

Note that the *WTO Agreement on Trade-Related Investment Measures* contains an illustrative list of trade-related investment measures (TRIMs) that are inconsistent with Article III:4.¹⁵⁴ The list includes, for example, measures that:

- are mandatory or enforceable under domestic law, or compliance with which is necessary to obtain an advantage; and
- require the purchase or use by an enterprise of products of domestic origin; or require that an enterprise’s purchases or use of imported products be limited to an amount related to the volume or value of local products that it exports.

It has been suggested that Article III:4 might *not* apply to ‘laws, regulations...’ making distinctions based on extra-territorial policy considerations not affecting the characteristics or properties of the products concerned.¹⁵⁵ An example of such a law would be a law prohibiting the sale of biomass produced in the exporting country in a manner inconsistent with minimum labour standards or in an

environmentally unfriendly manner. It might be argued that such laws regulating non-product related processes and production methods (nPR PPMs) fall under the scope of application of the prohibition of quantitative restrictions of Article XI of the GATT 1994 rather than the national treatment obligation of Article III:4 of the GATT 1994. However, the broad scope of application given to Article III:4 in the case law to date pleads against the exclusion of measures regulating nPR PPMs from the scope of application of Article III:4.

2.2.4.2 Are the products concerned ‘like products’?

As with Articles I:1 and III:2, first sentence, of the GATT 1994, both discussed above, the non-discrimination obligation of Article III:4 applies only to ‘like products’.¹⁵⁶ The Appellate Body considered the meaning of the concept of ‘like products’ of Article III:4 in *EC – Asbestos*. In its report in this case, the Appellate Body first noted that the concept of ‘like products’ was also used in Article III:2, first sentence, and that, in previous reports, it had held that the scope of ‘like products’ was to be construed ‘narrowly’ in that provision.¹⁵⁷ The Appellate Body then examined whether this interpretation of ‘like products’ in Article III:2 could be taken to suggest a similarly narrow reading of ‘like products’ in Article III:4, since both provisions form part of the same Article. The Appellate Body reasoned as follows:

... we observe that, although the obligations in Articles III:2 and III:4 both apply to ‘like products’, the text of Article III:2 differs in one important respect from the text of Article III:4. Article III:2 contains *two separate sentences*, each imposing *distinct obligations*: the first lays down obligations in respect of ‘like products’, while the second lays down obligations in respect of ‘directly competitive or substitutable’ products. By contrast, Article III:4 applies only to ‘like products’ and does not include a provision equivalent to the second sentence of Article III:2.¹⁵⁸

The Appellate Body considered that this textual difference between Article III:2 and Article III:4 had considerable implications for the meaning of the concept of ‘like products’ in these two provisions. After recalling the reasoning in *Japan – Alcoholic Beverages II* underlying its ‘narrow’ interpretation of ‘like products’ in Article III:2, first sentence, the Appellate Body subsequently observed:

In construing Article III:4, the same interpretive considerations do not arise, because the ‘general principle’ articulated in Article III:1 is expressed in Article III:4, not through two distinct obligations, as in the two sentences in Article III:2, but instead through a

150 See GATT Panel Report, *Canada – FIRA*.

151 *Ibid.*, para. 5.5. The measures at issue in *Canada – FIRA* were written undertakings by investors to purchase goods of Canadian origin in preference to imported goods, or in specified amounts or proportions, or to purchase goods from Canadian sources.

152 The question of whether actions of private parties can qualify as ‘requirements’ within the meaning of Article III:4 was previously addressed in GATT Panel Report, *Canada – FIRA*, para. 5.4 and GATT Panel Report, *EEC – Parts and Components*, para. 5.21. The Panel in *Canada – Autos* explicitly refers to this case law and takes it further.

153 See Panel Report, *Canada – Autos*, paras. 10.106-10.107.

154 See Article 2.2 of, and the Annex to the *Agreement on Trade-Related Investment Measures*.

155 See G. Marceau and J. Trachtmann, ‘A map of the WTO law of domestic regulation of goods’, in G. Bermann and P. Mavroidis, *Trade and Human Health and Safety* (Cambridge University Press, 2006), p.55.

156 See above, p. 21 and p. 30.

157 The Appellate Body referred in a footnote to Appellate Body Report, *Japan – Alcoholic Beverages II*, 112 and 113 and Appellate Body Report, *Canada – Periodicals*, 473.

158 Appellate Body Report, *EC – Asbestos*, para. 94.

single obligation that applies solely to 'like products'. ... Thus, we conclude that, given the textual difference between Articles III:2 and III:4, the 'accordion' of 'likeness' stretches in a different way in Article III:4.¹⁵⁹

In other words, the Appellate Body came to the conclusion that, unlike for the concept of 'like products' in Article III:2, there is no reason to give a narrow interpretation to the concept of 'like products' in Article III:4. Having made this distinction, the Appellate Body then proceeded to examine the meaning of this concept in Article III:4. It first recalled that, in *Japan – Alcoholic Beverages II*, it had ruled that the broad and fundamental purpose of Article III is to avoid protectionism in the application of internal taxes and regulatory measures. As explicitly stated in Article III:1, the purpose of Article III is to ensure that internal measures 'not be applied to imported and domestic products so as to afford protection to domestic production'. To this end, Article III obliges Members of the WTO to provide *equality of competitive conditions for imported products in relation to domestic products*.¹⁶⁰ This 'general principle' is not explicitly invoked in Article III:4. Nevertheless, it does 'inform' that provision.¹⁶¹ The Appellate Body in *EC – Asbestos* thus reasoned that the term 'like product' in Article III:4 must be interpreted to give proper scope and meaning to the anti-protectionism principle of Article III:1.¹⁶² It is clear that an internal regulation can only afford protection to domestic production if the internal regulation addresses domestic and imported products that are in a competitive relationship. In the absence of a competitive relationship between the domestic and imported products, internal regulation cannot be applied to these products so as to afford protection of domestic production.

The Appellate Body in *EC – Asbestos* thus came to the following conclusion with respect to the meaning of 'like products' in Article III:4:

... a determination of 'likeness' under Article III:4 is, fundamentally, a determination about the nature and extent of a competitive relationship between and among products. In saying this, we are mindful that there is a spectrum of degrees of 'competitiveness' or 'substitutability' of products in the marketplace, and that it is difficult, if not impossible, in the abstract, to indicate precisely where on this spectrum the word 'like' in Article III:4 of the GATT 1994 falls. We are not saying that *all* products which are in *some* competitive relationship are 'like products' under Article III:4. In ruling on the measure at issue, we also do not attempt to define the precise scope of the word 'like'

159 *Ibid.*, para. 96.

160 See Appellate Body Report, *Japan – Alcoholic Beverages II*, 109-10.

161 *Ibid.*, 111.

162 Appellate Body Report, *EC – Asbestos*, para. 98.

in Article III:4. Nor do we wish to decide if the scope of 'like products' in Article III:4 is co-extensive with the combined scope of 'like' and 'directly competitive or substitutable' products in Article III:2 ... In view of [the] different language [of Articles III:2 and III:4], and although we need not rule, and do not rule, on the precise product scope of Article III:4, we do conclude that the product scope of Article III:4, although broader than the *first* sentence of Article III:2, is certainly *not* broader than the *combined* product scope of the *two* sentences of Article III:2 of the GATT 1994.¹⁶³

In brief, the determination of whether products are 'like products' under Article III:4 is, fundamentally, a determination about the nature and extent of the competitive relationship between these products. Note that the Appellate Body refers both to the nature *and* the extent of the competitive relationship. A mere economic analysis of the cross-price elasticity of demand for the products at issue will not suffice to determine whether these products are 'like'. 'Likeness' is a matter of judgement – qualitatively as well as quantitatively.¹⁶⁴ Precisely what the nature and extent of the competitive relationship needs to be for products to be 'like' within the meaning of Article III:4 cannot be indicated in the abstract. Nevertheless, it can be said that the concept of 'like products' in Article III:4 has a relatively broad scope. Its scope is broader than that of the concept of 'like products' in Article III:2, first sentence. However, it is no broader than the combined scope of the concepts of 'like product' and 'directly competitive or substitutable products' of Article III:2, first and second sentence, respectively. In line with this reasoning, the Panel in *Mexico – Taxes on Soft Drinks* concluded that, as it had found soft drinks sweetened with cane sugar and soft drinks sweetened beet sugar to be 'like' under Article III:2, first sentence, these products could also be considered 'like' under Article III:4.¹⁶⁵ Furthermore, the Panel concluded that soft drinks sweetened with cane sugar and soft drinks sweetened with high-fructose corn syrup, which were considered 'directly competitive or substitutable' within the meaning of Article III:2, second sentence, were in a close competitive relationship and could thus be considered 'like' products within the meaning of Article III:4.¹⁶⁶

Having reached a conclusion on the scope of 'likeness', the Appellate Body in *EC – Asbestos* then turned to the question of how it should determine whether products are 'like' within the meaning of Article III:4. The Appellate Body noted:

163 *Ibid.*, paras. 99-100.

164 R. Howse and E. Türk, 'The WTO impact on internal regulations', in G. Bermann and P. Mavroidis, *Trade and Human Health and Safety* (Cambridge University Press, 2006), p.91.

165 Panel Report, *Mexico – Taxes on Soft Drinks*, para. 8.105.

166 *Ibid.*, para. 8.106.

As in Article III:2, in this determination, '[n]o one approach ... will be appropriate for all cases'. Rather, an assessment utilizing 'an unavoidable element of individual, discretionary judgement' has to be made on a case-by-case basis. The Report of the Working Party on Border Tax Adjustments outlined an approach for analyzing 'likeness' that has been followed and developed since by several panels and the Appellate Body. This approach has, in the main, consisted of employing four general criteria in analyzing 'likeness': (i) the properties, nature and quality of the products; (ii) the end-uses of the products; (iii) consumers' tastes and habits – more comprehensively termed consumers' perceptions and behaviour – in respect of the products; and (iv) the tariff classification of the products. We note that these four criteria comprise four categories of 'characteristics' that the products involved might share: (i) the physical properties of the products; (ii) the extent to which the products are capable of serving the same or similar end-uses; (iii) the extent to which consumers perceive and treat the products as alternative means of performing particular functions in order to satisfy a particular want or demand; and (iv) the international classification of the products for tariff purposes.¹⁶⁷

The Appellate Body in *EC – Asbestos* hastened to add, however, that, while these general criteria, or groupings of potentially shared characteristics, provide a framework for analysing the 'likeness' of particular products, they are 'simply tools to assist in the task of sorting and examining the relevant evidence'.¹⁶⁸ The Appellate Body stressed that these criteria are 'neither a treaty-mandated nor a closed list of criteria that will determine the legal characterization of products'.¹⁶⁹ In each case, all pertinent evidence, whether related to one of these criteria or not, must be examined and considered by panels to determine whether products are 'like'. Such pertinent evidence could relate to the nPR PPMs of the products concerned. What is important is whether these nPR PPMs affect the competitive relationship in the market between the imported and domestic products concerned. With regard to the general criteria (i.e. physical properties; end-uses; consumers' tastes/habits; tariff classification), the Appellate Body in *EC – Asbestos* finally noted:

167 *Ibid.*, para. 101. In a footnote, the Appellate Body referred to Appellate Body Report, *Japan – Alcoholic Beverages II*, 113 and 114; it also referred to Panel Report, *US – Gasoline*, para. 6.8, where the approach set out in the *Border Tax Adjustments* report was adopted in a dispute concerning Article III:4 of the GATT 1994. The Appellate Body noted in a footnote that the fourth criterion, tariff classification, was not mentioned by the Working Party on *Border Tax Adjustments*, but was included by subsequent panels (see e.g. GATT Panel Report, *EEC – Animal Feed Proteins*, para. 4.2; and GATT Panel Report, *Japan – Alcoholic Beverages I*, para. 5.6).

168 Appellate Body Report, *EC – Asbestos*, para. 102.

169 *Ibid.*

... under Article III:4 of the GATT 1994, the term 'like products' is concerned with competitive relationships between and among products. Accordingly, whether the *Border Tax Adjustments* framework is adopted or not, it is important under Article III:4 to take account of evidence which indicates whether, and to what extent, the products involved are – or could be – in a competitive relationship in the marketplace.¹⁷⁰

The Appellate Body in *EC – Asbestos* was highly critical of the manner in which the Panel had examined the 'likeness' of chrysotile asbestos fibres and PCG fibres¹⁷¹ as well as the 'likeness' of cement-based products containing chrysotile asbestos fibres and cement-based products containing PCG fibres.¹⁷² The Appellate Body criticized the Panel for not examining each of the criteria set forth in the Report of the Working Group on *Border Tax Adjustments*, and for not examining these criteria separately. The Appellate Body also disagreed with the Panel's refusal to consider the health risks posed by asbestos in the determination of 'likeness', stating:

... neither the text of Article III:4 nor the practice of panels and the Appellate Body suggest that any evidence should be excluded *a priori* from a panel's examination of 'likeness'. Moreover, as we have said, in examining the 'likeness' of products, panels must evaluate *all* of the relevant evidence. We are very much of the view that evidence relating to the health risks associated with a product may be pertinent in an examination of 'likeness' under Article III:4 of the GATT 1994. We do not, however, consider that the evidence relating to the health risks associated with chrysotile asbestos fibres need be examined under a *separate* criterion, because we believe that this evidence can be evaluated under the existing criteria of physical properties, and of consumers' tastes and habits.¹⁷³

In the opinion of the Appellate Body, the carcinogenic or toxic nature of chrysotile asbestos fibres constitutes a defining aspect of the physical properties of those fibres and must therefore be considered when determining 'likeness' under Article III:4.¹⁷⁴ According to the Appellate Body, evidence relating to health risks may thus be relevant in assessing the competitive relationship in the marketplace between allegedly 'like' products.¹⁷⁵

In a 'concurring' opinion (which was in fact a 'dissenting' opinion) in *EC – Asbestos*, one of the Members of the Appellate Body considered that, in view of the nature

170 *Ibid.*, para. 103.

171 PCG fibres are polyvinyl alcohol (PVA), cellulose and glass fibres.

172 Appellate Body Report, *EC – Asbestos*, para. 109.

173 *Ibid.*, para. 113.

174 *Ibid.*, para. 114.

175 *Ibid.*, para. 115.

and the quantum of the scientific evidence showing that the physical properties and qualities of chrysotile asbestos fibres include or result in carcinogenicity, there is ample basis for a 'definitive characterization' of such fibres as not 'like' PCG fibres.¹⁷⁶ This Appellate Body Member suggested that this 'definitive characterization' may and should be made even in the absence of evidence concerning end uses and consumers' tastes and habits. As the Member explained:

It is difficult for me to imagine what evidence relating to economic competitive relationships as reflected in end-uses and consumers' tastes and habits could outweigh and set at naught the undisputed deadly nature of chrysotile asbestos fibres, compared with PCG fibres, when inhaled by humans, and therefore compel a characterization of 'likeness' of chrysotile asbestos and PCG fibres.¹⁷⁷

The Member who wrote this separate opinion clearly did not share the position taken by the two other Appellate Body Members that the competitive relationship in the market is decisive in the determination of the 'likeness' of products under Article III:4.¹⁷⁸ In the opinion of this Member, 'the necessity or appropriateness of adopting a 'fundamentally' economic interpretation of the 'likeness' of products under Article III:4 of the GATT 1994 does not appear to me to be free from substantial doubts'.¹⁷⁹ There are no indications in subsequent case law that this critique of a 'fundamentally' economic interpretation of the concept of 'likeness' has (growing) support among the Members of the Appellate Body. It should be noted, however, that to the extent that a 'less-economic interpretation' of the concept of 'likeness' would gain acceptance, a difference between products in nPR PPMs may lead more easily to the conclusion that the products concerned are not 'like'.

With regard to the second and third criteria set out in the Report of the Working Group on *Border Tax Adjustments*, i.e. end-uses and consumers' tastes and habits, the Appellate Body found in *EC – Asbestos*:

Evidence of this type is of particular importance under Article III of the GATT 1994, precisely because that provision is concerned with competitive relationships in the marketplace. If there is – or could be – no competitive relationship between products, a Member cannot intervene, through internal taxation or regulation, to protect domestic production. Thus, evidence about the extent to which products can serve the same

176 Note that pursuant to Article 17.11 of the *Dispute Settlement Understanding*, the opinions expressed in an Appellate Body report by an individual Member are expressed anonymously.

177 *Ibid.*, para. 152.

178 *Ibid.*, para. 153, in fine.

179 *Ibid.*, para. 154.

end-uses, and the extent to which consumers are – or would be – willing to choose one product instead of another to perform those end-uses, is highly relevant evidence in assessing the 'likeness' of those products under Article III:4 of the GATT 1994.

We consider this to be especially so in cases where the evidence relating to properties establishes that the products at issue are physically quite different. In such cases, in order to overcome this indication that products are not 'like', a higher burden is placed on complaining Members to establish that, despite the pronounced physical differences, there is a competitive relationship between the products such that all of the evidence, taken together, demonstrates that the products are 'like' under Article III:4 of the GATT 1994.¹⁸⁰

With respect to end-uses, the Appellate Body found that, while it is certainly relevant that products have similar end-uses for a 'small number of ... applications', a panel must also consider the other, *different* end-uses for products. As the Appellate Body stated in *EC – Asbestos*:

It is only by forming a complete picture of the various end-uses of a product that a panel can assess the significance of the fact that products share a limited number of end-uses.¹⁸¹

With respect to consumers' tastes and habits, the Appellate Body was very critical of the Panel for declining to examine this criterion because, as the Panel stated, 'this criterion would not provide clear results'.¹⁸² The Appellate Body noted that, in its opinion, consumers' tastes and habits regarding asbestos fibres or PCG fibres, even in the case of commercial parties such as manufacturers, are very likely to be shaped by the health risks associated with a product that is known to be highly carcinogenic (as asbestos fibres are).¹⁸³

After reversing the Panel's findings, in *EC – Asbestos*, on the 'likeness' of chrysotile asbestos fibres and PCG fibres, the Appellate Body itself examined the 'likeness' of these products and came to the conclusion that the evidence was certainly far from sufficient to satisfy the complainant's burden of proving that chrysotile asbestos fibres are 'like' PCG fibres under Article III:4.

180 *Ibid.*, paras. 117 and 118.

181 *Ibid.*, para. 119.

182 Panel Report, *EC – Asbestos*, para. 8.139.

183 Appellate Body Report, *EC – Asbestos*, para. 122.

The Appellate Body considered that the evidence tended rather to suggest that these products are not ‘like products’.¹⁸⁴

At a more general level, the Appellate Body in *EC – Asbestos*, on the one hand, confirmed (two to one) the prior case law by upholding the market-based, economic interpretation of the concept of ‘likeness’, *but*, on the other, it remedied the narrowness of this case law by allowing non-economic interests and values to be considered in the determination of ‘likeness’ (*in casu* ‘health concerns’).

Two additional observations on the determination of ‘likeness’ under Article III:4 of the GATT 1994 are called for: one observation regarding the ‘aim-and-effect’ approach already discussed above in the context of Article III:2, first sentence, of the GATT 1994;¹⁸⁵ and one observation regarding the relevance of non-product related process and production methods (nPR PPMs) discussed above in the context of both Article I and Article III:2 of the GATT 1994.¹⁸⁶

With regard to the ‘aim and effect’ approach to the determination of ‘likeness’, note that in 1992, in *US – Malt Beverages*, the Panel considered the question of whether low-alcohol beer and high-alcohol beer should be regarded as ‘like products’ within the meaning of Article III:4. Recalling its earlier statement on like product determinations under Article III:2, first sentence, the Panel considered that:

*... in the context of Article III, it is essential that such determinations be made not only in the light of such criteria as the products’ physical characteristics, but also in the light of the purpose of Article III, which is to ensure that internal taxes and regulations ‘not be applied to imported or domestic products so as to afford protection to domestic production’.*¹⁸⁷

The Panel noted that, on the basis of their ‘physical characteristics’, low- and high-alcohol beers were ‘similar’. However, in order to determine whether low- and high-alcohol beers were ‘like products’ under Article III:4, the Panel considered that it had to examine whether the purpose of the distinction between low- and high-alcohol beers was ‘to afford protection to domestic production’. The Panel noted that the United States had argued that the distinction was made to encourage the consumption of low- rather than high-alcohol beer. The Panel eventually concluded

that the purpose of the regulatory distinction was not to afford protection to domestic production and that low- and high-alcohol beers were, therefore, not ‘like products’.¹⁸⁸ For reasons discussed above in the context of Article III:2, this ‘aim-and-effect’ approach to the determination of ‘likeness’ has been discredited and abandoned by WTO panels and the Appellate Body.¹⁸⁹ A first indication that WTO panels would not follow this ‘aim-and-effect’ approach was given in *US – Gasoline*, in which the Panel found that chemically identical imported and domestic gasoline were ‘like products’ because ‘chemically identical imported and domestic gasoline by definition have exactly the same physical characteristics, end-uses, tariff classification, and are perfectly substitutable’.¹⁹⁰ The aim and effect of the regulatory distinction made was not given any consideration in determining ‘likeness’.

With regard the relevance of nPR PPMs in determining ‘likeness’, note that the Panel in *US – Tuna I (Mexico)* found that differences in nPR PPMs are not relevant in determining ‘likeness’. The Panel stated:

*Article III:4 calls for a comparison of the treatment of imported tuna as a product with that of domestic tuna as a product. Regulations governing the taking of dolphins incidental to the taking of tuna could not possibly affect tuna as a product. Article III:4 therefore obliges the United States to accord treatment to Mexican tuna no less favourable than that accorded to United States tuna, whether or not the incidental taking of dolphins by Mexican vessels corresponded to that of United States vessels.*¹⁹¹

However, as reflected above, the thinking on the concept of ‘likeness’ has evolved since the 1991 *US – Tuna I (Mexico)* case. The question of whether nPR PPMs may be of relevance in the determination of ‘likeness’ now requires a more nuanced answer than that given by the Panel in *US – Tuna I (Mexico)*. It should be noted that nPR PPMs may have an impact on consumer preferences and tastes, and thus on the nature and the extent of the competitive relationship between products. If carpets made by children are shunned by the consumers in a particular market, a situation may arise in which there is in fact no (or only a weak) competitive relationship between these carpets and carpets made by adults. In the light of the nature and the extent of the competitive relationship between them, carpets made by children and carpets made by adults could in such a situation be found to be not

184 *Ibid.*, para. 141. Also, with regard to the products containing asbestos and PCG fibres, the Appellate Body concluded that Canada had not satisfied the burden of proof that these products were ‘like’ (see Appellate Body Report, *EC – Asbestos*, para. 147).

185 See above, p. 37.

186 See above, p. 23 and p. 35-36.

187 GATT Panel Report, *US – Malt Beverages*, para. 5.71.

188 *Ibid.*, paras. 5.25-5.26 and 5.71-5.76.

189 See above, p. 32.

190 Panel Report, *US – Gasoline*, para. 6.9.

191 GATT Panel Report, *US – Tuna I (Mexico)*, para. 5.15. Note that this report was never adopted. The relevance of PPMs in determining whether products are ‘like’ was also rejected in the GATT Panel Report, *US – Malt Beverages*, GATT Panel Report, *US – Taxes on Automobiles*; Panel Report, *US – Gasoline* and Panel Report, *Indonesia – Autos*.

'like'. However, it seems unlikely that this type of situation will often arise as consumers in most markets are in their choice between products primarily guided by the price and other aspects that are *not* related to the conditions (e.g. environmental, labour or animal welfare conditions) under which the products were produced. Some commentators have argued, however, that:

*'... the prevailing anti-PPM rationale in Geneva – and in the trade community more generally – has grown out of sync with market realities, namely, the interest of significant numbers of consumers in the environmental consequences of how a product is produced.'*¹⁹²

Note in this respect a Zogby poll of consumers in the United States in 2000, which showed that 75.4% of respondents found it unacceptable to induce moulting in laying hens by withholding feed, and 80.7% said they would be willing to pay more for eggs from hens raised in a 'humane manner'.¹⁹³ A UK survey revealed that 79% of respondents supported legislation to phase out battery cages in the EU, and 87% indicated that they were willing to pay more for eggs from non-battery cage hens.¹⁹⁴

In the context of the current study, the question arises as to whether on the Dutch market:

- the fact that biomass is, or is not, produced consistently with the Cramer sustainability requirements; or
 - the fact that livestock products are, or are not, produced in accordance with animal welfare requirements,
- have significant impacts on consumer preferences and tastes, and thus on the nature and the extent of the competitive relationship between the products concerned and their derivatives. If so, the products concerned and their derivatives may be found to be *not* 'like'.

2.2.4.3 Are the imported products accorded 'treatment no less favourable' than the domestic products?

The fact that a measure distinguishes between 'like products' does not suffice to conclude that this measure is inconsistent with Article III:4.¹⁹⁵ As the Appellate Body noted in *EC – Asbestos*:

*... there is a second element that must be established before a measure can be held to be inconsistent with Article III:4 ... A complaining Member must still establish that the measure accords to the group of 'like' imported products 'less favourable treatment' than it accords to the group of 'like' domestic products.'*¹⁹⁶

The Panel in *US – Section 337* explained the 'treatment no less favourable' element of the Article III:4 test in clear terms, noting that:

*the 'no less favourable' treatment requirement set out in Article III:4, is unqualified. These words are to be found throughout the General Agreement and later Agreements negotiated in the GATT framework as an expression of the underlying principle of equality of treatment of imported products as compared to the treatment given either to other foreign products, under the most favoured nation standard, or to domestic products, under the national treatment standard of Article III. The words 'treatment no less favourable' in paragraph 4 call for effective equality of opportunities for imported products in respect of the application of laws, regulations and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use of products. This clearly sets a minimum permissible standard as a basis.'*¹⁹⁷ [emphasis added]

The Panel in *US – Section 337* thus interpreted 'treatment no less favourable' as requiring 'effective equality of competitive opportunities'. In later GATT and WTO reports, the Appellate Body and panels have consistently interpreted 'treatment no less favourable' in the same way.¹⁹⁸

192 R. Howse, P. van Bork and C. Hedebrand, *WTO Disciplines and Biofuels: Opportunities and Constraints in the Creation of a Global Marketplace*, IPC Discussion Paper, October 2006, referring to M. Araya, *WTO Negotiations on Environmental Goods and Services: Maximizing Opportunities?* Global Environmental and Trade Study (GETS), Yale Center for Environmental Law and Policy, June 2003, pp.1-2.

193 A.B.Thiermann and S. Babcock, 'Animal welfare and international trade', *Rev. Sci. Tech. (Int. Office of Epizootics)*, vol. 24 (2005), p.751.

194 *Ibid.*

195 In other words, regulatory distinctions between 'like products' are not necessarily inconsistent with Article III:4 of the GATT 1994. See below, p. 66.

196 Appellate Body Report, *EC – Asbestos*, para. 100. See also R. Howse and E. Türk, 'The WTO impact on internal regulations'. Howse and Türk argue that while the Appellate Body has rejected the 'aim-and-effect' test with respect to likeness, it has in effect brought this test back in at this stage of considering whether there is less favourable treatment. R.

197 GATT Panel Report, *US – Section 337*, para. 5.11.

198 See e.g. GATT Panel Report, *Canada – Provincial Liquor Boards (US)*, paras. 5.12-5.14 and 5.30-5.31; GATT Panel Report, *US – Malt Beverages*, para. 5.30; Panel Report, *US – Gasoline*, para. 6.10; Panel Report, *Canada – Periodicals*, 75; Panel Reports, *EC – Bananas III*, paras. 7.179-7.180; and Panel Report, *Japan – Film*, para. 10.379.

In *US – Gasoline*, a dispute concerning legislation designed to prevent and control air pollution, the Panel found that the measure at issue afforded less favourable treatment to imported gasoline than to domestic gasoline because, for domestic refiners of gasoline, an individual baseline (representing the quality of the gasoline produced by that refiner in 1990) was established while, for importers of gasoline, the more onerous statutory baseline applied.¹⁹⁹ Recalling the ruling of the Panel in *US – Section 337* that the words ‘treatment no less favourable’ in paragraph 4 call for effective equality of opportunities for imported products, the Panel in *US – Gasoline* concluded that

*since, under the baseline establishment methods, imported gasoline was effectively prevented from benefiting from as favourable sales conditions as were afforded domestic gasoline by an individual baseline tied to the producer of a product, imported gasoline was treated less favourably than domestic gasoline.*²⁰⁰

Although the ‘less favourable treatment’ finding of the Panel in *EC – Asbestos* had not been appealed, the Appellate Body could not resist noting that:

*The term ‘less favourable treatment’ expresses the general principle, in Article III:1, that internal regulations ‘should not be applied ... so as to afford protection to domestic production’. If there is ‘less favourable treatment’ of the group of ‘like’ imported products, there is, conversely, ‘protection’ of the group of ‘like’ domestic products.*²⁰¹

In *Korea – Various Measures on Beef*, a dispute concerning a dual retail distribution system for the sale of beef under which imported beef was, *inter alia*, to be sold in specialized stores selling only imported beef or in separate sections of supermarkets, the Panel ruled that:

*any regulatory distinction that is based exclusively on criteria relating to the nationality or the origin of the products is incompatible with Article III.*²⁰²

However, the Appellate Body disagreed with the Panel and reversed this ruling. According to the Appellate Body the formal difference in treatment between domestic and imported ‘like’ products is *neither necessary nor sufficient* for a violation of Article III:4. Formally different treatment of imported products did not necessarily constitute less favourable treatment while the absence of formal difference in treatment did not

necessarily mean that there was no less favourable treatment.²⁰³

The Appellate Body in *Korea – Various Measures on Beef* stated:

*We observe ... that Article III:4 requires only that a measure accord treatment to imported products that is ‘no less favourable’ than that accorded to like domestic products. A measure that provides treatment to imported products that is **different** from that accorded to like domestic products is not necessarily inconsistent with Article III:4, as long as the treatment provided by the measure is ‘no less favourable’. According ‘treatment no less favourable’ means, as we have previously said, according **conditions of competition** no less favourable to the imported product than to the like domestic product.*

*This interpretation, which focuses on the **conditions of competition** between imported and domestic like products, implies that a measure according formally **different** treatment to imported products does not *per se*, that is, necessarily, violate Article III:4.*²⁰⁴

The Appellate Body recalled that this point was already persuasively made in the GATT Panel Report in *US – Section 337*.²⁰⁵ The Appellate Body concluded in *Korea – Various Measures on Beef*:

*A formal difference in treatment between imported and like domestic products is thus neither necessary, nor sufficient, to show a violation of Article III:4. Whether or not imported products are treated ‘less favourably’ than like domestic products should be assessed instead by examining whether a measure modifies the **conditions of competition** in the relevant market to the detriment of imported products.*²⁰⁶

In *US – Gasoline*, the Panel rejected the US argument that the requirements of Article III:4 were met because imported gasoline was treated similarly to domestic gasoline from *similarly situated* domestic parties.²⁰⁷ The Panel pointed out, *inter alia*, that:

203 See also GATT Panel Report, *US – Section 337*, para. 5.11; and Panel Report, *US – Gasoline*, para. 6.25.

204 Appellate Body Report, *Korea – Various Measures on Beef*, paras. 135-6.

205 The Panel in that case had to determine whether United States patent enforcement procedures, which were formally different for imported and for domestic products, violated Article III:4. See GATT Panel Report, *US – Section 337*, para. 5.11.

206 Appellate Body Report, *Korea – Various Measures on Beef*, para. 137.

207 Panel Report, *US – Gasoline*, para. 6.11. The Appellate Body did not address this finding of the Panel.

199 Panel Report, *US – Gasoline*, para. 6.10

200 *Ibid.*, para. 6.10.

201 Appellate Body Report, *EC – Asbestos*, para. 100.

202 Panel Report, *Korea – Various Measures on Beef*, para. 6.27.

[the] wording [of Article III:4] does not allow less favourable treatment dependent on the characteristics of the producer.²⁰⁸

In *US – Gasoline*, the Panel also rejected the US contention that the regulation at issue treated imported products ‘equally overall’ and was therefore not inconsistent with Article III:4.²⁰⁹ Under Article III:4, as under Articles I:1 and III:2, ‘balancing’ less favourable treatment with more favourable treatment does not ‘excuse’ the less favourable treatment.²¹⁰ Finally, when establishing whether there is ‘treatment less favourable’, what is to be compared is the treatment given to the group of imports as a whole and the treatment given to the group of domestic products as a whole. A finding of ‘treatment less favourable’ cannot be based on the fact that products of the particular foreign producer face less favourable conditions of competition than the products of a particular domestic producer.

Note that in a recent case, *Canada – Wheat Imports and Grain Exports*, the Panel stated that the measure at issue, i.e. a prohibition to enter foreign grain in grain elevators unless specifically authorized, would appear to be inconsistent with Article III:4 of the GATT 1994 because imported grain is treated less favourably than like domestic grain.²¹¹ However, as the Panel noted, Canada argued that the measure at issue:

... does not adversely affect the conditions of competition for imported grain as compared with like domestic grain. More particularly, Canada argues that the authorization process is not onerous; that elevator operators are very familiar with the process; that authorizations are consistently granted; that the CGC [Canadian Grain Commission] has discretion to always authorize receipt of foreign grain; and that advance authorization may be obtained.²¹²

The Panel recognized that, in the *Canada – Wheat Imports and Grain Exports* case, there may be legitimate reasons for Canada to treat domestic grain and like imported grain differently, for example, because the latter has not been subjected to the Canadian quality assurance system, which imposes certain restrictions and conditions on Canadian grain, including with respect to production.²¹³ However, it was not clear to the Panel how the arguments put forward by Canada to justify the difference in treatment between domestic grain and like imported grain could

support the conclusion that the measure at issue treats imported grain ‘no less favourably’ than like domestic grain. The Panel, therefore, found as follows:

*In conclusion, since the Panel is not persuaded by the defences put forward by Canada to suggest that the additional regulatory requirement imposed on imported grain pursuant to Section 57(c) of the **Canada Grain Act** does not impose any burden on imported grain or, at least, does not impose a burden that is not also borne by like domestic grain, the Panel confirms its provisional conclusion above at paragraph 6.187 that Section 57(c) of the **Canada Grain Act** is, as such, inconsistent with Article III:4 of the GATT 1994.²¹⁴*

With respect to the tax stamp to be affixed to all cigarette packets in the territory of the Dominican Republic, one of the measures at issue in *Dominican Republic – Import and Sale of Cigarettes*, the Panel found that:

... although the tax stamp requirement is applied in a formally equal manner to domestic and imported cigarettes, it does modify the conditions of competition in the marketplace to the detriment of imports. The tax stamp requirement imposes additional processes and costs on imported products. It also leads to imported cigarettes being presented to final consumers in a less appealing manner.²¹⁵

Subsequently, the Panel noted:

*... in this case, the differences in the conditions between imported and domestic products mean that the Dominican Republic should not apply the tax stamp requirement in a formally identical manner that does not take those differences into account, since this would, in practice, accord less favourable treatment to imported products. On the contrary, the Dominican Republic could have chosen to apply the requirement in a different manner to imported products, to ensure that the treatment accorded to them is *de facto* not less favourable.²¹⁶*

In *Dominican Republic – Import and Sale of Cigarettes* the Panel also found – and the Appellate Body upheld on appeal – that Honduras failed to establish that a requirement that importers and domestic producers post a bond of five million pesos (RD\$5 million) accorded less favourable treatment to imported cigarettes than that accorded to like domestic products, in a manner inconsistent with Article

208 *Ibid.*

209 See *ibid.*, para. 6.14.

210 See GATT Panel Report, *US – Section 337*, para. 5.14.

211 Panel Report, *Canada – Wheat Imports and Grain Exports*, para. 6.187.

212 *Ibid.*, para. 6.188.

213 *Ibid.*, para. 6.209

214 *Ibid.*, para. 6.214

215 Panel Report, *Dominican Republic – Import and Sale of Cigarettes*, para. 7.196

216 *Ibid.*, para. 7.197.

III:4 of the GATT 1994.²¹⁷ The reasoning underlying the rejection of this claim of inconsistency by Honduras introduced a new element in the case law on ‘less favourable treatment’ within the meaning of Article III:4. As the Appellate Body recalled in its Report, Honduras argued that the requirement to post a bond of RD\$5 million accorded ‘less favourable treatment’ to imported cigarettes because, as the sales of domestic cigarettes are greater than those of imported cigarettes on the Dominican Republic market, the per unit cost of the bond requirement for imported cigarettes is higher than that for domestic products.²¹⁸

As discussed above, the Appellate Body ruled in *Korea – Various Measures on Beef* that imported products are treated less favourably than like products if a measure modifies the conditions of competition in the relevant market *to the detriment of imported products*.²¹⁹ In *Dominican Republic – Import and Sale of Cigarettes*, the Appellate Body elaborated on its ruling in *Korea – Various Measures on Beef* as follows:

However, the existence of a detrimental effect on a given imported product resulting from a measure does not necessarily imply that this measure accords less favourable treatment to imports if the detrimental effect is explained by factors or circumstances unrelated to the foreign origin of the product, such as the market share of the importer in this case. In this specific case, the mere demonstration that the per-unit cost of the bond requirement for imported cigarettes was higher than for some domestic cigarettes during a particular period is not, in our view, sufficient to establish ‘less favourable treatment’ under Article III:4 of the GATT 1994. Indeed, the difference between the per-unit costs of the bond requirement alleged by Honduras is explained by the fact that the importer of Honduran cigarettes has a smaller market share than two domestic producers (the per-unit cost of the bond requirement being the result of dividing the cost of the bond by the number of cigarettes sold on the Dominican Republic market). In this case, the difference between the per-unit costs of the bond requirement alleged by Honduras does not depend on the foreign origin of the imported cigarettes. Therefore, in our view, the Panel was correct in dismissing the argument that the bond requirement accords less favourable treatment to imported cigarettes because the per-unit cost of the bond was higher for the importer of Honduran cigarettes than for two domestic producers.²²⁰ [emphasis added]

In brief, the Appellate Body ruled in *Dominican Republic – Import and Sale of Cigarettes* that if the less favourable treatment can be explained by factors or circumstances unrelated to the foreign origin of the product (such as the market share of the importer), this less favourable treatment would not be inconsistent with Article III:4.

In line with this ruling of the Appellate Body, the Panel in *EC – Biotech Products*, the Panel rejected Argentina’s claim of inconsistency with Article III:4 stating that:

Argentina has not adduced argument and evidence sufficient to raise a presumption that the alleged less favourable treatment is explained by the foreign origin of the relevant biotech products.²²¹

In the opinion of the Panel, Argentina, one of the complainants in *EC – Biotech Products*, failed to demonstrate that the (alleged) less favourable treatment was less favourable treatment within the meaning of Article III:4 of the GATT 1994, as Argentina did not demonstrate that this less favourable treatment is explained by the foreign origin of the imported product concerned.

In the context of this study, the question arises as to whether measures that give effect to the Cramer sustainability criteria for biomass production or measures that give effect to animal welfare requirements accord ‘treatment less favourable’ to imported products than to domestic products?²²² The case law on Article III:4, discussed above, suggests that such measures accord ‘treatment less favourable’:

- if they impose a heavier burden on imported products than they impose on domestic products (or, in other words, if they do not give effective equality of competitive opportunities to imported products); and
- if this heavier burden is explained by, i.e. results from, the foreign origin of the imported products (or, in other words, if this lack of effective equality of competitive opportunities cannot be explained by factors or circumstances unrelated to the foreign origin of the imported products).

It is clear that complying with the Cramer sustainability criteria in the production of biomass or animal welfare requirements in the production of livestock products will, in many instances, impose a heavier burden on imported biomass or livestock products, and especially on biomass or livestock products imported from developing countries, than on Dutch or European domestic biomass or livestock

217 *Ibid.*, paras. 7.311 and 7.316; and Appellate Report, *Dominican Republic – Import and Sale of Cigarettes*, para. 96.

218 Appellate Body Report, *Dominican Republic – Import and Sale of Cigarettes*, para. 96.

219 See above, p. 67.

220 Appellate Body Report, *Dominican Republic – Import and Sale of Cigarettes*, para. 96.

221 Panel Report, *EC – Biotech Products*, para. 7.2514.

222 For a non-exhaustive list of such measures, see above, p. 9.

products.²²³ This heavier burden is clearly explained by the foreign origin of the imported products because the heavier burden is the result of the significant investments and policy changes that will be required in the exporting countries, especially developing countries, to meet the Cramer sustainability criteria and the animal welfare requirements which the importing country, *in casu*, the Netherlands or the European Union, impose on the exporting countries.

Robert Howse and others have suggested that:

*Where the difference in treatment derives from norms, criteria and methods widely accepted in the international community and which have developed through broad consultation among diverse states, and take into account the variety of conditions in different countries, it should be considerably more difficult for the complainant to establish that there is an overall bias against imports as a group.*²²⁴

In the light of the current case law on Article III:4, discussed above, and Article XX of the GATT 1994, discussed below, however, these factors seem more relevant in the context of justifying a measure under Article XX than in the context of determining whether imported products are given less favourable treatment than like domestic products.

2.2.5 GATT consistency of particular types of internal regulation

In concluding this section on the national treatment obligation of Article III of the GATT 1994, we note that Article III sets out special rules for particular types of internal regulation which are of relevance in the context of this study, namely:

- internal quantitative regulations;
- laws, regulations and requirements governing the procurement by governmental agencies of products purchased for governmental purposes; and
- payments of subsidies exclusively to domestic producers.

2.2.5.1 Internal quantitative regulations

According to Article III:5, no Member shall establish or maintain any internal quantitative regulation relating to the mixture, processing or use of products in specified amounts or proportions which requires that any specified amount or

proportion of any product must be supplied from domestic sources.²²⁵

A mixing regulation requiring that fuel sold in the Netherlands must contain a specified proportion of biofuel (possibly biofuel from biomass produced consistently with the Cramer sustainability criteria) may be inconsistent with Article III:5, if this biofuel must – as a result of the requirements imposed on the biofuel – *de facto* be Dutch biofuel. If the biofuel used in the mixing must meet requirements that cannot, or only with great difficulty, be met by developing country Members, then a mixing requirement would constitute a *de facto* violation of Article III:5.

2.2.5.2 Internal regulations concerning government procurement

According to Article III:8(a) of the GATT 1994, the national treatment obligation of Article III does not apply to laws, regulations or requirements governing the procurement by governmental agencies of products purchased for governmental purposes.²²⁶ The Dutch government could thus require that fuel purchased for the public transport system or the heating of public buildings is biofuel from biomass produced consistently with the Cramer sustainability criteria. The national treatment obligation of Article III:4 does not apply to such government purchases. Note that the plurilateral WTO *Agreement on Government Procurement* does provide for a national treatment obligation with regard to measures concerning government procurement. In addition, this agreement:

- requires that procurement specifications be based on international standards where available and, if not, on national technical regulations;
- expresses a preference for performance-based criteria; and
- requires that the specifications do not constitute an unnecessary obstacle to trade.

To date, however, only 13 WTO Members (counting the European Communities (EC) and the 27 EU Member States as one Member) are Parties to the *Agreement on Government Procurement*. Moreover, the EC has excluded from the scope of application of the *Government Procurement Agreement* measures relating to the procurement of energy or of fuels for the production of energy by a range of procurement entities.

223 To give one concrete example: a requirement for industrial users of biomass (oil companies and electricity companies) to report whether biomass they use is produced consistently with the sustainability requirements is inconsistent with Article III:4 if it is found to give treatment less favourable to imported biomass than to domestic biomass. This could be the case if the reporting obligations would be especially burdensome for biomass imported from developing countries.

224 R. Howse, P. van Bork and C. Hedebrand, *WTO Disciplines and Biofuels: Opportunities and Constraints in the Creation of a Global Marketplace*, IPC Discussion Paper, October 2006.

225 Article III:5 has not yet been applied and interpreted by WTO panels or the Appellate Body. However, there is some relevant GATT case law, including GATT Panel Report, *EEC – Animal Feed Proteins*, para 4.5-4.9; GATT Panel Report, and, *US – Tobacco*, paras. 66-69, as well as a few unadopted GATT panel reports (including GATT Panel Report, *US – Taxes on Automobiles*, paras. 3.300-3.313; and GATT Panel Report, *Spain – Soyabean Oil*, paras. 4.4-4.5).

226 Article III:8(a) of the GATT 1994 furthermore requires that these products are not purchased with a view to commercial resale or with a view to use in the production of goods for commercial sale.

2.2.5.3 Subsidies to domestic producers

Article III:8(b) of the GATT 1994 excludes payments of subsidies exclusively to domestic producers from the scope application of the national treatment obligation of Article III. Article III:8(b) states that the national treatment obligation of Article III shall 'not prevent the payment of subsidies exclusively to producers'. Such subsidies are subject to the disciplines set out in Article XVI of the GATT 1994, the *SCM Agreement* and (in the case of subsidies to agricultural producers) the *Agreement on Agriculture*, discussed below.²²⁷

2.3 Obligations regarding tariff barriers to trade

The most common and widely used barriers to market access for goods are customs duties. Further market access for goods is also impeded by other duties and charges. This section examines the GATT obligations regarding these tariff barriers to trade.

2.3.1 Obligations regarding ordinary customs duties

2.3.1.1 Scope and nature of the obligations regarding customs duties

A customs duty, or tariff, is a financial charge, in the form of a tax, imposed on products at the time of, and/or because of, their importation. Market access is conditional upon the payment of the customs duty. Governments can also impose customs duties on products at the time of, and/or because of, their exportation. However, this is uncommon and, therefore, not addressed in this study. Customs duties are specific (e.g. €10 per tonne), *ad valorem* (e.g. 15% of the value) or mixed (10% per tonne and 15% of the value). Nowadays, *ad valorem* duties are by far the most widespread type of customs duty, although mixed duties on agricultural products are still common. *Ad valorem*, specific or mixed customs duties can be MFN duties, preferential duties or neither of the two:

- *MFN duties* are the 'standard' customs duties that are applicable to all other WTO Members in compliance with the MFN treatment obligation of Article I:1 of the GATT 1994, discussed above.²²⁸
- *Preferential duties* are customs duties applied to specific countries pursuant to conventional or autonomous arrangements under which products from these countries are subject to duties lower than MFN duties (e.g. customs duties under the Generalized System of Preferences (GSP) scheme for all developing countries; under the 'Everything but Arms' (EBA) scheme for least developed countries; or under the *Cotonou Agreement* for African, Caribbean and Pacific (ACP) countries).

- Finally, there are customs duties that are neither MFN duties nor preferential duties. These are the duties applicable on goods from the few countries that are not (yet) WTO Members and, therefore, do not benefit from MFN treatment.
- The customs duties applied by the European Communities are set out in the *Common External Tariff* of the European Community and in a large number of legal instruments concerning preferential arrangements. Accurate, up-to-date information on the duties applied can best be obtained through the TARIC database of the European Commission.²²⁹

Generally speaking, customs duties serve three purposes. First, customs duties are a source of revenue for governments. Especially for developing countries this is an important purpose. For industrialized countries with a well-developed system for direct and indirect taxation, this purpose has become much less important. Second, customs duties are used to protect domestic industries by giving domestic products a price advantage over imported products. Third, customs duties are used to support the importation of 'preferred' products (e.g. environmentally friendly products) by imposing lower duties on these products. In this way, customs duties could be used to support the importation and the use of biomass or biofuels from biomass produced consistently with of the Cramer sustainability criteria or livestock products produced consistently with animal welfare requirements. Whether this use of customs duties is compatible with the obligations of the European Communities (and the Netherlands) under the GATT 1994 is discussed in this section.

2.3.1.2 Rules on tariff concessions

In principle, WTO Members are free to impose customs duties on imported products. WTO law and, in particular, the GATT 1994, does not prohibit the imposition of customs duties. However, it does recognize that customs duties often constitute significant obstacles to trade. Article XXVIII *bis* of the GATT 1994, therefore, calls upon WTO Members to negotiate the reduction of customs duties. The negotiations conducted before 1995 by the GATT Contracting Parties led to very significant reductions in customs duties.²³⁰ The negotiations on a further reduction of customs duties is an important element of the current Doha Development Round.

The results of negotiations on the reduction of customs duties, or tariffs, are referred to as 'tariff concessions' or 'tariff bindings'. A tariff concession, or tariff

²²⁷ See below, p. 157.

²²⁸ See above, p. 18.

²²⁹ The Integrated Tariff of the (European) Community (Tariff Integre Communautaire, TARIC) database: http://ec.europa.eu/taxation_customs/dds/en/tarhome.htm.

²³⁰ In the late 1940s, the average duty on industrial products imposed by developed countries was about 40% per cent *ad valorem*. As Today, as a result of the eight GATT Rounds, the average duty of developed-country Members on industrial products is now as low as 3.9 per cent *ad valorem*.

binding, is a commitment of a WTO Member not to raise the customs duty on a certain product above an agreed level. As a result of the Uruguay Round tariff negotiations, all, or almost all, customs duties imposed by developed-country Members are now 'bound', i.e. are subject to a maximum level. For the European Communities (and thus for the Netherlands), 100 per cent of customs duties on both agricultural products and industrial products are bound.²³¹

The tariff concessions or bindings of a Member are set out in that Member's Schedule of Concessions. Each Member of the WTO has a schedule, except when the Member is (as the Netherlands) part of a customs union in which case the Member has a common schedule with the other members of the customs union. The Schedules resulting from the Uruguay Round negotiations are all annexed to the *Marrakesh Protocol* to the GATT 1994. Pursuant to Article II:7 of the GATT 1994, the Schedules of Members are an integral part of the GATT 1994. These Schedules, including the Schedule of the European Communities, can be found on the WTO website.²³²

As noted in the beginning of this section, under WTO law, customs duties are not prohibited. This does not mean, however, that there are no rules on customs duties. WTO rules on customs duties relate primarily to the protection of the tariff concessions or bindings agreed to in the context of tariff negotiations. The basic rules are set out in Article II:1 of the GATT 1994, which states:

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

Article II:1(a) provides that Members shall accord to products imported from other Members *treatment no less favourable* than that provided for in their Schedule.

Article II:1(b), first sentence, provides that products described in Part I of the Schedule of any Member shall, on importation, be *exempt from ordinary customs*

duties in excess of those set out in the Schedule. This means that products may not be subjected to customs duties above the tariff concessions or bindings.²³³

Note that while Article II:1 of the GATT prohibits Members to apply duties in excess of their tariff concession, it does not require Members to apply duties at that level. As the Appellate Body noted in *Argentina – Textiles and Apparel*:

*A tariff binding in a Member's Schedule provides an upper limit on the amount of duty that may be imposed, and a Member is permitted to impose a duty that is less than that provided for in its Schedule.*²³⁴

For many Members, the customs duties on manufacturer products actually applied are often in fact lower than the tariff concessions for these products. The European Communities can thus apply on, for example, a livestock product produced consistently with animal welfare requirements, customs duties below the binding agreed to by the European Communities for the product concerned. Note, however, that, as discussed above, the application of a lower duty on livestock products produced consistently with animal welfare requirements and a higher duty on 'like' products produced otherwise, will constitute a violation of the MFN treatment obligation of Article I:1 of the GATT 1994.²³⁵

Some of the disputes under Article II:1(a) and (b) of the GATT 1994 do not directly stem from the imposition of duties or charges in excess of those contained in the Schedules of Concessions but rather from the interpretation of the scope of application of the concessions made. By way of example of such dispute, consider the recent *EC – Chicken Cuts* dispute. In that case, the European Communities did not deviate from the customs duties as contained in its Schedule of Concessions. It did, however, reclassify a certain type of chicken meat, namely, frozen boneless chicken cuts impregnated with salt, under a different tariff heading, Heading 02.07. Under that particular tariff heading, the customs duty imposed was higher than that under the heading that should have been applied, according to the complainants in the case, namely, Heading 02.10. The outcome of the dispute depended on the interpretation of the tariff headings, and, more specifically, on the interpretation of the term 'salted'. According to the European Communities, the key element under Heading 02.10 was preservation, and therefore the term 'salted' implied that the meat should be impregnated with salt sufficient to ensure long-term preservation. The complainants, Thailand and Brazil, contended that 'salted'

231 For the United States, 100 per cent of the tariff lines for agricultural products and 99.9 per cent of the tariff lines for industrial products are bound. See WTO Secretariat, *Market Access: Unfinished Business*, Special Studies 6 (WTO, 2001), p.49. Most Latin American developing-country Members have also bound all customs duties; however, for Asian and African developing-country Members the situation is more varied.

232 See www.wto.org/english/tratop_e/schedules_e/goods_schedules_e.htm.

233 With respect to the relationship between Article II:1(a) and (b), first sentence, see Appellate Body Report, *Argentina – Textiles and Apparel*, para. 45.

234 *Ibid.*, para. 46.

235 See above, p. 18.

did not imply long-term preservation and that the chicken cuts thus fell under Heading 02.10.

The Panel and the Appellate Body followed the customary rules of treaty interpretation as contained in Articles 31 and 32 of the *Vienna Convention on the Law of Treaties*. Both the Panel and the Appellate Body came to the conclusion that ‘salted’ did not imply long-term preservation in any way and, therefore, that the chicken cuts did fall within the more favourable Heading 02.10. The European Communities had acted inconsistently with Article II:1(a) and (b) by wrongly classifying the chicken cuts, which resulted in treatment less favourable than that provided for in the Schedule.

It is important to note that in interpreting the scope of tariff concessions that may be of relevance to biomass and livestock products, the rules of interpretation of Articles 31 and 32 are applied.²³⁶

Article XXVIII of the GATT 1994 sets out rules as well as a procedure for the modification or withdrawal of agreed tariff concessions. The modification or withdrawal of a tariff concession or binding is based on the principle of renegotiation and *compensation*. When a tariff concession is modified or withdrawn, compensation in the form of new concessions needs to be granted in order to maintain a general level of concessions not less favourable to trade. If negotiations fail to lead to an agreement on the appropriate level of compensation, Article XXVIII:3(a) provides that the Member that proposes to modify or withdraw the concession shall, in spite of the failure of the negotiations, be free to do so. In that case, however, other Members shall be free to withdraw substantially equivalent concessions. In other words, if the European Communities would want to change its tariff bindings on certain non-preferred products in order to be able to impose duties above the current bindings, it will have to consider the ‘cost’ of this change.

2.3.1.3 Rules on customs classification

As illustrated above, in the discussion of the *EC – Chicken Cuts* dispute, the imposition of customs duties requires the determination of the proper customs classification of the imported good. WTO law does not specifically address the issue of customs classification. In *Spain – Unroasted Coffee*, the Panel ruled:

²³⁶ For a discussion of the rules of interpretation of Articles 31 and 32 of the *Vienna Convention on the Law of Treaties* and the relevance of these rules in WTO dispute settlement, see P. Van den Bossche, *The Law and Policy of the World Trade Organization* (Cambridge University Press, 2005), pp.206ff.

*that there was no obligation under the GATT to follow any particular system for classifying goods, and that a contracting party had the right to introduce in its customs tariff new positions or sub-positions as appropriate.*²³⁷

However, in classifying products for customs purposes, Members have of course to consider their general obligations under WTO law, such as the MFN treatment obligation. As discussed above, the Panel in *Spain – Unroasted Coffee* ruled that:

*whatever the classification adopted, Article I:1 required that the same tariff treatment be applied to ‘like products’.*²³⁸

Specific rules on classification can be found in the *International Convention on the Harmonized Commodity Description and Coding System*, which entered into force on 1 January 1988 and to which most WTO Members are party.²³⁹ The *Harmonized Commodity Description and Coding System*, commonly referred to as the ‘*Harmonized System*’, or HS, is an international commodity classification system, developed under the auspices of the Brussels-based Customs Cooperation Council (CCC), known today as the World Customs Organization (WCO).²⁴⁰ As a result of the *Harmonized System*, the national tariffs and WTO schedules of concessions of all WTO Members who are a party to the *HS Convention*, have an identical structure with the same tariff lines up to the six-digit level.²⁴¹ Beyond that level, the structure of national tariffs the WTO schedules differs as Members are free to introduce different (eight- or higher-digit level) tariff lines. To allow for a systematic and uniform classification of goods, at least up to the six-digit level, the *Harmonized System* provides not only for a structured list of commodity descriptions, but also includes:

- General Rules for the Interpretation of the *Harmonized System*; and
- *Explanatory Notes*.

WTO Members are not obliged under the GATT 1994, or under any other WTO agreement, to adopt the *Harmonized System*. However, as already noted, most WTO Members are a party to the *International Convention on the Harmonized System*. Consequently, most WTO Members use the *Harmonized System*, its

²³⁷ GATT Panel Report, *Spain – Unroasted Coffee*, para. 4.4.

²³⁸ *Ibid.* See also above, p. 22; and GATT Panel Report, *Japan – SPF Dimension Lumber*, para. 5.9.

²³⁹ See www.wcoomd.org/ie/En/Conventions/conventions.html.

²⁴⁰ To keep the *Harmonized System* up to date, to include new products (resulting from new technologies) and to take account of new developments in international trade, the *Harmonized System* is revised every four to six years. See Article 16 of the *International Convention on the Harmonized System*. To date, there have been revisions in 1992, 1996, 2002 and 2007.

²⁴¹ In fact, the WTO Schedules of Concessions of all WTO Members, including those that are not a party to the *HS Convention*, follow the structure of the HS.

General Rules for the Interpretation of the *Harmonized System* and its *Explanatory Notes* in their national tariffs and for the customs classification of goods.

Although the *Harmonized System* is not part of WTO law, it can be relevant to the interpretation and application of WTO obligations. In *EC – Computer Equipment*, the Appellate Body expressed its surprise that:

*Neither the European Communities nor the United States argued before the Panel that the Harmonized System and its Explanatory Notes were relevant in the interpretation of the terms of Schedule LXXX. We believe, however, that a proper interpretation of Schedule LXXX should have included an examination of the Harmonized System and its Explanatory Notes.*²⁴²

Note that the imposition of customs duties not only requires the determination of the proper customs classification of the imported good. It may also require the determination of the customs value of the imported good (in the case of *ad valorem* duties) and the determination of the origin of the imported good (*inter alia* for the correct application of preferential duties). The WTO rules applicable on customs valuation (Article VII of the GATT 1994 and the WTO *Agreement on the Implementation of Article VII of the GATT 1994*, commonly referred to as the *Customs Valuation Agreement*), as well as the evolving WTO rules on national rules of origin (WTO *Agreement on Rules of Origin*), are beyond the scope of this study.

In the context of this study the question arises as to whether a Member could distinguish in its national tariff between:

- biomass (or biofuels from biomass) produced consistently with the Cramer sustainability criteria (tariff line with lower duty); and
- biomass (or biofuels from biomass) produced otherwise (tariff line with higher duty).

A similar question arises with regard to livestock products produced consistently, or not, with animal welfare requirements. Distinguishing between these products in the national tariff and applying different duties is only possible if:

- the differentiation takes place below the six-digit level (e.g. at the eight- or ten-digit level) because up to the six-digit level the structure of the national tariff of WTO Members (which are parties to the *HS Convention*) is determined by the *HS Convention* and this Convention does not provide for such distinction;
- biomass (or biofuels from biomass) produced consistently with the Cramer sustainability criteria are not ‘like’ the biomass (or biofuels from biomass) that are produced differently because, as discussed above in the context of the MFN treatment obligation of Article I:1 of the GATT 1994, products that are ‘like’ may not be classified differently; and

- the newly applicable duties are not above the relevant binding set out in the Schedule of Concessions of the Member concerned because otherwise the duties would be in violation with the obligation under Article II:1 of the GATT 1994.

The second of the conditions mentioned here is the most problematic. As discussed above, it is most likely that biomass (or biofuels from biomass) produced consistently with the Cramer sustainability criteria *and* biomass (or biofuels from biomass) produced differently will be considered to be ‘like products’. As noted above, this would only be different if the fact whether the biomass is or is not produced consistently with the Cramer sustainability criteria is highly relevant to consumers and determines their choices on the market. This is, however, unlikely.²⁴³

It has been suggested that in the context of the Doha Development Round tariff negotiations, Members should be able to ensure fair competition between domestic and imported products by applying smaller tariff reductions on products that do not meet the animal welfare requirements that apply to domestic products. The tariffs on products produced inconsistently with animal welfare requirements would thus be higher than those on products produced consistently with these requirements. As discussed above, this would constitute a violation of the MFN treatment of Article I:1 of the GATT 1994, if products produced inconsistently with these requirements and products produced consistently with the requirements are ‘like products’. As also explained above, in the current state of WTO law, it is most likely that these products will be considered to be ‘like’.

2.3.2 Obligations regarding other duties and charges

Next to ‘ordinary customs duties’, discussed above, financial barriers to trade can also take the form of ‘other duties and charges’. ‘Other duties and charges’ are financial charges, *other than* ordinary customs duties, imposed on, or in the context of, the importation of a good. ‘Other duties and charges’ form a residual category.

Examples of ‘other duties and charges’ taken from the GATT and WTO case law are:

- an import surcharge, i.e. a duty imposed on an imported product in addition to the ordinary customs duty;
- a security deposit to be made on the importation of goods;
- a statistical tax imposed to finance the collection of statistical information;

²⁴² Appellate Body Report, *EC – Computer Equipment*, para. 89.

²⁴³ See above, p. 63 ff.

- a customs fee, i.e. a financial charge imposed for the processing of imported goods by the customs authorities;
- a transitional surcharge for economic stabilization imposed on imported goods; and
- a foreign exchange fee imposed on imported goods.

To protect the tariff concessions set forth in the Schedules and to prevent ‘circumvention’ of the prohibition of Article II:1(b), first sentence, of the GATT 1994, to impose ordinary customs duties in excess of the tariff concessions, WTO law provides for rules on ‘other duties and charges’. These rules are set out in Article II:1(b), second sentence, and the *WTO Understanding on the Interpretation of Article II:1(b) of the GATT 1994*. It follows from these rules that Members may:

- impose only ‘other duties and charges’ that have been properly recorded in their Schedules; and
- impose ‘other duties and charges’ only at a level that does not exceed the level recorded in their Schedules.

In *Chile – Price Band System*, the Panel ruled on the WTO consistency of the other duties and charges at issue in this case, as follows:

Pursuant to the Uruguay Round Understanding on the Interpretation of Article II:1(b), such other duties or charges had to be recorded in a newly created column ‘other duties and charges’ in the Members’ Schedules ... Other duties or charges must not exceed the binding in this ‘other duties and charges’ column of the Schedule. If other duties or charges were not recorded but are nevertheless levied, they are inconsistent with the second sentence of Article II:1(b), in light of the Understanding on the Interpretation of Article II:1(b). We note that Chile did not record its PBS in the ‘other duties and charges’ column of its Schedule. We therefore find that the Chilean [Price Band System] duties are inconsistent with Article II:1(b) of GATT 1994.²⁴⁴

In *Dominican Republic – Import and Sale of Cigarettes*, the Panel found that the two ‘other duties or charges’ at issue in this case, namely, the transitional surcharge for economic stabilization and the foreign exchange fee imposed on imported products, had not been recorded in a legally valid manner in Schedule of Concessions of the Dominican Republic. The Panel ruled that the recording of the Selective Consumption Tax, i.e. an internal tax, could not be used as legal basis to justify the current transitional surcharge or the foreign exchange fee.²⁴⁵ With regard

to the transitional surcharge for economic stabilization, the Panel thus came to the following conclusion:

For all legal and practical purposes, what was notified by the Dominican Republic in document G/SP/3 is equivalent to ‘zero’ in the Schedule. The Panel finds that the surcharge as an ‘other duty or charge’ measure is applied in excess of the level ‘zero’ pursuant to the Schedule. Therefore, the surcharge measure is inconsistent with Article II:1(b) of the GATT 1994.²⁴⁶

With regard to the foreign exchange fee, the Panel came to the same conclusion.²⁴⁷

There are a number of exceptions to the rule that Members may not impose ‘other duties or charges’ unless recorded and not in excess of the recorded level.

Pursuant to Article II:2 of the GATT 1994, Members may – despite their obligations under Article II:1(b), second sentence – impose on imported products:

- any financial charge that is not in excess of the internal tax imposed on the like domestic product;²⁴⁸ i.e. border tax adjustment;
- WTO-consistent anti-dumping or countervailing duties; or
- fees or other charges ‘commensurate’ with, i.e. limited to, the cost of the services rendered.²⁴⁹

With regard to the first exception, namely, the exception relating to border tax adjustment, note that through border tax adjustment WTO Members may impose domestic taxes and charges on imports, and exempt or reimburse them on exports. The objective is to ensure trade neutrality of domestic taxation.²⁵⁰ Border tax adjustment on imported products in excess of taxes borne by like domestic

²⁴⁶ *Ibid.*, para. 7.89.

²⁴⁷ *Ibid.*, para. 7.121.

²⁴⁸ Note that taxes that are not directly levied on products [i.e. direct taxes (taxes on wages, profits, interests, rents, royalties, and all other forms of income, and taxes on the ownership of real property)] are not eligible for border tax adjustment

²⁴⁹ Note that Article VIII:1(a) of the GATT 1994 provides for the same obligation as Article II:2(c). The fees and charges for services rendered at issue in Articles II:2(c) and VIII:1(a) include, pursuant to Article VIII:4, fees and charges relating to consular transactions, such as consular invoices and certificates; quantitative restrictions; licensing; exchange control; statistical services; documents, documentation and certification; analysis and inspection; and quarantine, sanitation and fumigation.

²⁵⁰ See Committee on Trade and Environment, *Taxes and Charges for Environmental Purposes – Border Tax Adjustment*. WT/CTE/W/47, para. 24. In the absence of a harmonized taxation system between trading partners, border tax adjustment aims at preventing double taxation or loopholes in taxation, and thus to preserve the competitive equality between domestic and imported products.

²⁴⁴ Panel Report, *Chile – Price Band System*, paras. 7.105 and 7.107-7.108. On appeal, the Appellate Body found that the Panel’s finding on Article II:1(b), second sentence, related to a claim that had not been made, and this finding was therefore in violation of Article 11 of the Dispute Settlement Understanding (DSU). As a result, the Appellate Body reversed the finding.

²⁴⁵ See Panel Report, *Dominican Republic – Import and Sale of Cigarettes*, para. 7.86.

products is, as discussed above, in violation of the national treatment of Article III of the GATT 1994.²⁵¹

In the context of this study, the question arises whether the Netherlands could impose, by way of border tax adjustment, an additional charge on imported biomass (or imported biofuels from biomass) produced inconsistently with the Cramer sustainability criteria when in the Netherlands a tax is imposed on the domestic production of biomass in a manner not consistent with the Cramer sustainability criteria. Through border tax adjustment, the economic playing field between imports and domestic products would be levelled. It is quite doubtful, however, that border tax adjustment is permitted for taxes related to nPR PPMs. If border tax adjustment were to be allowed in this situation, the consequence would be that imported biomass produced inconsistently with the Cramer sustainability criteria is subject to higher taxation than the (arguably) 'like' domestic biomass produced consistently with those criteria. As discussed above, this amounts to a violation of the national treatment obligation of Article III:2, first sentence, of the GATT 1994.

With regard to the third exception to the rules on 'other duties or charges', namely, fees limited to the cost of services rendered, the Panel in *US – Customs User Fee* noted that the requirement that a fee or charge be limited in amount to the cost of the services rendered is in fact a dual requirement:

- the fee or charge in question must first involve a 'service' rendered to the *individual* importer in question; and
- the level of the charge must not exceed the approximate cost of that service'.²⁵²

The financial charge at issue in *US – Customs User Fee* was a merchandise processing fee, in the form of an *ad valorem* charge without upper limits. The complainants, the European Communities and Canada, challenged the GATT-consistency of an *ad valorem* charge without upper limit. The Panel found as follows:

*... the term 'cost of services rendered' in Articles II:2(c) and VIII:1 (a) must be interpreted to refer to the cost of the customs processing for the individual entry in question and accordingly that the ad valorem structure of the United States merchandise processing fee was inconsistent with the obligations of Articles II:2(c) and VIII:1(a) to the extent that it caused fees to be levied in excess of such costs.*²⁵³

251 *Ibid.*, para. 26. See also above, p. 39.

252 GATT Panel Report, *US – Customs User Fee*, para. 69. See also Panel Report, *Argentina – Textiles and Apparel*, para. 6.74; and Panel Report, *US – Certain EC Products*, para. 6.69.

253 GATT Panel Report, *US – Customs User Fee*, para. 86.

2.4 Obligations regarding quantitative restrictions on trade

Apart from customs duties and other duties or charges on imported goods, discussed above, trade in goods is also impeded by non-tariff barriers. This section focuses on the GATT rules applicable to quantitative restrictions. The next section briefly discusses the GATT rules applicable to other non-tariff barriers.

A quantitative restriction is a measure that *limits the quantity* of a product that may be imported or exported.²⁵⁴ There are different types of quantitative restriction:

- a *prohibition*, or ban, of a product; such a prohibition may be absolute or conditional, i.e. only applicable when certain defined conditions are *not* fulfilled;
- a *quota*, i.e. a measure indicating the quantity that may be imported or exported; a quota can be a global quota, a global quota allocated among countries, or a bilateral quota;
- import and export *licences*; and
- *other* quantitative restrictions on the importation or exportation of products, such as a quantitative restriction made effective through State trading operations; a mixing regulation; a minimum price triggering a quantitative restriction; and a voluntary export restraint.²⁵⁵

Article XI:1 of the GATT 1994, entitled 'General Elimination of Quantitative Restrictions', sets out a general prohibition on quantitative restrictions, whether on imports or exports. As the Panel in *Turkey – Textiles* stated:

*The prohibition on the use of quantitative restrictions forms one of the cornerstones of the GATT system.*²⁵⁶

Article XI:1 provides, in relevant part:

No prohibitions or restrictions other than duties, taxes or other charges, whether made effective through quotas, import or export licences or other measures, shall be instituted or maintained by any [Member] on the importation of any product of the territory of any other [Member] or on the exportation or sale for export of any product destined for the territory of any other [Member].

254 Therefore, a tariff quota is *not* a quota; it is *not* a quantitative restriction. See the unadopted GATT Panel Report, *EEC – Bananas II*, DS38/R, paras. 138-9. A tariff quota is a quantity which can be imported at a certain duty. Any quantity above that amount is subject to a higher (often much higher) tariff but can (in principle at least) still be imported.

255 For an illustrative list of quantitative restrictions, see Council for Trade in Goods, Decision on Notification Procedures for Quantitative Restrictions, G/L/59, dated 10 January 1996, Annex.

256 Panel Report, *Turkey – Textiles*, para. 9.63.

As the Panel in *Japan – Semi-Conductors* noted, the wording of Article XI:1

*... was comprehensive: it applied to all measures instituted or maintained by a contracting party prohibiting or restricting the importation, exportation or sale for export of products other than measures that take the form of duties, taxes or other charges.*²⁵⁷
[Emphasis added]

As an illustration of the broad scope of the prohibition on quantitative restrictions, consider the following examples of measures that were found to be inconsistent with Article XI:1:

- In *US – Shrimp*, the Panel found that the United States acted inconsistently with Article XI:1 by imposing an import ban on shrimp and shrimp products harvested by vessels of foreign nations where the exporting country had not been certified by the US authorities as using methods to avoid the accidental killing of sea turtles above certain levels.²⁵⁸
- In *EEC – Minimum Import Prices*, the Panel found that the prohibition on quantitative restrictions in Article XI:1 applied to a system of minimum import prices.²⁵⁹
- In *Japan – Agricultural Products I*, the Panel ruled that the prohibition of Article XI:1 applied to import restrictions made effective through an import monopoly, or more broadly through State trading operations.²⁶⁰
- In *India – Quantitative Restrictions*, the Panel held that non-automatic import licensing systems are import restrictions prohibited by Article XI:1.²⁶¹

While it is clear that the scope of application of Article XI:1 covers more than bans and quotas, it is unclear how broad is its scope of application beyond bans and quotas. As discussed above, it has been argued that nPR PPM measures are caught under Article XI (and not Article III:4, which would only apply to product-related measures). However, there is little, if any, support for this position in the case law.²⁶²

Unlike other GATT provisions, Article XI refers not to laws or regulations but more broadly to measures. A measure instituted or maintained by a Member which restricts imports (or exports) is covered by Article XI, *irrespective* of the legal status of the measure.²⁶³ In *Japan – Semi-Conductors*, the Panel therefore ruled that *non-mandatory* measures of the Japanese Government, restricting the export of certain semiconductors at below cost price, were nevertheless ‘restrictions’ within the meaning of Article XI:1.²⁶⁴

Note that, in addition, quantitative restrictions which do not *actually* impede trade are nevertheless prohibited under Article XI:1 of the GATT 1994.²⁶⁵ The Panel in *EEC – Oilseeds I* ruled in this respect in 1990:

*the contracting parties have consistently interpreted the basic provisions of the General Agreement on restrictive trade measures as provisions establishing conditions of competition. Thus they decided that an import quota constitutes an import restriction within the meaning of Article XI:1 whether or not it actually impeded imports.*²⁶⁶

On the other hand, the Panel in *EEC – Minimum Import Prices* found in 1978 that automatic import licensing does not constitute a restriction of the type meant to fall under the purview of Article XI:1.²⁶⁷

Finally, note that restrictions of a *de facto* nature are also prohibited under Article XI:1 of the GATT 1994. In *Argentina – Hides and Leather*, the issue arose as to whether Argentina had violated Article XI:1 by authorizing the presence of domestic tanners’ representatives in the customs inspection procedures for hides destined for export operations. According to the complainant (the European Communities), Argentina had thus imposed a *de facto* restriction on the exportation of hides inconsistent with Article XI:1. The Panel ruled:

*There can be no doubt, in our view, that the disciplines of Article XI:1 extend to restrictions of a de facto nature.*²⁶⁸

257 GATT Panel Report, *Japan – Semi-Conductors*, para. 104.

258 See Panel Report, *US – Shrimp*, paras. 7.17 and 8.1. Previous GATT panels in *US – Tuna II (EEC)*, para. 5.10, and *US – Tuna I (Mexico)*, paras. 5.17–5.18, found similar measures also to be ‘restrictions’ within the meaning of Article XI.

259 See GATT Panel Report, *EEC – Minimum Import Prices*, para. 4.14. Also, restrictions on exports below a certain price fall within the scope of application of Article XI:1 (see GATT Panel Report, *Japan – Semi-Conductors*, para. 117).

260 See GATT Panel Report, *Japan – Agricultural Products I*, para. 5.2.2.2.

261 See Panel Report, *India – Quantitative Restrictions*, para. 5.130.

262 See above, p. 54.

263 See GATT Panel Report, *Japan – Semi-Conductors*, para. 106.

264 See GATT Panel Report, *Japan – Semi-Conductors*, paras. 104-17.

265 Such non-biting quotas, i.e. quotas above current levels of trade, cause increased transaction costs and create uncertainties that could affect investment plans. See GATT Panel Report, *Japan – Leather II (US)*, para. 55.

266 GATT Panel Report, *EEC – Oilseeds I*, para. 150.

267 GATT Panel Report, *EEC – Minimum Import Prices*, para. 4.1.

268 Panel Report, *Argentina – Hides and Leather*, para. 11.17.

However, the Panel concluded with respect to the Argentinean regulation providing for the presence of the domestic tanners' representatives in the customs inspection procedures that there was insufficient evidence that this regulation really operated as an export restriction inconsistent with Article XI:1 of the GATT 1994.²⁶⁹

The relationship between Article III, the national treatment obligation, and Article XI, the prohibition of quantitative restrictions, is not very clear. The Note *Ad Article III* states that internal measures applied to imported products at the time of importation are to be regarded as 'internal measures' falling within the scope of application of Article III:4. However, the Note *Ad Article III* leaves it unclear whether Article XI could also be applied to such measure. The issue of the relationship between Article III and Article XI was raised in *EC – Asbestos* and *Korea – Various Measures on Beef*. However, the Panels in both cases refrained from addressing the issue (by exercising judicial economy with regard to the claim of inconsistency with Article XI after having found a violation of Article III:4). Some commentators suggest that the Panels in the above cases might have proceeded to examine the measures at issue under Article XI if they had found that the measures were consistent with Article III:4.²⁷⁰ Note, however, that in *EC – Asbestos*, the inconsistency with Article XI:1 was Canada's prime claim.²⁷¹ The Panel's decision to examine the inconsistency with Article III:4, rather than with Article XI:1 (Canada's prime claim), seems to suggest that the Panel considered that Article XI:1 did not apply to the measure at issue. Unfortunately, the Panel does not state this explicitly and thus leaves the case law on this point unclear.

2.5 Obligations regarding other non-tariff barriers to trade

In addition to customs duties and other duties and charges (i.e. tariff barriers) and quantitative restrictions (i.e. the first subcategory of non-tariff barriers), all discussed above, trade in goods is also impeded by 'other non-tariff barriers'. As the term indicates, this is a *residual* category of measures and actions that restrict – to various degrees and in different ways – market access of goods.²⁷² The category of 'other non-tariff barriers' covers measures and actions (or the absence thereof), such as technical barriers to trade, customs formalities and procedures, lack of transparency regarding applicable trade laws and regulations, unfair and

arbitrary application of trade measures, and government procurement practices. For some of these 'other non-tariff barriers' the GATT 1994 provides specific, albeit (very) rudimentary rules. This is the case for the lack of transparency (see Article X:1 and 2), the unfair and arbitrary application of trade measures (Article X:3(a)) and customs formalities and procedures (Article VIII:1–3). A detailed discussion of these GATT rules is beyond the scope of this study. The important rules on technical barriers are set out in the *TBT Agreement* and are discussed below.²⁷³

3 Relevant general exceptions from obligations under the GATT 1994

The protection of public health, the environment, public morals, consumer safety and national security are *core* tasks of governments. In order to protect and promote these and other societal values and interests, governments frequently adopt legislation or take measures that inadvertently *or* deliberately constitute barriers to trade. Members are often politically and/or economically 'compelled' to adopt legislation or measures which are inconsistent with rules of WTO law and, in particular, with the MFN treatment obligation, the national treatment obligation, the obligations with regard to tariff barriers to trade and the obligations with regard to non-tariff barriers to trade, all discussed above. Trade liberalization, and its principles of non-discrimination and rules on market access, often conflict with other important societal values and interests.

This section and the next discuss the rules provided for in the GATT 1994 to reconcile trade liberalization with other societal values and interests. As discussed above, they address the wide-ranging *exceptions* to the basic GATT rules, allowing Members to adopt trade-restrictive legislation and measures that address non-trade concerns.²⁷⁴ This section deals with the 'general exceptions' of Article XX of the GATT 1994, while section 4 addresses some other exceptions of interest in the context of this study.²⁷⁵

269 *Ibid.*, para. 11.55.

270 See e.g. N. Bernasconi-Osterwalder *et al.*, *Environment and Trade: A Guide to WTO Jurisprudence* (London: Earthscan, 2005), p.209.

271 Canada stated that if the Panel were to consider that the measure at issue could not be examined under both Article III:4 and Article XI, then the measure should be examined under Article XI.

272 See e.g. table of contents of the *Inventory of Non-Tariff Measures*, Note by the Secretariat, TN/MA/S/5/Rev.1, dated 28 November 2003.

273 See below, p. 136. As discussed above, the *SPS Agreement*, which applies to a specific category of technical barriers to trade, is not relevant in the context of this study and will therefore not be discussed.

See above, p 18, fn. 30.

274 See above, p. 15.

275 This section is based on and in parts further elaborates and updates P. Van den Bossche, *The Law and Policy of the World Trade Organization* (Cambridge University Press, 2005, reprinted 2006), pp.598-624.

See www.cambridge.org/catalogue/catalogue.asp?isbn=9780521529815.

3.1 The nature and function of Article XX of the GATT 1994

Article XX of the GATT 1994, entitled ‘General Exceptions’, states:

Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade, nothing in this Agreement shall be construed to prevent the adoption or enforcement by any [Member] of measures:

- a. necessary to protect public morals;*
- b. necessary to protect human, animal or plant life or health;*
- c. relating to the importations and exportations of gold and silver;*
- d. necessary to secure compliance with laws or regulations which are not inconsistent with the provisions of this Agreement, including those relating to customs enforcement, the enforcement of monopolies operated under paragraph 4 of Article II and Article XVII, the protection of patents, trade marks and copyrights, and the prevention of deceptive practices;*
- e. relating to the products of prison labour;*
- f. imposed for the protection of national treasures of artistic, historic or archaeological value;*
- g. relating to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption;*
- h. undertaken in pursuance of obligations under any intergovernmental commodity agreement ...;*
- i. involving restrictions on exports of domestic materials necessary to ensure essential quantities of such materials to a domestic processing industry ...;*
- j. essential to the acquisition or distribution of products in general or local short supply ...*

Thus, Article XX allows Members to take measures addressing non-trade concerns and protecting important societal values, such as public health and the environment. Note that some of the paragraphs of Article XX have frequently been invoked and have given rise to a substantial body of case law (e.g. paragraphs (b), (d) and (g)). Other paragraphs, however, have been of much less importance in international trade law and practice (e.g. paragraphs (h), (i) and (j)).

3.1.1 Limited and conditional exceptions

The Panel in *US – Section 337* noted, with respect to the nature and function of Article XX,

that Article XX is entitled ‘General Exceptions’ and that the central phrase in the introductory clause reads: ‘nothing in this Agreement shall be construed to prevent the adoption or enforcement ... of measures ...’. Article XX(d) thus provides for a limited and conditional exception from obligations under other provisions. The Panel therefore concluded that Article XX(d) applies only to measures inconsistent with another provision of the General Agreement, and that, consequently, the application of Section 337 has to be examined first in the light of Article III:4. If any inconsistencies with Article III:4 were found, the Panel would then examine whether they could be justified under Article XX(d).²⁷⁶

In general, Article XX is relevant and will be invoked by a Member *only* when a measure of that Member has been found to be inconsistent with another GATT provision. In such a case, Article XX will be invoked to justify the GATT-inconsistent measure. As the Panel in *US – Section 337* noted, the central phrase in the first sentence of Article XX is that ‘nothing in this Agreement shall be construed to prevent the adoption or enforcement by any Member of measures ...’. Measures satisfying the conditions set out in Article XX are thus permitted, even if they are inconsistent with other provisions of the GATT 1994. As noted by the Panel in *US – Section 337*, however, Article XX provides for limited and conditional exceptions from obligations under other GATT provisions. The exceptions are ‘limited’ as the list of exceptions in Article XX is exhaustive. This is problematic as Article XX – which was drafted in the late 1940s – does not explicitly provide for the protection of certain societal values – such as minimum labour standards – which are felt to be core values today.²⁷⁷ Measures for the protection or promotion of human rights, food security, minimum labour standards or animal welfare cannot be – at least not directly – justified under Article XX since these grounds for justification are not included in the exhaustive list of Article XX. Any attempt to include these grounds of justification in Article XX are likely to meet strong opposition from developing country Members which fear that these new grounds will be used by developed country Members for trade protectionist purposes.

The exceptions provided for in Article XX of the GATT 1994 are not only ‘limited’; they are also ‘conditional’ in that Article XX only provides for justification of an otherwise illegal measure when the conditions set out in Article XX – and

²⁷⁶ GATT Panel Report, *US – Section 337*, para. 5.9.

²⁷⁷ Note, however, that there has been very little debate on expanding the list of exceptions/grounds of justification for otherwise GATT inconsistent measures. The current WTO DG, Pascal Lamy, while he was still EU Trade Commissioner argued in September 2004 for such expansion in the context of his proposal on the protection of collective preferences (see http://trade.ec.europa.eu/doclib/docs/2004/september/tradoc_118929.pdf). However, Peter Mandelson, his successor as EU Trade Commissioner, did not take over this idea. The European Parliament has reportedly commissioned a study on this issue, which is due to be published soon.

discussed below – are fulfilled. While Article XX allows Members to adopt or maintain measures promoting or protecting important societal values, it provides an exception to, or limitation of, affirmative commitments under the GATT 1994. In this light, it is not surprising that Article XX has played a central role in many GATT and WTO disputes.

3.1.2 Interpretation of Article XX

While it could be argued that it is an accepted principle of interpretation that exceptions are to be construed narrowly (*singularia non sunt extendenda*) and that Article XX should, therefore, be construed narrowly, the Appellate Body has not adopted this approach. Instead, it has advocated in *US – Gasoline* and *US – Shrimp* a kind of balancing between the general rule and the exception. It stated, with regard to Article XX(g), the exception at issue in both cases:

The context of Article XX(g) includes the provisions of the rest of the General Agreement, including in particular Articles I, III and XI; conversely, the context of Articles I and III and XI includes Article XX. Accordingly, the phrase ‘relating to the conservation of exhaustible natural resources’ may not be read so expansively as seriously to subvert the purpose and object of Article III:4. Nor may Article III:4 be given so broad a reach as effectively to emasculate Article XX(g) and the policies and interests it embodies. The relationship between the affirmative commitments set out in, e.g. Articles I, III and XI, and the policies and interests embodied in the ‘General Exceptions’ listed in Article XX, can be given meaning within the framework of the General Agreement and its object and purpose by a treaty interpreter only on a case-to-case basis, by careful scrutiny of the factual and legal context in a given dispute, without disregarding the words actually used by the WTO Members themselves to express their intent and purpose.²⁷⁸

Clearly, therefore, the Appellate Body considers a *narrow* interpretation of the exceptions of Article XX, i.e. the exceptions allowing for, *inter alia*, trade-restrictive measures to protect public health or the environment, to be inappropriate. The Appellate Body advocates a *balance* between trade liberalization and other societal values.

3.1.3 Kind of measures justifiable under Article XX

With regard to the kind of measure that can be justified under Article XX, the Panel in *US – Shrimp* ruled that Article XX could not justify measures that ‘undermine

the WTO multilateral trading system’,²⁷⁹ and that a measure of a Member ‘conditioning access to its market for a given product upon the adoption by the exporting Member of certain policies’ would undermine the multilateral trading system.²⁸⁰ According to the Panel in *US – Shrimp*, Article XX could therefore not justify measures that oblige exporting countries to change certain domestic policies and make them compliant with the policies of the importing country. An import ban on biomass not produced consistently with the Cramer sustainability criteria would be such measure, which – in the line of the ruling of the Panel in *US – Shrimp* – could not be justified under Article XX. On appeal, however, the Appellate Body categorically rejected this ruling by the Panel on the scope of measures that Article XX could justify. The Appellate Body held:

*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. Paragraphs (a) to (j) comprise measures that are recognized as exceptions to substantive obligations established in the GATT 1994, because the domestic policies embodied in such measures have been recognized as important and legitimate in character. 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, of the specific exceptions of Article XX inutile, a result abhorrent to the principles of interpretation we are bound to apply.²⁸¹*

Measures requiring that exporting countries comply with, or adopt, certain policies prescribed by the importing country are, in fact, typical of the measures that Article XX can justify. They are definitely not *a priori* excluded from the scope of Article XX. That is also, for example, the case for an import ban on biomass not produced consistently with the Cramer sustainability criteria. Note, however, that – as discussed below – a measure that imposes in a rigid and inflexible manner purely domestic criteria on the importing Member without consultations or consideration of the different conditions in the exporting Member, will fail to meet the requirements of the chapeau of Article XX, namely, that a provisionally justified measure is not applied in a manner that constitutes unjustifiable or arbitrary discrimination or a disguised restriction on trade.²⁸²

²⁷⁸ Appellate Body Report, *US – Gasoline*, 18.

²⁷⁹ Panel Report, *US – Shrimp*, para. 744.

²⁸⁰ *Ibid.*, para. 745.

²⁸¹ Appellate Body Report, *US – Shrimp*, para. 121.

²⁸² See below, p. 121.

As the Appellate Body found in *US – Shrimp (Article 21.5 - Malaysia)*, an nPR PPM measure can be justified under Article XX. This was the first time that this was established. To date, the nPR PPM measure at issue in *US – Shrimp (Article 21.5 - Malaysia)* has been the only nPR PPM measure that fulfilled the requirements of Article XX. Other measures, such as those at issue in *US – Shrimp* and *US – Gasoline*, did not meet the requirements of the chapeau of Article XX.²⁸³ There is, however, definitely no reason to think that nPR PPM measures could not be justified under Article XX.

3.1.4 Jurisdictional limitation on the application of Article XX?

The Appellate Body has yet to rule on whether measures that protect, or purport to protect, a societal value or interest outside the territorial jurisdiction of the Member taking the measure can be justified under Article XX. There is no explicit jurisdictional limitation in Article XX. As discussed below, the wording of Article XX(b) does not explicitly limit the protection of life and health to the territory of the country enacting the measure at issue. Likewise, the wording of Article XX(a) and (g) has no such explicit limitation either. However, the question is whether there is an *implied* jurisdictional limitation, in that Article XX cannot be invoked to protect societal values outside the territorial jurisdiction of the Member concerned.

In *US – Tuna I (Mexico)*, the United States invoked Article XX(b) and (g) to justify the GATT-inconsistent prohibition on imports of yellowfin tuna caught with nets that also catch and kill dolphins.²⁸⁴ The Panel, however, excluded from the scope of application of Article XX(b) and (g) all measures protecting human, animal or plant life or health, or relating to the conservation of exhaustible natural resources *outside* the jurisdiction of the country enacting the measures concerned. The Panel argued that if Article XX(b) or XX(g) could justify trade-restrictive measures for the protection of life or health or the conservation of exhaustible natural resources outside the jurisdiction of the country enacting the measures, that country could unilaterally determine the public health and environmental policies of other countries (dependent as these countries may be on access to the market of the country enacting the measure at issue).²⁸⁵

The Panel in *US – Tuna II (EEC)* confirmed that Article XX(b) and (g) cannot justify measures that pursue the protection of public health and environmental policy

objectives *outside* the jurisdiction of the Member enacting the measure.²⁸⁶ In the opinion of the Panel, countries should not be allowed under Article XX to take trade-restrictive measures that would force other countries to change their domestic environmental policies.

In *US – Shrimp*, a case involving an import ban on shrimp harvested through methods resulting in the incidental killing of sea turtles,²⁸⁷ the Appellate Body noted that sea turtles migrate to or traverse waters subject to the jurisdiction of the United States, and subsequently stated:

*We do not pass upon the question of whether there is an implied jurisdictional limitation in Article XX(g), and if so, the nature or extent of that limitation. We note only that in the specific circumstances of the case before us, there is a sufficient nexus between the migratory and endangered marine populations involved and the United States for purposes of Article XX(g).*²⁸⁸

While the position of the Appellate Body on the use of Article XX of the GATT 1994 for the protection or promotion of a societal value or interest outside the territorial jurisdiction of the Member taking the otherwise GATT-inconsistent measure is still undetermined, the Panel in *EC – Tariff Preferences* found that:

*... the policy reflected in the Drug Arrangements is not one designed for the purpose of protecting human life or health in the European Communities and, therefore, the Drug Arrangements are not a measure for the purpose of protecting human life or health under Article XX(b) of GATT 1994.*²⁸⁹ [emphasis added]

In the context of this study, the question arises as to whether otherwise GATT-inconsistent measures giving effect to the Cramer sustainability criteria, discussed above, can be justified under Article XX of the GATT 1994, or whether they fall outside the scope of this provision because of its jurisdictional limitation. The ruling of the Appellate Body in *US – Shrimp* suggests that if a sufficient nexus exists between, on the one hand, the protection of the societal values expressed in the Cramer sustainability criteria, and, on the other, the territory of the

283 See below, p. 119.

284 Unless the tuna exporting country proved that its programme for avoiding the accidental killing of dolphins was comparable to the US programme.

285 See GATT Panel Report, *US – Tuna I (Mexico)*, paras. 5.27 and 5.32 (unadopted).

286 Note that the Panel in *US – Tuna II (EEC)* found that in addition to measures aiming to protect public policy objectives on the territory of the Member enacting the measure, Article XX also covers measures involving a Member's exercise of jurisdiction over their own nationals and vessels. See GATT Panel Report, *US – Tuna II (EEC)*, paras. 5.15-17, 5.20 and 5.31-33.

287 The United States allowed the importation of shrimp harvested in waters of a country certified as complying with the US standards for the protection of sea turtles.

288 *Ibid.*, para. 133.

289 Panel Report, *EC – Tariff Preferences*, para. 7.210

Netherlands, Article XX may be applied. Such a nexus definitely exists when the measure at issue concerns nPR PPMs affecting a global situation (e.g. measures concerning climate change or the depletion of the ozone layer). Such a nexus may also exist when the measure at issue concerns nPR PPMs affecting a transboundary situation (e.g. measures concerning air or water pollution across national borders) or concerns nPR PPMs affecting a situation in multiple/undetermined national territories (e.g. measures concerning the protection of migratory species). This nexus clearly does not exist, however, when the measure at issue concerns nPR PPMs affecting a purely national situation in the country of production (e.g. measures concerning minimum labour standards, human rights, the local environment, child labour or animal welfare). As stated above, the Appellate Body has still to rule on whether measures of this kind, when otherwise GATT inconsistent, can be justified under the Article XX of the GATT 1994.

3.1.5 The two-tier test under Article XX

Article XX of the GATT 1994 sets out a two-tier test for determining whether an otherwise GATT-inconsistent measure can be justified. In *US – Gasoline*, the Appellate Body stated:

In order that the justifying protection of Article XX may be extended to it, the measure at issue must not only come under one or another of the particular exceptions – paragraphs (a) to (j) – listed under Article XX; it must also satisfy the requirements imposed by the opening clauses of Article XX. The analysis is, in other words, two-tiered: first, provisional justification by reason of characterization of the measure under Article XX(g); second, further appraisal of the same measure under the introductory clauses of Article XX.²⁹⁰

Thus, for a GATT-inconsistent measure to be justified under Article XX, it must meet:

- the requirements of one of the exceptions listed in paragraphs (a) to (j) of Article XX; *and*
- the requirements of the introductory clause, commonly referred to as the ‘chapeau’, of Article XX.

In examining whether a measure can be justified under Article XX, one must always examine, first, whether this measure can be provisionally justified under one of the specific exceptions listed in paragraphs (a) to (j) of Article XX and, if so, whether the application of this measure meets the requirements of the chapeau of Article XX. The following paragraphs will, therefore, first discuss the specific exceptions and their requirements provided for in Article XX before analysing the requirements of the chapeau of Article XX.

3.2 Provisional justification of otherwise GATT-inconsistent measures

As discussed above, the first step in the two-tier test for determining whether an otherwise GATT-inconsistent measure is justified under Article XX is to examine whether that measure meets the requirements of one of the exceptions listed in the paragraphs of Article XX. This section first examines the exceptions set out in paragraphs (b), (d) and (g), on which there is a considerable body of WTO case law; and then addresses the exceptions set out in paragraphs (a) and (j), which have not been the subject of any dispute settlement to date.

3.2.1 Protection of life or health of humans, animals and plants

Article XX(b) concerns measures that are ‘necessary to protect human, animal or plant life or health’. It sets out a two-tier test to determine whether a measure is *provisionally* justified under this provision. The Panel in *US – Gasoline* stated that the United States, as the party invoking Article XX(b), had to establish:

that the policy in respect of the measures for which the provision was invoked fell within the range of policies designed to protect human, animal or plant life or health; [and] that the inconsistent measures for which the exception was being invoked were necessary to fulfil the policy objectives ...²⁹¹

In other words, for a GATT-inconsistent measure to be provisionally justified under Article XX(b):

- the policy objective pursued by the measure must be the protection of life or health of humans, animals or plants; and
- the measure must be necessary to fulfil that policy objective.

3.2.1.1 Is the measure designed to ‘protect life or health...’?

The first element of this test under Article XX(b) is relatively easy to apply and has not given rise to many interpretative problems. In *Thailand – Cigarettes*, for example, the Panel ruled with regard to this element of the test under Article XX(b):

Consequently, measures designed to reduce the consumption of cigarettes fell within the scope of Article XX(b).²⁹²

In *EC – Tariff Preferences*, the European Communities sought to justify under Article XX(b) its additional tariff preferences under the Drug Arrangements of the EC

291 Panel Report, *US – Gasoline*, para. 6.20. For a more recent application of this test, see Panel Report, *EC – Tariff Preferences*, paras. 7.179 and 7.199.

292 GATT Panel Report, *Thailand – Cigarettes*, para. 73.

290 Appellate Body Report, *US – Gasoline*, 22.

Generalized System of Preferences by arguing that:

*... narcotic drugs pose a risk to human life and health in the European Communities and that tariff preferences contribute to the protection of human life and health by supporting the measures taken by other countries against the illicit production and trafficking of those substances, thereby reducing their supply to the European Communities.*²⁹³

In its examination of whether the additional tariff preferences of the Drug Arrangements are designed to achieve the stated health objectives, the Panel noted that it needed to consider not only the express provisions of the legislation or measures at issue, but also the design, architecture and structure of this legislation or these measures.²⁹⁴ As already noted above, the Panel in *EC – Tariff Preferences* came to the conclusion that:

*... the policy reflected in the Drug Arrangements is not one designed for the purpose of protecting human life or health in the European Communities and, therefore, the Drug Arrangements are not a measure for the purpose of protecting human life or health under Article XX(b) of GATT 1994.*²⁹⁵

As Article XX(b) covers measures designed for the protection of ‘human, animal or plant life or health’, it covers public health policy measures as well as environmental policy measures. Measures to ensure that biofuels and electricity produced from biomass contribute to a reduction in greenhouse gas emissions can certainly be considered to be measures designed for the protection of ‘human, animal or plant life or health’. As already noted above, there is no specific mention of the protection of animal welfare in Article XX, as a possible ground for justification for otherwise GATT-inconsistent measures. It has been argued that there is an important correlation between animal welfare and animal health as poor animal welfare can affect animal health. If in specific cases such link can indeed be demonstrated, then a measure aimed at protecting animal welfare can be considered to be a measure whose policy objective is to protect animal life or health within the meaning of Article XX(b).

Alternatively, it has been suggested that a contemporary interpretation of the term ‘animal health’ might include ‘animal welfare’. If ‘exhaustible natural resources’ are

now interpreted by the Appellate Body – in a contemporary and evolutionary manner – as including living natural resources, then the term ‘animal health’ can perhaps also be interpreted as including ‘animal welfare’. At present, however, there is little support, and few arguments, for such a ‘contemporary’ and ‘evolutionary’ interpretation of the term ‘animal welfare’.

3.2.1.2 Is the measure ‘necessary’ to protect life or health ...?

The second element of the two-tier test under Article XX(b), the ‘necessity’ requirement, is more problematic than the first. In *Thailand – Cigarettes*, the Panel examined whether Thailand’s import prohibition on cigarettes – inconsistent with Article XI of the GATT 1947 – was justified under Article XX(b). The Panel ruled as follows:

that this provision clearly allowed contracting parties to give priority to human health over trade liberalization; however, for a measure to be covered by Article XX(b) it had to be ‘necessary’.

*The Panel concluded ... that the import restrictions imposed by Thailand could be considered to be ‘necessary’ in terms of Article XX(b) only if there were no alternative measure consistent with the General Agreement, or less inconsistent with it, which Thailand could reasonably be expected to employ to achieve its health policy objectives.*²⁹⁶

The principal health objectives advanced by Thailand to justify its import restrictions on cigarettes were twofold: first, to ensure the quality of cigarettes by protecting the public from harmful ingredients in imported cigarettes; and, second, to reduce the consumption of cigarettes in Thailand. Applying its ‘necessity’ test defined above, the Panel in *Thailand – Cigarettes* therefore examined:

*whether the Thai concerns about the quality of cigarettes consumed in Thailand could be met with measures consistent, or less inconsistent, with the General Agreement. It noted that other countries had introduced strict, non-discriminatory labelling and ingredient disclosure regulations which allowed governments to control, and the public to be informed of, the content of cigarettes. A non-discriminatory regulation implemented on a national treatment basis in accordance with Article III:4 requiring complete disclosure of ingredients, coupled with a ban on unhealthy substances, would be an alternative consistent with the General Agreement. The Panel considered that Thailand could reasonably be expected to take such measures to address the quality-related policy objectives it now pursues through an import ban on all cigarettes whatever their ingredients.*²⁹⁷

²⁹³ Panel Report, *EC – Tariff Preferences*, para. 7.180.

²⁹⁴ *Ibid.*, para. 7.200. In support of this approach, the Panel referred to the Appellate Body Report, *Japan – Alcoholic Beverages II*, p. 29 (relating to Article III:2 of the GATT 1994; see above, p. 49); and the Appellate Body Report, *US – Shrimp*, para.137 (relating to Article XX(g) of the GATT 1994; see below, p. 110).

²⁹⁵ Panel Report, *EC – Tariff Preferences*, para. 7.210.

²⁹⁶ GATT Panel Report, *Thailand – Cigarettes*, paras. 73 and 75.

²⁹⁷ *Ibid.*, para. 77.

With regard to the second health objective of the import restriction at issue, namely, the reduction in the consumption of cigarettes:

The Panel then considered whether Thai concerns about the quantity of cigarettes consumed in Thailand could be met by measures reasonably available to it and consistent, or less inconsistent, with the General Agreement. ... A ban on the advertisement of cigarettes of both domestic and foreign origin would normally meet the requirements of Article III:4 [or] ... would have to be regarded as unavoidable and therefore necessary within the meaning of Article XX(b) because additional advertising rights would risk stimulating demand for cigarettes.²⁹⁸

The Panel in *Thailand – Cigarettes* thus came to the conclusion that there were in fact various measures consistent with the GATT which were reasonably available to Thailand to control the quality and quantity of cigarettes smoked and which, taken together, could achieve the health policy goals pursued by the Thai government. The import restrictions on cigarettes were therefore not ‘necessary’ within the meaning of Article XX(b).²⁹⁹

For the Panel in *Thailand – Cigarettes*, a measure is ‘necessary’ within the meaning of Article XX(b) only when there exists no alternative measure that is GATT-consistent or less inconsistent, and that a Member could reasonably be expected to employ to achieve the public health objective pursued. It is clear that a Member can only be reasonably expected to employ an alternative measure when that measure is at least *as effective* in achieving the policy objective pursued.

In *US – Gasoline*, the Panel made an important clarification as to the requirement of ‘necessity’ under Article XX(b): it is not the necessity of the policy objective but the necessity of the disputed measure to *achieve* that objective which is at issue. The Panel stated:

it was not the necessity of the policy goal that was to be examined, but whether or not it was necessary that imported gasoline be effectively prevented from benefiting from as favourable sales conditions as were afforded by an individual baseline tied to the producer of a product. It was the task of the Panel to address whether these inconsistent measures were necessary to achieve the policy goal under Article XX(b). It was therefore not the task of the Panel to examine the necessity of the environmental objectives of the Gasoline Rule, or of parts of the Rule that the Panel did not specifically find to be inconsistent with the General Agreement.³⁰⁰

In *EC – Asbestos*, a dispute between Canada and the European Communities on a French ban on asbestos and asbestos products, Canada argued on appeal that the Panel had erred in applying the ‘necessity’ test under Article XX(b) of the GATT 1994. In addressing Canada’s arguments in support of its appeal, the Appellate Body clarified the ‘necessity’ test under Article XX(b) in three important respects.

First, the Appellate Body noted that:

it is undisputed that WTO Members have the right to determine the level of protection of health that they consider appropriate in a given situation. France has determined, and the Panel accepted, that the chosen level of health protection by France is a ‘halt’ to the spread of asbestos-related health risks. By prohibiting all forms of amphibole asbestos, and by severely restricting the use of chrysotile asbestos, the measure at issue is clearly designed and apt to achieve that level of health protection.³⁰¹

It is therefore for WTO Members to determine the *level* of protection of health or the environment they consider appropriate. Other Members cannot challenge the level of protection chosen; they can only argue that the measure at issue is not ‘necessary’ to achieve that level of protection.³⁰²

Second, in *EC – Asbestos*, the Appellate Body clarified the meaning of the requirement, formulated in *Thailand – Cigarettes* and *US – Gasoline*, that there is ‘no alternative to the measure at issue that the Member could *reasonably* be expected to employ’. Canada asserted, before the Appellate Body, that the Panel had erred in finding that ‘controlled use’ of asbestos and asbestos products is not a reasonably available alternative to an import ban on asbestos. According to Canada, an alternative measure is only excluded as a ‘reasonably available’ alternative if implementation of that measure is ‘impossible’. The Appellate Body stated that, in determining whether a suggested alternative measure is ‘reasonably available’, several factors must be taken into account, alongside the difficulty of implementation. The Appellate Body subsequently referred to its earlier findings on the ‘necessity’ test under Article XX(d) in *Korea – Various Measures on Beef*.³⁰³

In *EC – Asbestos*, the Appellate Body noted with respect to ‘necessary’ in Article XX(b):

301 Appellate Body Report, *EC – Asbestos*, para. 168.

302 As France did in *EC – Asbestos*, a WTO Member can thus chose a zero-risk level, even though this means that there will be few, if any, measures other than a ban that will achieve this level of protection.

303 It was held that there is no reason to interpret the ‘necessity’ requirement in Article XX(b) differently from that in Article XX(d) in the GATT.

298 *Ibid.*, para. 78.

299 *Ibid.*, para. 81.

300 Panel Report, *US – Gasoline*, para. 6.22.

We indicated in Korea – Beef that one aspect of the ‘weighing and balancing process ... comprehended in the determination of whether a WTO-consistent alternative measure’ is reasonably available is the extent to which the alternative measure ‘contributes to the realization of the end pursued’. In addition, we observed, in that case, that ‘[t]he more vital or important [the] common interests or values’ pursued, the easier it would be to accept as ‘necessary’ measures designed to achieve those ends. 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.³⁰⁴

In deciding whether a measure is necessary, the Appellate Body therefore considers the *importance* of the societal value pursued by the measure at issue, as well as the *extent* to which the alternative measure will contribute to the protection or promotion of that value. Note that in criticism on this case law, the question has been raised as to whether it is appropriate for panels or the Appellate Body come to conclusions on the relative importance of societal values pursued by Members. Is it appropriate for panels or the Appellate Body to find that the pursuit of religious purity or piety is a less compelling objective than the protection of human health?³⁰⁵

Third, instead of the requirement in *Thailand – Cigarettes* that the alternative measure needs to be GATT-consistent or less inconsistent, the Appellate Body in *EC – Asbestos* puts forward another requirement, namely, that the alternative measure must be *less trade-restrictive* than the measure at issue.³⁰⁶ In summarizing the test under Article XX(b), the Appellate Body held in *EC – Asbestos*:

The ... question ... is whether there is an alternative measure that would achieve the same end and that is less restrictive of trade than a prohibition.³⁰⁷

Canada, the complainant in *EC – Asbestos*, had asserted that ‘controlled use’ of asbestos and asbestos products represented a ‘reasonably available’ measure that

would serve the same end as the ban on asbestos and asbestos products. The issue for the Appellate Body was, therefore, whether France could reasonably be expected to employ ‘controlled use’ practices to achieve its chosen level of health protection – a halt in the spread of asbestos-related health risks. The Appellate Body concluded that this was not the case. It reasoned as follows:

In our view, 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’. Such an alternative measure would, in effect, prevent France from achieving its chosen level of health protection. On the basis of the scientific evidence before it, the Panel found that, in general, the efficacy of ‘controlled use’ remains to be demonstrated. Moreover, even in cases where ‘controlled use’ practices are applied ‘with greater certainty’, the scientific evidence suggests that the level of exposure can, in some circumstances, still be high enough for there to be a ‘significant residual risk of developing asbestos-related diseases’. The Panel found too that the efficacy of ‘controlled use’ is particularly doubtful for the building industry and for DIY enthusiasts, which are the most important users of cement-based products containing chrysotile asbestos. Given these factual findings by the Panel, we believe that ‘controlled use’ would not allow France to achieve its chosen level of health protection by halting the spread of asbestos-related health risks. ‘Controlled use’ would, thus, not be an alternative measure that would achieve the end sought by France.³⁰⁸

Note also that, with regard to the evaluation of the ‘necessity’ of a measure, the Appellate Body stated that:

In justifying a measure under Article XX(b) of the GATT 1994, a Member may also rely, in good faith, on scientific sources which, at that time, may represent a divergent, but qualified and respected, opinion. A Member is not obliged, in setting health policy, automatically to follow what, at a given time, may constitute a majority scientific opinion. Therefore, a panel need not, necessarily, reach a decision under Article XX(b) of the GATT 1994 on the basis of the ‘preponderant’ weight of the evidence.³⁰⁹

3.2.2 Ensuring compliance with GATT-consistent legislation

As mentioned above, Article XX(d) concerns and can justify measures:

necessary to secure compliance with laws or regulations which are not inconsistent with the provisions of this Agreement, including those relating to customs enforcement, the enforcement of monopolies operated under paragraph 4 of Article II

³⁰⁸ *Ibid.*, para. 174.

³⁰⁹ *Ibid.*, para. 178.

³⁰⁴ Appellate Body Report, *EC – Asbestos*, para. 172.

³⁰⁵ See R. Howse and E. Türk, ‘The WTO impact on internal regulations: A case study of the *EC – Asbestos* dispute’, in G. Bermann and P. Mavroidis, *Trade and Human Health and Safety* (Cambridge University Press, 2006), p.116.

³⁰⁶ Note that in *Korea – Various Measures on Beef*, the Appellate Body still applied the *Thailand – Cigarettes* requirement that the alternative measure must be GATT-consistent or less inconsistent. See Appellate Body Report, *Korea – Various Measures on Beef*, para. 165.

³⁰⁷ *Ibid.* A more recent application of this test can be found in the Panel Report, *EC – Tariff Preferences*, para. 7.211.

and Article XVII, the protection of patents, trade marks and copyrights, and the prevention of deceptive practices.

Article XX(d) sets out a two-tier test for the provisional justification of GATT-inconsistent measures. In *Korea – Various Measures on Beef*, a dispute concerning the regulation of retail sales of both domestic and imported beef products (the dual retail system) designed to secure compliance with a consumer protection law, the Appellate Body ruled:

For a measure, otherwise inconsistent with GATT 1994, to be justified provisionally under paragraph (d) of Article XX, two elements must be shown. First, the measure must be one designed to ‘secure compliance’ with laws or regulations that are not themselves inconsistent with some provision of the GATT 1994. Secondly, the measure must be ‘necessary’ to secure such compliance. A Member who invokes Article XX(d) as a justification has the burden of demonstrating that these two requirements are met.³¹⁰

Thus, for a GATT-inconsistent measure to be provisionally justified under Article XX(d):

- the measure must be designed to *secure compliance* with national law, such as customs law or intellectual property law, which, in itself, is not GATT-inconsistent; and
- the measure must be *necessary* to ensure such compliance.³¹¹

3.2.2.1 Is the measure designed to ‘secure compliance’ ...?

With respect to the first element of the Article XX(d) test, namely, that the measure must be designed to secure compliance with GATT-consistent laws or regulations, note that Article XX(d) itself clarifies the ‘laws or regulations’ concerned by listing a few examples. This illustrative list includes laws or regulations relating to customs enforcement, the enforcement of monopolies, the protection of patents, trade marks and copyrights, and the prevention of deceptive practices. With regard to the terms ‘to secure compliance’, the Panel in *EEC – Parts and Components* found that ‘to secure compliance with laws and regulations’ means to enforce the obligations under these laws and regulations; it does not mean to secure the attainment of the

objectives of the laws and regulations.³¹²

In *US – Gasoline* the Panel found with regard to the type of measures covered by Article XX(d) that:

maintenance of discrimination between imported and domestic gasoline contrary to Article III:4 under the baseline establishment methods did not ‘secure compliance’ with the baseline system. These methods were not an enforcement mechanism. They were simply rules for determining the individual baselines. As such, they were not the type of measures with which Article XX(d) was concerned.³¹³

In *Canada – Periodicals*, Canada argued that the import prohibition of special edition periodicals under its Tariff Code 9958 was intended to secure the attainment of the objectives of Section 19 of the Income Tax Act, which itself allowed for the deduction of expenses for advertising in Canadian periodicals. The Panel decided, however, that Tariff Code 9958 cannot be regarded as an enforcement measure for Section 19 of the Income Tax Act. The Panel could therefore not accept Canada’s argument that the import prohibition of special edition periodicals under its Tariff Code 9958 could be justified under Article XX(d) of the GATT 1994. Although the import prohibition under the Tariff Code made a contribution to the achievement of the objective of Section 19 of the Income Tax Act, it was merely an incidental effect because the Tariff Code’s actual objective was different from that of the Income Tax Act.³¹⁴

Two recent cases, *Mexico – Taxes on Soft Drinks* and *EC – Trademarks and Geographical Indications*, provide further insights into the first element of the Article XX(d) test. In *Mexico – Taxes on Soft Drinks*, the Appellate Body was called upon to clarify the meaning of the phrase ‘to secure compliance with laws or regulations’. Mexico had argued before the Panel that the measures at issue in this case were necessary to secure compliance ‘by the United States with the United States’ obligations under the NAFTA [the North American Free Trade Area], an international agreement that is a law not inconsistent with the provisions of the GATT 1994’.³¹⁵ The Panel, however, found that:

the phrase ‘to secure compliance’ in Article XX(d) does not apply to measures taken by a Member in order to induce another Member to comply with obligations owed to it under a non-WTO treaty.³¹⁶

310 Appellate Body Report, *Korea – Various Measures on Beef*, para. 157. See also Panel Report, *US – Gasoline*, para. 6.31.

311 Note that the Panel in *Canada – Wheat Imports and Grain Exports* applied a three-tier test. According to the Panel, for a GATT-inconsistent measure to be provisionally justified under Article XX(d): (a) the measure justified for which justification is claimed must secure compliance with other laws or regulations; (b) those other laws or regulations must not be inconsistent with the provisions of the GATT 1994; and (c) the measure for which justification is claimed must be necessary to secure compliance with those other laws or regulations. See Panel Report, *Canada – Wheat Imports and Grain Exports*, para. 6.218.

312 GATT Panel Report, *EEC – Parts and Components*, paras. 5.14-5.18.

313 Panel Report, *US – Gasoline*, para. 6.33. The Panel referred in a footnote to GATT Panel Report, *EEC – Parts and Components*, paras. 5.12-5.18.

314 Panel Report, *Canada – Periodicals*, para. 5.10.

315 Panel Report, *Mexico – Taxes on Soft Drinks*, para. 8.162.

316 *Ibid.*, para. 8.181

In considering Mexico's appeal against this Panel finding, the Appellate Body started with an analysis of the terms 'laws or regulations' of Article XX(d).³¹⁷ According to the Appellate Body:

The terms 'laws or regulations' are generally used to refer to domestic laws or regulations. As Mexico and the United States note, previous GATT and WTO disputes in which Article XX(d) has been invoked as a defence have involved domestic measures. Neither disputes that the expression 'laws or regulations' encompasses the rules adopted by a WTO Member's legislative or executive branches of government. We agree with the United States that one does not immediately think about international law when confronted with the term 'laws' in the plural. Domestic legislative or regulatory acts sometimes may be intended to implement an international agreement. In such situations, the origin of the rule is international, but the implementing instrument is a domestic law or regulation. In our view, the terms 'laws or regulations' refer to rules that form part of the domestic legal system of a WTO Member. Thus the 'laws or regulations' with which the Member invoking Article XX(d) may seek to secure compliance do not include obligations of another WTO Member under an international agreement.³¹⁸

The Appellate Body made it clear that 'laws or regulations' refer to domestic rules, and not the obligations of another WTO Member under an international agreement. Subsequently, the Appellate Body in *Mexico – Taxes on Soft Drinks* turned to the terms 'to secure compliance', which 'speak to the types of measures a WTO Member can seek to justify under Article XX(d)' and 'relate to the design of the measures to be justified'.³¹⁹ The Panel had argued that there was uncertainty regarding the effectiveness of the tax measures, and that it was therefore not convinced that these measures were meant 'to secure compliance'. The Appellate Body, however, did not agree with this reasoning:

*We see no reason, however, to derive from the Appellate Body's examination of 'necessity', in *US – Gambling*, a requirement of 'certainty' applicable to the terms 'to secure compliance'. In our view, a measure can be said to be designed 'to secure compliance' even if the measure cannot be guaranteed to achieve its result with absolute certainty. Nor do we consider that the 'use of coercion' is a necessary component of a measure designed 'to secure compliance'. Rather, Article XX(d) requires that the design of the measure contribute 'to secur[ing] compliance with laws or regulations which are not inconsistent with the provisions of' the GATT 1994.³²⁰ [emphasis added]*

The fact that the tax measures are designed 'to secure compliance', did not, however, alter the general conclusion of the Appellate Body that Article XX(d) was not applicable in *Mexico – Taxes on Soft Drinks*. As explained above, the international obligations of other WTO Members, such as the United States' obligations under the NAFTA, do not fall within the scope of the terms 'laws or regulations' the compliance with which Article XX(d) measures must be designed to secure.

In *EC – Trademarks and Geographical Indications*, the European Communities had invoked the exception of Article XX(d) to justify the otherwise GATT-inconsistent measures at issue in this case. The European Communities contended that these measures were employed to secure compliance with an EC regulation, namely, EC Council Regulation (EEC) No. 2081/92 of 14 July 1992 on the protection of geographical indications and designations of origin for agricultural products and foodstuffs. As the Panel in *EC – Trademarks and Geographical Indications* noted, the terms 'laws or regulations' in Article XX(d) are qualified by the phrase 'not inconsistent with the provisions of this Agreement'. In other words, the 'laws or regulations' referred to in Article XX(d) have to be GATT-consistent. However, the Panel found that EC Council Regulation (EEC) No. 2081/92 to be inconsistent with the GATT 1994 and that this EC regulation, therefore, did not qualify as a 'law or regulation' within the meaning of Article XX(d).³²¹

3.2.2.2 Is the measure 'necessary' to secure compliance?

With respect to the second element of the Article XX(d) test, namely, the 'necessity' requirement, the GATT Panel Report in *US – Section 337* stated:

It was clear to the Panel that a contracting party cannot justify a measure inconsistent with another GATT provision as 'necessary' in terms of Article XX(d) if an alternative measure which it could reasonably be expected to employ and which is not inconsistent with other GATT provisions is available to it. By the same token, in cases where a measure consistent with other GATT provisions is not reasonably available, a contracting party is bound to use, among the measures reasonably available to it, that which entails the least degree of inconsistency with other GATT provisions.³²²

The meaning given to the 'necessity' requirement of Article XX(d) in *US – Section 337* was thus very similar to the meaning given to 'necessity' requirement of Article

317 Appellate Body Report, *Mexico – Taxes on Soft Drinks*, paras. 68-69.

318 *Ibid.*, para. 69.

319 *Ibid.*, para. 72.

320 *Ibid.*, para. 74.

321 See Panel Report, *EC – Trademarks and Geographical Indications* (complaint by Australia), paras. 7.331-332, and Panel Report, *EC – Trademarks and Geographical Indications* (complaint by the United States), paras. 7.296-297.

322 GATT Panel Report, *US – Section 337*, para. 5.26.

XX(b) in *Thailand – Cigarettes*, discussed above.³²³ A measure is ‘necessary’ within the meaning of Article XX(d) only when there exists no alternative measure that is GATT-consistent or less inconsistent, and that a Member could reasonably be expected to employ to ensure compliance with GATT-consistent laws or regulations.

In *Korea – Various Measures on Beef*, the Appellate Body further clarified the ‘necessity’ requirement of Article XX(d) of the GATT 1994. The Appellate Body first noted that:

*We believe that, as used in the context of Article XX(d), the reach of the word ‘necessary’ is not limited to that which is ‘indispensable’ or ‘of absolute necessity’ or ‘inevitable’. Measures which are indispensable or of absolute necessity or inevitable to secure compliance certainly fulfil the requirements of Article XX(d). But other measures, too, may fall within the ambit of this exception. As used in Article XX(d), the term ‘necessary’ refers, in our view, to a range of degrees of necessity. At one end of this continuum lies ‘necessary’ understood as ‘indispensable’; at the other end, is ‘necessary’ taken to mean as ‘making a contribution to’. We consider that a ‘necessary’ measure is, in this continuum, located significantly closer to the pole of ‘indispensable’ than to the opposite pole of simply ‘making a contribution to’.*³²⁴

The Appellate Body subsequently stated:

It seems to us that a treaty interpreter assessing a measure claimed to be necessary to secure compliance of a WTO-consistent law or regulation may, in appropriate cases, take into account the relative importance of the common interests or values that the law or regulation to be enforced is intended to protect. The more vital or important those common interests or values are, the easier it would be to accept as ‘necessary’ a measure designed as an enforcement instrument.

There are other aspects of the enforcement measure to be considered in evaluating that measure as ‘necessary’. One is the extent to which the measure contributes to the realization of the end pursued, the securing of compliance with the law or regulation at issue. The greater the contribution, the more easily a measure might be considered to be ‘necessary’. Another aspect is the extent to which the compliance measure produces restrictive effects on international commerce, that is, in respect of a measure inconsistent with Article III:4, restrictive effects on imported goods. A measure with a

*relatively slight impact upon imported products might more easily be considered as ‘necessary’ than a measure with intense or broader restrictive effects.*³²⁵

In *Korea – Various Measures on Beef*, the Appellate Body thus came to the following conclusion concerning the ‘necessity’ requirement of Article XX(d):

*In sum, determination of whether a measure, which is not ‘indispensable’, may nevertheless be ‘necessary’ within the contemplation of Article XX(d), 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.*³²⁶

An evaluation of whether a measure is ‘necessary’, as required by the second element of the test under Article XX(d), involves, in every case (in which the measure is not clearly ‘indispensable’), the weighing and balancing of factors such as:

- the relative importance of the common interests or values that the law or regulation to be enforced is intended to protect;
- the extent to which the measure contributes to the securing of compliance with the law or regulation at issue; and
- the extent to which the compliance measure produces restrictive effects on international trade.

As noted by the Appellate Body in *Korea – Various Measures on Beef*, the weighing and balancing of these factors:

*...is comprehended in the determination of whether a WTO-consistent alternative measure which the Member concerned could ‘reasonably be expected to employ’ is available, or whether a less WTO-inconsistent measure is ‘reasonably available’.*³²⁷

323 See above, p. 99.

324 Appellate Body Report, *Korea – Various Measures on Beef*, para. 161.

325 *Ibid.*, paras. 162-163. In para. 165, the Appellate Body cited GATT Panel Report, *US – Section 337*, para. 5.26.

326 *Ibid.*, para. 164.

327 Appellate Body Report, *Korea – Certain Measures on Beef*, para.166.

Note that the Panels in *Canada – Wheat Imports and Grain Exports* (2004), *Dominican Republic – Import and Sale of Cigarettes* (2004), and *EC – Trademarks and Geographical Indications* (2005) applied the ‘necessity’ requirement of Article XX(d) as interpreted and clarified by the Appellate Body in *Korea – Various Measures on Beef*.³²⁸

3.2.3 Preservation of exhaustible natural resources

Article XX(g) concerns measures relating to the conservation of exhaustible natural resources. Article XX(g) is fundamentally important because, together with Article XX(b), it permits measures that depart from core GATT rules for environmental protection purposes.

Article XX(g) sets out a three-tier test requiring that:

- the policy objective pursued by the measures at issue be the ‘conservation of exhaustible natural resources’;
- the measures at issue ‘relate to’ the conservation of exhaustible natural resources; and
- the measures be ‘made effective in conjunction with restrictions on domestic production or consumption’.

3.2.3.1 Is the policy objective pursued the ‘conservation of exhaustible natural resources’?

With respect to the first element of the test under Article XX(g), namely, that the measure must relate to the ‘conservation of exhaustible natural resources’, the Appellate Body, in *US – Shrimp*, adopted a broad, ‘evolutionary’ interpretation of the concept of ‘exhaustible natural resources’. In this case, the complainants had taken the position that Article XX(g) was limited to the conservation of ‘mineral’ or ‘non-living’ natural resources. Their principal argument was rooted in the notion that ‘living’ natural resources are ‘renewable’ and therefore cannot be ‘exhaustible’ natural resources. The Appellate Body disagreed. It noted:

We do not believe that ‘exhaustible’ natural resources and ‘renewable’ natural resources are mutually exclusive. One lesson that modern biological sciences teach us is that living species, though in principle, capable of reproduction and, in that sense, ‘renewable’, are in certain circumstances indeed susceptible of depletion, exhaustion and extinction, frequently because of human activities. Living resources are just as

328 See Panel Report, *Canada – Wheat Import and Grain Exports*, paras. 6.222-248, Panel Report, *Dominican Republic – Import and Sale of Cigarettes* (2004), paras. 7.205-209, 212-215, 217-232; and Panel Reports, *EC – Trademarks and Geographical Indications*, paras. 7.333-341 (Australia) and paras. 7.298-306 and 449-462 (US).

*‘finite’ as petroleum, iron ore and other non-living resources.*³²⁹

As already discussed in the Introduction to this Study, the Appellate Body noted with regard to the appropriate interpretation of the concept of ‘exhaustible natural resources’:

The words of Article XX(g), ‘exhaustible natural resources’, were actually crafted more than 50 years ago. They must be read by a treaty interpreter in the light of contemporary concerns of the community of nations about the protection and conservation of the environment. While Article XX was not modified in the Uruguay Round, the preamble attached to the WTO Agreement shows that the signatories to that Agreement were, in 1994, fully aware of the importance and legitimacy of environmental protection as a goal of national and international policy. The preamble of the WTO Agreement – which informs not only the GATT 1994, but also the other covered agreements – explicitly acknowledges ‘the objective of sustainable development’.

*... From the perspective embodied in the preamble of the WTO Agreement, we note that the generic concept of ‘natural resources’ in Article XX(g) is not ‘static’ in its content or reference but is rather ‘by definition, evolutionary’. It is, therefore, pertinent to note that modern international conventions and declarations make frequent references to natural resources as embracing both living and non-living resources.*³³⁰

The Appellate Body thus concluded on the scope of the concept of ‘exhaustible natural resources’:

Given the recent acknowledgement by the international community of the importance of concerted bilateral or multilateral action to protect living natural resources, and recalling the explicit recognition by WTO Members of the objective of sustainable development in the preamble of the WTO Agreement, we believe it is too late in the day to suppose that Article XX(g) of the GATT 1994 may be read as referring only to the conservation of exhaustible mineral or other non-living natural resources. Moreover, two adopted GATT 1947 panel reports previously found fish to be an ‘exhaustible natural resource’ within the meaning of Article XX(g). We hold that, in line with the principle of effectiveness in treaty interpretation, measures to conserve exhaustible natural

329 Appellate Body Report, *US – Shrimp*, para. 128.

330 Appellate Body Report, *US – Shrimp*, paras. 129 and 130. See also above, p. XXXVII.

resources, whether living or non-living, may fall within Article XX(g).³³¹

3.2.3.2 Does the measure 'relate to' the conservation of exhaustible natural resources?

With respect to the second element of the test under Article XX(g), namely, that the measure must be a measure 'relating to' the conservation of exhaustible natural resources, the GATT Panel in *Canada – Herring and Salmon* observed that:

Article XX(g) does not state how the trade measures are to be related to the conservation ... This raises the question of whether any relationship with conservation ... [is] sufficient for a trade measure to fall under Article XX(g) or whether a particular relationship ... [is] required. ... The Panel noted that some of the subparagraphs of Article XX state that the measure must be 'necessary' or 'essential' to the achievement of the policy purpose set out in the provision (cf. subparagraphs (a), (b), (d) and (j)) while subparagraph (g) refers only to measures 'relating to' the conservation of exhaustible natural resources. This suggests that Article XX(g) does not only cover measures that are necessary or essential for the conservation of exhaustible natural resources but a wider range of measures. However, as the preamble of Article XX indicates, the purpose of including Article XX(g) in the General Agreement was not to widen the scope for measures serving trade policy purposes but merely to ensure that commitments under the General Agreement do not hinder the pursuit of policies aimed at the conservation of exhaustible natural resources. The Panel concluded for these reasons that, while a trade measure did not have to be necessary or essential to the conservation of an exhaustible natural resource, it had to be primarily aimed at the conservation of an exhaustible natural resource to be considered as 'relating to' conservation within the meaning of Article XX(g).³³²

In *US – Gasoline*, the Appellate Body accepted the *Canada – Herring and Salmon* interpretation of 'relating to ... conservation' as meaning 'primarily aimed at conservation'. The Appellate Body stated in *US – Gasoline*:

All the participants and the third participants in this appeal accept the propriety and applicability of the view of the Herring and Salmon report and the Panel Report that a measure must be 'primarily aimed at' the conservation of exhaustible natural resources in order to fall within the scope of Article XX(g). Accordingly, we see no need to examine this point further, save, perhaps, to note that the phrase 'primarily aimed at' is

331 *Ibid.*, para. 131. In a footnote, the Appellate Body also noted that the drafting history does not demonstrate an intent on the part of the framers of the GATT 1947 to exclude 'living' natural resources from the scope of application of Article XX(g). The Appellate Body also noted that in the GATT 1947 panel reports in *US – Tuna (Canada)*, para. 4.9, and in *Canada – Herring and Salmon*, para. 4.4, fish had previously been found to be an 'exhaustible' natural resource.

332 GATT Panel Report, *Canada – Herring and Salmon*, paras. 4.5-4.6.

not itself treaty language and was not designed as a simple litmus test for inclusion or exclusion from Article XX(g).³³³

Applying this test to the baseline establishment rules for the quality of gasoline, i.e. the measure at issue in *US – Gasoline*, the Appellate Body held that these rules were 'primarily aimed at' the conservation of clean air, an exhaustible natural resource. The Appellate Body considered that:

the baseline establishment rules cannot be regarded as merely incidentally or inadvertently aimed at the conservation of clean air in the United States for the purposes of Article XX(g).³³⁴

According to the Appellate Body, a 'substantial relationship' existed between the baseline establishment rules and the policy objective of preventing further deterioration of the level of air pollution.

The Appellate Body further clarified its understanding of the concept of 'relating to' the conservation of exhaustible natural resources in *US – Shrimp*. In this case, the Appellate Body stated with regard to section 609 of Public Law 101-162 relating to the Protection of Sea Turtles in Shrimp Trawl Fishing Operations, i.e. the measure in dispute:

In its general design and structure ... Section 609 is not a simple, blanket prohibition of the importation of shrimp imposed without regard to the consequences (or lack thereof) of the mode of harvesting employed upon the incidental capture and mortality of sea turtles. Focusing on the design of the measure here at stake, it appears to us 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. The means are, in principle, reasonably related to the ends. The means and ends relationship between Section 609 and the legitimate policy of conserving an exhaustible, and, in fact, endangered species, is observably a close and real one.³³⁵

Thus, according to the Appellate Body in *US – Shrimp*, Article XX(g) requires 'a close and real' relationship between the measure and the policy objective. The means employed, i.e. the measure, must be *reasonably* related to the end pursued, i.e. the conservation of an exhaustible natural resource. A measure may not be disproportionately wide in its scope or reach in relation to the policy objective pursued.

333 Appellate Body Report, *US – Gasoline*, 18-19. In a footnote, the Appellate Body noted that the same interpretation had been applied in two recent unadopted panel reports: GATT Panel Report, *US – Tuna II (EEC)* and GATT Panel Report, *US – Taxes on Automobiles*.

334 Appellate Body Report, *US – Gasoline*, p.19.

335 Appellate Body Report, *US – Shrimp*, para. 141.

3.2.3.3 Is the measure 'made effective in conjunction with restrictions on domestic production and consumption'?

The third element of the test under Article XX(g), namely, that the measure at issue is 'made effective in conjunction with ...', has been interpreted by the Appellate Body in *US – Gasoline* as follows:

*the ordinary or natural meaning of 'made effective' when used in connection with a measure – a governmental act or regulation – may be seen to refer to such measure being 'operative', as 'in force', or as having 'come into effect'. Similarly, the phrase 'in conjunction with' may be read quite plainly as 'together with' or 'jointly with'. Taken together, the [third] clause of Article XX(g) appears to us to refer to governmental measures like the baseline establishment rules being promulgated or brought into effect together with restrictions on domestic production or consumption of natural resources. Put in a slightly different manner, we believe that the clause 'if such measures are made effective in conjunction with restrictions on domestic product or consumption' is appropriately read as a requirement that the measures concerned impose restrictions, not just in respect of imported gasoline but also with respect to domestic gasoline. The clause is a requirement of **even-handedness** in the imposition of restrictions, in the name of conservation, upon the production or consumption of exhaustible natural resources.³³⁶*

Basically, the third element of the Article XX(g) test is thus a requirement of 'even-handedness' in the imposition of restrictions on imported and domestic products. Article XX(g) does *not* require imported and domestic products to be treated equally; it merely requires that they are treated in an 'even-handed' manner. The Appellate Body in *US – Gasoline* stated in this respect:

There is, of course, no textual basis for requiring identical treatment of domestic and imported products. Indeed, where there is identity of treatment – constituting real, not merely formal, equality of treatment – it is difficult to see how inconsistency with Article III:4 would have arisen in the first place.³³⁷

Note that, if the requirement of 'even-handedness' is not met, it is also doubtful whether the measure at issue meets the 'primarily aimed at ...' requirement of the second element of the Article XX(g) test.³³⁸ The Appellate Body observed in *US – Gasoline*:

*if no restrictions on domestically-produced like products are imposed at all, and all limitations are placed upon imported products **alone**, the measure cannot be accepted as primarily or even substantially designed for implementing conservationist goals. The measure would simply be naked discrimination for protecting locally-produced goods.³³⁹*

Applying the 'even-handedness' requirement to the baseline establishment rules, the measure at issue in *US – Gasoline*, the Appellate Body held as follows:

In the present appeal, the baseline establishment rules affect both domestic gasoline and imported gasoline, providing for – generally speaking – individual baselines for domestic refiners and blenders and statutory baselines for importers. Thus, restrictions on the consumption or depletion of clean air by regulating the domestic production of 'dirty' gasoline are established jointly with corresponding restrictions with respect to imported gasoline. That imported gasoline has been determined to have been accorded 'less favourable treatment' than the domestic gasoline in terms of Article III:4, is not material for purposes of analysis under Article XX(g).³⁴⁰

In *US – Gasoline*, the Appellate Body also stated that it did not believe that the third element of Article XX(g) was intended to establish an empirical 'effects test' for the availability of the Article XX(g) exception. The Appellate Body reasoned as follows:

In the first place, the problem of determining causation, well-known in both domestic and international law, is always a difficult one. In the second place, in the field of conservation of exhaustible natural resources, a substantial period of time, perhaps years, may have to elapse before the effects attributable to implementation of a given measure may be observable. The legal characterization of such a measure is not reasonably made contingent upon occurrence of subsequent events. We are not, however, suggesting that consideration of the predictable effects of a measure is never relevant. In a particular case, should it become clear that realistically, a specific measure cannot in any possible situation have any positive effect on conservation goals, it would very probably be because that measure was not designed as a conservation regulation to begin with. In other words, it would not have been 'primarily aimed at' conservation of natural resources at all.³⁴¹

In *US – Shrimp*, the Appellate Body confirmed its approach to the third element of the Article XX(g) test.³⁴² In this case, the record showed that the United States

336 Appellate Body Report, *US – Gasoline*, 20-1.

337 *Ibid.*, 21.

338 See also GATT Panel Report, *Canada – Herring and Salmon*, para. 4.7.

339 Appellate Body Report, *US – Gasoline*, 21.

340 *Ibid.*

341 *Ibid.*, 21-2.

342 Appellate Body Report, *US – Shrimp*, para. 144.

had – albeit through earlier regulations – taken measures applicable to US shrimp trawl vessels to prevent the incidental killing of sea turtles. Because of these regulations imposing ‘restrictions on domestic production’, the import ban at issue in this case met the ‘even-handedness’ requirement of the third element of the Article XX(g) test.

3.2.4 Protection of public morals

In addition to the exceptions set out Article XX(b), (d) and (g), discussed above, the GATT 1994 also provides for an exception concerning the protection of public morals. Article XX(a) states that nothing in the GATT 1994 shall prevent the adoption or enforcement of any measure ‘necessary for the protection of public morals’. To date, this provision has never been applied or interpreted by a GATT or WTO panel or the Appellate Body. Article XX(a) was referred to in *US – Malt Beverages* and *US – Tuna I (Mexico)* but in neither case did the Panel examine the relevance of this provision. In *US – Tuna I (Mexico)*, Australia, a third party in this case, suggested that the measure at issue could be justified under Article XX(a) as a measure against inhuman treatment of animals.³⁴³ From the Report of the Working Party on the *Accession of Saudi Arabia*, it appears that this Member, which acceded to the WTO in December 2005, invokes Article XX(a) of the GATT 1994 to ban, for example, the importation of the Holy Quran; alcoholic beverages and intoxicants of all kinds, including those containing alcohol in any intoxicating proportion; and all types of machines, equipment and tools for gambling or games of chance.³⁴⁴

While Article XX(a) has not yet been the subject of dispute settlement, it is clear that for a measure to meet the requirements of the exception of Article XX(a), two separate requirements must be met, namely:

- the policy objective pursued by the measure at issue must be the ‘protection of public morals’; and
- the measure at issue must be ‘necessary’ for the protection of public morals.

3.2.4.1 Is the policy objective pursued the ‘protection of public morals’?

With regard to the first requirement of the test under Article XX(a) of the GATT 1994, namely, whether the policy objective pursued by the measure at issue is the ‘protection of public morals’, note that the concept of ‘public morals’ is not defined in the GATT 1994. Moreover, this concept has thus far not been interpreted by panels or the Appellate Body. However, the concept of ‘public morals’ is also used

in Article XIV of the GATS, the counterpart of Article XX in the GATS. While ‘public morals’ are equally undefined in the GATS, the Panel in *US – Gambling*, has had occasion to clarify the meaning of this concept. According to the Panel, the content of ‘public morals’:

*can vary in time and space, depending upon a range of factors, including prevailing social, cultural, ethical and religious values.*³⁴⁵

The Panel noted moreover that the Appellate Body had stated on several occasions that, in applying similar societal concepts (such as public health), Members have ‘the right to determine the level of protection that they consider appropriate’.³⁴⁶ The Panel in *US – Gambling* thus ruled that:

*Members should be given some scope to define and apply for themselves the concept[s] of ‘public morals’ [...] in their respective territories, according to their own systems and scales of values.*³⁴⁷

Looking at the dictionary meaning of the concept of ‘public morals’, the Panel noted ‘morals’ relate to ‘standards of right and wrong conduct’ and found that the measure that is sought to be justified under Article XIV(a) must be aimed at protecting the interests of the people within a community or a nation as a whole.³⁴⁸ The Panel in *US – Gambling* thus defined ‘public morals’ as being ‘standards of right and wrong conduct maintained by or on behalf of a community or nation’.³⁴⁹ While *US – Gambling* concerned the concept of ‘public morals’ in Article XIV(a) of the GATS, the Panel’s findings in this case are highly relevant for the interpretation of this concept in Article XX(a) of the GATT 1994.

It could be argued that the protection of public morals can be invoked as a ground for justification by a Member adopting or maintaining a ban on the sale and use of products produced in a manner inconsistent with minimum labour standards or basic human rights.³⁵⁰ Recall that some of the Cramer sustainability criteria for the

³⁴³ See GATT Panel Report, *US – Tuna I (Mexico)*, para. 4.4.

³⁴⁴ See Report of the Working Party on the *Accession of the Kingdom of Saudi Arabia to the World Trade Organization*, WT/ACC/SAU/61, dated 1 November 2005, Annex F, List of Banned Products.

³⁴⁵ Panel Report, *US – Gambling*, para. 6.462.

³⁴⁶ See above, p. 101.

³⁴⁷ Panel Report, *US – Gambling*, para. 6.462.

³⁴⁸ *Ibid.*, paras. 6.463-6.465.

³⁴⁹ *Ibid.*, para. 6.465.

³⁵⁰ Whether trade restrictions on the products of child labour can be justified as necessary to protect the public morals in the importing countries is disputed. See L. Brittan, ‘How to make trade liberalization popular’, *World Economy*, vol.18 (1995), p.761. Brittan pointed out that since for many families in developing countries child labour is a necessary for survival; trade restrictions on the products of child labour would therefore be morally unacceptable.

production of biomass relate to production consistent with minimum labour standards and basic human rights.³⁵¹ It could be argued that the sale or use in the Netherlands of biomass (or biofuels from biomass) produced inconsistently with these specific Cramer sustainability criteria would offend the core ‘standards of right and wrong’ of the Dutch population, and that the sale or use of such biomass should and could therefore be banned on the basis of Article XX(a). Whether the same reasoning also applies to livestock products produced inconsistently with animal welfare requirements, depends on whether in the Netherlands ‘public morals’, i.e. the core ‘standards of right and wrong’, also include ‘standards’ on animal welfare. In most WTO Member countries, this would definitely not be the case, but the question is whether this is the case in the Netherlands.

The dangers to international trade of an overly broad interpretation of the concept of ‘public morals’ and, thus, of the scope of application of Article XX(a) are obvious. Awareness of these dangers among WTO Members may explain why to date this ground for justification has not yet been applied in GATT disputes.

3.2.4.2 Is the measure ‘necessary’ to protect public morals?

As discussed above, it is not enough for Member to argue successfully that the policy objective of the measure concerned is the protection of public morals. The measure concerned must also be ‘necessary’ for the protection of the public morals of the Member adopting the measure. The ‘necessity’ requirement of Article XX(a) has never been the subject of dispute settlement. It is most likely, however, that if a panel or the Appellate Body would in the future be asked to interpret and apply the ‘necessity’ requirement of Article XX(a), they will follow the now well established case law on the ‘necessity’ requirement of Article XX(b) and (d).³⁵² Whether an import ban on *foie gras* meets the ‘necessity’ requirement of Article XX(a) will therefore depend on whether there is an alternative, less trade-restrictive measure that a Member could reasonably be expected to employ to protect its ‘public morals’. To establish what can ‘reasonably be expected’ from a Member, panels and the Appellate Body will weigh the factors discussed above in the context of the ‘necessity’ requirement of Article XX(b) and (d).³⁵³

3.2.5 Acquisition or distribution of products in short supply

Finally, Article XX(j) of the GATT 1994 concerns measures ‘essential to the acquisition or distribution of products in general or local short supply’. There is no case law on this exception, but it is clear that an otherwise GATT-inconsistent

measure can be justified under Article XX(j) only if:

- the policy objective pursued by the measure at issue is ‘the acquisition or distribution of products in short supply’; and
- the measure at issue must be ‘essential’ for the acquisition or distribution of products in short supply.

Whatever the precise scope of the concept of ‘products in short supply’ may be, it is unlikely that in the Netherlands biomass or livestock products are products in short supply. It is therefore unlikely that the policy objectives of measures taken with regard to biomass or to livestock products (to give effect to animal welfare requirements) are ‘the acquisition or distribution of products in short supply’, and that the requirement of the first element of the test under Article XX(j) would be met.

With regard to the second element of this test, it is not clear how the term ‘essential’ must be interpreted. However, on the basis of the ordinary meaning of this term, in its context (in particular the other exceptions of Article XX) and in the light of the object and purpose of the GATT 1994, it seems that this term imposes a stricter requirement than the term ‘necessary’ used in Article XX(a), (b) and (d). In addition, for a measure to be justified under Article XX(j), the provision explicitly states that the measure concerned must be consistent with the principle that all Members are entitled to an equitable share of the international supply of the products in short supply. Moreover, the measure concerned must be discontinued as soon as the shortage of products concerned has ceased to exist.

3.3 Requirements of the chapeau of Article XX of the GATT 1994

As discussed above, Article XX sets out a two-tier test for determining whether a measure that is otherwise inconsistent with GATT obligations can be justified.³⁵⁴ First, a measure must meet the requirements of one of the particular exceptions listed in the paragraphs of Article XX. This part of the test was discussed above. Second, the application of the measure concerned must meet the requirements of the chapeau of Article XX.

The legal requirements imposed by the chapeau of Article XX of the GATT 1994 have been highly relevant in dispute settlement practice. Several of the most controversial decisions by panels and the Appellate Body have turned on these requirements. With regard to measures provisionally justified under one of the paragraphs of Article XX, the chapeau of Article XX imposes:

351 See above, p. 4.

352 See above, p. 99 and 107.

353 See above, p. 99 and 107.

354 See above, p. 99.

the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade.

3.3.1 Object and purpose of the chapeau

With respect to the object and purpose of the chapeau of Article XX, the Appellate Body ruled in *US – Gasoline*:

The chapeau 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. It is, accordingly, important to underscore that the purpose and object of the introductory clauses of Article XX is generally the prevention of ‘abuse of the exceptions of [what was later to become] Article [XX]’.³⁵⁵

Later, in *US – Shrimp*, the Appellate Body stated with regard to the chapeau:

... we consider that it embodies the recognition on the part of WTO Members of the need to maintain a balance of rights and obligations between the right of a Member to invoke one or another of the exceptions of Article XX, specified in paragraphs (a) to (j), on the one hand, and the substantive rights of the other Members under the GATT 1994, on the other hand. Exercise by one Member of its right to invoke an exception, such as Article XX(g), if abused or misused, will, to that extent, erode or render naught the substantive treaty rights in, for example, Article XI:1, of other Members. Similarly, because the GATT 1994 itself makes available the exceptions of Article XX, in recognition of the legitimate nature of the policies and interests there embodied, the right to invoke one of those exceptions is not to be rendered illusory.³⁵⁶

In short, the object and purpose of the chapeau of Article XX is to avoid that the application of provisionally justified measures would constitute a misuse or abuse of the exceptions of Article XX. According to the Appellate Body, a balance must be struck between the right of a Member to invoke an exception under Article XX and the substantive rights of the other Members under the GATT 1994. The chapeau is inserted at the head of the list of ‘General Exceptions’ in Article XX to ensure that this balance is struck, and to prevent abuse.

With respect to the interpretation and application of the chapeau, in *US – Shrimp* the Appellate Body came to the following conclusion:

³⁵⁵ Appellate Body Report, *US – Gasoline*, 22.

³⁵⁶ Appellate Body Report, *US – Shrimp*, para 156.

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 the other Members under varying substantive provisions (e.g. Article XI) of the GATT 1994, so that neither of the competing rights will cancel out the other and thereby distort and nullify or impair the balance of rights and obligations constructed by the Members themselves in that Agreement. The location of the line of equilibrium, as expressed in the chapeau, is not fixed and unchanging; the line moves as the kind and the shape of the measures at stake vary and as the facts making up specific cases differ.³⁵⁷

The interpretation and application of the chapeau in a particular case is a search for the appropriate *line of equilibrium* between the right of Members to adopt and maintain trade-restrictive legislation and measures that pursue certain legitimate societal values or interests *and* the right of other Members to trade. The search for this line of equilibrium is guided by the requirements set out in the chapeau that the application of the trade-restrictive measure may not constitute:

- either ‘arbitrary or unjustifiable discrimination between countries where the same conditions prevail’; or
- ‘a disguised restriction on international trade’.

3.3.2 Arbitrary or unjustifiable discrimination

For a measure to be justified under Article XX, the application of that measure, pursuant to the chapeau of Article XX, should *not* constitute ‘arbitrary or unjustifiable discrimination between countries where the same conditions prevail’. In *US – Gasoline*, the Appellate Body found that the ‘discrimination’ at issue in the chapeau of Article XX must necessarily be different from the discrimination addressed in other provisions of the GATT 1994, such as Articles I and III. The Appellate Body stated:

*The enterprise of applying Article XX would clearly be an unprofitable one if it involved no more than applying the standard used in finding that the baseline establishment rules were inconsistent with Article III:4. That would also be true if the finding were one of inconsistency with some other substantive rule of the *General Agreement*.³⁵⁸*

As the Appellate Body noted:

The provisions of the chapeau cannot logically refer to the same standard(s) by which a violation of a substantive rule has been determined to have occurred. To proceed down that path would be both to empty the chapeau of its contents and to deprive the

³⁵⁷ *Ibid.*, para. 159.

³⁵⁸ Appellate Body Report, *US – Gasoline*, 23.

exceptions in paragraphs (a) to (j) of meaning. Such recourse would also confuse the question of whether inconsistency with a substantive rule existed, with the further and separate question arising under the chapeau of Article XX as to whether that inconsistency was nevertheless justified.³⁵⁹

According to the Appellate Body, the chapeau of Article XX does not prohibit discrimination *per se*, but rather, *arbitrary* and *unjustifiable* discrimination.

In *US – Gasoline*, the Appellate Body also addressed the meaning of the words ‘discrimination *between countries* where the same conditions prevail’. According to the Appellate Body, these words refer not only to discrimination *between exporting countries* where the same conditions prevail, but also to discrimination *between an importing country and an exporting country* where the same conditions prevail.³⁶⁰

To date, panels and/or the Appellate Body have found in a number of cases that the application of a provisionally justified measure constituted a means of unjustifiable or arbitrary discrimination. In *US – Gasoline* the Appellate Body concluded that the measure at issue constituted ‘unjustifiable discrimination’ for the following reasons:

We have above located two omissions on the part of the United States: to explore adequately means, including in particular cooperation with the governments of Venezuela and Brazil, of mitigating the administrative problems relied on as justification by the United States for rejecting individual baselines for foreign refiners; and to count the costs for foreign refiners that would result from the imposition of statutory baselines. In our view, these two omissions go well beyond what was necessary for the Panel to determine that a violation of Article III:4 had occurred in the first place. The resulting discrimination must have been foreseen, and was not merely inadvertent or unavoidable. In the light of the foregoing, our conclusion is that the baseline establishment rules in the Gasoline Rule, in their application, constitute ‘unjustifiable discrimination’.³⁶¹

The Appellate Body decided that the application of the measure at issue constituted unjustifiable discrimination because the discrimination resulting from the measure at issue ‘must have been foreseen’, i.e. it was deliberate. The discrimination was ‘unjustifiable’ because it ‘was not merely inadvertent or unavoidable’.

In *US – Shrimp*, the Appellate Body found that, in order for a measure to be applied in a manner that would constitute ‘arbitrary or unjustifiable discrimination between countries where the same conditions prevail’, three elements must exist:

First, the application of the measure must result in discrimination. As we stated in United States – Gasoline, the nature and quality of this discrimination is different from the discrimination in the treatment of products which was already found to be inconsistent with one of the substantive obligations of the GATT 1994, such as Articles I, III or XI. Second, the discrimination must be arbitrary or unjustifiable in character ... Third, this discrimination must occur between countries where the same conditions prevail. In United States – Gasoline, we accepted the assumption of the participants in that appeal that such discrimination could occur not only between different exporting Members, but also between exporting Members and the importing Member concerned.³⁶²

In *US – Shrimp*, the Appellate Body further elaborated this test and stated:

It may be quite acceptable for a government, in adopting and implementing a domestic policy, to adopt a single standard applicable to all its citizens throughout that country. However, it is not acceptable, in international trade relations, for one WTO Member to use an economic embargo to require other Members to adopt essentially the same comprehensive regulatory program, to achieve a certain policy goal, as that in force within that Member’s territory, without taking into consideration different conditions which may occur in the territories of those other Members.

We believe that discrimination results not only when countries in which the same conditions prevail are differently treated, but also when the application of 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.³⁶³

Applying its test to the US measure at issue in *US – Shrimp*, the Appellate Body came to the following conclusion:

Section 609, in its application, imposes a single, rigid and unbending requirement that countries applying for certification ... adopt a comprehensive regulatory program that is essentially the same as the United States’ program, without inquiring into the

359 *Ibid.*

360 *Ibid.*

361 *Ibid.*, 28-9.

362 Appellate Body Report, *US – Shrimp*, para. 150. See also Panel Report, *EC – Tariff Preferences*, paras. 7.225-235.

363 *Ibid.*, paras. 164-165.

appropriateness of that program for the conditions prevailing in the exporting countries. Furthermore, there is little or no flexibility in how officials make the determination for certification pursuant to these provisions. In our view, this rigidity and inflexibility also constitute 'arbitrary discrimination' within the meaning of the chapeau.³⁶⁴

The Appellate Body thus decided that discrimination may also result when the same measure is applied on countries where different conditions prevail. When a measure is applied without any regard for the difference in conditions between countries and this measure is applied in a rigid and inflexible manner, the application of the measure may constitute 'arbitrary discrimination' within the meaning of the chapeau of Article XX.

To implement the recommendations and rulings in *US – Shrimp*, the United States amended the measure at issue in this case. In the opinion of Malaysia, however, this amended measure was still WTO inconsistent, and Malaysia therefore challenged the amended measure before an Article 21.5 panel. This Panel in *US – Shrimp (Article 21.5 – Malaysia)* concluded that, unlike the original US measure, the amended measure was justified under Article XX and thus WTO-consistent. In the appeal from this Panel report, the Appellate Body held:

In our view, there is an important difference between conditioning market access on the adoption of essentially the same programme, and conditioning market access on the adoption of a programme comparable in effectiveness. Authorizing an importing Member to condition market access on exporting Members putting in place regulatory programmes comparable in effectiveness to that of the importing Member gives sufficient latitude to the exporting Member with respect to the programme it may adopt to achieve the level of effectiveness required. It allows the exporting Member to adopt a regulatory programme that is suitable to the specific conditions prevailing in its territory. As we see it, the Panel correctly reasoned and concluded that conditioning market access on the adoption of a programme comparable in effectiveness, allows for sufficient flexibility in the application of the measure so as to avoid 'arbitrary or unjustifiable discrimination'.³⁶⁵

Note that the Appellate Body thus seems to introduce in the chapeau of Article XX an 'embryonic' and 'soft' requirement on Members to recognize the equivalence of foreign measures comparable in effectiveness.³⁶⁶ The Appellate Body found in *US – Shrimp (Article 21.5 – Malaysia)* that the amended US measure at issue in the

implementation dispute was sufficiently flexible to meet the standards of the chapeau.³⁶⁷ The Appellate Body added:

a measure should be designed in such a manner that there is sufficient flexibility to take into account the specific conditions prevailing in any exporting Member, including, of course, Malaysia. Yet this is not the same as saying that there must be specific provisions in the measure aimed at addressing specifically the particular conditions prevailing in every individual exporting Member. Article XX of the GATT 1994 does not require a Member to anticipate and provide explicitly for the specific conditions prevailing and evolving in every individual Member.³⁶⁸

The application of measures adopted to give effect to the Cramer sustainability criteria would constitute arbitrary discrimination within the meaning of the chapeau of Article XX if the application of these measures would make market access for biomass conditional upon the adoption by the exporting country of *essentially the same* sustainability criteria for the production of biomass. However, it follows from the Appellate Body's ruling in *US – Shrimp (Article 21.5 - Malaysia)* that the application of measures to give effect to the Cramer sustainability criteria would *not* constitute arbitrary discrimination if the application of these measures would make market access for biomass conditional on the adoption by the exporting country of a programme for the sustainable production of biomass *comparable in effectiveness*. More generally, if the Netherlands were to apply measures adopted to give effect to the Cramer sustainability requirements (such a certification procedure) in an overly rigid and inflexible manner, the application of such measures would constitute arbitrary discrimination. The same reasoning applies to measures adopted to give effect to animal welfare requirements.

The Appellate Body in *US – Shrimp* also addressed the question of whether the application of the measure at issue constituted an 'unjustifiable discrimination' within the meaning of the chapeau. The Appellate Body noted the following:

Another aspect of the application of Section 609 [of Public Law 101-162] that bears heavily in any appraisal of justifiable or unjustifiable discrimination is the failure of the United States to engage the appellees, as well as other Members exporting shrimp to the United States, in serious, across-the-board negotiations with the objective of concluding bilateral or multilateral agreements for the protection and conservation of sea turtles, before enforcing the import prohibition against the shrimp exports of those other Members.³⁶⁹

364 *Ibid.*, paras. 164, 165 and 177.

365 Appellate Body Report, *US – Shrimp (Article 21.5 – Malaysia)*, para. 144.

366 See also, G. Marceau and J. Trachtmann, 'A map of the WTO law of domestic regulations of goods', in: G. Bermann and P. Mavroidis, *Trade and Human Health and Safety* (Cambridge University Press, 2006), p.42.

367 Appellate Body Report, *US – Shrimp (Article 21.5 – Malaysia)*, paras. 145-8.

368 *Ibid.*, para. 149.

369 Appellate Body Report, *US – Shrimp*, para. 166.

The Appellate Body made three observations in this respect. First, in enacting Section 609, the Congress of the United States expressly recognized the importance of securing international agreements for the protection and conservation of the sea turtle species. Second, the protection and conservation of highly migratory species of sea turtle, i.e. the very policy objective of the measure, demand concerted and cooperative efforts on the part of the many countries whose waters are traversed in the course of recurrent sea turtle migrations. Third, the United States negotiated and concluded *one* regional international agreement for the protection and conservation of sea turtles, namely, the *Inter-American Convention for the Protection and Conservation of Sea Turtles*.³⁷⁰ The existence of this agreement provided convincing demonstration that an alternative course of action was reasonably open to the United States for securing the legitimate policy goal of its measure, a course of action other than the unilateral and non-consensual procedures of the import prohibition under Section 609. The record does not, however, show that serious efforts were made by the United States to negotiate similar agreements with any other country or group of countries. Finally, the record also does not show that the United States attempted to make use of such international mechanisms that exist to achieve cooperative efforts to protect and conserve sea turtles before imposing the import ban.³⁷¹ The Appellate Body therefore concluded:

*Clearly, the United States negotiated seriously with some, but not with other Members (including the appellees), that export shrimp to the United States. The effect is plainly discriminatory and, in our view, unjustifiable. The unjustifiable nature of this discrimination emerges clearly when we consider the cumulative effects of the failure of the United States to pursue negotiations for establishing consensual means of protection and conservation of the living marine resources here involved.*³⁷²

As the Appellate Body noted, the principal consequence of the failure to pursue negotiations may be seen in the resulting unilateralism evident in the application of Section 609:

As we have emphasized earlier, the policies relating to the necessity for use of particular kinds of TEDs in various maritime areas, and the operating details of these policies, are all shaped by the Department of State, without the participation of the exporting Members. The system and processes of certification are established and administered by the United States agencies alone. The decision-making involved in the

370 *Ibid.*, para. 169.

371 The United States, for example, did not make any attempt to raise the issue of sea turtle mortality due to shrimp trawling in the CITES Standing Committee as a subject requiring concerted action by States.

372 Appellate Body Report, *US – Shrimp*, para. 172.

*grant, denial or withdrawal of certification to the exporting Members, is, accordingly, also unilateral. The unilateral character of the application of Section 609 heightens the disruptive and discriminatory influence of the import prohibition and underscores its unjustifiability.*³⁷³

The extent to which a Member has to seek a multilateral solution to a problem before it may resort to unilateral measures was one of the main issues in *US – Shrimp (Article 21.5 – Malaysia)*. The Appellate Body made it clear that, in order to meet the requirement of the chapeau of Article XX, the Member needs to make serious efforts, in good faith, to negotiate a multilateral solution before resorting to unilateral measures.³⁷⁴ Failure to do so may lead to the conclusion that the discrimination is ‘unjustifiable’.

If the Netherlands were to adopt unilateral measures to give effect to the Cramer sustainability criteria without first undertaking a good faith effort to negotiate international criteria for the sustainable production of biomass, then these measures would constitute unjustifiable discrimination within the meaning of the chapeau of Article XX. The same reasoning applies to measures adopted to give effect to animal welfare requirements.

Finally, note that the Appellate Body stated in *US – Shrimp*, that:

*What is appropriately characterizable as ‘arbitrary discrimination’ or ‘unjustifiable discrimination’, or as a ‘disguised restriction on international trade’ in respect of one category of measures, need not be so with respect to another group or type of measures. The standard of ‘arbitrary discrimination’, for example, under the chapeau may be different for a measure that purports to be necessary to protect public morals than for one relating to the products of prison labour.*³⁷⁵

3.3.3 Disguised restrictions on international trade

With respect to the requirement that the application of a measure does not constitute a ‘disguised restriction on international trade’, the Appellate Body stated in *US – Gasoline*:

the kinds of considerations pertinent in deciding whether the application of a particular measure amounts to ‘arbitrary or unjustifiable discrimination’, may also be taken into account in determining the presence of a ‘disguised restriction’ on international trade.

373 *Ibid.*

374 Appellate Body Report, *US – Shrimp (Article 21.5– Malaysia)*, paras. 115-34.

375 Appellate Body Report, *US – Shrimp*, para. 120.

The fundamental theme is to be found in the purpose and object of avoiding abuse or illegitimate use of the exceptions to substantive rules available in Article XX.³⁷⁶

The Panel in *EC – Asbestos* further clarified the requirement of the chapeau that the application of the measure at issue does not constitute a ‘disguised restriction on international trade’ as follows:

*... a restriction which formally meets the requirements of Article XX(b) will constitute an abuse if such compliance is in fact only a disguise to conceal the pursuit of trade-restrictive objectives. However, as the Appellate Body acknowledged in *Japan – Alcoholic Beverages*, the aim of a measure may not be easily ascertained. Nevertheless, we note that, in the same case, the Appellate Body suggested that the protective application of a measure can most often be discerned from its design, architecture and revealing structure.³⁷⁷*

This approach to establishing whether a measure was applied so as to afford protection was, as discussed above, developed in relation to Article III:2 of the GATT 1994.³⁷⁸ In *EC – Asbestos*, however, the Panel saw no reason why this approach should not be applicable in other circumstances where it is necessary to determine whether a measure is being applied for protective purposes. The Panel in *US – Shrimp (Article 21.5 – Malaysia)* took the same approach.³⁷⁹ In short, a measure that is provisionally justified under one of the paragraphs of Article XX will be considered to constitute ‘a disguised restriction on international trade’ if the design, architecture or structure of the measure at issue reveal that this measure does not pursue the legitimate policy objective on which the provisional justification was based but, in fact, pursues trade-restrictive, i.e. protectionist, objectives. Such a measure cannot be justified under Article XX of the GATT 1994.

4 Other relevant exceptions from obligations under the GATT 1994

In addition to the general exceptions from GATT obligations, discussed in the previous section, the GATT provides for a number of other exceptions that allow Members under specific conditions to adopt or maintain otherwise GATT-inconsistent measures. These exceptions include the national security exception of Article XXI, the economic emergency exception of Article XIX (as elaborated in the *Agreement on Safeguards*), the regional integration exception of Article XXIV, the balance of payments exception of Articles XII and XVIII:B, the infant industry

376 Appellate Body Report, *US – Gasoline*, 25.

377 Panel Report, *EC – Asbestos*, para. 8.236.

378 See above, p. 49.

379 Panel Report, *US – Shrimp (Article 21.5 – Malaysia)*, paras. 5.138-5.144.

exception of Article XVIII:A and the Generalized System of Preferences (GSP) exception of the Enabling Clause. This section addresses only those exceptions that are of particular relevance to the topic of this study, namely, the national security exception and the GSP exception.³⁸⁰

4.1 Security exceptions of Article XXI of the GATT 1994

Article XXI of the GATT 1994, entitled ‘Security Exceptions’, states:

Nothing in this Agreement shall be construed

- a. *to require any [Member] to furnish any information the disclosure of which it considers contrary to its essential security interests; or*
- b. *to prevent any [Member] from taking any action which it considers necessary for the protection of its essential security interests*
 - i. *relating to fissionable materials or the materials from which they are derived;*
 - ii. *relating to the traffic in arms, ammunition and implements of war and to such traffic in other goods and materials as is carried on directly or indirectly for the purpose of supplying a military establishment;*
 - iii. *taken in time of war or other emergency in international relations; or*
- c. *to prevent any [Member] from taking any action in pursuance of its obligations under the United Nations Charter for the maintenance of international peace and security.*

Unlike Article XX, Article XXI has not played a significant role in the practice of dispute settlement under the GATT 1947, or the WTO to date. Article XXI has been invoked in only a few disputes.³⁸¹ Nevertheless, this provision is not without importance. WTO Members do, on occasion, take trade-restrictive measures, either unilaterally or multilaterally, against other Members as a means to achieve national or international security and peace.

380 This section is based on and in parts further elaborates and updates P. Van den Bossche, *The Law and Policy of the World Trade Organization* (Cambridge University Press, 2005, reprinted 2006), pp.628-632 (national security exception) and pp.679-683 (GSP exception). See pp.633-679 for an analysis of the exceptions not discussed here. www.cambridge.org/catalogue/catalogue.asp?isbn=9780521529815.

381 Article XXI of the GATT was invoked as a defence in *US – Export Restraints* (1949), *US – Imports of Sugar from Nicaragua* (1984), *US – Trade Measures Affecting Nicaragua* (1986), *EEC – Trade Measures taken against the Socialist Republic of Yugoslavia* (1991), and *US – The Cuban Liberty and Democratic Solidarity Act (Helms–Burton Act)* (1996).

Members taking such measures will seek justification for these measures under Article XXI.

In the context of this study, Articles XXI(b)(iii) and XXI(c) are of particular interest. Article XXI(b)(iii) concerns ‘any action which [a Member] considers necessary for the protection of its essential security interests ... taken in time of war or other emergency in international relations’. Article XXI(c) concerns ‘any action in pursuance of its obligations under the United Nations Charter for the maintenance of international peace and security.’

4.1.1 Protection of essential security interests

In international relations, national security takes precedence over the benefits of trade for various reasons and in various situations. One situation in which national security takes precedence over trade is when a State considers that it is necessary to restrict trade in order to protect strategic domestic production capabilities from import competition. The judgement as to which production capabilities deserve to be qualified as strategically important differs among countries and is, to a great extent, a political decision.

Defined broadly, energy production capabilities might be considered by some Members to be production capabilities of strategic importance to national security. While the GATT 1994 allows for considerable leeway to preserve national industries of strategic importance (e.g. by providing protection through import tariffs, production subsidies or government procurement), in some situations, Article XXI may provide justification for otherwise GATT-inconsistent measures. A question that immediately arises, however, is the question of the ‘justiciability’ of Article XXI. As a matter of principle, Members must be able to seek judicial review of national measures taken by other Members pursuant to Article XXI. However, it is not clear how far such a review *can* go. It remains to be seen whether a panel or the Appellate Body will define what an ‘essential national security interest’ is and what is ‘necessary’ to protect such an interest. The scope for judicial review seems to be limited by the language of Article XXI(b) itself. Article XXI(b) refers to what the *Member concerned considers* necessary for the protection of its essential security interests. The use of the term ‘considers’ in Article XXI(b) seems to make the application of the exception largely self-judging and not suitable for review by panels and the Appellate Body. However, as stated above, it is imperative that a certain degree of judicial review be maintained; otherwise the provision would be prone to abuse without redress.³⁸² At a minimum, panels should have the authority to conduct an examination as to whether the explanation provided by the Member

concerned is reasonable, or whether the measure constitutes an apparent abuse.³⁸³ Uncertainty regarding the ‘justiciability’ of the exceptions of Article XXI(b), and their requirements, was apparent in the few cases in which Article XXI(b) has been raised.³⁸⁴

4.1.2 Implementation of obligations under the UN Charter

As explained above, Article XXI(c) of the GATT 1994 allows WTO Members to take actions required under the United Nations Charter for the maintenance of international peace and security. This has been generally interpreted to mean that Members may depart from their GATT obligations in order to implement economic sanctions imposed by the United Nations. Article 41 of the *UN Charter* empowers the Security Council to impose economic sanctions pursuant to Article 39 of the Charter, once it has determined the existence of any threat to the peace, breach of the peace, or act of aggression. Note, however, that the International Confederation of Free Trade Unions (ICFTU) has advocated a broader interpretation of the scope of Article XXI(c) than is now commonly accepted. According to the ICFTU, the obligations under the *UN Charter* for the maintenance in international peace and security also include obligations relating to minimum labour standards set out in ILO Conventions. Measures taken to implement these minimum labour standards would thus be measures within the meaning of Article XXI(c) and be justified even though they are inconsistent with basic GATT obligations. Presumably a similar argument could be made for measures taken to implement human rights obligations set out in UN human rights agreements. To date, however, there has been very little support for this broad interpretation of the scope of Article XXI(c) of the GATT 1994.³⁸⁵

383 See further also W. Cann, *Creating standards and accountability for the use of the WTO security exception*, *Yale Journal of International Law*, vol. 26 (2001), p.426.

384 See e.g. *US – Imports of Sugar from Nicaragua* (1984) and *US – Cuban Liberty and Democratic Solidarity Act (Helms–Burton Act)* (1996).

385 Note that the issue of ‘justiciability’, discussed above with regard to Article XXI(b), appears to be less problematic for the exception provided in Article XXI(c), given that this provision does not refer to what the Member invoking the exception ‘considers’ to be necessary. The basis of the departure from GATT obligations must be an obligation under the *UN Charter*, and a panel can assess whether there is such an obligation.

382 See the GATT Panel’s statement in *US – Trade Measures Affecting Nicaragua*, in GATT Activities 1986, pp.58-9.

4.2 GSP exception and the Enabling Clause of the GATT 1994

The 1979 GATT decision on *Differential and More Favourable Treatment, Reciprocity, and Fuller Participation of Developing Countries*, commonly referred to as the ‘Enabling Clause’, is now an integral part of the GATT 1994, Paragraph 1 states:

Notwithstanding the provisions of Article I of the General Agreement, [Members] may accord differential and more favourable treatment to developing countries, without according such treatment to other [Members].

Paragraph 2(a) of the Enabling Clause provides that the differential and more favourable treatment referred to in paragraph 1 includes:

Preferential tariff treatment accorded by [developed-country Members] to products originating in [developing-country Members] in accordance with the Generalized System of Preferences ...³⁸⁶

As the Appellate Body ruled in *EC – Tariff Preferences*, the Enabling Clause operates as an ‘exception’ to Article I:1 of the GATT 1994.³⁸⁷ Paragraph 1 of the Enabling Clause explicitly exempts Members from complying with the obligation contained in Article I:1 for the purposes of providing differential and more favourable treatment to developing countries.³⁸⁸ The Enabling Clause authorizes developed-country Members to grant enhanced market access to products from developing countries extending beyond the access granted to like products from developed countries.³⁸⁹ This deviation from the MFN obligation of Article I:1 is allowed only when, and to the extent that, the conditions set out in paragraphs 3 and 4 of the Enabling Clause are met. Paragraph 3 sets out the following substantive conditions:

Any differential and more favourable treatment provided under this clause:

- a. *shall be designed to facilitate and promote the trade of developing countries and not to raise barriers to or create undue difficulties for the trade of any other [Members];*
- b. *shall not constitute an impediment to the reduction or elimination of tariffs and other restrictions to trade on a most-favoured-nation basis;*
- c. *shall in the case of such treatment accorded by [developed-country Members] to developing countries be designed and, if necessary, modified, to respond positively to the development, financial and trade needs of developing countries.*

Paragraph 4 sets out the procedural conditions for the introduction, modification and withdrawal of a preferential measure for developing countries. Pursuant to paragraph 4, Members granting preferential tariff treatment to developing countries must notify the WTO and afford adequate opportunity for prompt consultations at the request of any interested Member with respect to any difficulty or matter that may arise.

Note that most developed-country Members grant preferential tariff treatment to imports from developing countries under their respective Generalized System of Preferences (GSP) schemes. The Enabling Clause thus plays a vital role in promoting trade as a means of stimulating economic growth and development.³⁹⁰ Of particular importance in the context of this study, however, is the question whether developed countries may under the Enabling Clause give some developing countries *additional* preferential tariff treatment. This was the central question in *EC – Tariff Preferences*. Council Regulation (EC) No. 2501/2001 of 10 December 2001, the EC’s Generalized System of Preferences Regulation, provided for five preferential tariff ‘arrangements’, namely:

- the ‘General Arrangements’;
- special incentive arrangements for the protection of labour rights;
- special incentive arrangements for the protection of the environment;
- special arrangements for least-developed countries; and
- special arrangements to combat drug production and trafficking.

The General Arrangements, which provide for tariff preferences for all developing countries, and the special arrangements for least-developed countries, are not problematic. Both arrangements are justified under the Enabling Clause: the General Arrangements under paragraph 2(a), discussed above; and the special arrangements for least-developed countries under paragraph 2(d). The latter provision states that the Enabling Clause also covers:

386 The footnote in the original reads: ‘As described in the Decision of the Contracting Parties of 25 June 1971, relating to the establishment of ‘generalized, non-reciprocal and non-discriminatory preferences beneficial to the developing countries’ (BISD 18S/24).

387 See Appellate Body Report, *EC – Tariff Preferences*, para. 99.

388 See *ibid.*, para. 90. Note that the Enabling Clause does not merely allow developed country Members to deviate from Article I:1 in the pursuit of ‘differential and more favourable treatment’ for developing countries; it encourages them to do so.

389 See *ibid.*, para. 106.

390 See Appellate Body Report, *EC – Tariff Preferences*, para. 106.

Special treatment of the least developed among the developing countries in the context of any general or specific measures in favour of developing countries.

However, questions as to GATT-consistency arise with regard to the other preferential arrangements, i.e. the special incentive arrangements for the protection of labour rights, the special incentive arrangements for the protection of the environment and the special arrangements to combat drug production and trafficking. Only some developing countries are beneficiaries of these special arrangements. For example, additional tariff preferences under the special incentive arrangements for the protection of labour rights and the special incentive arrangements for the protection of the environment are restricted to those countries that 'are determined by the European Communities to comply with certain labour [or] environmental policy standards', respectively. Preferences under the special arrangements to combat drug production and trafficking (the 'Drug Arrangements') were provided only to 11 Latin American countries and Pakistan.³⁹¹

While India, the complainant in *EC – Tariff Preferences*, challenged, in its panel request, the WTO-consistency of the Drug Arrangements as well as the special incentive arrangements for the protection of labour rights and the environment, it later decided to limit its complaint to the Drug Arrangements. Accordingly, the *EC – Tariff Preferences* dispute, and the rulings in that case, concerned only the WTO-consistency of the Drug Arrangements. However, it is clear that the rulings in this case are also of relevance to other special arrangements.

The main substantive issue disputed between India and the European Communities in *EC – Tariff Preferences* was whether the Drug Arrangements were consistent with paragraph 2(a) of the Enabling Clause, and, in particular, the requirement of non-discrimination in footnote 3 thereto, quoted above.³⁹² On this issue, the Panel in *EC – Tariff Preferences* found that:

*the clear intention of the negotiators was to provide GSP equally to all developing countries and to eliminate all differentiation in preferential treatment to developing countries ...*³⁹³

According to the Panel, the term 'non-discriminatory' in footnote 3 requires that identical tariff preferences under GSP schemes be provided to all developing countries without differentiation.³⁹⁴ As the Drug Arrangements did not provide identical tariff preferences to *all* developing countries, the Panel concluded that the Drug Arrangements were inconsistent with paragraph 2(a) of the Enabling Clause and, in particular, the requirement of non-discrimination in footnote 3 thereto.³⁹⁵

On appeal, the Appellate Body modified this finding.³⁹⁶ After a careful examination of the text, the context of footnote 3 to paragraph 2(a) of the Enabling Clause, and the object and purpose of the *WTO Agreement* and the Enabling Clause, the Appellate Body came to the conclusion that:

*the term 'non-discriminatory' in footnote 3 does not prohibit developed-country Members from granting different tariffs to products originating in different GSP beneficiaries, provided that such differential tariff treatment meets the remaining conditions in the Enabling Clause. In granting such differential tariff treatment, however, preference-granting countries are required, by virtue of the term 'non-discriminatory', to ensure that identical treatment is available to all similarly-situated GSP beneficiaries, that is, to all GSP beneficiaries that have the 'development, financial and trade needs' to which the treatment in question is intended to respond.*³⁹⁷

In other words, a developed-country Member may grant additional preferential tariff treatment to some, and not to other, developing-country Members, as long as additional preferential tariff treatment is available to all *similarly situated* developing-country Members. *Similarly situated* developing-country Members are all those that have the development, financial and trade needs to which additional preferential tariff treatment is intended to respond.

The determination of whether developing-country Members are similarly situated must be based on objective and transparent criteria (applied with due process). With respect to the Drug Arrangements of the European Communities, however, the Appellate Body found in *EC – Tariff Preferences* that these arrangements provided for a *closed* list of 12 identified beneficiaries and contained no criteria or standards to provide a basis for distinguishing developing-country Members which are beneficiaries under the Drug Arrangements from other developing-country Members.³⁹⁸ The Appellate Body therefore upheld – albeit for different reasons – the

391 See Appellate Body Report, *EC – Tariff Preferences*, para. 3. Preferences under the Drug Arrangements were provided to Bolivia, Colombia, Costa Rica, Ecuador, El Salvador, Guatemala, Honduras, Nicaragua, Pakistan, Panama, Peru and Venezuela.

392 The requirement of non-discrimination is derived from the words 'non-discriminatory preferences' in footnote 3. See above, footnote 386, on p. 132.

393 Panel Report, *EC – Tariff Preferences*, para. 7.144.

394 *Ibid.*, paras. 7.161 and 7.176.

395 *Ibid.*, para. 7.177.

396 Appellate Body Report, *EC – Tariff Preferences*, para. 174.

397 *Ibid.*, para. 173.

398 *Ibid.*, paras. 187 and 188.

Panel's conclusion that the European Communities 'failed to demonstrate that the Drug Arrangements are justified under paragraph 2(a) of the Enabling Clause'.²⁷⁶

Note that under the EC GSP scheme, biofuels are granted tariff preferences. Biofuels imported from least-developed countries even benefit from zero duties under the Everything but Arms scheme of the European Communities.³⁹⁹ In the context of this study, the question arises, however, whether it would be GATT-consistent to grant (additional) preferential tariff treatment to biomass (or biofuels from biomass) from developing countries, if such biomass is produced consistently with the Cramer sustainability criteria. The ruling of the Appellate Body in *EC – Tariff Preferences* suggests that such preferential tariff treatment – which would obviously constitute a violation of the MFN treatment obligation of Article I:1 of the GATT 1994 – would be justified under the Enabling Clause provided that the (additional) preferential tariff treatment is granted to all developing-country Members that are *similarly situated*, i.e. that have the development, financial and trade needs (e.g. food security, respect for minimum labour standards and human rights, protection of the local environment, regional and national economic prosperity) to which additional preferential tariff treatment is intended to respond.

5 Relevant obligations under the *TBT Agreement*

As discussed above, trade in goods is often obstructed by non-tariff barriers.⁴⁰⁰ These non-tariff barriers take many different forms, but one of the most troublesome is the technical barrier to trade (TBT). In modern society, products are often subject to technical requirements relating to their characteristics and/or the manner in which they are produced, i.e. processes and production methods (PPMs).⁴⁰¹ The purpose of these requirements may be the protection of life or health, the protection of the environment, the prevention of deceptive practices, or to ensure the quality of products. Regardless their legitimacy, however, these requirements often constitute formidable barriers to trade. Moreover, procedures set up to verify and/or certify whether a product meets certain requirements may also obstruct trade. In WTO law, these technical barriers to trade are divided into two categories:

- the general category of technical barriers to trade, for which rules have been set out in the *TBT Agreement*; and
- a special category of technical barriers to trade, namely, sanitary and phytosanitary measures, for which rules are provided in the *SPS Agreement*.

399 See R. Howse, P van Bork and C. Hedebrand, *WTO Disciplines and Biofuels: Opportunities and Constraints in the Creation of a Global Marketplace*, IPC Discussion Paper, October 2006.

400 See above, p. 88.

401 See above, p. 8-9.

For reasons explained above, this study does not deal with the rules on sanitary and phytosanitary measures set out in the *SPS Agreement*.⁴⁰²

This section focuses on the rules applicable to the general category of technical barriers, as set out in the *TBT Agreement*.⁴⁰³ It first addresses the scope of application of the *TBT Agreement* and then, successively, the main obligations under the *TBT Agreement*. These obligations of the *TBT Agreement* reflect several principles that are also found in the GATT 1994, such as: the MFN treatment obligation, the national treatment obligation and the obligation to refrain from creating unnecessary obstacles to international trade. In *EC – Asbestos*, the Appellate Body observed that the *TBT Agreement* intends to further the objectives of the GATT 1994. However, it immediately noted that the *TBT Agreement* does so through a specialized legal regime, containing different and additional obligations to those of the GATT 1994.⁴⁰⁴

5.1 Scope of application of the *TBT Agreement*

With respect to the scope of application of the *TBT Agreement*, this section distinguishes between the scope of application *ratione materiae*, i.e. the types of measure to which the agreement applies, and the scope of application *ratione personae*, i.e. the entities to whom rules of the *TBT Agreement* apply.

5.1.1 Scope of application *ratione materiae*

As the Appellate Body stated in *EC – Asbestos*, the *TBT Agreement* applies to a 'limited class of measures'.⁴⁰⁵ The rules of the *TBT Agreement* apply to:

- technical regulations;
- standards; and
- conformity assessment procedures.

These three types of measure are defined in Annex 1 to the *TBT Agreement*.

402 See above, p. 18.

403 This section on the *TBT Agreement* is based on P. Van den Bossche, D. Prévost and Marielle Mathee, *WTO Rules on Technical Barriers to Trade*, Maastricht Faculty of Law Working Paper 2005-6, available at www.unimaas.nl/default.asp?template=werkveld.htm&id=F60BL5P00MJ0466V63M6&taal=nl.

404 See Appellate Body Report, *EC – Asbestos*, para. 80. Therefore, caution needs to be used when transposing interpretation the interpretations given to these obligations under the GATT 1994 to the similar provisions in the *TBT Agreement*. The different context, structure and formulation of provisions of the *TBT Agreement*'s provisions can result in an interpretation that deviates from previously pronounced interpretations under the GATT 1994.

405 Appellate Body Report, *EC – Asbestos*, para. 80.

5.1.1.1 Technical regulations

In Annex 1.1, a technical regulation is defined as:

... [a] 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.

For example, a law requiring that batteries be rechargeable, a law requiring that mineral water be sold in glass bottles only, or a law requiring that gasoline be mixed with ethanol are all technical regulations within the meaning of the *TBT Agreement*.

In two disputes to date, *EC – Asbestos* and *EC – Sardines*, the panels and the Appellate Body had occasion to examine whether the measures at issue were ‘technical regulations’ falling within the scope of the *TBT Agreement*. In *EC – Asbestos*, the measure at issue, a French decree, consisted of, on the one hand, a general ban on asbestos and asbestos-containing products and, on the other, limited exceptions referring to situations in which asbestos-containing products would be allowed. The Panel concluded that the ban itself was not a technical regulation, whereas the exceptions to the ban were.⁴⁰⁶ On appeal, the Appellate Body reversed the Panel’s finding that the measure at issue did not constitute a technical regulation. In addressing this issue, the Appellate Body first firmly rejected the Panel’s approach of considering separately the ban and the exceptions to the ban. According to the Appellate Body, the ‘proper legal character’ of the measure cannot be determined unless the measure is looked at as a whole. The Appellate Body stated:

Article 1 of the Decree contains broad, general prohibitions on asbestos and products containing asbestos. However, the scope and generality of those prohibitions can only be understood in light of the exceptions to it which, albeit for a limited period, permit, inter alia, the use of certain products containing asbestos and, principally, products containing chrysotile asbestos fibres. The measure is, therefore, not a total prohibition on asbestos fibres, because it also includes provisions that permit, for a limited duration, the use of asbestos in certain situations. Thus, to characterize the measure simply as a general prohibition, and to examine it as such, overlooks the complexities of the measure, which include both prohibitive and permissive elements.⁴⁰⁷

The Appellate Body thus concluded that the measure at issue was to be examined as an integrated whole, taking into account as appropriate the prohibitive and the permissive elements that are part of it.⁴⁰⁸

The Appellate Body then examined whether the measure at issue, considered as a whole, was a technical regulation within the meaning of the *TBT Agreement*. On the basis of the definition of a ‘technical regulation’ of Annex 1.1, quoted above, the Appellate Body set out a number of considerations for determining whether a measure is a technical regulation. This section discusses these considerations.

First, for a measure to be a ‘technical regulation’, it must ‘lay down’ – i.e. set forth, stipulate or provide – ‘product characteristics’. With respect to the term ‘characteristics’, the Appellate Body noted:

*... the ‘characteristics’ of a product include, in our view, any objectively definable ‘features’, ‘qualities’, ‘attributes’, or other ‘distinguishing mark’ of a product. Such ‘characteristics’ might relate, inter alia, to a product’s composition, size, shape, colour, texture, hardness, tensile strength, flammability, conductivity, density, or viscosity. In the definition of a ‘technical regulation’ in Annex 1.1, the *TBT Agreement* itself gives certain examples of ‘product characteristics’ – ‘terminology, symbols, packaging, marking or labelling requirements’. These examples indicate that ‘product characteristics’ include, not only features and qualities intrinsic to the product itself, but also related ‘characteristics’, such as the means of identification, the presentation and the appearance of a product.⁴⁰⁹*

The Appellate Body also noted that a technical regulation may be confined to laying down only one or a few product characteristics.

Second, a ‘technical regulation’ must regulate the characteristics of products in a binding or compulsory fashion. According to the Appellate Body, it follows that:

... with respect to products, a ‘technical regulation’ has the effect of prescribing or imposing one or more ‘characteristics’ – ‘features’, ‘qualities’, ‘attributes’, or other ‘distinguishing mark’.⁴¹⁰

Product characteristics may be prescribed or imposed with respect to products in either a positive or a negative form. That is, the document may provide, positively, that products must possess certain ‘characteristics’, or the document may require,

406 Panel Report, *EC – Asbestos*, paras. 8.63 and 8.70.

407 Appellate Body Report, *EC – Asbestos*, para. 64.

408 *Ibid.*

409 *Ibid.*, para. 67.

410 *Ibid.*, para. 68.

negatively, that products must not possess certain ‘characteristics’. In both cases, the legal result is the same: the document ‘lays down’ certain binding ‘characteristics’ for products.⁴¹¹

Third, a ‘technical regulation’ must be applicable to an identifiable product or group of products. Otherwise, enforcement of the regulation will be, in practical terms, impossible. Clearly, identification of the product coverage of a technical regulation is required. The Panel in *EC – Asbestos* interpreted this to mean that a ‘technical regulation’ must apply to ‘given’ products which are actually named, identified or specified in the regulation. The Appellate Body disagreed. Nothing in the text of the *TBT Agreement* suggests that the products concerned need be named or otherwise expressly identified in a ‘technical regulation’. The Appellate Body noted that:

*... there may be perfectly sound administrative reasons for formulating a ‘technical regulation’ in a way that does not expressly identify products by name, but simply makes them identifiable – for instance, through the ‘characteristic’ that is the subject of regulation.*⁴¹²

On the basis of the above three considerations, the Appellate Body examined the measure at issue in *EC – Asbestos*, the French decree, noting that the first and second paragraphs of Article 1 of the Decree imposed a prohibition on asbestos fibres. According to the Appellate Body, prohibition on these fibres does not, in itself, prescribe or impose any ‘characteristics’ on asbestos fibres but simply bans them in their natural state. Accordingly, if this measure consisted only of a prohibition on asbestos fibres, it might not constitute a ‘technical regulation’. The Appellate Body then noted, however:

An integral and essential aspect of the measure is the regulation of ‘products containing asbestos fibres’, which are also prohibited by Article 1, paragraphs I and II of the decree. It is important to note here that, although formulated negatively – products containing asbestos are prohibited – the measure, in this respect, effectively prescribes or imposes certain objective features, qualities or ‘characteristics’ on all products. That is, in effect, the measure provides that all products must not contain asbestos fibres. Although this prohibition against products containing asbestos applies to a large number of products, and although it is, indeed, true that the products to which this prohibition applies cannot be determined from the terms of the measure itself, it seems to us that the products covered by the measure are identifiable: all products must be

411 *Ibid.*, para. 69.

412 *Ibid.*, para. 70.

*asbestos free; any products containing asbestos are prohibited. We also observe that compliance with the prohibition against products containing asbestos is mandatory and is, indeed, enforceable through criminal sanctions.*⁴¹³

The prohibition of all asbestos-containing products is a measure that effectively prescribes – although negatively – certain objective characteristics for all products.

Furthermore, the Appellate Body noted that Articles 2, 3 and 4 of the French decree contain certain exceptions to the prohibitions found in Article 1 of the decree. Any person seeking to avail of these limited exceptions must provide a detailed justification to the authorities, complete with necessary supporting documentation concerning ‘the state of scientific and technological progress’. Compliance with these administrative requirements is mandatory.

Through the exceptions to the prohibitions, the measure at issue sets out the ‘applicable administrative provisions, with which compliance is mandatory’ for products with certain objective ‘characteristics’.

The Appellate Body thus concluded in *EC – Asbestos*:

*Viewing the measure as an integrated whole, we see that it lays down ‘characteristics’ for all products that might contain asbestos, and we see also that it lays down the ‘applicable administrative provisions’ for certain products containing chrysotile asbestos fibres which are excluded from the prohibitions in the measure. Accordingly, we find that the measure is a ‘document’ which ‘lays down product characteristics ... including the applicable administrative provisions, with which compliance is mandatory’. For these reasons, we conclude that the measure constitutes a ‘technical regulation’ under the *TBT Agreement*.*⁴¹⁴

Confirming its ruling in *EC – Asbestos*, the Appellate Body in *EC – Sardines* established a three-tier test for determining whether a measure is a ‘technical regulation’ under the *TBT Agreement*:

- the measure must apply to an identifiable product or group of products;
- the measure must lay down product characteristics;⁴¹⁵ and
- compliance with the product characteristics laid down in the measure must be mandatory.⁴¹⁶

413 *Ibid.*, para. 72.

414 *Ibid.*, para. 75.

415 Note that the Appellate Body made no reference to ‘related processes and production methods’ because it was not relevant in the factual context of the case at hand.

416 Appellate Body Report, *EC – Sardines*, para. 176.

Applying this test in *EC – Sardines* to EC Regulation 2136/89 on Common Marketing Standards for Preserved Sardines, the Appellate Body further clarified its reasoning in *EC – Asbestos*. With regard to the first element of its three-tier test, the Appellate Body held that a measure that did not expressly identify the products to which it applied could still be applicable to identifiable products (as required by the first element of the test). The tool that the Appellate Body used to determine whether, in this case, *Sardinops sagax* was an identifiable product was by examining the way the EC Regulation was enforced. As the enforcement of the EC Regulation had led to a prohibition against labelling *Sardinops sagax* as ‘preserved sardines’, this product was therefore considered to be identifiable.⁴¹⁷

With regard to the second element of the three-tier test, the question arose as to whether a ‘naming’ rule, such as the rule to name *Sardina pilchardus* ‘preserved sardines’ laid down product characteristics. In this respect, the Appellate Body held that product characteristics include means of identification and that, therefore, the naming rule at issue definitely met the requirement of the second element of the test.⁴¹⁸

5.1.1.2 Standards

Annex 1.2 to the *TBT Agreement* defines a standard as:

... [a] 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.

Contrary to technical regulations, standards are of a voluntary nature, meaning compliance is not mandatory. The voluntary standards set by the European Committee for Electrotechnical Standardization (CENELEC), such as standards for mobile phones or handheld computers, are clearly standards within the meaning of the *TBT Agreement*. Other examples include the standards for sustainable forest management set by the Forest Stewardship Council, or the standards for the certification of agricultural products set by EurepGAP. Companies comply with these voluntary standards set by public or private bodies for various reasons, ranging from the facility of having industry-wide common standards, to the wish to be responsive to the concerns of consumers or civil society. In fact, companies often have no choice but to adhere to the standards set by standardization bodies. Not adhering to these standards would, in practice, exclude their products from the

market. It is therefore important that these voluntary standards are also subject to international disciplines under the *TBT Agreement*. Note that, to date, there is no case law further clarifying the concept of ‘standards’.

5.1.1.3 Conformity assessment procedures

In addition to technical regulations and standards, conformity assessment procedures also fall within the scope of application of the *TBT Agreement*. Conformity assessment procedures are defined in Annex 1.3 of the *TBT Agreement* as:

... any procedure used, directly or indirectly, to determine that relevant requirements in technical regulations or standards are fulfilled.

Examples of conformity assessment procedures include, for example, procedures for sampling, testing and inspection. To date, there is no case law clarifying the concept of ‘conformity assessment procedures’.

5.1.1.4 Do nPR PPM measures fall within the scope of application of the *TBT Agreement*?

The *TBT Agreement* applies to technical regulations, standards and conformity assessment procedures relating to:

- products (both industrial and agricultural); and
- related processes and production methods.⁴¹⁹

It is much debated whether the processes and production methods, to which the *TBT Agreement* applies, include non-product-related processes and production methods (nPR PPMs). This question is obviously of great importance in the context of this study as it determines whether the disciplines of the *TBT Agreement* apply to technical regulations, standards and conformity assessment procedures relating to the Cramer sustainability criteria or animal welfare requirements.

The issue of the applicability of the *TBT Agreement* to nPR PPM measures was discussed during the negotiations on the *TBT Agreement*. However, as has been explicitly recorded, the negotiators failed to reach agreement on this issue.⁴²⁰ The newly established WTO Committee on Trade and Environment (CTE) discussed this

419 Article 1.3 and the explanatory note to Annex 1, paragraph 2, of the *TBT Agreement*. Note that the *TBT Agreement* does not apply to technical regulations, standards and conformity assessment procedures that deal with services.

420 Committee on Technical Barriers to Trade, *Negotiating History of the Coverage of the Agreement on Technical Barriers to Trade with regard to Labelling Requirements, Voluntary Standards and Processes and Production Methods Unrelated to Product Characteristics*, Note by the Secretariat, G/TBT/W11, dated 29 August 1995.

417 *Ibid.*, para. 184.

418 *Ibid.*, paras. 190-191.

issue in 1996, although with specific regard to voluntary ‘eco-labelling’ schemes.⁴²¹ If anything, this discussion revealed the extent of the disagreement among Members on this issue. In the report of the Committee on Trade and Environment, it is noted that:

*many delegations expressed the view that the negotiating history of the TBT Agreement indicates clearly that there was no intention of legitimizing the use of measures based on non-product-related PPMs under the TBT Agreement, and that voluntary standards based on such PPMs are inconsistent with the provisions of the Agreement as well as with other provisions of the GATT. There is objection to any attempt through CTE work on eco-labelling to extend the scope of the TBT Agreement to permit the use of standards based on non-product-related PPMs.*⁴²²

The report also noted that:

*Another view is that the definition of the term ‘Standard’ in the TBT Agreement is ambiguous with respect to its coverage of standards based on non-product-related PPMs. Some Members suggested that the definition does not seem to cover standards based, *inter alia*, on non-product-related PPMs. It cannot be stated, therefore, *a priori*, that such standards are inconsistent with the terms of the Agreement.*⁴²³

The report went on to observe that:

*Still others have stated that the TBT Agreement does not cover measures based on non-product-related PPMs, and voluntary eco-labelling schemes/programmes based on LCA are not covered by transparency provisions of the Agreement, since criteria concerning non-product-related PPMs do not fall within the definition of ‘Standard’ in Annex 1.*⁴²⁴

Finally, the report of the CTE noted:

Another view is that all forms of eco-labelling, including eco-labels that involve non-product-related PPMs, are covered by the TBT Agreement and that the inclusion of non-product-related PPM-based elements in an eco-labelling regime is not per se a violation of WTO rules. According to this view, the TBT Agreement provides sufficient flexibility to permit non-product-related PPM-based eco-labelling to be used, subject to

*appropriate trade disciplines, and the validity of any eco-labelling regime under the WTO must be judged according to the relevant rules of the multilateral trading system.*⁴²⁵

Some WTO Members suggested that the WTO confirm that the provisions of the *TBT Agreement* and its *Code of Good Practice for the Preparation, Adoption and Application of Standards*, discussed below, apply to all eco-labelling schemes/programmes, whether voluntary or mandatory, and whether administered by governmental or non-governmental bodies. It was suggested that the scope of the *TBT Agreement* should be interpreted to cover the use of standards based on nPR PPMs in eco-labelling schemes/programmes, provided that these standards adhere to multilaterally agreed eco-labelling guidelines based on scientific criteria, and that they are transparent, consensual and non-discriminatory.⁴²⁶ However, in response to this proposal, other WTO Members stated that they saw no need to confirm what is already included in existing provisions of the *TBT Agreement*, and opposed changing the interpretation or application of the *TBT Agreement*.⁴²⁷

The definitions in Annex 1, paragraphs 1–3, quoted above, seem to indicate that technical regulations, standards and conformity assessment procedures relating to nPR PPMs do not fall within the scope of application of the *TBT Agreement*. The definitions refer to ‘characteristics for products and *related* processes and production methods’ [emphasis added]. However, note that in the last sentence of the definitions of technical regulations and standards, it is stated that technical regulations and standards also include measures that are concerned with ‘terminology, symbols, packaging, marking or labelling requirements *as they apply to a product, process or production method*’ [emphasis added]. Therefore, while there may be uncertainty and debate about whether technical regulations, standards or conformity assessment procedures relating to nPR PPMs in general fall within the scope of application of the *TBT Agreement*, it is clear that ‘labelling requirements’ relating to nPR PPMs are TBT measures within the meaning of Annex 1 to the *TBT Agreement*, and thus fall within the scope of application of the *TBT Agreement*.

A law requiring that eggs bear a label indicating that in the production process animal welfare requirements were met, is therefore a technical regulation to which the disciplines of the *TBT Agreement* apply. As noted above, it is doubtful that in view of the wording of the definitions of technical regulations and standards, and in particular the words ‘*related* processes and product methods’ [emphasis added], nPR PPM measures are TBT measures within the meaning of Annex 1 of the *TBT*

421 Report of the Committee on Trade and Environment, WT/CTE/1 (1996), paras. 66-81.

422 *Ibid.*, para. 70.

423 *Ibid.*, para. 71.

424 *Ibid.*, para. 72. Note that ‘LCA’ stands for ‘life-cycle approaches’.

425 *Ibid.*, para. 73.

426 *Ibid.*, para. 74.

427 *Ibid.*, para. 75.

Agreement. To date, however, no nPR PPM measure has been tested under the *TBT Agreement*. Some uncertainty and debate regarding the scope of the *TBT Agreement* is likely to persist as long as the Appellate Body has not yet ruled on this issue.⁴²⁸ If and when the Appellate Body rules that the *TBT Agreement* does not apply to nPR PPM measures, the analysis in this section would become largely without object. It would only still be of relevance to mandatory or voluntary labelling relating to nPR PPMs.⁴²⁹

5.1.2 Scope of application *ratione personae*

Although the *TBT Agreement* is mainly addressed to central government bodies, it explicitly aims to extend the application of its rules to 'other bodies' responsible for the establishment of technical regulations, standards, or execution of conformity assessment procedures. These 'other bodies' covered by the *TBT Agreement* primarily consist of local government and non-governmental bodies. Local government bodies are all bodies of government other than the central government, such as provinces, *Länder*, cantons or municipalities. They include any organ subject to the 'control of such a [local] government in respect of the activity in question'.⁴³⁰ Non-governmental bodies in the context of the *TBT Agreement* are defined as bodies other than central or local government bodies that 'ha[ve] legal power to enforce a technical regulation'.⁴³¹ The *TBT Agreement* extends its application to those 'other bodies' by imposing, on WTO Members, the obligation:

- to take measures in order to ensure compliance with the *TBT Agreement* by local government bodies and non-governmental bodies; or
- to refrain from taking measures that could encourage actions by these other bodies that are inconsistent with the provisions of the *TBT Agreement*.

428 Note that if technical requirements setting out nPR PPMs are not subject to the disciplines of the *TBT Agreement*, the disciplines of the GATT 1994, and in particular the national treatment obligation of Article III:4, still applies. See above, p. 51-72.

429 With regard to conformity assessment procedures, note that they only fall within the scope of application of the *TBT Agreement* when they determine the conformity of products with technical regulations and standards which themselves fall within the scope of application of the *TBT Agreement*. Conformity assessment procedures to determine whether products meet the Cramer sustainability requirements set out technical regulations or standards are therefore only subject to the disciplines of the *TBT Agreement* to the extent that such technical regulations or standards fall within the scope of application of the *TBT Agreement*.

430 Annex 1.7 to the *TBT Agreement*.

431 Annex 1.8 to the *TBT Agreement*.

It does so with respect to the obligations related to technical regulations, standards and procedures for assessment of conformity.⁴³² Note in particular the 'Code of Good Practice' in Annex 3 to the *TBT Agreement*. This 'Code of Good Practice' applies to the preparation, adoption and use of standards. Members have to ensure that their central government standardizing bodies accept and comply with the 'Code of Good Practice'. In addition, Members have, pursuant to Article 4 of the *TBT Agreement*, the obligation to take reasonable measures as are available to them to ensure that local and non-governmental standardizing bodies also accept and comply with the Code.⁴³³

5.1.3 Relationship between the *TBT Agreement* and the GATT 1994

The relationship between the *TBT Agreement* and the GATT 1994 is not such that the applicability of one agreement triggers the exclusion of applicability of the other. Both agreements can apply simultaneously to the same measure.⁴³⁴ The Panel in *EC – Asbestos* held that in a case where both the GATT 1994 and the *TBT Agreement* appear to apply to a given measure, a panel must first examine whether the measure at issue is consistent with the *TBT Agreement*, since this agreement deals 'specifically and in detail' with technical barriers to trade.⁴³⁵ However, should a panel find a measure to be consistent with the *TBT Agreement*, it must still examine whether the measure is also consistent with the GATT 1994. Note that, in general, the relationship between the GATT 1994 and the other multilateral agreements on trade in goods (including the *TBT Agreement*) is governed by the *General Interpretative Note to Annex 1A to the WTO Agreement*. This note provides that in case of conflict between a provision of the GATT 1994 and a provision of another multilateral agreement on trade in goods, the latter will prevail to the extent of the conflict. However, such a conflict between the *TBT Agreement* and the GATT 1994 is rather unlikely.

432 See Articles 3, 4, 7 and 8 of the *TBT Agreement*.

433 As of 18 November 2002, 145 standardizing bodies from 101 WTO Member countries had notified their acceptance of the 'Code of Good Practice'. See List of Standardizing Bodies that have accepted the Code of Good Practice for the Preparation, Adoption and Application of Standards.

434 Note that the relationship between the *TBT Agreement* and the *SPS Agreement* is quite different. Pursuant to Article 1.5 of the *TBT Agreement*, the provisions of the *TBT Agreement* do not apply to sanitary or phytosanitary measures.

435 Panel Report, *EC – Asbestos*, para. 8.16. On this point more generally, see the Appellate Body Report, *EC – Bananas III*, para. 204.

5.2 MFN treatment and national treatment obligations

Article 2.1 of the *TBT Agreement* provides that, with respect to technical regulations:

Members shall ensure that in respect of technical regulations, products imported from the territory of any Member shall be accorded treatment no less favourable than that accorded to like products of national origin and to like products originating in any other country.

The national treatment obligation and the MFN treatment obligation thus apply to technical regulations.⁴³⁶ Pursuant to Annex 3D and Article 5.1.1 of the *TBT Agreement*, these obligations also apply to standards and conformity assessment procedures, respectively. Thus, for example, a requirement that tropical wood from Brazil be labelled ‘tropical wood’, while there is no such requirement for tropical wood from African countries, would constitute a violation of the MFN treatment obligation set out in Article 2.1 of the *TBT Agreement*. Requiring accurate testing for the presence of genetically modified organisms (GMOs) in corn arriving from the United States, while such verification is not required for corn from Australia would constitute a violation of the MFN treatment obligation set out in Article 5.1.1 of the *TBT Agreement*. A requirement that imported furniture is fire-resistant, while no such requirement exists for domestically produced furniture, would constitute a violation of the national treatment obligation set out in Article 2.1 of the *TBT Agreement*.

When establishing whether certain treatment is discriminatory, the determination of ‘likeness’ of two products, which are subject to different treatment, is a prerequisite. The concept of ‘like products’ within the meaning of the relevant provisions of the *TBT Agreement* has not yet been the subject of dispute settlement proceedings. However, the concept of ‘like products’ has been clarified in panel and Appellate Body reports relating to Articles I and III of the GATT.⁴³⁷ This case law is undoubtedly instructive for the interpretation of the concept of ‘like products’ in the context of the *TBT Agreement*. Note, however, that, as discussed above, the Appellate Body in *Japan – Alcoholic Beverages II* has ruled that the concept of ‘like products’ has different meanings in the different contexts in which it is used.⁴³⁸ In this regard, it is useful to recall that in the GATT context a finding

436 Note that with regard to technical regulations adopted by local government bodies or non-governmental bodies, Article 3 of the *TBT Agreement* requires Members to take such reasonable measures as may be available to them to ensure compliance by such bodies with the provisions of Article 2.

437 See above, p. 22, p. 32 and p. 55.

438 See above, p. 22.

that products are ‘like’ and are given discriminatory treatment can be overcome by a justification of this discriminatory treatment on the basis of the Article XX exceptions.⁴³⁹ However, the ‘rule-exception’ relationship, which exists between, for example, Articles I and III of the GATT 1994, on the one hand, and Article XX of the GATT 1994, on the other, is not so clearly replicated in the *TBT Agreement*. The relationship between, for example, Articles 2.1 and 2.2 of the *TBT Agreement* remains to be clarified.⁴⁴⁰

5.3 Necessity requirement

Article 2.2 of the *TBT Agreement* provides that, with respect to technical regulations:

Members shall ensure that technical regulations are not prepared, adopted or applied with a view to or with the effect of creating unnecessary obstacles to international trade.

With respect to standards and conformity assessment procedures, Annex 3E and Article 5.1.2 of the *TBT Agreement* provide for the same obligation that such measures shall not be ‘prepared, adopted or applied with the view to, or the effect of, creating unnecessary obstacles to trade’.

To ensure that technical regulations do not constitute unnecessary obstacles to trade, Article 2.2 of the *TBT Agreement* further requires that:

... technical regulations shall not be more trade-restrictive than necessary to fulfil a legitimate objective, taking account of the risks non-fulfilment would create.

Article 2.2 enumerates several legitimate objectives that may justify the creation of a trade obstacle in the form of a technical regulation. The list of legitimate policy objectives of Article 2.2 includes, *inter alia*:

- national security;
- the prevention of deceptive practices;
- the protection of human health and safety, animal or plant life or health; and
- the protection of the environment.

As indicated by the words ‘*inter alia*’ introducing the list, this is not an exhaustive list of legitimate policy objectives. It will be up to panels and the Appellate Body to assess whether the policy objectives other than those listed, such as energy

439 See above, p. 89.

440 On Article 2.2 of the *TBT Agreement*, see below, p. 149.

security or animal welfare, are, in a particular case, legitimate policy objectives within the meaning of Article 2.2 of the *TBT Agreement*. Moreover, note that Article 2.2 does not specify whether the policy objectives referred to must be pursued within the territory of the Member enacting the technical regulation. Recall in this respect the discussion on the implicit jurisdictional limitation on Article XX of the GATT 1994.⁴⁴¹

A technical regulation 'justified' under Article 2.2 as necessary to fulfil a legitimate policy objective at present will not automatically remain 'justified' in the future. Article 2.3 of the *TBT Agreement* provides that:

Technical regulations shall not be maintained if the circumstances or objectives giving rise to their adoption no longer exist or if the changed circumstances or objectives can be addressed in a less trade-restrictive manner.

Members thus continually have to assess the necessity of their technical regulations. They also have to continually assess whether their technical regulations are not more trade restrictive than necessary to fulfil a legitimate policy objective.

In assessing the necessity of their technical regulations, Members must, as is explicitly stated in Article 2.2 of the *TBT Agreement*, take 'account of the risks non-fulfilment would create'.⁴⁴² It is clear that the risks of non-fulfilment of a technical regulation, aimed at meeting consumer preferences or avoiding deceptive practices, will be different from the risks that non-fulfilment of a regulation, aimed at the protection of human health, may entail. Note that the *TBT Agreement* does not explicitly require a *quantitative* evaluation of risk. It could therefore be argued that, in line with the case law on Article XX of the GATT 1994, that an indication of risks in *qualitative* terms would suffice to justify a more trade-restrictive measure.⁴⁴³ Moreover, it is likely that, again in line with the case law on Article XX of the GATT 1994, Members may rely on scientific sources which, although diverging from the majority scientific opinion, constitute a qualified and respected opinion.⁴⁴⁴ Other elements that, according to Article 2.2, may be useful to consider in assessing the necessity of a technical regulation include: available scientific and technical information; related processing technology; and the intended end-uses of products. To date, there is no case law on the assessment of necessity under the

TBT Agreement. However, in line with the case law on the assessment of necessity under Article XX(b) and (d) of the GATT 1994, it is to be expected that the assessment of necessity under the *TBT Agreement* will also involve a process of 'weighing and balancing' the above-mentioned and other factors and elements.⁴⁴⁵

5.4 Use of international standards

The harmonization of national technical regulations and standards around international standards greatly facilitates the conduct of international trade.⁴⁴⁶ Harmonization around international standards diminishes the trade-restrictive effects of technical barriers to trade by minimizing the variety of requirements that exporters have to meet in their different export markets thus making it possible for them to take (more) advantage of economies of scale. Thus, the *TBT Agreement* requires Members to base their technical regulations on international standards. Article 2.4 of the *TBT Agreement* provides, in relevant part:

*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 ...*⁴⁴⁷

However, Article 2.4 further provides that Members do not have to base their technical regulations on international standards if:

... 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.

The Panel and Appellate Body reports in *EC – Sardines* illustrate the importance, as well as the contentious nature, of the requirement under Article 2.4 of the *TBT Agreement* that a technical regulation be based on an international standard. The first question that arose in this case was whether the international standard, 'Codex Stan 94' developed by an international food standard-setting body, the Codex Alimentarius Commission, constituted a relevant international standard for the purposes of Article 2.4. The Panel's examination of this question focused on whether the product coverage of the Codex Stan 94 was similar to that of the EC's

441 See above, p. 94.

442 With regard to conformity assessment procedure, Article 5.1.1 states that risks of non-conformity shall be taken into account. Annex 3 E (standards) does not contain the provision of risks to be taken into account.

443 See in particular Appellate Body Report, *EC – Asbestos*, para. 167.

444 See Appellate Body Report, *EC – Asbestos*, para. 178. See above, p. 103.

445 See above, p. 102 and 109.

446 Also the harmonization of national conformity assessment procedures around international guides and recommendations for conformity assessment procedures facilitates international trade.

447 In view of this requirement, it is not surprising that Article 2.6 of the *TBT Agreement* requires Members to play a full part, within the limits of their resources, in the preparation of international standards for products for which they either have adopted, or expect to adopt, technical regulations.

technical regulation, the measure at issue. According to the Panel, the examination of relevance with regard to the subject matter entails an analysis of whether the Codex Stan 94 'bear[s] upon, relate[s] to or [is] pertinent to' the EC's technical regulation.⁴⁴⁸ The European Communities argued that while the Codex Stan 94 deals with sardines and other sardine-type products, the EC's technical regulation exclusively concerns the product *Sardina pilchardus*. However, the Panel concluded that this argument was not sufficient to reject the relevance of Codex Stan 94 as an international standard, as both measures cover the same product (*Sardina pilchardus*) and include similar types of requirement in regard to this product such as labelling, presentation and packing media.

Another question that arose in *EC – Sardines* was whether the EC's technical regulation was, as required by Article 2.4, based on the international standard. In line with the case law on the meaning of 'based on' in the *SPS Agreement*, the Panel in *EC – Sardines* concluded that the term 'based on' is not equivalent to the term 'conform to', but imposes the obligation to 'employ or apply' the international standard as 'the principal constituent or fundamental principle for the purpose of enacting the technical regulation'.⁴⁴⁹ According to the Appellate Body in *EC – Sardines*, this comes down to an analysis of 'whether there is a contradiction between Codex Stan 94 and the EC regulation'.⁴⁵⁰

As noted above, a technical regulation does not have to be based on the relevant international standard if that standard constitutes an inappropriate or ineffective means to achieve the legitimate objective pursued. In *EC – Sardines*, the Panel and the Appellate Body examined whether this exemption from the obligation to base the technical regulation on the relevant international standard was applicable.

A first step in this examination is whether a 'legitimate objective' is pursued. As indicated above, Article 2.2 of *TBT Agreement* contains a *non-exhaustive* list of legitimate policy objectives. The objectives pursued by the EC's technical regulation at issue in *EC – Sardines*, namely, the protection of market transparency, consumer protection and fair competition, are not included in the list of Article 2.2. However, Peru, the complainant, did not contest the legitimacy of these objectives and the Panel thus refrained from ruling on their legitimacy.⁴⁵¹

A second step in the examination of the applicability of the Article 2.4 exemption is whether the international standard is an inappropriate or ineffective means to achieve the legitimate objective(s) pursued by the technical regulation. According to the Appellate Body in *EC – Sardines*, it is for the complainant to demonstrate that the international standard in question is both an effective and appropriate means to fulfil a legitimate objective.⁴⁵² The difference between effectiveness and appropriateness is that:

*the question of effectiveness bears upon the results of the means employed, whereas the question of appropriateness relates to the nature of the means employed.*⁴⁵³

In other words, the international standard 'would be effective if it had the capacity to accomplish all ... objectives [pursued], and it would be appropriate if it were suitable for the fulfilment of all ... objectives [pursued]'.⁴⁵⁴ To date, no international standards with regard to biomass (or biofuels) in general, or with regard to the sustainability of their production in particular, have been developed. For animal products and animal welfare the situation is somewhat different as the Council of Europe has adopted certain animal welfare standards. However, the World Organization for Animal Health (OIE), the competent international organization, has not yet adopted any animal welfare standards.

Note that, as provided for in Article 2.5 of the *TBT Agreement*, a technical regulation that is adopted to achieve a legitimate objective explicitly enumerated in Article 2.2, and is in accordance with a relevant international standard, shall be presumed *not* to create an unnecessary obstacle to trade, as required by Article 2.2 discussed above.⁴⁵⁵ This means that in combination with the enumerated legitimate objectives under Article 2.2, international standards have the function of exempting trade-restrictive technical regulations from the necessity requirement of the Article 2.2.

With regard to conformity assessment procedures, the *TBT Agreement* introduces similar requirements in Article 5.4. Member countries shall use the relevant guides or recommendations, existing or imminent, as a basis for their conformity assessment procedures unless the guide or recommendation is an inappropriate means to ensure conformity. Unlike Article 2.4, the criterion of effectiveness of the international guide or recommendation is not mentioned in Article 5.4. With regard to standards, note Paragraph F of the Code of Good Practice.

448 Panel Report, *EC – Sardines*, para. 7.68.

449 *Ibid.*, para. 7.110.

450 Appellate Body Report, *EC – Sardines*, para. 249.

451 The Panel, however, referred to the interpretation of the Panel in *Canada – Pharmaceuticals Patents* of the concept of 'legitimate interests' as 'a normative claim for protection of interests that are "justifiable" in the sense that they are supported by relevant public policies or other social norms' (Panel Report, *EC – Sardines*, para. 7.121).

452 See Appellate Body Report, *EC – Sardines*, para. 287.

453 Panel Report, *EC – Sardines*, para. 7.116.

454 Appellate Body Report, *EC – Sardines*, para. 288.

455 Article 2.5 of the *TBT Agreement*.

5.5 Other obligations under the *TBT Agreement*

Apart from the basic obligations under the *TBT Agreement* discussed in the previous sections, the *TBT Agreement* also contains a number of other obligations which deserve to be mentioned. This section briefly examines the provisions of the *TBT Agreement* relating to:

- equivalence and mutual recognition;
- product requirements in terms of performance; and
- transparency and notification.

5.5.1 Equivalence and mutual recognition

Article 2.7 of the *TBT Agreement* provides:

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.

The *TBT Agreement* thus requires WTO Members to consider accepting, as equivalent, the technical regulations of other Members. They should, however, only do so if they are satisfied that the foreign technical regulations adequately fulfil the legitimate objectives pursued by their own technical regulations.

With regard to conformity assessment procedures, Article 6.1 of the *TBT Agreement* requires Members to accept the results of such procedures by other Member countries, even if their conformity assessment procedures differ, as long as they provide an assurance of conformity with the domestic technical regulations or standards. Compliance with international guides and recommendations on conformity assessment procedures shall be taken into consideration when evaluating the adequacy of the competent conformity assessment bodies. Members are encouraged to enter into negotiations for the conclusion of agreements acknowledging mutual recognition of the results of each other's conformity assessment procedures.⁴⁵⁶

Article 9 of the *TBT Agreement* encourages the adoption of, and participation in, international and regional systems for conformity assessment. Such systems aim for cooperation between national certification bodies of Members and often take the form of multilateral recognition agreements. Examples of such international or regional systems are the International Accreditation Forum (IFA) or the Worldwide System for Conformity Testing and Certification of Electrical Equipment (IECEE).

5.5.2 Product requirements in terms of performance

With respect to technical regulations, Article 2.8 of the *TBT Agreement* provides:

Wherever appropriate, Members shall specify technical regulations based on product requirements in terms of performance rather than design or descriptive characteristics.

The *TBT Agreement* thus prefers Members to adopt technical regulations on the basis of product requirements in terms of performance. With regard to standards, Annex 3I to the *TBT Agreement* provides for the same preference for standards based on product requirements in terms of performance.

5.5.3 Transparency and notification

When no relevant international standard exists or when a proposed technical regulation is not in accordance with a relevant international standard and the proposed technical regulation may have a significant effect on trade of other Members, Article 2.9 of the *TBT Agreement* requires Members to:

- publish a notice, at an early stage, in such a manner as to enable interested parties in other Member states to become acquainted with the proposed technical requirement;
- notify other Members through the WTO Secretariat of the products to be covered by the proposed technical regulation, together with a brief indication of the objective and rationale of the technical regulation. This notification must be done at an early stage of the process, when amendments to the proposed technical regulation can still be made and comments can be taken into account;
- provide other Members, upon their request, with copies of and information on the proposed technical regulation, including information on how the proposed technical regulation deviates from relevant international standards; and
- allow a reasonable time for other Members to make comments on the proposed technical regulation, to discuss these comments upon request, and to take the comments and the resulting discussion into account when eventually deciding on the technical regulation.

When a technical regulation is adopted to address an urgent problem of safety, health, environmental protection or national security, a Member may set aside the notification (and consultation) requirements set out in Article 2.9 of the *TBT Agreement*. However, in such instances, Members are subject to certain notification (and consultation) obligations after the adoption of the technical regulation.⁴⁵⁷

⁴⁵⁶ See Article 6.3 of the *TBT Agreement*.

⁴⁵⁷ See Article 2.10 of the *TBT Agreement*.

Article 2.11 of the *TBT Agreement* requires that all adopted technical regulations are:

... published promptly or otherwise made available in such a manner as to enable interested parties in other Members to become acquainted with them.

Except when a technical regulation addresses an urgent problem, as referred to above, technical regulations may not enter into force immediately after publication.

Article 2.12 of the *TBT Agreement* provides in relevant part:

... Members shall allow a reasonable interval between the publication of technical regulation and their entry into force in order to allow time for producers in exporting Members ... to adapt their products or methods of production to the requirements of the importing Member.

Such a reasonable interval between the publication and the entry into force of a technical regulation is particularly important for producers in exporting developing country Members.

The *TBT Agreement* contains similar provisions with regard to the notification of standards and conformity assessment requirements.⁴⁵⁸ As an additional requirement for standards, the *TBT Agreement* requires Members' national standardizing bodies to publish, at least every six months, their work programme and report on the progress regarding the preparation and adoption of standards.⁴⁵⁹

Note that the 1996 Report of the WTO Committee on Trade and Environment states, with regard to proposals on transparency concerning voluntary eco-labelling schemes:

Another proposal is that full transparency should be encouraged to enable timely public input at each stage of an eco-labelling programme's development. This would reduce the risk that environmental criteria in eco-labelling schemes/programmes narrowly reflect national considerations, take different environmental approaches into account, and help ensure that foreign producers or countries with significant trade interests in a labelled product have both timely and effective input throughout the entire eco-labelling process. Transparency provisions should emphasize the timely access to information regarding product group definition; the identification and elaboration of environmental

458 Annex 3 L, M, N and O of to the *TBT Agreement* (for standards) and Articles 5.6, 5.7 5.8 and 5.8 of the *TBT Agreement* (for conformity assessment procedures).

459 See Annex 3 J of to the *TBT Agreement*.

*criteria; procedures used in the awarding of labels, and other factors. Transparency, it has been noted, is of importance not only to the trading system but to the environmental policy objectives as well.*⁴⁶⁰

6 Relevant WTO obligations on subsidies

Granting subsidies to promote the use of 'preferred' products or technologies (e.g. environmentally friendly products or technologies) is an important and often indispensable policy instrument for many WTO (developed country) Members.⁴⁶¹ The Netherlands currently subsidizes the production of electricity from 'alternative' energy sources, including biofuels, under the *Subsidieregeling Milieukwaliteit van de Elektriciteitsproductie* (MEP programme). Under the *Unieke Kansenregeling (UKR)*, a programme for the reduction of CO₂ emissions, the Netherlands has granted an investment subsidy of € 4 million for the construction of a biodiesel production plant in the southwest of the Netherlands (Terneuzen). Reportedly the biomass used by this plant would have to come from farmers of the region and would have to be consistent with the Cramer sustainability criteria. The Netherlands Ministry of Transport has proposed a subsidy programme (*Subsidieprogramma CO₂-reductie Innovatieve Biobrandstoffen* (IBB programme) to promote the use of innovative biofuels for traffic and transport as these sectors contribute significantly to CO₂ emissions.⁴⁶²

The WTO rules on subsidies are primarily contained in two agreements, namely, the *Agreement on Subsidies and Countervailing Measures* (the '*SCM Agreement*'), which applies to all subsidies within the meaning of Articles 1 and 2 of that Agreement; and the *Agreement on Agriculture*, which applies, in addition to the *SCM Agreement*, to subsidies on agricultural products (or, to be precise, to subsidies that confer a benefit to agricultural products). In case of conflict between the rules of the *SCM Agreement* and the *Agreement on Agriculture*, the latter rules prevail.⁴⁶³ Whether only the *SCM Agreement* or the *SCM Agreement* as well as the *Agreement on Agriculture* would apply to subsidies on biomass or biofuels depends on whether these products are classified as agricultural products, i.e. in HS Chapters 1 to 24 (except fish and fish products), plus the HS Headings and Codes listed in Annex 1 to the *Agreement on Agriculture*. The HS does not refer to

460 Report (1996) of the Committee on Trade and Environment, WT/CTE/1, para. 77.

461 This section is based on, and in parts further elaborates and updates P. Van den Bossche, *The Law and Policy of the World Trade Organization* (Cambridge University Press, 2005, reprinted 2006), pp.551-595.

462 *Staatscourant* 2006, nr. 247, p.24.

463 See Article 21 of the *Agreement on Agriculture*, which states that the provisions of the GATT 1994 and other multilateral agreements on trade in goods (including the *SCM Agreement*) apply subject to the provisions of the *Agreement on Agriculture*.

biomass as such, but it does refer in Chapters 1 to 24 to the various specific kinds of biomass used (e.g. sugar beet). Likewise, the HS does not refer to biofuels as such. It does, however, refer to ethanol (as a processed agricultural product), without distinguishing between ethanol used as biofuel or ethanol used for different purposes.

6.1 Obligations under the *SCM Agreement*

The principal WTO agreement on subsidies is the *SCM Agreement*. Article 1.1 of the *SCM Agreement* defines a subsidy as a ‘financial contribution by a government or any public body’ whereby ‘a benefit is ... conferred’. Both the *SCM Agreement* as well as case law work out and clarify each element of this definition. Note, for example, that a ‘financial contribution’ includes, in addition to direct cash payments, also the provision of goods and services and tax exemptions or rebates.⁴⁶⁴ Tax exemptions and rebates constitute financial contributions by a government to the extent that the government has ‘forgone revenue otherwise due’.⁴⁶⁵ A ‘benefit’ is being conferred if the subsidy confers a competitive advantage on the recipient (compared with the conditions that the recipient would otherwise have to face in the marketplace). In other words, a ‘benefit’ is an advantage in relation to normal market conditions. As the Appellate Body noted in *US – Softwood Lumber IV*, determining whether a benefit has been granted may be particularly difficult in situations where the market conditions have been pervasively influenced by government intervention and the ‘market’ can therefore not function as a benchmark in determining whether a benefit was granted. This may be the case with regard to biofuels.⁴⁶⁶ Not all subsidies within the meaning of Article 1.1 of the *SCM Agreement* fall within the scope of application of the *SCM Agreement*. As provided for in Article 1.2 of the *SCM Agreement*, the disciplines of the *SCM Agreement* apply only to subsidies that are ‘specific’ within the meaning of Article 2 of the *SCM Agreement*.

⁴⁶⁴ See Article 1.1(a)(1)(ii) of the *SCM Agreement*.

⁴⁶⁵ If a Member, rather than giving a tax rebate to biofuels produced consistently with the Cramer sustainability criteria, were to adopt a new tax regulation under which the amount of the tax on biofuels depends on whether the biofuels have been produced consistently with the Cramer sustainability criteria, it may be difficult to argue that the Member concerned has forgone revenue otherwise due. In that case, there may well be no ‘financial contribution by a government’. The *SCM Agreement* and the *Agreement on Agriculture* would then not apply. Note, however, that this tax regulation may still be found to be inconsistent with the national treatment obligation of Article III:2 of the GATT 1994. See above, p. 27.

⁴⁶⁶ See Appellate Body Report, *US – Softwood Lumber IV*, para. 93. R. Howse, P van Bork and C. Hedeband, WTO Disciplines and Biofuels: Opportunities and Constraints Constraints in the Creation of a Global Marketplace, IPC Discussion Paper, October 2006.

For a subsidy to be ‘specific’, it must be targeted, *de jure* or *de facto*, to a specific or limited class of industries or companies. A national health security system or vocational schooling are not *specific* subsidies within the meaning of Article 2 of the *SCM Agreement* since they are not targeted to, or to the benefit of, a specific or limited class of industries or companies.

6.1.1 Prohibited subsidies

Under the *SCM Agreement* certain subsidies are *prohibited* while others are *actionable*, i.e. they can be challenged as WTO-inconsistent if they adversely affect the interests of other Members. The prohibited subsidies are:

- export subsidies; and
- import substitution subsidies.

As defined in Article 3.1(a) of the *SCM Agreement*, export subsidies are subsidies contingent upon export performance. Annex I of the *SCM Agreement* contains an ‘Illustrative List of Export Subsidies’. As defined in Article 3.1(b) of the *SCM Agreement*, import substitution subsidies are subsidies contingent upon the use of domestic products over imported products. In the Netherlands, if the subsidies granted under the IBB programme or the MEP programme were to be contingent, *de jure* or *de facto*, on the use of Dutch biofuels, these subsidies would be prohibited. If the Netherlands were to make IBB or MEP subsidies conditional upon the use of biofuels from biomass produced in accordance with the Cramer sustainability criteria and these criteria cannot, or only with great difficulty, be met by (most) developing country Members, it could be argued that these subsidies are *de facto* contingent upon the use of domestic products over imported products and, therefore, prohibited import substitution subsidies. To the extent that the subsidy granted under the *Unieke Kansenregeling* (UKR) programme for the construction of a biodiesel production plant in the southwest of the Netherlands is conditional upon the use by this plant of biomass produced by farmers of the region (*de jure* contingency) or biomass produced consistently with the Cramer sustainability criteria (arguably *de facto* contingency), this subsidy would be a prohibited import substitution subsidy. Subsidies that are found to be prohibited must be withdrawn, i.e. removed, without delay. If the subsidizing Member fails to withdraw a prohibited subsidy, the WTO Dispute Settlement Body must, upon the request of the complainant and by reverse consensus (i.e. automatically), authorize ‘appropriate countermeasures’ (i.e. retaliation in the form of suspensions of concessions or other obligations).

6.1.2 Actionable subsidies

Unlike export subsidies and import substitution subsidies, most subsidies are not prohibited but are ‘actionable’. As noted above, this means that they can be

challenged in the event that they cause adverse effects to the interests of other Members. As provided for in Article 5 of the *SCM Agreement*, there are three types of 'adverse effects' to the interests of other Members:

- *material injury*, or threat thereof, to the domestic industry of another Member;⁴⁶⁷
- *nullification or impairment* of benefits accruing directly or indirectly to other Members under the GATT 1994; and
- *serious prejudice*, or threat thereof, to the interests of another Member.

Serious prejudice *may* arise where a subsidy has one or more of the effects described in Article 6 of the *SCM Agreement*, including the impediment of imports of another Member into the market of the subsidizing Member, or the significant price undercutting by the subsidized product in comparison to the like product of another Member in the same market.⁴⁶⁸ It is possible that the subsidies under the MEP, IBB and UKR programmes, referred to above, may have these effects and may, therefore, be considered to cause serious prejudice to the interests of other Members. If that is the case, the Netherlands would be, pursuant to Article 7 of the *SCM Agreement*, under an obligation to take appropriate steps to remove the adverse effects of the subsidy *or* withdraw the subsidy itself. The Netherlands would have to do so within six months. If it fails to do so, the WTO Dispute Settlement Body must, upon the request of the complainant, authorize 'appropriate countermeasures'.⁴⁶⁹

6.2 Obligations under the *Agreement on Agriculture*

As already noted above (in footnote), Article 21 of the *Agreement on Agriculture* states that:

The provisions of the GATT 1994 and of the other Multilateral Agreements in Annex 1A to the WTO Agreement shall apply subject to the provisions of this Agreement.

⁴⁶⁷ See Article 15 of the *SCM Agreement*. Note that the concept of 'injury' also includes 'material retardation of the establishment of a domestic industry'. Also note that the concept of 'like product' in this context is specifically defined in the *SCM Agreement*. However, the approach to establishing 'likeness' under the *SCM Agreement* is, in fact, similar to the approach under the GATT 1994, as discussed above (see p. 22, p. 32 and p. 55).

⁴⁶⁸ Pursuant to Article 6.3 of the *SCM Agreement*, serious prejudice exists when the effect of the subsidy is to displace imports of a 'like' product into the market of the subsidizing member or to displace exports of the complaining Member to a third country market. Serious prejudice also exists when the effect of the subsidy is significant price suppression or price undercutting with respect to the like products, or when the effect of the subsidy is an (sustained) increase in the world market share of the subsidizing Member in a particular primary product or commodity.

⁴⁶⁹ See above, p. 159.

Therefore, the provisions of the *SCM Agreement*, discussed above, apply to subsidies to promote the use of agricultural products only to the extent that the *Agreement on Agriculture* does not provide for different, conflicting rules. Agricultural subsidies have traditionally been, and continue to be, a highly contentious issue in international trade. Agricultural subsidies were a major topic of discussion during the Uruguay Round, and are again high on the agenda of the Doha Development Round. Agricultural export subsidies and domestic agricultural support measures are indispensable instruments of the current agricultural policies of a number of developed-country Members and, most notably, the European Communities. At the same time, the trade interests and the economic development of many other Members are severely affected by these agricultural subsidies. The particularly sensitive nature of the issue of agricultural subsidies explains why the rules on the *SCM Agreement* do not apply in full to agricultural subsidies. The *Agreement on Agriculture* provides for special rules on agricultural subsidies which, in case of conflict with the rules of the *SCM Agreement*, prevail over the latter rules.

6.2.1 Agricultural export subsidies

The prohibition of the *SCM Agreement* on export subsidies applies to agricultural export subsidies except as provided otherwise in the *Agreement on Agriculture*. A distinction must be made between export subsidies on:

- agricultural products that are specified in Section II of Part IV of a Member's GATT Schedule of Concessions; and
- agricultural products that are not specified in that section.

With respect to the first group of agricultural products, the export subsidies of the types listed in Article 9.1(a) to (f) of the *Agreement on Agriculture*, are subject to reduction commitments. As set out in the relevant section of their GATT Schedule, developed-country Members agreed to reduce the export subsidies on these products by an average of 36% by value (budgetary outlay) and 21% by volume (subsidized quantities). Developing-country Members agreed to reduce the export subsidies by an average of 24% by value and 14% by volume. WTO Members may not grant export subsidies of the types listed in Article 9.1 *in excess* of the budgetary outlay and quantitative levels specified in their GATT Schedules.⁴⁷⁰ According to Article 10.1 of the *Agreement on Agriculture*, export subsidies of a type that are not listed in Article 9.1, may not be applied in a manner that would result in circumvention of export subsidy commitments. This effectively prohibits any export subsidy other than those listed in Article 9.1. With regard to agricultural products not specified in the relevant section of their GATT Schedule, Members shall not provide export subsidies.

⁴⁷⁰ See Articles 3.3 and 8 of the *Agreement on Agriculture*.

6.2.2 Domestic agricultural support measures

Apart from agricultural export subsidies, the *Agreement on Agriculture* also regulates domestic agricultural support measures. With respect to these measures, WTO Members have agreed to reduce the level of support. Developed-country Members agreed to reduce between 1995 and 2000 their 'aggregate measurement of support' (AMS) by 20%. Developing-country Members agreed to reduce their AMS by 13.3% in the period 1995-2004.⁴⁷¹ WTO Members may not provide domestic support *in excess* of the commitment levels specified in their GATT Schedules.⁴⁷²

Certain domestic agricultural support measures are exempted from the reduction commitments. These exempted domestic support measures are commonly referred to as 'green box' measures.⁴⁷³ As set out in Annex 2 to the *Agreement on Agriculture*, 'green box' measures include support for agricultural research and infrastructure, training and advisory services and domestic food aid.⁴⁷⁴ According to Annex 2, 'green box' measures must:

- be provided through a publicly funded government programme (including government revenue forgone) not involving transfers from consumers; and
- not have the effect of providing price support to producers.⁴⁷⁵

Moreover, the domestic support measures must meet the policy-specific criteria and conditions set out in paragraphs 2 to 13 of Annex 2. Most relevant in the context of this study are the conditions set out in paragraph 12, which concerns 'payments under environmental programmes'. Paragraph 12(a) states:

Eligibility for such payments shall be determined as part of a clearly-defined government environment or conservation programme and be dependent on the fulfilment of specific conditions under the government programme, including conditions related to production methods and inputs. [emphasis added]

Paragraph 12(b) states:

The amount of payment shall be limited to the extra costs or loss of income involved in complying with the government programme.

An example of such 'green box' measures is the subsidies in the form of exemptions from gasoline taxes granted to purchasers of biofuels under the 2003 EC Biofuels Directive.⁴⁷⁶ Subsidies in the form of direct grants or tax exemptions or rebates to oil or electricity companies that use biomass (or biofuels from biomass) produced consistently with the environment-related Cramer sustainability criteria, may be 'green box' subsidies within the meaning of Annex 2 and, therefore, not subject to any limitation under the *Agreement on Agriculture*. However, these subsidies would have to be limited to an amount necessary to compensate oil or electricity companies for the extra cost of using biomass (of biofuels from biomass) that is produced consistently with the environment-related Cramer sustainability criteria. Note that in the context of the Doha Development Round, the European Communities initially proposed that direct subsidies granted to farmers to assist them with the extra costs incurred in meeting high animal welfare standards should be included in the category of 'green box' subsidies. As this proposal found very little support among the WTO membership, the European Communities no longer attaches much importance to it.

471 See Article 15.2 of the *Agreement on Agriculture*.

472 The commitments of Members on the reduction of domestic agricultural support measures are set out in Part IV of their GATT Schedule.

473 Note that the domestic support measures that are subject to reduction commitments, are often referred to as 'amber box' measures. In addition to 'green box' measures, there is another category of domestic support measures that is exempted from reduction criteria. These measures, commonly referred to as the 'blue box' measures, include certain developing-country subsidies designed to encourage agricultural production, certain *de minimis* subsidies, and certain direct subsidies aimed at limiting agricultural production. See Article 6 of the *Agreement on Agriculture*.

474 Article 7 of the *Agreement on Agriculture* provides that 'green box' measures must be maintained in conformity with the criteria set out in Annex 2 to the *Agreement on Agriculture*. These criteria, discussed below, justify the exemption from the reduction commitments.

475 See para. 1(a) and (b) of Annex 2 to the *Agreement on Agriculture*.

476 Note that it may be argued that the subsidy is not 'specific' (see above, p. XXXVIII) since the subsidy is not targeted to specific industries or companies but is available to all purchasers of biofuels. However, this argument could be refuted by pointing out that not the purchasers but the biofuel industry is the beneficiary of this subsidy (upstream subsidy) and that the subsidy is therefore 'specific'. It is assumed here that a 'benefit', in the sense of a competitive advantage, is conferred to the domestic biofuel industry.

PART 2
RELEVANCE OF OTHER
INTERNATIONAL AGREEMENTS
FOR UNILATERAL NPR PPM
MEASURES ADDRESSING
NON-TRADE CONCERNS

Nico Schrijver

1 General introduction

Environment, human rights and labour standards are the subject of separate international agreements, as introduced in Part 1 of this report. Occasionally, such agreements contain provisions that have a bearing on international trade. These provisions either directly pose obligations upon parties that affect trade or allow for parties to install trade measures addressing environmental or social concerns. Examples include the regime of import and export restrictions under the *Convention on International Trade in Endangered Species of Wild Fauna and Flora* (CITES) – which is in part obligatory and in part voluntary – and the protection of labour rights under the International Labour Organization (ILO) conventions. Also, the production standards developed by private or non-governmental organizations, such as those of the Euro Retailer Working Group (EurepGAP) and the Forest Stewardship Council, have a direct bearing on international trade.

The first part of this chapter will address the WTO compatibility of these specific international agreements and measures, while the second part will assess the place and role of other norms of international law – such as those emanating from human rights and environmental agreements – in the WTO system. It must be noted that, so far, a dispute over conflicting obligations under environmental or human rights agreements on the one hand, and WTO law on the other, has not yet been put forward to the WTO dispute settlement system. However, there is an apparent need for answers in order to avoid or to address such disputes in future.

2 Obligations stemming from other international agreements and measures

This section describes the pertinent features of the international environmental and social agreements and measures introduced in section 1 above. It will address the obligations stemming from these agreements and measures and briefly explain how these relate to WTO obligations. It will also assess some possibilities for installing unilateral measures based on these agreements and measures.

2.1 International agreements on environmental protection

International environmental agreements occasionally resort to trade-related measures to further their objectives. Out of the 200 multilateral environmental agreements (MEAs) currently in force, the WTO has identified 14 agreements containing trade-related provisions.⁴⁷⁷

477 See the Matrix on Trade Measures pursuant to Selected Multilateral Environmental Agreements, prepared by the WTO Secretariat, WT/CTE/W/160/Rev.3, 16 February 2005, available at www.wto.org.

It should be noted that in most cases these trade provisions relate to product-related processes and production methods (PR PPMs). Nonetheless, their relevance for the current discussion is twofold. First, the discussion on the relation of MEAs to WTO law is still not resolved, while the need for answers is of high relevance, notably in the context of unilateral measures adopted pursuant to these agreements. Second, these unilateral measures may relate to non-product related PPMs introduced in furtherance of the objectives of environmental agreements. Examples include a prohibition on harvesting techniques detrimental to biological diversity (protected under the *Convention on Biological Diversity*) or to endangered species (protected under CITES), and the levy of a carbon tax on products produced in an unsustainable way by States not party to the *Kyoto Protocol*.

This subsection will review the major environmental agreements and their trade-related provisions. Particular conflicts with WTO law will be assessed within the context of these treaties. Some common features of the environmental agreements – i.e. provisions on the transfer of technology to developing countries and provisions affecting non-Parties – and their relation to WTO law will be dealt with separately at the end of this subsection.

2.1.1 Convention on International Trade in Endangered Species of Wild Fauna and Flora (CITES)

CITES is among the earliest multilateral environmental conventions and regulates the trade in endangered species of wild fauna and flora.⁴⁷⁸ Its main purpose is to prevent overexploitation of wild animals and plants leading to their extinction. Article 2 of the Convention distinguishes three categories:

- ‘species threatened with extinction which are or may be affected by trade’, listed in Appendix I to the Convention;
- ‘species which although not necessarily now threatened with extinction may become so unless trade in specimens of such species is subject to strict regulation in order to avoid utilization incompatible with their survival’, listed in Appendix II to the Convention; and
- ‘species which any Party identifies as being subject to regulation within its jurisdiction for the purpose of preventing or restricting exploitation, and as

478 *Convention on International Trade in Endangered Species of Wild Fauna and Flora* (CITES), concluded in Washington, DC, on 3 March 1973 (entry into force 1 July 1975), 993 *UNTS* 243. As of early 2007, 169 states had ratified CITES. On international wildlife law, see P. van Heijnsbergen, *International Legal Protection of Wild Fauna and Flora* (Amsterdam: IOS Press, 1997); and S. Lyster, *International Wildlife Law: An Analysis of International Treaties Concerned with the Conservation of Wildlife* (Cambridge: Grotius Publications, 1985).

needing the cooperation of other Parties in the control of trade’, listed in Appendix III to the Convention.⁴⁷⁹

Requirements for trade in these species differ according to the appendix they are listed in, the Appendix I regime being the most severe. Trade in species listed in Appendix I requires both an export and an import permit, granted after approval of both a Scientific and Management Authority (Article III). The Scientific Authority must determine that trade in the species involved will not be detrimental to its survival. This is the so-called ‘no detriment’ requirement. For species listed in Appendix II the same requirements apply, except for the obligation to present an import permit (Article IV). Finally, a species listed in Appendix III only require an export permit for States that have included that species in Appendix III and do not need the approval of a Scientific Authority (Article V). Although the Convention does not specifically provide for it, export quotas for specific species can be installed by the Conference of the Parties or – on a voluntary basis – by Parties themselves. Furthermore, in order to enforce the provisions of the Convention, Parties are required to take domestic measures. According to Article VIII of the Convention, these shall include measures ‘to penalize trade in, or possession of [...] specimens’ and ‘to provide for the confiscation or return to the State of export of such specimens’.

CITES is the only MEA that exclusively resorts to trade measures to protect the environment.⁴⁸⁰ These measures, which consist of import and export licences and (voluntary) quotas, are *prima facie* incompatible with Article XI of the GATT. However, these may be justified under the general exception clauses of Article XX of the GATT.⁴⁸¹ First, the measures may be considered necessary for the protection of animal and plant life and health (Article XX(b) of the GATT) since they intend to protect species threatened with extinction.⁴⁸² It is difficult to think of another less

479 Parties to the convention may propose amendments to Appendices I and II to be adopted by the Conference of the Parties (Article XV). Since inclusion of a species in Appendix III is voluntary and only relates to trade in species from the Party that has included them, amendments to Appendix III may be made by any Party at any time (Article XVI).

480 See G. van Calster, *International and EU Trade Law: The Environmental Challenge* (London: Cameron May, 2000), p. 83.

481 For an in-depth analysis of Articles XI and XX GATT, see Part I of this study.

482 Van Calster points out that the ‘no detriment requirement’ of CITES for trade in species listed in Appendices I and II might make it difficult for a country to justify the import restrictions under Article XX of the GATT, since this might result in a situation in which different trade restrictions apply for the same species depending on whether it is threatened or not in the region from which it originates. However, it could also be argued that in these circumstances ‘the same conditions’, as stipulated by Article XX of the GATT, do not apply. See G. van Calster, *International and EU Trade Law*, pp.110-121.

trade-restrictive way to attain this objective. Second, the measures relate to the conservation of exhaustible natural resources and are made effective in conjunction with domestic restrictions (Article XX(g) of the GATT). In the *US – Shrimp* case, the Appellate Body made it clear to be a proponent of international cooperation for the protection of the environment. Therefore, it is likely that the measures prescribed by a multilateral convention like CITES, that creates the same obligations for all Parties and serves a legitimate objective (i.e. the protection of species threatened with extinction), will be found compatible with WTO law. This leaves open the question of how to deal with the obligations the Convention creates for non-parties. Article X of the Convention states that

where export or re-export is to, or import is from, a State not a Party to the present Convention, comparable documentation issued by the competent authorities in that State which substantially conforms with the requirements of the present Convention for permits and certificates may be accepted in lieu thereof by any Party.

This provision essentially requires non-signatories to abide by the Convention in their trade relations with Parties to CITES. In its Resolution 9.5, the Conference of the Parties established strict criteria for documentation issued by non-parties.⁴⁸³ That is not to say that these automatically amount to – in the words of Article XX of the GATT – ‘arbitrary or unjustifiable discrimination’. Much will depend on the interpretation of the CITES requirements in the context of WTO law. In the *US – Shrimp* case, the Appellate Body determined that requiring other countries to adopt ‘essentially the same’ regulatory programme amounts to arbitrary discrimination.⁴⁸⁴ However, in the follow-up to this case, the Appellate Body ruled

that requiring other countries to adopt a programme which is ‘comparable in effectiveness’ is allowed. In this regard, the Appellate Body stated that

... there is an important difference between conditioning market access on the adoption of essentially the same programme, and conditioning market access on the adoption of a programme comparable in effectiveness. Authorizing an importing Member to condition market access on exporting Members putting in place regulatory programmes comparable in effectiveness to that of the importing Member gives sufficient latitude to the exporting Member with respect to the programme it may adopt to achieve the level of effectiveness required. It allows the exporting Member to adopt a regulatory programme that is suitable to the specific conditions prevailing in its territory.⁴⁸⁵

2.1.2 Vienna Convention for the Protection of the Ozone Layer and the Montreal Protocol on Substances that Deplete the Ozone Layer

The *Vienna Convention for the Protection of the Ozone Layer* is a multilateral framework convention, negotiated in the early 1980s in response to concerns regarding acid rain and the depletion of the ozone layer by substances such as chlorofluorocarbons (CFCs).⁴⁸⁶ The Convention aims ‘to protect human health and the environment against adverse effects resulting or likely to result from human activities which modify or are likely to modify the ozone layer’. The Convention sets out general policy guidelines relating to research and systematic observations (Article 3) and to international cooperation in the legal, scientific and technical fields (Article 4). Amongst these guidelines is the obligation for Parties to ‘cooperate in the formulation of agreed measures, procedures and standards for the implementation of this Convention, with a view to the adoption of protocols and annexes’. Thus, the Convention provides for a framework for Parties to take further action through the adoption of protocols and annexes.

So far, the Conference of the Parties has only adopted one – but highly successful – protocol to the *Vienna Convention*. The *Montreal Protocol on Substances that Deplete the Ozone Layer* aims

483 Resolution 9.5, adopted at the ninth meeting of the Conference of the Parties in Fort Lauderdale, 7-18 November 1994; amended at the thirteenth meeting in Bangkok, 2-14 October 2004. The Conference of the Parties recommends that Parties only accept permits and certificates issues by non-signatories if they contain ‘i) the name, stamp and signature of a competent issuing authority; ii) sufficient identification of the species concerned for the purposes of the Convention; iii) certification of the origin of the specimen concerned including the export permit number from the country of origin, or justification for omitting such certification; iv) in the case of export of specimens of a species included in Appendix I or II, certification to the effect that the competent scientific institution has advised that the export will not be detrimental to the survival of the species (in case of doubt a copy of such advice should be required) and that the specimens were not obtained in contravention of the laws of the State of export; v) in the case of re-export, certification to the effect that the competent authority of the country of origin has issued an export document that substantially meets the requirements of Article VI of the Convention; and vi) in the case of export or re-export of live specimens, certification to the effect that they will be transported in a manner that will minimize the risk of injury, damage to health or cruel treatment.’

484 For a discussion of the requirements of the chapeau of Article XX of the GATT, see Part I of this study. See also section 3.3 below.

485 See Appellate Body Report, *US – Shrimp (Article 21.5 – Malaysia)*, para. 144.

486 *Convention for the Protection of the Ozone Layer*, concluded in Vienna on 22 March 1985 (entry into force 22 September 1988), 26 *ILM* 1529 (1987). As of early 2007, 191 states had ratified the *Vienna Convention*. On this subject, see O. Yoshida, *The International Legal Regime for the Protection of the Stratospheric Ozone Layer* (The Hague: Kluwer Law International, 2001).

*to protect the ozone layer by taking precautionary measures to control equitably total global emissions of substances that deplete it, with the ultimate objective of their elimination on the basis of developments in scientific knowledge.*⁴⁸⁷

These precautionary measures consist of the phasing out of the consumption of certain controlled substances as specified in the Annexes to the Protocol. Parties to the Protocol undertake to reduce their levels of consumption of ozone-depleting substances to an established base level. Article 2 of the Protocol allows for Parties to transfer portions of their calculated level of production of a number of the controlled substances to other Parties, 'provided that the total combined calculated levels of production of the Parties concerned for any group of controlled substances do not exceed the production limits set out in those Articles for that group'. The Protocol also allows for limited transfer of portions of the consumption level of substances known as hydrochlorofluorocarbons, which are considered less damaging to the ozone layer than CFCs. On the basis of Article 2(8), members of a regional economic integration organization such as the European Union may form a 'bubble', that is they may choose to jointly fulfil their obligations in order to reduce their consumption levels.

Furthermore, Article 5 of the Protocol provides for preferential treatment for developing countries. It also makes the implementation of the Protocol by those Parties dependent upon the effective implementation of the provisions for financial assistance and the transfer of technology by industrialized countries. While WTO law provides for special and preferential treatment for developing countries Members, the provision on the transfer of technology may conflict with WTO law. This issue will be discussed below.

Finally, Article 4 of the Protocol contains provisions for trade with non-parties to the Protocol. In theory, these provisions are the most problematic in relation to WTO law, because they provide for a complete ban on trade through a phasing-out method.⁴⁸⁸ This ban even applies to the export of technology for the production and utilization of substances that deplete the ozone layer and to the granting of subsidies, aid, credits, guarantees or insurance programmes for the export of products, equipment, plant or technology that facilitate the production of such

substances.⁴⁸⁹ Furthermore, Article 4(4) relates to non-product-related production methods. It prohibits the import from non-parties of products 'produced with, but not containing' certain controlled substances. Finally, Article 4(8) determines that non-parties who *de facto* abide by the Protocol – as determined by the Parties – are exempted from the ban. These provisions clearly violate Article XI of the GATT. However, as pointed out by Yoshida, the measures in Article 4 of the *Montreal Protocol* are to be considered necessary to ensure the effectiveness of the protocol and to overcome the free-rider problem, i.e. the problem that non-parties benefit from the measures taken under the protocol without taking their share in the measures to preserve the ozone layer.⁴⁹⁰ Furthermore, although in a strict sense CFCs or other ozone-depleting substances (ODSs) are not directly harmful to human, animal or plant life or health, it could be argued that their phasing-out is necessary to protect human, animal and plant life and health against the negative effects due to the depletion of the ozone layer.

2.1.3 **Basel Convention on the Control of Transboundary Movements of Hazardous Wastes and their Disposal**

The *Basel Convention on the Control of Transboundary Movements of Hazardous Wastes and their Disposal* was drawn up in response to incidents in the 1980s involving the dumping of hazardous wastes by industrialized countries in developing states.⁴⁹¹ This multilateral convention aims to regulate the trade in hazardous and other wastes with the objective of protecting human health and the environment from the dangers posed by such wastes. The Convention excludes radioactive wastes from its scope.

Article 2 of the Convention defines wastes as 'substances or objects which are disposed of or are intended to be disposed of or are required to be disposed of by the provisions of national law'. Article 4 of the Convention obliges Parties to reduce

⁴⁸⁹ See Part I of this study for a discussion of the scope of measures falling within the scope of Article XI of the GATT.

⁴⁹⁰ O. Yoshida, *The International Legal Regime for the Protection of the Stratospheric Ozone Layer* (The Hague: Kluwer Law International, 2001). Yoshida argues that 'without such trade restrictions, non-parties would simply increase their production as Parties gradually phase out their ozone-depleting substances (ODS) production, and it is possible that unrestricted imports from non-parties would impair the further development of CFC/ODS substitutes. Furthermore, if industries using ODSs simply moved to non-parties and then manufacture such products for export to the parties, this would eventually nullify the environmental benefits of the Montreal Protocol regime' (p.139).

⁴⁹¹ *Basel Convention on the Control of Transboundary Movements of Hazardous Wastes and their Disposal*, concluded in Basel on 22 March 1989 (entry into force 5 May 1992), 28 *ILM* 657 (1989). As of April 2007, 170 States had ratified the *Basel Convention*.

⁴⁸⁷ *Montreal Protocol on Substances that Deplete the Ozone Layer*, concluded in Montreal on 16 September 1987 (entry into force 1 January 1989), 26 *ILM* 1550 (1987). As of early 2007, all Parties to the *Vienna Convention* had also ratified the *Montreal Protocol*. For an explanation of the precautionary principle/approach, see section 2.1.4 on the *Cartagena Protocol* below.

⁴⁸⁸ In practice, almost the entire international community – 191 out of 192 States – have ratified the *Vienna Convention* and its *Montreal Protocol*.

to a minimum the generation and transboundary movements of hazardous wastes, and to ensure their environmentally sound management. Parties are not allowed to export wastes to countries that have prohibited the import of such wastes, or that have not consented in writing to the specific import, or when there is reason to believe that the wastes in question will not be managed in an environmentally sound manner.⁴⁹² Trade with non-parties to the Convention is prohibited altogether, except through the conclusion of an agreement.⁴⁹³ Furthermore, the Convention adopts the ‘proximity principle’. The transboundary movement of wastes is only allowed if the exporting State does not have the capacity or facilities to dispose of the wastes in an environmentally sound manner, or when the wastes are required as a raw material for recycling or recovery industries in the importing State, or if it is in accordance with other criteria decided by the Parties. In addition, Article 4 requires wastes to be packaged, labelled and transported in conformity with generally accepted international rules and standards.⁴⁹⁴ Article 6 provides for an extensive procedure for the transboundary movement of hazardous wastes, based upon notification by the exporting Party and prior informed consent by the importing State.

Finally, Article 11 allows Parties to ‘enter into bilateral, or regional agreements or arrangements regarding transboundary movement of hazardous wastes or other wastes with Parties or non-parties provided that such agreements or arrangements do not derogate from the environmentally sound management of hazardous wastes and other wastes as required by this Convention’.

Furthermore, the provisions in these agreements or arrangements are not to be less environmentally sound. Examples of such regional agreements are the *1991 Bamako Convention* between the members of the former Organization of African Unity – which even provides for a complete import ban of hazardous wastes from non-Parties into Africa – and the *1995 Waigani Convention* between the Pacific

Island developing countries.⁴⁹⁵ Also, reference can be made to Article 32 of the 2000 *Cotonou Agreement*, a mixed partnership agreement between the European Communities and the Member States of the EU on the one hand, and the African, Caribbean and Pacific (ACP) countries on the other, and to the EC Waste Shipment Regulation 259/93. Unlike its predecessor, the *Lomé IV Convention*, which contained a detailed provision on waste management, the *Cotonou Agreement* confines itself in Article 32 to mentioning that ‘cooperation on environmental protection and sustainable utilisation and management of natural resources shall [take] into account issues relating to the transport and disposal of hazardous waste’.⁴⁹⁶ The EC Waste Shipment Regulation contains a regime for members of the European Community concerning the shipment of hazardous wastes within, into and out of the European Community.⁴⁹⁷

At least two features of the regime for the transboundary movement of wastes as set out in the *Basel Convention* are problematic in view of the requirements of WTO law.⁴⁹⁸ First, Article 4(5) of the *Basel Convention* prohibits Parties to trade with non-parties, which constitutes a violation of Articles I and XI of the GATT. The Convention does not include any exceptions to this rule, except for the possibility for a Party to conclude an agreement with a non-party through Article XI of the Convention. Nonetheless, held against the requirements of Article XX(b) of the GATT, this restriction may pass the test. The possibility offered by the Convention to conclude an agreement with a non-party – supplementary to the option for a non-party to join the Convention – may be deemed compatible with the ‘good faith efforts’ requirements as set out by the Appellate Body in *US – Shrimp (Article 21.5 – Malaysia)*.

The second aspect relates to the decisions by the second and third Conferences of the Parties to install an export ban on hazardous wastes from OECD countries to

492 The second Conference of the Parties approved a ban for all export by OECD countries to non-OECD countries, known as the ‘Basel ban’. Failing to receive the required number of ratifications, the ban has not yet entered into force. See P. Sands, *Principles of International Environmental Law*, 2nd edition (Cambridge: Cambridge University Press, 2003), pp.694-695.

493 See Article 11 further below.

494 This requirement is in conformity with and even exceeds the requirements of the *TBT* and *SPS Agreements*. Article 2.4 of the *TBT Agreement* requires national measures to be based on relevant international standards, if available. Article 3.1 of the *SPS Agreement* requires Members to base their national measures on international standards, guidelines or recommendations, where they exist.

495 *Bamako Convention on the ban of the Import into Africa and the Control of Transboundary Movement of Hazardous Wastes within Africa*, concluded in Bamako on 30 January 1991 (entry into force 10 March 1999); *Convention to Ban the Importation Into Forum Island Countries of Hazardous and Radioactive Wastes and to Control the Transboundary Movement and Management of Hazardous Wastes within the South Pacific Region*, concluded in Waigani on 16 September 1995 (not yet in force).

496 Article 39 of the *Lomé IV Convention* contained a prohibition on the movement of hazardous and radioactive wastes from EC to ACP states and provided for consultation between Parties in case of difficulties.

497 Council Regulation (EEC) No. 259/93 of 1 February 1993 on the supervision and control of shipments of waste within, into and out of the European Community. *Official Journal* L 30, 6/2/1993, p.1, as amended.

498 The packaging and labelling requirements of Article 4(7)b could also pose problems. However, the *Basel Convention* requires these measures to be in conformity with ‘generally accepted and recognized international rules and standards’. This is compatible with the ‘international standards’ rule of the *SPS* and *TBT Agreements*.

developing countries, which also includes a ban on the export of hazardous wastes for recycling purposes. Although the Convention applies to both hazardous and other wastes, the 'Basel ban' – not yet applied – only prohibits shipments of hazardous wastes from industrialized to developing countries. Schoenbaum has argued that 'an export ban on hazardous wastes may be justified under GATT Article XX(b) on the same basis as export restrictions on domestically prohibited goods' because they 'have the potential to endanger human health and the environment'. In his opinion,

*even a discriminatory export ban may be upheld under Article XX(b) if the discrimination is not 'arbitrary or unjustifiable ... between countries where the same conditions prevail'. A ban that distinguishes between OECD and developing countries, arguably at least, could pass this test because of the very different conditions in developing countries.'*⁴⁹⁹

Actually, this is far from certain. First, the GATT does not contain an explicit exception for trade in dangerous goods. Second, the 'Basel ban' aims at extraterritorial application. If there is no genuine connection with the interests of the exporting party, i.e. to protect the health of its inhabitants or its domestic environment, it is doubtful whether the ban will be compatible with WTO obligations. The exporting state would have to prove that the environmentally unsound management of wastes in the importing state poses a risk to human health or the environment of the exporting state. This might be the case if the wastes were to pollute the sea.⁵⁰⁰

2.1.4 Convention on Biological Diversity and the Cartagena Protocol on Biosafety

The *Convention on Biological Diversity* is a multilateral convention that aims at

*the conservation of biological diversity, the sustainable use of its components and the fair and equitable sharing of the benefits arising out of the utilization of genetic resources, including by appropriate access to genetic resources and by appropriate transfer of relevant technologies, taking into account all rights over those resources and to technologies, and by appropriate funding.*⁵⁰¹

Article 2 of the Convention defines biological diversity as 'the variability among living organisms from all sources including, inter alia, terrestrial, marine and other aquatic ecosystems and the ecological complexes of which they are part; this includes diversity within species, between species and of ecosystems.' Although the *Biodiversity Convention* sets only broad policy goals and does not contain specific trade-related measures, it does contain some provisions that have been the subject of considerable debate within the context of the *TRIPS Agreement* on the protection of intellectual property. These provisions relate to the protection of traditional knowledge and folklore (Article 8(j)); the sharing of benefits arising out of the utilization of genetic resources (Article 15); access to and transfer of technology, including biotechnology (Article 16); and the handling of biotechnology and the distribution of its benefits (Article 19). A particular controversial subject is the sharing of benefits arising from traditional knowledge and genetic resources. Indigenous peoples have acquired knowledge of genetic resources over centuries, without being able to identify a specific inventor as required under the *TRIPS Agreement*.⁵⁰² Therefore, the pharmaceuticals industry has been able to register patents on plants and herbs for their medicinal effects without seeking the permission of, or having to compensate the original holders of the knowledge. The *Biodiversity Convention* purports to make this practice more difficult in the future.⁵⁰³

On 29 January 2000, a Protocol to the *Convention on Biological Diversity* was adopted. The *Cartagena Protocol on Biosafety* addresses the issue of genetic modification through biotechnology. It intends to minimize the potential risks for the environment and human health surrounding the use of living modified organisms, better known as genetically modified organisms (GMOs). It aims to ensure

*an adequate level of protection in the field of the safe transfer, handling and use of living modified organisms resulting from modern biotechnology that may have adverse effects on the conservation and sustainable use of biological diversity, taking also into account risks to human health.*⁵⁰⁴

For this purpose, the *Cartagena Protocol* establishes a regulatory framework for the use or transboundary movement of GMOs consisting of different procedures,

499 T. Schoenbaum, 'International trade and environmental protection', in P. Birnie and A. Boyle, eds, *International Law and the Environment*, 2nd edition (Oxford: Oxford University Press, 2002), p.727. Also, see M. Matsushita, T.J. Schoenbaum and P.C. Mavroidis, *The World Trade Organization: Law, Policy and Practice*, 2nd edition (Oxford: Oxford University Press, 2006), p.822.

500 See also Part I of this study for a discussion on the scope of Article XX(b) of the GATT.

501 *Convention on Biological Diversity*, concluded in Rio de Janeiro on 5 June 1992 (entry into force 29 December 1993), 31 *ILM* 818 (1992). As of early 2007, 190 states had ratified the *Biodiversity Convention*.

502 See C. Dommen, 'Raising human rights concerns in the WTO', in *Human Rights Quarterly*, vol. 24 (2002), pp.38-39.

503 On this subject, see P. Birnie and A. Boyle, *International Law and the Environment*, pp.733-734.

504 *Cartagena Protocol on Biosafety to the Convention on Biological Diversity*, concluded in Montreal on 29 January 2000 (entry into force 11 September 2003), 39 *ILM* 1027 (2000). As of early 2007, 138 states had ratified the *Cartagena Protocol*.

depending on the purpose of the use or the transboundary movement (e.g. the advanced informed agreement procedure of Articles 8–10 and 12 for the intentional introduction of GMOs into the environment of the importing Party, or the simplified procedure of Article 11 for the direct use of GMOs as food or feed or for processing). A Party is free to decide, on the basis of a risk assessment, whether it will allow a certain GMO on its territory or not.

The Protocol further stipulates, in Articles 10.6 and 11.8, that

lack of scientific certainty due to insufficient relevant scientific information and knowledge regarding the extent of the potential adverse effects of a living modified organism on the conservation and sustainable use of biological diversity in the Party of import, taking also into account risks to human health, shall not prevent that Party from taking a decision [...] in order to avoid or minimize such potential adverse effects.

These provisions incorporate the precautionary principle, sometimes referred to as the precautionary approach. In a somewhat other – more restricted – form, this principle is also incorporated into Article 5.7 of the *SPS Agreement*, which allows WTO Members to provisionally adopt sanitary or phytosanitary measures on the basis of available pertinent information, in cases where relevant scientific evidence is insufficient.⁵⁰⁵ This right is coupled with the obligation for Members to ‘seek to obtain the additional information necessary for a more objective assessment of risk and review the sanitary or phytosanitary measure accordingly within a reasonable period of time’. What constitutes ‘a reasonable period of time’ depends on the specific circumstances of the case and must therefore be determined on a case-by-case basis. Yet, Members have to make a real effort to seek to obtain additional information necessary to conduct a risk assessment.⁵⁰⁶ In other words, as long as measures taken under the *Cartagena Protocol* are based on available pertinent information, and Parties make a genuine effort to seek additional information to conduct a risk assessment, these measures are compatible with WTO law.

2.1.5 United Nations Framework Convention on Climate Change and the Kyoto Protocol

The *United Nations Framework Convention on Climate Change* is a multilateral convention that aims to achieve ‘the stabilization of greenhouse gas concentrations in the atmosphere at a level that would prevent dangerous anthropogenic interference with the climate system’ and applies to all greenhouse gases not controlled by the *Montreal Protocol*.⁵⁰⁷

Just like the *Montreal Protocol* and the *Cartagena Protocol*, the *Convention on Climate Change* adopts a precautionary approach. Article 3(3) states that ‘where there are threats of serious and irreversible damage, lack of full scientific certainty should not be used as a reason for postponing such measures’. Furthermore, the preamble to the Convention pronounces climate change to be a ‘common concern of humankind’, which calls for the ‘widest possible cooperation by all countries’. However, since ‘the largest share of historical and current global emissions has originated in developed countries’ and since they have the financial and technological capabilities, the Convention proclaims that these countries should take the lead in combating the adverse effects of climate change. Therefore, the Convention adopts the principle of ‘common but differentiated responsibilities’ as one of the cornerstones of the climate change regime, together with the principle of equity. This is made explicit in the commitments of Parties, as formulated in Article 4 of the Convention. Article 4(1) contains a number of general policy guidelines and reporting requirements that apply to all Parties.⁵⁰⁸ In this respect, Article 4(2) formulates stricter requirements for the industrialized countries and for those with economies in transition. For the latter category, some flexibility is allowed. Furthermore, industrialized countries must provide financial resources and transfer technology to developing-country Parties.⁵⁰⁹ The extent to which developing countries are required to implement the Convention is made

505 In *EC – Hormones*, the Panel considered that the precautionary principle would not override the explicit wording of Articles 5.1 and 5.2 of the *SPS Agreement*, ‘in particular since the precautionary principle has been incorporated and given a specific meaning in Article 5.7 of the *SPS Agreement*’. The Appellate Body determined that Article 5.7 of the *SPS Agreement* does not exhaust the relevance of a precautionary principle. However, in the view of the Appellate Body, the principle ‘at least outside the field of international environmental law, still awaits authoritative formulation’. Therefore, the Appellate Body upheld the finding of the Panel that the precautionary principle does not override the provisions of Articles 5.1 and 5.2 of the *SPS Agreement*. See on this subject also S. Safrin, ‘Treaties in collision? The Biosafety Protocol and the World Trade Organization Agreements’, in *American Journal of International Law*, vol. 96, no. 3 (2002), p.610; and S.D. Murphy, ‘Biotechnology and international law’, in *Harvard International Law Journal*, vol. 42, no. 1 (2001), pp.47-139.

506 See Appellate Body Report, *Japan – Agricultural Products II*.

507 *United Nations Framework Convention on Climate Change*, concluded in New York on 9 May 1992 (entry into force 21 March 1994) 31 *ILM* 849 (1992). As of early 2007, 190 States had ratified the *Climate Change Convention*.

508 The *Climate Change Convention* differentiates between three groups of countries, listed in the appendices to the Convention. The first group consists of industrialized Parties (listed in Appendix II). The second group consists of the industrialized countries and of countries undergoing the process of transformation from a planned to a market economy (Appendix I). The third group consists of developing countries (non-Annex I countries).

509 See Article 4(3) to (5) of the Convention.

dependent on the effective implementation by industrialized countries of their commitments relating to financial resources and transfer of technology.⁵¹⁰

The *Convention on Climate Change* does not contain specific obligations concerning the reduction of greenhouse gases. These must be regulated through protocols. The *Kyoto Protocol*, containing a framework of measures for the reduction of greenhouse gas emissions until the year 2012, was adopted in 1997⁵¹¹ and entered into force in 2005. The *Kyoto Protocol* is guided by the same principles as the *Convention on Climate Change*. These take shape in the Protocol's regime, which only imposes targets for the limitation and reduction of greenhouse gases on industrialized countries and on countries with economies in transition (the Annex I countries, listed in Annex B to the Protocol). Furthermore, Article 11(2) of the Protocol reiterates the obligations for industrialized countries under the Convention, i.e. to provide additional financial resources to assist developing countries with the implementation of the Convention. In order to achieve the emissions reduction targets, Parties are to implement measures into their domestic policies. To this effect, Article 2 of the Protocol contains a list of potential policy instruments. Complementary to domestic measures, Parties are allowed to fulfil their commitments by reducing emissions abroad if this is more cost-effective than in their own countries. For this purpose, the Protocol contains three flexible mechanisms:

- the Joint Implementation mechanism, which allows Annex I Parties to transfer to or acquire from other Annex I Parties emission reduction units resulting from projects aimed at reducing emissions by sources or enhancing removals by sinks (Article 6);
- the Clean Development Mechanism, which makes it possible for Annex I countries to gain emission credits from projects in non-Annex I countries aimed at achieving sustainable development (Article 12); and
- Emissions Trading, which allows the countries listed in Annex B (the Annex I countries) to trade emission credits amongst each other (Article 17).⁵¹²

Although the principles of both the Convention and the Protocol appear to be compatible with WTO law, certain measures taken pursuant to the *Kyoto Protocol* could resort to discrimination or be trade restrictive. The *Kyoto Protocol* leaves it open to Parties to decide on the domestic measures they will take to reach their emissions reduction targets. A number of countries have adopted measures – such as energy labelling, subsidies to promote the development and consumption of green energy, carbon and energy taxes, and border adjustment measures – that might conflict with WTO rules.⁵¹³ As far as the flexible mechanisms of the Protocol are concerned, it is not certain yet whether they are compatible with the WTO agreements.⁵¹⁴ Furthermore, it is not yet clear whether the WTO Agreement applies to emissions trading, since it is uncertain whether 'emission credits' can be defined as either goods or services.⁵¹⁵

2.1.6 UN Fish Stocks Agreement

The *UN Agreement for the Implementation of the Provisions of the United Nations Convention on the Law of the Sea of 10 December 1982 relating to the Conservation and Management of Straddling Fish Stocks and Highly Migratory Fish Stocks*, commonly known as the Straddling Stocks Agreement, is a multilateral agreement that aims 'to ensure the long-term conservation and sustainable use of straddling fish stocks and highly migratory fish stocks' (Article 2).⁵¹⁶ As the full title suggests, this Agreement is supplementary to the *UN Convention on the Law of the Sea* and must be 'interpreted and applied in the context of and in a manner

513 These types of unilateral measures are considered more generally in Part I of this study on the compatibility of unilateral measures to protect environmental and social concerns with WTO law. For a more specific analysis of the compatibility of measures taken pursuant to the Kyoto Protocol with WTO law, see also *Climate and Trade Rules: Harmony or Conflict?*, Report by the Swedish National Board of Trade, September 2004. Available at www.kommers.se.

514 In their report, the Swedish National Board of Trade raises the question of whether the free allocation of emission credits within the European Union under the Joint Implementation Mechanism might constitute a subsidy in the sense of the *SCM Agreement*. However, as long as the system of allocation is designed and applied in a non-discriminatory way, it should be in conformity with WTO law. Also, with respect to the Clean Development Mechanism, problems could arise with regard to the transfer of technology in relation to the *TRIPS Agreement*. This problem, which is common to all environmental agreements providing for the transfer of technology to developing countries, will be discussed below.

515 Swedish National Board of Trade, *Climate and Trade Rules*. See also T. Brewer, 'The WTO and the Kyoto Protocol: Interaction issues', in *Climate Policy*, vol. 4 (2004), pp.3-12.

516 *UN Agreement for the Implementation of the Provisions of the United Nations Convention on the Law of the Sea of 10 December 1982 relating to the Conservation and Management of Straddling Fish Stocks and Highly Migratory Fish Stocks*, concluded in New York on 3 August 1995 (entry into force 11 December 2001) 34 *ILM* 1542 (1995). As of early 2007, 65 states had ratified the *Straddling Stocks Agreement*.

510 See Article 4(7) of the Convention.

511 *Kyoto Protocol to the United Nations Framework Convention on Climate Change*, concluded in Kyoto on 11 December 1997 (entry into force 16 February 2005) 37 *ILM* 22 (1998). As of early 2007, 169 Parties to the *Climate Change Convention* had joined the Protocol.

512 On the joint implementation mechanism, see O. Kuik, P. Peters and N.J. Schrijver (eds.), *Joint Implementation to Curb Climate Change* (Dordrecht: Kluwer Academic Publishers, 1994). On the subject of climate change, see also J. Gupta, *The Climate Change Convention and Developing Countries: From Conflict to Consensus?* Environment and Policy Series (Dordrecht: Kluwer Academic Publishers, 1997).

consistent with the Convention' (Article 4).

The *Straddling Stocks Agreement* adopts a precautionary approach to the conservation, management and exploitation of straddling and highly migratory fish stocks, and applies principally to fish stocks beyond areas under national jurisdiction.⁵¹⁷ Parties are to set precautionary reference points to guarantee the conservation and sound management of a stock, which may not be exceeded. Furthermore, under the Agreement Parties have a duty to cooperate in the conservation and management of fish stocks. In order to make this cooperation effective, Article 8 of the Agreement provides for Parties to give effect to their duty to cooperate by becoming a member of a sub-regional or regional fisheries management organization or a participant in a fisheries management arrangement which has the competence to establish conservation and management measures for particular straddling or highly migratory fish stocks. Parties can also agree 'to apply the conservation and management measures established by such an organization or arrangement' or, where such an organization or arrangement does not exist, establish a new organization.

The Agreement does not use trade-restrictive measures to further its objectives. Nonetheless, some of its provisions may have a bearing on trade. These provisions relate to Parties that are not members of a (sub)regional organization or participants in an arrangement (Article 17.4) on the one hand, and to non-parties to the Agreement (Article 33.2) on the other. The relevant provisions determine that members of a (sub)regional organization or participants in an arrangement shall take measures consistent with this Agreement and international law to deter activities of vessels which undermine the effectiveness of sub-regional or regional conservation and management objectives (Article 17.4), or which undermine the effective implementation of the Agreement (Article 33.2). Although these provisions do not restrict trade in a strict sense, a consistent application of the Agreement will result in a *de facto* import ban by the members of such organizations or participants in such arrangements on fish caught by these States. After all, if members of such organizations or participants in such arrangements are held to deter the fishing activities of other States, they will certainly not buy the fish. Although these provisions are not themselves incompatible with WTO law, the unilateral measures adopted to give effect to these provisions will be incompatible with Article XI of the GATT. It remains to be seen whether these may be justified under Article XX(b) or (g), since the provisions apply primarily to activities outside the limits of national economic jurisdiction. On the other hand, since the object of the treaty concerned constitutes 'migratory' fish, it could be argued on the basis of the Appellate Body Report in *US – Shrimp* that a sufficient nexus exists between

unilateral measures adopted pursuant to the Agreement and the interests of the States concerned in protecting these fish.⁵¹⁸

2.1.7 Some common features of environmental agreements

The majority of the environmental treaties discussed in this section contain provisions restricting or prohibiting trade with non-Parties to the agreements and/or promoting the transfer of technology to developing countries. Both types of measures potentially conflict with relevant WTO rules.

The restriction or prohibition of trade with non-Parties is a common feature of several environmental agreements. Under CITES, trade with non-Parties is only allowed if these States provide comparable documentation. The *Montreal Protocol* prohibits trade with non-Parties altogether, except for trade with non-Parties who *de facto* abide by the Protocol. Finally, the *Basel Convention* only allows trade with non-Parties through the conclusion of bilateral agreements. The compatibility of this type of trade restriction depends largely on whether they pass the two-tier test of Article XX of the GATT. For the *Basel Convention* and the *Montreal Protocol*, this means that the restrictions must be deemed 'necessary' to attain their objective, while for CITES it must be established that they 'relate to' their objective.⁵¹⁹

As far as *import* prohibitions under the *Montreal Protocol* and the *Basel Convention* are concerned, these could probably be justified under the general exception clauses of Article XX(b) of the GATT, because of the (potentially) harmful effects of the substances covered under these agreements to the human, animal or plant life or health in the importing State. Of course, the contention that these substances are harmful will have to be supported by (some) scientific evidence. A prohibition on the *export* of such substances, on the other hand, will be more difficult to justify under the relevant WTO provisions because of its extraterritorial application. Also, an *export* prohibition under CITES could be justified by reference to Article XX(g) of the GATT relating to the conservation of exhaustible natural resources, but it is uncertain whether this exception could be invoked for an *import* prohibition. Furthermore, it must be determined that the measures do not generally constitute 'arbitrary or unjustifiable discrimination'. Of course, the

518 See Appellate Body Report, *US – Shrimp*. In para. 133, the Appellate Body stated that 'sea turtles are highly migratory animals, passing in and out of waters subject to the rights of jurisdiction of various coastal states and the high seas. [...] The sea turtle species here at stake, i.e., covered by Section 609, are all known to occur in waters over which the United States exercises jurisdiction. [...] in the specific circumstances of the case before us, there is a sufficient nexus between the migratory and endangered marine populations involved and the United States for purposes of Article XX(g)'.

519 See Part I of this study for the different criteria of these tests.

517 The *Straddling Stocks Agreement* also contains some provisions that apply within the jurisdiction of the Party. See Articles 6 and 7 of the Agreement.

measures discriminate between Parties and non-Parties to the agreements. That is not to say that the discrimination is 'arbitrary or unjustifiable'. However, this has to be determined on a case-by-case basis.⁵²⁰

The provisions on the transfer of technology to developing countries in the *Montreal Protocol* and the *Biodiversity* and *Climate Change Conventions* and their Protocols may conflict with intellectual property rights protection under the *TRIPS Agreement*. These provisions require the States Parties to transfer technology to developing countries on preferential terms, while the rights on the technologies involved belong to (private) patent holders. Schoenbaum proposes to resolve these problems through the financial mechanisms of the Conventions. The transfer of technology to developing countries on preferential terms could then be resolved by the provision of financial resources to these countries to be used for the acquisition of technology. With regard to the *Biodiversity Convention*, Schoenbaum argues that

nothing in the TRIPS Agreement would prohibit the use of an international financial mechanism to assure access and the transfer of technology. Articles 15, 16 and 19 can be interpreted to mean that transfer of technology should be left to negotiations between private parties, but should be supplemented where needed by the financial mechanism established by the Convention's contracting parties under Articles 20 and 21.⁵²¹

2.2 International agreements on human rights and labour standards

2.2.1 General remarks

Unlike environmental agreements, most human rights treaties do not contain explicit trade-restrictive provisions. Furthermore, it can be observed that whereas Article XX of the GATT contains an explicit environmental exception, a clear social exception is absent. Also, where trade restrictions under environmental treaties in most cases concern product-related process and production methods, the type of human rights trade measures of concern for the current discussion generally relate to labour standards, a typical example of non-product related PPMs. Important human rights treaties in this respect include the *International Covenants on Economic, Social and Cultural Rights* and *on Civil and Political Rights* as well as the *International Convention on the Elimination of All Forms of Racial Discrimination*;

520 See Part I of this study for a discussion of what constitutes arbitrary or unjustifiable discrimination. See also paragraphs 2.1.1. above and 3.3. below for an analysis in the context of the *US – Shrimp* case.

521 T. Schoenbaum, 'International trade and environmental protection', as quoted by P. Birnie and A. Boyle, *International Law and the Environment*, p.736.

the Convention on the Elimination of All Forms of Discrimination against Women; the Anti-Torture Convention; and the International Convention on the Rights of the Child. These have attained broad – sometimes even almost universal – membership.⁵²² Furthermore, several human rights have achieved the status of customary international law, some even amounting to peremptory norms of international law.⁵²³

This section will concentrate on core labour rights as an example of the relation between core human rights and WTO law. Furthermore, cultural rights will be discussed within the context of the *UNESCO Convention on Cultural Diversity*.

2.2.2 International agreements on labour rights

The link between trade and labour rights is not a new concern to the WTO. Already under the GATT, the issue of 'social dumping' has been discussed. Moreover, the question of including a social clause in the WTO agreement has been on the agenda of the WTO since its very inception.⁵²⁴ Nevertheless, a solution reconciling the divergent interests of industrialized and developing countries on this point is still to be found.

522 *International Covenant on Economic, Social and Cultural Rights*, adopted in New York on 16 December 1966 (entry into force 3 January 1976; 155 parties as of early 2007), 6 *ILM* 368 (1967); *International Covenant on Civil and Political Rights*, adopted in New York on 16 December 1966 (entry into force 23 March 1976; 160 parties as of early 2007), 6 *ILM* 368 (1967); the *International Convention on the Rights of the Child*, adopted in New York on 20 November 1989 (entry into force 2 September 1990; 193 parties as of early 2007), 28 *ILM* 1456 (1989); *Convention against Torture and Other Cruel, Inhuman or Degrading Treatment or Punishment*, adopted in New York on 10 December 1984 (entry into force 26 June 1987; 144 parties), 1465 *UNTS* 85; *Convention on the Elimination of All Forms of Discrimination against Women*, adopted in New York on 18 December 1979 (entry into force 3 September 1981; 185 parties as of early 2007), 19 *ILM* 33 (1980); and *International Convention on the Elimination of All Forms of Racial Discrimination*, adopted in New York on 21 December 1965 (entry into force 4 January 1969; 173 parties as of early 2007), 660 *UNTS* 195.

523 The rights formulated in the *Universal Declaration on Human Rights* (General Assembly Resolution 217A(III), 10 December 1948) are part of customary international law. Examples of peremptory norms include the right to life, the right to be free from torture and other inhumane or degrading treatment or punishment and the right to be free from slavery or servitude. Such non-derogatory human rights norms are listed in Article 4 of the *International Covenant on Civil and Political Rights*.

524 See F. Weiss, 'Trade and labor I', in P.F.J. Macrory, A.E. Appleton and M.G. Plummer, *The World Trade Organization: Economic and Political Analysis*, vol. II (New York: Springer, 2005), pp.572-596.

The WTO has turned to the International Labour Organization (ILO) to deal with the question of setting internationally recognized labour standards.⁵²⁵ In response, the ILO has adopted the *1998 Declaration on Fundamental Principles and Rights at Work* recognizing some of the ILO conventions as containing fundamental rights, which must be respected by all ILO members whether or not they have ratified the relevant conventions.⁵²⁶ Article 2 of the Declaration mentions four categories of fundamental labour rights. These relate to freedom of association and the effective recognition of the right to collective bargaining; the elimination of all forms of forced or compulsory labour; the effective abolition of child labour; and the elimination of discrimination in respect of employment and occupation.⁵²⁷ These rights and prohibitions are also included in the *International Human Rights Covenants* and in the *International Convention on the Rights of the Child*, which is indicative of their paramount importance in the human rights system.⁵²⁸ However, that is not to say they may be used to adopt trade measures to protect labour rights abroad. In this respect, the concluding Article of the Declaration is revealing: ‘nothing in this Declaration and its follow-up shall be invoked or otherwise used for [protectionist trade] purposes’ and ‘the comparative advantage of any country should in no way be called into question by this Declaration and its follow-up’. How should these provisions be interpreted? How should ‘protectionist’ be defined in this respect? The academic literature on this subject does not provide a clear answer to these questions.⁵²⁹ With respect to the use of trade measures to protect core human rights, Cleveland poses that

*under customary international law, states clearly are authorized to adopt trade sanctions to promote human rights values. On the other hand, neither the human rights treaties nor customary international law clearly establishes a right of states to impose human rights trade measures that cannot be overridden by treaty.*⁵³⁰

525 See Article 4 of the *Singapore Ministerial Declaration*, adopted on 13 December 1996, WT/MIN(96)/DEC, 18 December 1996.

526 ILO *Declaration on Fundamental Principles and Rights at Work*, International Labour Conference, 86th session, Geneva, June 1998.

527 The special incentive arrangements for the protection of labour rights under the EU’s Generalized System of Preferences are based on these core labour rights. The compatibility of the GSP with WTO law will be discussed in more detail in section 2.4 below on international measures.

528 See Articles 6, 7(a)i, 7(c), 8 and 10(3) of the *International Covenant on Economic, Social and Cultural Rights*; Articles 8, 22 and 26 of the *International Covenant on Civil and Political Rights*; and Articles 19 and 32 of the *International Convention on the Rights of the Child*. With the exception of the prohibition on child labour, these rights are also included in the *Universal Declaration of Human Rights*.

529 See, for example, F. Weiss, ‘Trade and labor I’, p.573.

530 S. Cleveland, ‘Human rights sanctions and the WTO’, in F. Francioni (ed.), *Environment, Human Rights and International Trade* (Oxford: Hart Publishing, 2001), p.212

Mutatis mutandis, whether states may impose labour rights trade measures beyond their own jurisdiction depends on the hierarchy of the relevant norms. This matter will be discussed in the following section.

2.3 UNESCO Convention on Cultural Diversity

The *Convention on the Protection and Promotion of the Diversity of Cultural Expressions* is a multilateral convention open to all ‘members of the United Nations, or of any of its specialized agencies, that are invited by the General Conference of UNESCO to accede to it’.⁵³¹ The Convention aims *inter alia* ‘to protect and promote the diversity of cultural expressions’ and ‘to give recognition to the distinctive nature of cultural activities, goods and services as vehicles of identity, values and meaning’.⁵³²

For this purpose, Article 2, paragraph 2 of the *Convention on Cultural Diversity* confirms the sovereign right of states ‘to adopt measures and policies to protect and promote the diversity of cultural expressions within their territory’. These measures and policies may consist *inter alia* in providing public financial assistance and support to public institutions. Furthermore, Article 8 of the Convention allows Parties to determine ‘the existence of special situations where cultural expressions on its territory are at risk of extinction, under serious threat, or otherwise in need of urgent safeguarding’. In these circumstances, ‘Parties may take all appropriate measures to protect and preserve cultural expressions [...] in a manner consistent with the provisions of this Convention’. These provisions are rather intriguing in light of the WTO *Subsidies and Countervailing Measures (SCM) Agreement* and the principle of non-discrimination in the GATT and the *General Agreement on Trade in Services (GATS)*.

First, the Convention explicitly allows for Parties to provide public financial assistance or support to public institutions. Depending on the kind of measures taken, a conflict with the *SCM Agreement* is foreseeable. This is especially the case with subsidies intended to increase the export of a certain cultural good or

531 Article 27 of the *Convention on the Protection and Promotion of the Diversity of Cultural Expressions*, adopted in Paris on 20 October 2005 (entry into force 18 March 2007), available at www.unesco.org. As of early 2007, 45 states had ratified the Convention on Cultural Diversity.

532 Article 4(3) defines cultural expressions as ‘those expressions that result from the creativity of individuals, groups and societies, and that have cultural content’. According to Article 4(4), cultural activities, goods and services ‘refers to those activities, goods and services, which at the time they are considered as a specific attribute, use or purpose, embody or convey cultural expressions, irrespective of the commercial value they may have. Cultural activities may be an end in themselves, or they may contribute to the production of cultural goods and services’.

service.⁵³³ Second, measures taken by Parties under the Convention to protect and preserve cultural expressions in their territory may include import restrictions or a restriction of market access, which results in a conflict with Article XI of the GATT or Article XVI of the GATS, respectively. Third, a conflict with GATT Article III or GATS Article XVII on national treatment may occur, since the Convention implicitly allows Parties to favour domestic cultural goods and services over foreign goods and services.⁵³⁴ The potential for conflict also depends on the scope of the Convention. Of course, products like movies, books, magazines or music qualify as cultural goods and services, but one could also imagine that the Convention applies to specific local products like champagne or parmesan cheese,⁵³⁵ which could be defined as embodying a cultural expression.

Moreover, the potential for conflict is reinforced through the Convention's dispute settlement mechanism, which may be an alternative to WTO dispute settlement.⁵³⁶ The Convention does not contain a clear-cut conflict rule as to its relationship to other treaties, such as the WTO agreements. Article 20 of the Convention calls on Parties to 'foster mutual supportiveness' between this Convention and other treaties, and to 'take into account the relevant provisions of this Convention' when interpreting or applying other treaties, while at the same time it determines that 'nothing in this Convention shall be interpreted as modifying the rights and obligations of the Parties under any other treaties to which they are parties'. This means that disputes between Parties to the Convention who are also WTO Members can be settled both through the dispute settlement mechanism of the *Convention on Cultural Diversity* and through the WTO dispute settlement mechanism. Depending on the law these dispute settlement bodies will apply, this could lead to inconsistencies in case law between the two systems. This is especially so since it is not clear whether WTO dispute settlement bodies are allowed to consider obligations under non-WTO agreements. An even more difficult problem would arise if a non-Party to this Convention were to bring a complaint before a WTO Panel against a Party to the Convention.

These issues will be considered more generally in the next section.⁵³⁷

2.4 International measures addressing non-trade concerns

2.4.1 General remarks

An increasing number of regulatory programmes addressing socially and environmentally sound production are being developed at the international level. Examples of such programmes include those adopted by intergovernmental organizations such as the EU's Generalized System of Preferences (GSP); by the private sector, such as the Euro Retailer Working Group Good Agricultural Practices (EurepGAP); and by non-governmental organizations (NGOs), such as the Forest Stewardship Council certification programme for timber, and the Sustainable Agriculture Network (SAN) certification programme.⁵³⁸ An example of an intergovernmental programme providing for special incentive arrangements with regard to environmentally and socially sound production in developing countries is the EU's GSP. These programmes should be distinguished from those exclusively aimed at setting standards in the field of product-related process and production methods, such as the joint FAO/WHO Food Standards Programme under the auspices of the Codex Alimentarius Commission. This programme exclusively develops standards in the field of food and consumer safety. For the purpose of the current discussion, which focuses on non-product related PPMs, the work of the Codex Alimentarius Commission is therefore considered to be outside the scope of this study.

2.4.2 Certification programmes

Certification programmes developed by NGOs and/or the private sector are voluntary in nature and are primarily aimed at enabling consumers to make informed choices concerning the products they buy. Relevant examples of these programmes include the Forest Stewardship Council (FSC) certification programme for sustainable timber, the Sustainable Agriculture Network (SAN) certification programme initiated by the Rainforest Alliance, and the Fair Trade Organizations programme. Whereas the aforementioned certification programmes are aimed at the labelling of products to inform consumers, other programmes, such as EurepGAP, a partnership of agricultural producers and retailers, use certification for the purpose of informing retailers. They also set standards for Good Agricultural Practice (GAP).⁵³⁹

533 The *SCM Agreement* distinguishes 'prohibited subsidies' from 'actionable subsidies'. The example quoted above would fall within the category of prohibited subsidies, since it is designed to disrupt trade. On this subject, see Part I of this study.

534 On this subject, see T. Voon, 'UNESCO and the WTO: A clash of cultures?' in *International and Comparative Law Quarterly*, vol. 55 (2006), pp.635-652; and J. Pauwelyn, 'The UNESCO Convention on Cultural Diversity and the WTO: Diversity in international lawmaking?', in *ASIL Insights*, 15 November 2005, available at www.asil.org/insights/2005/11/insights051115.html.

535 See J. Pauwelyn, *ibid.*

536 The Convention's dispute settlement mechanism provides for conciliation concerning the interpretation or the application of the Convention by a Conciliation Committee. See Article 25 of the Convention and the Annex to the *Convention on Cultural Diversity*.

537 For a discussion of the relation between the two systems and their dispute settlements mechanisms, see T. Voon, 'UNESCO and the WTO: A clash of cultures?', pp.635-652; and J. Pauwelyn, 'The UNESCO Convention on Cultural Diversity and the WTO'.

538 On the issue of international standards and the requirements of the *TBT Agreement*, see Part I of this study.

539 See EurepGAP: www.eurepgap.org.

All of these programmes address both environmental and social concerns. The criteria for certification under these programmes are largely based on principles from international social and environmental conventions, such as the ILO Conventions and environmental agreements such as CITES and the *Biodiversity Convention*. Since adherence to these programmes is voluntary and does not involve government regulation, they fall outside the scope of the GATT.⁵⁴⁰ The *TBT Agreement*, on the other hand, expressly covers voluntary standards set by ‘recognized’ bodies.⁵⁴¹ Annex 1.2 to the *TBT Agreement* defines standards as documents

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.

The *TBT Agreement* does not define what should be understood by a ‘recognized body’. Also, it is not clear whether the *TBT Agreement* covers non-product related processes and production methods. Whereas the first sentence of the provision expressly refers to ‘related’ processes and production methods, a specific reference in this regard is missing in the second sentence.⁵⁴² The 2001 Doha Ministerial Conference instructed the WTO Committee on Trade and Environment ‘to give particular attention to [...] labelling requirements for environmental purposes’.⁵⁴³ To date, however, the Committee has not made any substantial progress in this field.

2.4.3 Some concluding observations

This section has revealed a number of potential conflicts between international environmental and human rights agreements and measures addressing non-trade concerns on the one hand, and WTO agreements on the other. It has also highlighted the basic differences between the environmental and human rights systems, in the sense that environmental treaties explicitly use trade measures to further their objectives while human rights treaties do not. Also, where trade restrictions under environmental treaties in most cases concern product-related processes and production methods, the type of human rights trade measures of concern for the current discussion generally relate to labour standards, a typical example of non-product related PPMs.

Finally, whereas the GATT contains a clear environmental exception, an explicit social clause is absent. The only option to address non-product related social concerns will be under the public morals exception of Article XX(a) of the GATT. These differences are also of relevance for the determination of the relation between WTO law and other international agreements, discussed in the following section.

3 Relation between WTO law and other international agreements and measures

3.1 General remarks

In this section, the relation between WTO law and other international agreements and measures is considered in more detail. Most authors regard trade law, human rights law and environmental law as three different branches of public international law, without an *a priori* hierarchy between these systems.⁵⁴⁴ This means that conflicts between WTO agreements and other agreements must be considered according to the general rules of treaty interpretation and the general rules of international law for resolving conflicts between norms.

In this section, the relation between these different branches of international law will be considered through an evaluation of these rules. Also, the place and role of other agreements and measures in WTO practice will be assessed.

⁵⁴⁴ See J. Pauwelyn, *Conflict of Norms in Public International Law: How WTO Law Relates to Other Rules of International Law* (Cambridge: Cambridge University Press, 2003); T. Cottier, ‘Trade and human rights: A relationship to discover’, in *Journal of International Economic Law*, vol.5 (2002), pp.114-115; and E.U. Petersmann, ‘Human rights and the law of the World Trade Organization’, in *Journal of World Trade*, vol. 37 (2003), pp.241-281.

⁵⁴⁰ If a government would were to decide to set voluntary standards (for the purpose of certification), the GATT principles on non-discrimination would apply. It should also be noted that – depending on their requirements – certification programmes can harm the opportunities for market access of producers in developing countries. Whereas the Fair Trade programme provides certification free of charge for small-scale producers in developing countries, the strict tracking-and-tracing requirements and social criteria of the Forest Stewardship Council programme, for example, place a heavy burden on (small-scale) producers in developing countries. Since it is difficult and costly for these producers to meet the requirements of the programme, their access to the market for sustainable timber is thus *de facto* restricted.

⁵⁴¹ See also Part I of this study.

⁵⁴² See C. Dankers, *Environmental and Social Standards, Certification and Labelling* (Rome: UN Food and Agriculture Organization, 2003), p.76, and Part I of this study.

⁵⁴³ See Article 32(iii) of the 2001 Doha Declaration.

3.2 Conflict rules

As no *a priori* hierarchy exists between trade law, human rights law and environmental law, a conflict between norms in these fields must in principle be resolved through the rules of treaty interpretation of Article 31 of the *Vienna Convention on the Law of Treaties*, and through the conflict rules of Article 30 of the *Vienna Convention*.⁵⁴⁵

First, Article 31 of the *Vienna Convention on the Law of Treaties* determines 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’. Article 31(2) specifies what should be understood by the context of a treaty, while Article 31(3) provides, *inter alia*, for ‘any applicable rules of international law applicable in the relations between the parties’ to be taken into account.⁵⁴⁶ In *US – Gasoline*, the Appellate Body concluded that this general rule for interpretation has attained the status of customary international law and thus forms part of the customary rules of interpretation of public international law that WTO dispute settlement bodies must use to clarify the provisions of the WTO agreements, as indicated in Article 3.2 of the *WTO Dispute Settlement Understanding* (DSU).⁵⁴⁷ Hence, WTO adjudicating bodies must interpret the WTO agreements ‘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’. In doing so, they must take into account ‘any relevant rules of international law applicable in the relations between the parties’.

In the recent *EC – Biotech Products* case, the Panel qualified the latter rule for interpretation. It acknowledged that Article 31(3)(c) ‘...should be interpreted to mandate consideration of rules of international law which are applicable between all parties to the treaty which is being interpreted’. This approach seems to imply that WTO adjudicating bodies are only required to consider other rules of international law when interpreting a WTO Agreement if these are applicable between all WTO Members. This limits the scope of Article 31(3)(c) of the *Vienna Convention* to treaties to which all WTO Members are party and to general international law, including customary international law and general principles of law. In all other situations, the Panel found that WTO dispute settlement bodies

545 The focus will be on conflicts in the applicable law. The issue of inherent normative conflict will be left aside.

For more on this subject, see J. Pauwelyn, *Conflict of Norms in Public International Law*, pp.275-326.

546 *Ibid.*, pp. 237-274. See also G. Marceau, ‘Conflicts of norms and conflicts of jurisdiction’, pp.1086-1090. As discussed in more detail below, Marceau considers the principles of *lex specialis* and *lex posterior* to be part of the ‘applicable rules of international law’.

547 See Appellate Body Report, *US – Gasoline*, p.17.

‘may consider other relevant rules of international law when interpreting the terms of the WTO Agreements if it deems such rules to be informative’, i.e. to determine the ordinary meaning of the terms of WTO law under Article 31(1) of the *Vienna Convention*.⁵⁴⁸ Yet, this still leaves ample room for dispute settlement bodies to take into account obligations from other international agreements in interpreting WTO law.

As far as interpretation of the terms of WTO law is concerned, the Panels and the Appellate Body have done so on several occasions. In the *EC – Bananas III* case, the Appellate Body, albeit with some reluctance, used the *Lomé Convention* to interpret the GATT/Lomé Waiver adopted by the General Council of the GATT pursuant to Article IX of the *WTO Agreement* at the request of the European Communities and of the 49 out of the 79 ACP States that were also GATT Contracting Parties.⁵⁴⁹ Furthermore, in *US – Shrimp* the Appellate Body referred to a number of international agreements, amongst which the *UN Convention on the Law of the Sea*, CITES and the *Biodiversity Convention*, to determine the meaning of the term ‘exhaustible natural resources’ in the general exception clause (g) of Article XX of the GATT.⁵⁵⁰ The Appellate Body also expressly adopted an evolutionary approach to treaty interpretation, when it determined that the term ‘exhaustible natural resources’ ‘must be read by a treaty interpreter in the light of contemporary concerns of the community of nations about the protection and conservation of the environment’.⁵⁵¹

548 See Panel Report, *EC – Biotech Products*, para 7.49-7.96. For an analysis of the Panel Report, see S. Cho, ‘The WTO Panel on the *EC – Biotech* dispute releases its final report’, in *ASIL Insights*, vol. 10 (2006). For a discussion on the rules of interpretation in the context of the WTO, see J. Pauwelyn, *Conflict of Norms in Public International Law*, pp.257-263.

549 Appellate Body Report, *EC – Bananas III*. The issue at stake was what was ‘required’ under the *Lomé Convention* for the purpose of interpreting the scope of the GATT/Lomé waiver. The operative paragraph of the GATT/Lomé Waiver read: ‘Subject to the terms and conditions set out hereunder, the 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’ [emphasis added].

550 Appellate Body Report, *US – Shrimp*, para 130.

551 *Ibid.* The Office of the High Commissioner for Human Rights recently issued a report on the use of the WTO general exception clauses to protect human rights, in which it asserts on the basis of WTO jurisprudence that ‘international human rights treaties with broad membership would be valid tools to interpret the terms “public morals”, “human life or health” and “public order”’. See Office of the UN High Commissioner for Human Rights, *Human Rights and World Trade Agreements: Using General Exception Clauses to Protect Human Rights* (2005), available at <http://ohchr.org/english/about/publications/docs/WTO.pdf>.

If the conflict cannot be resolved through interpretation of the conflicting treaty provisions, recourse should be made to the conflict rules of Article 30 of the *Vienna Convention* with regard to the application of successive treaties relating to the same subject matter. First, Article 30(2) of the *Vienna Convention* states that ‘when a treaty specifies that it is not to be considered as incompatible with an earlier or later treaty, the provisions of that other treaty prevail’. As far as the *WTO Agreement* is concerned, no general conflict clause in respect of either pre-existing or future treaties is included. This means that in case of conflict between WTO law and other law, the conflict rules of the other treaty should be examined. If this does not resolve the conflict, recourse should be made to the *lex posterior derogat lex anterior* principle of Article 30(4) of the *Vienna Convention* and to the customary international law principle of *lex specialis derogat lex generali*. The first principle relates to the aspect of temporality (a newer rule prevails over an older rule), while the second determines that a more specific obligation should prevail over a more general obligation.

Article 30(4) of the *Vienna Convention* determines that between States parties to both treaties, ‘the earlier treaty applies only to the extent that its provisions are compatible with those of the later treaty’, while between States not party to both treaties, ‘the treaty to which both States are parties governs their mutual rights and obligations’. Although most human rights and environmental agreements predate the 1994 WTO Agreement, the principle is of high relevance for the current discussion. It is generally accepted that the principle applies not only to treaties, but also to other sources of international law.⁵⁵² This means that provisions of human rights or environmental agreements that have crystallized into customary international law since 1994 may be of relevance to determine the obligations of Parties under WTO law. Examples of (emerging) international customary law principles include the precautionary approach, the principle of sustainable use of natural resources, the principle of common but differentiated responsibilities, and the duty to cooperate for sustainable development.

Also, Article 11 of the DSU explicitly allows for WTO dispute settlement bodies – within certain limits - to ‘make such other findings as will assist the DSB in making the recommendations or in giving the rulings provided for in the covered

agreements’.⁵⁵³ In *Korea – Procurement*, the panel stated – albeit in a footnote – with regard to its terms of reference: ‘...we do not see any basis for arguing that the terms of reference are meant to *exclude* reference to the broader rules of customary international law in interpreting a claim properly before the Panel’.⁵⁵⁴

Furthermore, Article 30(5) of the *Vienna Convention* determines that paragraph 4 is without prejudice to the possibility to modify multilateral treaties between certain of the Parties only under Article 41 of the *Vienna Convention*. That article provides the possibility for Parties to the WTO Agreement to modify the treaty between themselves alone if ‘the possibility of such a modification is provided for by the treaty’, or if ‘the modification in question is not prohibited by the treaty and does not affect the enjoyment by the other parties of their rights under the treaty or the performance of their obligations’. The WTO Agreement does not provide for modification, but does not prohibit it either. The question then arises as to whether a modification of the WTO Agreement among certain parties would affect the rights and obligations of other WTO Members. The answer to this question depends on how the WTO is viewed as a legal system and will be discussed in more detail in section 3.3 below.

The second conflict rule determines that a more specific obligation prevails over a more general obligation. Although human rights law, environmental law and trade law as such can all be considered *lex specialis* with regard to general international law, this principle is of high relevance to determine the interplay between specific

553 Article 11 reads: ‘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. Panels should consult regularly with the parties to the dispute and give them adequate opportunity to develop a mutually satisfactory solution’.

554 Panel Report, *Korea – Procurement*, footnote 755. Yet, in paragraph 7.96 of its report, the Panel states with regard to Article 3.2 of the DSU: ‘We take note that Article 3.2 of the DSU requires that we seek within the context of a particular dispute to clarify the existing provisions of the WTO agreements in accordance with customary rules of interpretation of public international law. However, the relationship of the WTO agreements to customary international law is broader than this. Customary international law applies generally to the economic relations between the WTO Members. Such international law applies to the extent that the WTO treaty agreements do not ‘contract out’ from it. To put it another way, to the extent there is no conflict or inconsistency, or an expression in a covered WTO agreement that implies differently, we are of the view that the customary rules of international law apply to the WTO treaties and to the process of treaty formation under the WTO’.

552 The sources of public international law are referred to in Article 38 of the *Statute of the International Court of Justice* and include treaty law out of the 79 customary international law and general principles of international law. There exists no formal hierarchy between these sources.

obligations under human rights or environmental treaties on the one hand, and international trade law on the other. Especially in the context of Article XX of the GATT, obligations under environmental or human rights law may be considered to be *lex specialis* for the purpose of determining the meaning of the exceptions.⁵⁵⁵

Finally, the principle of *lex specialis derogat lex generali* does not apply to rules of general international law that are of a peremptory nature, so-called *jus cogens*. Article 53 of the *Vienna Convention* describes these norms 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.

According to Articles 53 and 64 of the *Vienna Convention*, treaties conflicting with peremptory norms of international law are void. Although only a few norms in international law amount to *jus cogens*, they do have some relevance for this discussion. For example, one of the norms recognized as *jus cogens* is the prohibition on slavery.⁵⁵⁶ This means that trade in products derived from slave labour – an exception not expressly included in the WTO agreements – is prohibited.⁵⁵⁷

3.3 The WTO as a legal system and the nature of WTO obligations

The question of whether application of relevant environmental or human rights norms that have not become part of general international law between Parties to those agreements in WTO dispute settlement is possible, depends on how the WTO is viewed as a legal system and how to view WTO obligations. In this regard, this section will explore the two diametrically opposed conceptions of Marceau and Pauwelyn.

Marceau presents WTO law primarily as a 'specific subsystem of international law with specific rights and obligations, specific claims and causes of action, specific violations, specific enforcement mechanisms and specific remedies in case of their violation'.⁵⁵⁸ In her opinion, a conflict between WTO law and other agreements cannot be resolved through the WTO dispute settlement mechanism. The responsibility of States for violations of their environmental or human rights obligations should be made effective in other fora, 'so that the benefits obtained in one forum may be nullified by the consequences of a violation in another forum'.⁵⁵⁹ Moreover, she argues that 'WTO law 'cannot be overruled by situations and considerations belonging to another subsystem', even when all parties to a WTO dispute are also Parties to the other relevant agreement.⁵⁶⁰ Marceau advocates conflict avoidance through an extensive application of the interpretation rules of Article 31 of the *Vienna Convention*. In her opinion, the principles of *lex posterior* and *lex specialis* may also be considered 'relevant rules of international law' under Article 31(3)(c). This means that as a rule of interpretation, WTO dispute settlement bodies may take into account 'relevant rules' of other treaties, even as a valid legal defence against claims of violation of WTO rules.

In Marceau's opinion, no real conflict exists when a WTO Member invokes a relevant multilateral environmental agreement (MEA) as a defence under Article XX of the GATT against another Member party to that agreement, because Article XX explicitly authorizes trade restrictions for environmental purposes. Also, human rights obligations can be taken into account to interpret the exception of Article XX(a) of the GATT that addresses measures necessary to protect public morals. This can also be the case when the trade measure was not required but permitted, or when the trade measure was taken in pursuance of the objectives of the MEA or human rights treaty.⁵⁶¹ However, when a conflict cannot be avoided through interpretation, Marceau argues that

Article 30 of the Vienna Convention (lex posterior) and the rule on lex specialis may be used to identify which should be the prevailing provision (the 'applicable' provision). Article 30.5 of the Vienna Convention seems to allow two States to modify (distinct from an amendment) their rights and obligations within a multilateral treaty as long as the rights of third States are not affected.⁵⁶²

555 See also G. Marceau, 'Conflicts of norms and conflicts of jurisdiction: The relationship between the WTO Agreement and MEAs and other treaties', in *Journal of World Trade*, vol. 35(6) (2001), pp.1096-1097. Marceau proposes to use the *lex posterior* and *lex specialis* principles as rules of interpretation for determining the 'relevant rules' between WTO Members (Article 31(3)(c) of the *Vienna Convention on the Law of Treaties*).

556 The International Law Commission Special Rapporteur on State Responsibility, James Crawford, mentions the prohibitions against slavery and the slave trade, genocide, aggression, torture, racial discrimination and apartheid, and the obligation to respect the right of self-determination as examples of peremptory norms. See J. Crawford, *The International Law Commission's Articles on State Responsibility: Introduction, Text and Commentaries* (Cambridge University Press, 2002), pp.246-247.

557 It should be noted that slave labour may also be brought under the exception of Article XX(a) of the GATT.

558 G. Marceau, 'WTO dispute settlement and human rights', in *European Journal of International Law* vol. 13 no. 4 (2002), p.755.

559 *Ibid.*, p.805.

560 *Ibid.*, pp.774-775, citing B. Simma, 'Self-contained regimes', *Netherlands Yearbook of International Law*, vol. 16 (1985), p.111.

561 G. Marceau, 'Conflicts of norms and conflicts of jurisdiction', pp.1096-1097.

562 *Ibid.*, p. 1129.

In her opinion, such a situation would not be possible in the context of WTO dispute settlement: allowing a WTO dispute settlement body to give prevalence to a non-WTO norm as between the disputing parties would ‘amend’ the WTO agreement in question, which would also alter the rights and obligations of other WTO members not party to the non-WTO agreement.⁵⁶³

Pauwelyn, on the other hand, makes a clear distinction between the *jurisdiction* of the WTO dispute settlement bodies – which is in his opinion necessarily limited to WTO law – and the *law they may apply* to enforce WTO rules. Pauwelyn argues that although the jurisdiction of the WTO adjudicating bodies is limited to claims under the WTO agreements, this ‘does not mean that the applicable law available to a WTO panel is necessarily limited to WTO covered agreements’.⁵⁶⁴ In his opinion, the dispute settlement system ‘is merely a tool or an instrument to enforce WTO covered agreements as they were created and necessarily continue to exist in the wider corpus of international law’.⁵⁶⁵ Since the terms of reference set out in the *Dispute Settlement Understanding* (DSU) do not explicitly exclude the application of other norms of international law by WTO dispute settlement bodies, Pauwelyn argues that WTO adjudicating bodies are automatically authorized to apply non-WTO norms for the purpose of deciding the WTO claims before them. In his opinion, if WTO adjudicating bodies are authorized to apply rules of general or customary international law to decide WTO claims, they should also be authorized to apply human rights or environmental agreements to decide claims brought under the WTO agreements, provided that all Parties to the dispute are also Parties to the non-WTO agreement in question.⁵⁶⁶

In practice, according to Pauwelyn, this means that if a WTO adjudicating body determines that the non-WTO norm prevails, the *WTO rule cannot be applied*.⁵⁶⁷ If this would not be possible, the WTO dispute settlement mechanism would make it possible for States to opt out of their obligations under environmental or human

rights agreements, which would go ‘to the heart of the legitimacy and democratic content of international law’.⁵⁶⁸ In his opinion, modification of the *WTO Agreement* between Parties to the relevant environmental or human rights agreement is possible since WTO obligations are ‘reciprocal’, whereas human rights and environmental obligations are of an integral nature. Under a multilateral treaty, reciprocal obligations are to be considered as a ‘promise [...] made towards each and every state individually’ whereas ‘integral obligations, in contrast, imply a promise [...] towards the collectivity of all state parties taken together’.⁵⁶⁹ Therefore, if a WTO dispute settlement body gives prevalence to an integral norm from a relevant human rights or environmental treaty, this does not affect the rights and obligations of other WTO Members. It only modifies the relations between the disputing parties, which are all Parties to the non-WTO agreement.

3.4 Other international agreements: alternative or complementary to WTO law?

The previous section has highlighted the different conceptions in the academic literature on the WTO as a legal system. The answer to this question is of high relevance in view of the key question of whether environmental and human rights agreements should be considered alternative or complementary to WTO law. It is evident that a narrow conception of the WTO as a closed legal system will lead to a different outcome than a more progressive approach, considering WTO law as part of the wider corpus of international law. A balanced approach to the WTO as a legal system will in this way take into account its place within the wider corpus of international law – e.g. as demonstrated by the reference in the preamble of the *WTO Agreement* to sustainable development and to the international law in the field of sustainable development – but will also accept its limitations as a consequence of its speciality. As the Appellate Body determined in *US – Gasoline*, WTO law should ‘not to be read in clinical isolation from public international law’, but that is not to say that environmental and human rights obligations should automatically be applied as ‘legal norms’ within the context of the WTO.⁵⁷⁰

In the opinion of the present author, using other agreements as interpretation tools to determine the ‘relevant rules of international law applicable between the parties’ under Article 31(3)(c) of the *Vienna Convention*, even by means of the principles of *lex specialis* and *lex posterior*, would clarify the rights and obligations in the *WTO*

563 Article 3.2 of the DSU prohibits WTO adjudicating bodies to ‘add to or diminish the rights and obligations provided in the covered agreements’.

564 J. Pauwelyn, *Conflict of Norms in Public International Law*, p.460.

565 *Ibid*, p.461.

566 It should be noted that WTO dispute settlement bodies can apply other rules when deciding WTO claims, but they cannot judicially enforce these norms. See J. Pauwelyn, *Conflict of Norms in Public International Law*, p.473; G. Marceau, ‘Conflicts of norms and conflicts of jurisdiction’, p.763; and E.U. Petersmann, ‘Human rights and the law of the World Trade Organization’, in *Journal of World Trade*, vol. 37 no. 2 (2003), p.248. In practice, according to Pauwelyn, this means that if a WTO adjudicating body determines that the non-WTO norm prevails, the *WTO rule cannot be applied*.

567 It should be noted that the proper decision of the dispute settlement body would rather be a determination that the WTO norm has not been violated.

568 J. Pauwelyn, *Conflict of Norms in Public International Law*, p.476.

569 *Ibid*, p. 65.

570 Appellate Body Report, *US – Gasoline*.

Agreement in such a way as to bind all WTO Members.⁵⁷¹ It is difficult to imagine an interpretation of the WTO Agreement that would apply to some but not all WTO Members. Also, in the current state of legal doctrine the direct application of non-WTO norms as ‘legal norms’ would be considered a bridge too far. Nonetheless, this should not preclude WTO dispute settlement bodies from expressly considering and/or applying environmental agreements in their analysis of Article XX(b) or (g) and the chapeau of the GATT, especially where it concerns a dispute between WTO Members that are all parties to a relevant MEA or human rights treaty. When not all the parties to the dispute are also parties to the relevant MEA or human rights treaty, these agreements continue to be highly relevant.

With regard to the analysis of the exceptions, besides using environmental agreements to determine the ‘ordinary meaning’ of the WTO provisions, their role as factual evidence is of great importance. The observation that a measure was taken pursuant to a widely ratified environmental agreement could be considered relevant factual evidence that the measure taken was ‘necessary’ for the protection of human, animal or plant life or health, or that it ‘related to’ the conservation of exhaustible natural resources.⁵⁷² The use of environmental agreements as evidence is also of relevance to the analysis of the chapeau. In *US – Shrimp*, the Appellate Body used the *Inter-American Convention for the Protection and Conservation of Sea Turtles* as a factual reference in their analysis of the chapeau.⁵⁷³ Also, in the context of human and labour rights, agreements in these fields could be used to determine the meaning of the term ‘public morals’ in Article XX(a) of the GATT and serve as proof of the importance of the rights incorporated therein.

Furthermore, of particular relevance to the discussion on human and labour rights, is the extraterritorial application of measures taken pursuant to a multilateral treaty. In *US – Shrimp*, the Appellate Body expressly sought to establish a territorial link between the measures applied by the United States to protect sea turtles by resorting to the migration patterns of these animals. It concluded that sea turtles traverse the waters of many countries, including those of the United States. Yet, an evolutionary interpretation of the exceptions of Article XX of the

GATT should have to take into account modern notions such as a duty to cooperate for environmental conservation and to promote respect for human rights, which denote a common interest of the international community in environmental and human rights protection. Although these notions are not yet fully incorporated into general international law, it is to be expected that in future they will find application in WTO dispute settlement practice.

Also in the context of human rights, other notions denoting a common interest of States in the protection of human rights worldwide are emerging. Where gross and massive violations of human rights are at stake, recent developments in international law indicate that it might be possible for states to resort to Chapter VII of the *UN Charter* to adopt targeted economic sanctions.⁵⁷⁴ In addition, States sometimes apply unilateral sanctions, for example the economic sanctions by the European Union and the United States against Burma. These measures could probably be justified under the exceptions of Article XX(a) of the GATT as ‘necessary to protect public morals’ or even under Article XX(b) as ‘necessary to protect human life and health’ because of the *erga omnes* implications of such violations.⁵⁷⁵ Apart from such situations of gross and massive violations of human rights, it seems unlikely that WTO dispute settlement bodies will accept a measure to be ‘necessary to protect human life and health’ under Article XX(b), when it concerns a measure with extraterritorial effect.⁵⁷⁶ With regard to the exception of Article XX(a) of the GATT, in *US – Gambling* the Panel defined the concept of public morals in the context of Article XIV(a) of the GATS as ‘standards of right and wrong conduct maintained by or on behalf of a community or nation’.⁵⁷⁷ Although its scope is far from clear and its precise interpretation depends on the views of the state concerned, it could be contended that an evolutionary interpretation of this provision would include, *inter alia*, some of the core labour standards developed

571 See also J. Pauwelyn, *Conflict of Norms in Public International Law*, p.476. In the view of Pauwelyn, interpreting the WTO treaty differently depending on the parties to a particular dispute, ‘is not allowed and would definitely threaten the uniformity of WTO law’.

572 See also J. Pauwelyn, *Conflict of norms in public international law: how WTO law relates to other rules of international law*, Cambridge: Cambridge University Press (2003), p. 463.

573 The Appellate Body used the *Inter-American Convention* to show the existence of ‘unjustifiable discrimination’. In paragraph 172 of its report, the Appellate Body determined ‘clearly, the United States negotiated seriously with some, but not with other Members (including the appellees), that export shrimp to the United States. The effect is plainly discriminatory and, in our view, unjustifiable’.

574 See the report *Strengthening Targeted Sanctions through Fair and Clear Procedures*, UN Doc. A/60/887-S/2006/331, 14 June 2006.

575 Although in principle the exception of Article XX(b) cannot be invoked for the protection of human rights abroad, it could be argued that ‘gross and massive violations of human rights’ constitute a violation of *erga omnes* obligations, i.e. owed to the entire international community of states, thus giving other States the right to react against these violations. See also G. Marceau, ‘WTO Dispute Settlement and Human Rights’, in *EJIL* (2002), vol. 13 no. 4, p. 811-812.

576 For trade measures relating to the protection of labour standards for example, it is difficult to imagine the importing state having a legitimate interest in protecting labour rights outside its own jurisdiction. It could only claim a derived interest, in the sense that it indirectly violates its own obligations under human rights and labour conventions by profiting from human rights violations committed in the exporting state.

577 Panel Report, *US – Gambling*.

by the ILO, such as those relating to forced and prison labour and the worst forms of child labour.⁵⁷⁸

Finally, an alternative way to ensure that human rights measures, including those relating to labour standards, are compatible with WTO law is to follow the approach adopted in *US – Shrimp*. One of the main reasons why the Appellate Body in *US – Shrimp* determined that the discrimination was unjustifiable was that the United States had treated WTO Members differently by not attempting to negotiate a multilateral treaty with the affected countries, while it had concluded an agreement with others. In *US – Shrimp (Article 21.5 – Malaysia)*, the Appellate Body found that good faith efforts to negotiate a multilateral treaty were sufficient:

*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 fulfil its WTO obligations. Such a requirement would not be reasonable.*⁵⁷⁹

In the light of this decision, the best way to avoid discrimination is to opt for a multilateral agreement expressly containing trade measures to further its objectives. This agreement should be open to all WTO Members and must impose equal obligations on countries where the same conditions prevail. Furthermore, a multilateral treaty that aims at protecting certain core human and labour rights and that uses trade measures to further its objectives could constitute evidence regarding the legitimacy of the measures adopted. In the context of labour standards, the ILO would be the appropriate forum to negotiate such a treaty. Also, special arrangements for certain developing countries, adopted pursuant to the WTO Enabling Clause, if applied in a non-discriminatory way, are a credible alternative for addressing non-trade concerns.

578 It should be noted that prison labour is already listed among the general exceptions of Article XX of the GATT.

579 Appellate Body Report, *US – Shrimp (Article 21.5 – Malaysia)*, para. 123. The Appellate Body also states in paragraph 124 in a more general sense that 'clearly', and 'as far as possible', a multilateral approach is strongly preferred. Yet it is one thing to prefer a multilateral approach in the application of a measure that is provisionally justified under one of the subparagraphs of Article XX of the GATT 1994; it is another to require the conclusion of a multilateral agreement as a condition of avoiding 'arbitrary or unjustifiable discrimination' under the chapeau of Article XX. We see, in this case, no such requirement'.

PART 3
ECONOMIC EFFECTIVENESS AND
EFFICIENCY OF UNILATERAL
NPR PPM MEASURES ADDRESSING
NON-TRADE CONCERNS AND
THEIR IMPACT ON DEVELOPING
COUNTRIES

Gerrit Faber

1 Introduction to the economic analysis of policies

This third part of the report presents an economic analysis of measures addressing non-trade concerns (NTCs). In economic terms, these concerns are approached as market failures. The theory of economic policy has developed a useful approach to address market failures that will be reviewed in section 1.1 below. The rest of Part 3 is devoted to specific measures and tools that are used or have been proposed to address these non-trade concerns.

Section 2 will discuss biofuels (and bioethanol in particular) as an instrument to curb climate change, and will analyse the sustainability of bioethanol production, trade and consumption. Bioethanol and biomass production also offer export opportunities for developing countries, but barriers to trade (trade policy measures, regulatory barriers) may restrict the realization of these opportunities.

Animal welfare is the subject of section 3, in which the tool of labelling will be analysed. Important issues are the information asymmetry of consumers of animal products, the effectiveness of labelling in this respect, and the small market shares of products that have been produced in an animal-friendly way. Measures that address non-trade concerns often incur extra costs for producers in both rich and poor countries. These costs may be borne by consumers, by producers and processors or by retailers. Producers in developing countries may be weak links in the supply chain and will shoulder part of the cost burden, although there may be benefits as well. This issue will be discussed for the cases of bioethanol and labelling.

1.1 Economic analysis of policies to address market failures

Non-trade concerns can be regarded as the result of market failures: people are worried because markets do not produce efficient outcomes, or resources are wasted. There are several reasons for such market failures. First, it may be that the social value of products and services is different from their private value. If so, there is an externality, the quantities supplied and consumed are not in line with the social costs and benefits (polluting activities, knowledge creation).⁵⁸⁰ Second, there may be an information problem. If market parties are not well informed, supply or demand will be distorted (contaminated food, second-hand cars).⁵⁸¹ A third reason is the public good case: private actors cannot produce and sell the product or service at a profit (law and order). Finally, lack of competition may

580 Damage to the global commons (due to climate change) is an example of a negative external effect.

581 Labelling may be an instrument to redress this market failure in particular situations. The economic aspects of labelling are discussed in section 3.

produce a market failure (monopoly prices). Collective decision making is often needed to establish the existence of market failures,⁵⁸² and policies need to be devised and implemented to correct them. As policy-making institutions are not perfect, the corrective policies sometimes give rise to new problems – government failures – such as ineffectiveness (the objective is not realized), and inefficiencies (the objective can be realized at a lower cost and without undesirable side-effects). As this report does not discuss all possible market failures and instruments to redress them, we will limit ourselves to the instruments related to the use of biofuels and to animal welfare.

First, in order to design an effective policy, knowledge is needed about the causes of the market failure and the interrelationships involved in the failure in order to determine which factors should be influenced to produce the desired outcome without undesirable side-effects.

Second, the right instruments should be available to produce the impact on the factors that will lead to the desired outcome. The design of an effective and efficient policy is often complicated by the desire to serve several objectives by using one or a few instruments. Examples include the EU Common Agricultural Policy, which in the early stages used one price instrument to serve five objectives, and the impossibility of using monetary policy to achieve both inflation and employment targets. The Tinbergen rule formulates the solution: the number of independent objectives should be matched by an equal number of independent instruments.⁵⁸³ Thus, measures to increase the share of bioethanol in fuel consumption will reduce the dependence on mineral fuels and thus contribute to energy security. The production of bioethanol might also offer EU farmers new opportunities in times of falling prices and decreasing farm subsidies. Finally, bioethanol may be used in climate policy. If the first or second objective is chosen, this will not by definition reduce emissions of greenhouse gases (GHGs) in an optimal way, as bioethanol may be produced in a relatively climate unfriendly way. Since only one of these three objectives will have to be chosen, we will argue in section 2 that bioethanol should be used primarily to reduce emissions of greenhouse gases.

A policy is efficient if the objective is realized at the lowest cost in welfare terms. A policy instrument that addresses the cause of a market failure directly, i.e. as close to the root of the problem as possible, is more efficient than one that works in an indirect way. Thus, if a domestic market does not produce a product in sufficient quantity at the going price because the private net profit is lower than the social benefit, then paying a subsidy to domestic producers is more efficient than imposing an import tariff on the product. If production or consumption of a product affects the local environment or the global commons, measures that have a direct impact on the cause of the problem (e.g. setting caps on emissions enforced by tradable permits, emission taxes and licences) will be more efficient than measures aimed at curbing production or consumption.

Efficient measures generally provide incentives to realize the desired effect with minimal negative side-effects. Thus, to reduce GHG emissions, one might curb the production and consumption of GHG-emitting activities.⁵⁸⁴ Such ‘command and control regulations’ come at a high welfare cost, however. For example, *non-tradable licences* do not provide an incentive to lower levels of the damaging effect below the permitted level, and create vested interests in the damaging activity.⁵⁸⁵

Economic measures that encourage private parties to develop and apply new technologies and processes (such as engines that emit less or no GHG in combination with new clean fuels) stimulate static and dynamic efficiencies. *Tradable emission permits* are a case in point, as these provide an incentive to lower the negative effect in order to sell the permit. In equilibrium, the permits end up in the hands of those who produce the highest value with the allowed emissions (static efficiency) and propel innovation (dynamic efficiency). Sometimes the most efficient solutions cannot be applied because the costs of organization and implementation may be too high, but there are many second- and third-best options. A *tax on the damaging effect* (e.g. on CO₂ emissions) might work well in theory, but in practice, a first problem connected to tax measures is to define the level of taxes that will exactly redress the market failure. A second problem is that frequent changes in the tax level might be necessary to account for changes in the pre-tax price. The political cost of variable taxes is very high.⁵⁸⁶

Third, the impact of the taxes on the market failure, which may be costly, will have to be monitored. These remarks also apply to the *differential taxes* that have been

582 In some cases, private groups (e.g. producers’ associations) undertake this role.

583 J. Tinbergen, *On the Theory of Economic Policy* (Amsterdam: North-Holland, 1952). See also R.A. Mundell, *International Economics* (New York: Macmillan, 1968). The Tinbergen rule is used in the literature on economic policy-making in various policy areas (e.g. Central Bank monetary policies, macro-economic policies, agricultural policies). See also, e.g. T.R. Michl, *Tinbergen Rules the Taylor Rule*, Working Paper No. 444, Levy Economic Institute, 2006; I. Gombi, (2003) ‘Multiple market intervention for target zones’, in: *The Japanese Economic Review*, vol. 54, no. 1 (2003), pp.75-85; S. Mann, ‘Different perspectives on cross-compliance’, in: *Environmental Values*, vol. 14, no. 4 (2005), pp.471-482.

584 Constraining the level of an activity may be required for other reasons, e.g. lowering traffic density to prevent overcrowding of infrastructure.

585 For an extensive analysis of the tax instrument: OECD, *Environmentally Related Taxes in OECD Countries: Issues and Strategies* (Paris: OECD, 2001).

586 Governments will have to increase carbon taxes if fuel prices fall.

proposed to stimulate products or services that have been produced in a less damaging way or produce less damage in consumption (reduced excise duties or rates of VAT on biofuels, organic meat, low-emission cars, etc.).⁵⁸⁷ In general, the tax instrument is effective, but insufficient to realize the objective. It is often used to facilitate the transition to a new (improved) product (e.g. unleaded petrol) that will be compulsory.

In general, *trade policy measures* are third-best measures, as these interventions are far away from the cause of the market failure. Trade barriers have an effect on domestic and world market prices if there is import demand. Through price changes, there will be an impact on consumption and production. The relative inefficiency of these interventions stem from the fact that they work in an indirect way. An import tariff will reduce the welfare of all domestic consumers or processors (if the product is used as an input for other industries), it will reduce demand and burden the relationship with trade partners. A direct subsidy to producers to increase production comes at a lower welfare cost than import barriers. If a market failure is caused in consumption, an import barrier does not produce much of an incentive to find alternatives that do not have the same problem.

Labelling is one way to diminish information asymmetries.⁵⁸⁸ This is a different objective than *de facto* regulating particular actions by economic agents in the case of externalities. This section mainly addresses one particular type of asymmetric information, namely, the characteristics of the production process that cannot be verified by the consumer. These are the so-called credence attributes of a product.⁵⁸⁹ The supplier may label a product at his own initiative ('first-party labelling' or 'self-declaration'). As suppliers are party in the transaction of selling the product concerned, buyers may distrust the information they provide. In these cases, second- or third-party labelling schemes may be used by industry organizations or by independent agents, respectively. Strictly speaking, the effectiveness and efficiency of labelling should be measured against the objective of lowering the information asymmetry. If the effectiveness of labelling is sufficient, the 'credence good' becomes a 'search good': consumers will be able to buy the preferred product by inspecting the products on offer. Whether this will be realized depends on the communication and design of the label (does the

consumer know what label to look for, is it recognizable?), on its credibility, and on the amount and quality of information provided on other product varieties (there may be an overload of information). In practice, however, many advocates of the measures addressing the non-trade concerns concerned will gauge the effectiveness of labelling with reference to the observed change in the quantities sold of the preferred product. This change will depend not only on the solving of the information asymmetry – well-informed consumers may decide to stick to the conventional product – but also on the buyer's preference for the attribute that is labelled, whether the label is compulsory, whether there is competition with other labels, and product characteristics such as design, and the relative price of the labelled product.

The efficiency of the labelling instrument is difficult to measure, as one has to take into account the efficiency of the labelling and certification, the adaptation of process of producing the labelled product and the effects on non-labelled products. The net welfare effects will vary for different labelling systems and products.⁵⁹⁰ It may be concluded that labelling may be an effective and efficient instrument to solve information asymmetries. If the labelling does not have the effect that campaigners for higher standards hoped for, buyers will continue to choose the 'low standard product' for reasons such as lower prices or other product characteristics. The campaigners will probably try to frame their case as an externality, instead of an information asymmetry. Collective decision making is required to choose between the two alternatives. If an externality is accepted, more interventionist measures will be needed, as discussed above.

In practice, policies do not always stand the tests of effectiveness and efficiency, perhaps due to incomplete information or the absence of 'first-best' policy instruments. In many cases, policy makers design policies in response to the demands of special interest groups. For policy makers it is rational to balance these special interests against the 'general interest'. These special interest groups may form coalitions with groups that campaign for measures to address non-trade concerns, thus producing effective pressure on policy makers.

587 In the early 1990s, most OECD countries levied a lower excise duty on unleaded petrol than on the leaded variety.

588 Other ways to diminish information asymmetries include officially required diplomas for service providers, voluntary associations of service providers that adhere to a code of conduct, etc.

589 J.A. Caswell and E.M. Mojduszka, 'Using informational labelling to influence the market for quality in food products', in: *American Journal of Agricultural Economics*, vol. 78, no. 4 (1996), pp.1248-1253.

590 In a simple model of labelling food products (in the categories 'organic', 'conventional' and 'genetically modified') a high level of separation cost between GM and non-GM products substantially increases the market share of the organic products, while pushing the conventional products out of the market. All this gives rise to a fall in consumer welfare. K. Giannakas and A. Yiannaka, 'Agricultural biotechnology and organic agriculture: National organic standards and labelling of GM products', in: *AgBioForum*, vol. 9 no. 2 (2006), pp.84– 93.

2 Measures relating to sustainable production of biofuels

Biofuels are considered to be an important instrument in various policy areas.⁵⁹¹ First, biofuels can be used to reduce greenhouse gas emissions, thus contributing the goal of curbing climate change. Second, there is the reasoning that biofuels will reduce the dependency on imported fossil fuels, thus increasing energy security. Third, biofuels are seen as a solution for agricultural producers who are faced with falling prices and incomes as a result of reforms of traditional support policies.⁵⁹² According to the Tinbergen rule, biofuels should be used as an instrument for one policy objective, since trying to meet two or more objectives will seriously undermine the effectiveness and efficiency of the measures. This section is largely devoted to bioethanol as a substitute for gasoline.⁵⁹³ It is argued that bioethanol could be a very effective instrument in climate policy for the coming 10–15 years. If policy makers were also to use it for other objectives, the climate effect will be seriously reduced.

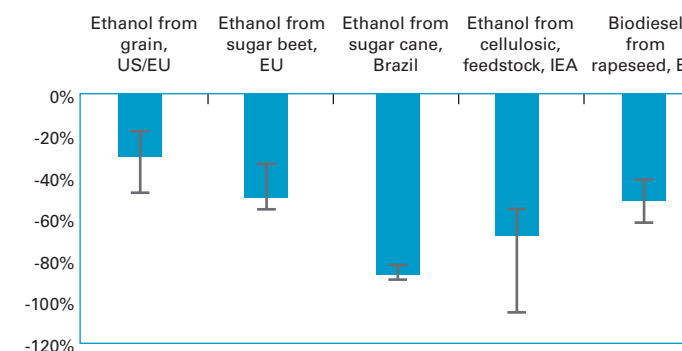
2.1 Effectiveness

Ethanol, or alcohol, is produced from petroleum by the petrochemical industry and from various biological feedstocks, including sugar (cane and beet), grain crops, cellulosic crops and waste biomass. The ethanol made from biological feedstocks is called bioethanol. Biological feedstocks are converted to sugars by different technologies. Sugar crops offer the least complicated way to produce ethanol. In tropical countries, sugar cane is mostly used as feedstock. It has the advantage that the production process yields a byproduct, 'bagasse', that is used for the process energy in the manufacture of methanol. If grain crops are used, the starchy part of the plant is used to produce sugars, leaving considerable fibrous residue.

A technology that is still under development uses the cellulose of plants (most parts of plants consist of cellulose), which can be converted into alcohol (via

sugar). This process is rather complicated and is not commercially viable. Cellulosic ethanol has important advantages – it can be produced using a wide variety of feedstocks such as grasses and trees, there is less competition in land use; it displaces a greater amount of fossil energy per litre of fuel, and produces much lower net 'well-to-wheels' greenhouse gas emissions than grain-based alcohol. If the production costs can be reduced, cellulosic ethanol offers a promising alternative to fossil fuels, but this may take another 10–15 years.⁵⁹⁴

Figure 1 Range of estimated greenhouse gas reductions from biofuels



Note: This figure shows reductions in wells-to-wheels CO₂-equivalent GHG emissions per kilometre from various biofuel/feedstock combinations, compared to conventional-fuelled vehicles. Ethanol is compared to gasoline vehicles and biodiesel to diesel vehicles. Blends provide proportional reductions – e.g. a 10% ethanol blend would provide reductions one-tenth of those shown here. The vertical thick lines indicate the ranges of estimates.

Source: IEA (2004).

To calculate the reduction in emissions of GHGs as a result of increased biofuel consumption, the whole supply chain has to be taken into account. Various studies have been undertaken to estimate the GHG emissions of various alternatives to petroleum-based fuels. A review by the International Energy Agency (IEA; see Figure 1) compared the different biofuels on a 'well-to-wheels' basis and showed that the largest reductions in GHG emissions are made by ethanol from sugar cane produced in Brazil. Ethanol from cellulosic feedstock is the second-best option, but the production process is not yet commercially viable. This is a promising technique in terms of both reducing GHG emissions and in not crowding out other crops.

591 M. Stilwell and E. Rose, 'Biofuels and trade: Perils and promises for policy-makers', in: *ICTSD, Linking Trade, Climate Change and Energy* (Geneva: ICTSD, 2006).

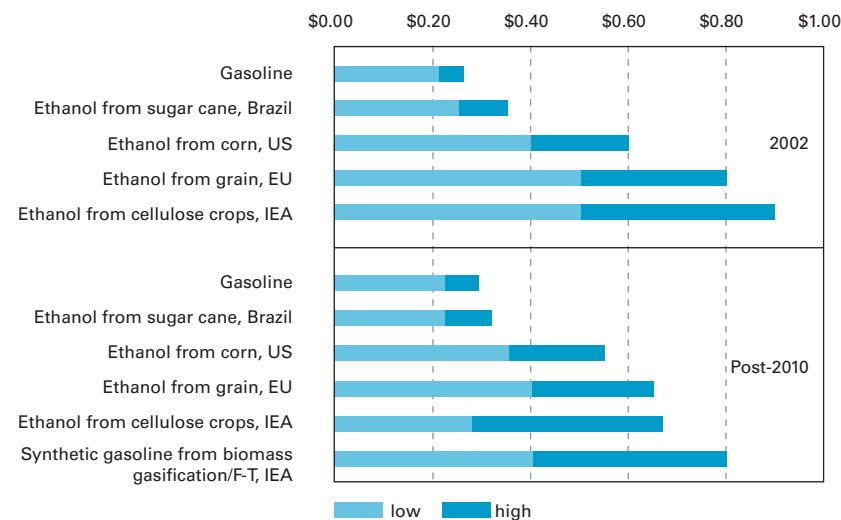
592 T. Turner, 'Biofuels, agriculture, and the developing world', in: *ICTSD, Linking Trade, Climate Change and Energy* (Geneva: ICTSD, 2006). Turner maintains that biofuels are the solution to the problems of trade liberalization in agriculture, as 'agriculture is changing from an industry that faces limited demand to an industry that faces unlimited demand'.

593 Biodiesel is produced in the EU using mainly rapeseed as feedstock. Biodiesel production based on other oils and fats, including palm oil (imported from Malaysia and Indonesia) is also increasing. In 2005, the world production of biodiesel amounted to 3.5 billion litres, of which 2.8 billion litres were produced in the EU using rapeseed as feedstock. The EU's MFN tariffs on biodiesel are 6.5 per cent on an *ad valorem* basis. The EU did not import biodiesel in 2005.

2.2 Efficiency

Biomass production in tropical and sub-tropical climates is five times more productive in terms of photosynthetic efficiency than in temperate regions.⁵⁹⁵ If such regions also have large areas of suitable cropland, the relative costs of biofuels will be low. The cost of producing ethanol is lowest for the sugarcane-based product. Thus, the cost levels in Brazil, India, Pakistan and other developing countries are less than half of those of the United States, the European Union and other IEA members. This is likely to remain the case until rather far into the future. The IEA estimates (*Figure 2*) indicate that even after 2020, by which time cellulose processing technology will have been developed to a much higher level, the cost of sugarcane-based ethanol will be in the same range as cellulose-based ethanol, and the latter may still be much more costly.⁵⁹⁶

Figure 2 Cost ranges for current and future ethanol production (US dollars per gasoline-equivalent litre)



Note: 'F-T' is Fischer-Tropsch type production process.

Source: IEA (2004).

2.3 Conclusions on the effectiveness and efficiency of bioethanol as an instrument of climate policy

From the studies reviewed by the IEA, ethanol from Brazil – and probably some other developing countries⁵⁹⁷ – is the ideal substitute for mineral gasoline: it ranks highest in terms of GHG emission reductions (more than 80 per cent), it is competitive with conventional fuel at current prices, and it is much cheaper than all other alternatives available now and in the foreseeable future. Thus, at present, the cost per tonne of GHG reductions using Brazilian ethanol is a fraction (around 5 per cent) of the cost of using ethanol produced from grain in the EU.⁵⁹⁸

The Copernicus Institute (Utrecht University) and the State University of Campinas (UNICAMP, Brazil) analyzed the sustainability of ethanol production in Brazil. While different types of uncertainties are mentioned, the conclusion for ethanol made from sugarcane, is that 'no prohibitive reasons were identified why ethanol from São Paulo in principle could not meet the Dutch sustainability standards set for 2007'.⁵⁹⁹ Whether it makes sense to make the importation of bioethanol conditional on the meeting of sustainability criteria will be discussed in section 2.5.

Imports of bioethanol from competitive producers in tropical regions have an impact on energy security by geographical diversification of sources of energy. Promotion of bioethanol production in the EU on the basis of feedstock grown in the EU contributes to increased energy security by reducing energy imports. Some will consider this a strong form of energy security, but it comes at a very high price, as the cost of bioethanol produced in the EU is up to twice that of imported bioethanol. The contribution of EU-produced bioethanol to GHG emission reductions is almost 50 per cent lower (per kilometre) compared to bioethanol from Brazil, which makes the EU product relatively ineffective for the realization of the Kyoto objectives.

2.4 Bioethanol production, trade flows and trade barriers

The promotion of biofuels to reduce GHG emissions and the introduction of standards for animal welfare will have impacts on developing countries' exports,

597 See section 2.4 below for other potential exporters.

598 Worldwatch Institute, *Biofuels for Transportation. Global Potential and Implications for Sustainable Agriculture and Energy in the 21st Century*. Extended summary (Washington, DC, Worldwatch Institute, 2006).

599 E. Smeets, M. Junginger, A. Faaij, W. Arnaldo and P. Dolzan, *Sustainability of Brazilian Bioethanol* (Utrecht: Copernicus Institute, and Campinas: State University of Campinas, 2006), p.2. Available at www.bioenergytrade.org/downloads/sustainabilityofbrazilianbioethanol.pdf.

production and development through international trade flows and foreign direct investment. This section will assess these impacts. For some of these effects, research data or estimates are available, while for other potential effects no reliable studies have yet been conducted. The section will also discuss trade policy measures that have an impact on the trade flows studied here. As biofuels and animal welfare are rather different policy areas, they are treated separately.

2.4.1 Bioethanol producing countries

Bioethanol is produced and traded in substantial quantities in many regions worldwide. In 2005, global production was more than 35 billion litres. Table 1 presents the top five producers.

Table 1 Top five bioethanol producers in 2005

Producing country	Production (million litres)
Brazil	16,500
United States	16,230
China	2,000
European Union	950
India	300

Source: Worldwatch Institute (2006).

In the near future, the production of bioethanol in developing countries will rise considerably, in response to rising domestic demand for ethanol as a fuel, and to rising import demand from temperate countries. Import demand from OECD countries is likely to rise, depending on their policies to protect domestic production. Given that cellulosic ethanol and synthetic biodiesel will not be commercially viable in the coming 10–15 years, the availability of land in the EU and the USA will probably limit the realization of their objectives for consumption of biofuels.⁶⁰⁰ In addition, trade liberalization and sound GHG emission reduction policies will make more imports of biofuels probable and attractive, as was argued in section 2.3.

Domestic demand in many developing countries (including Brazil, India and China) is rising as these countries are introducing compulsory blending, thus reducing the quantities available for export. Nevertheless, the potential export capacities in

developing countries are promising. Brazil could expand its bioethanol production significantly, by increasing the area under sugarcane cultivation and improving the productivity of land.⁶⁰¹ In India the government is also promoting production by paying sugar mills a premium on each litre of bioethanol they produce.⁶⁰²

Many developing countries already produce small quantities of bioethanol and have the potential for larger production. Africa is expected to become one of the largest producers of biomass in the future: its potential is estimated to be equal to that of Latin America.⁶⁰³ In Africa, where biomass is traditionally used for cooking and heating, South Africa is the lead country in the development of bioenergy production, but is unlikely to be able to export significant quantities of biofuels if the government decides to introduce compulsory blending. Other member countries of the Southern Africa Development Community (SADC) also have considerable export potential, particularly the least-developed countries (LDCs) Malawi, Mozambique and Zambia. Bioethanol production in these countries can use both sugar cane and sweet sorghum⁶⁰⁴ as feedstocks. Johnson *et al.* estimate that these countries have the natural resources to supply 6 per cent of EU demand in 2015 and 10 per cent in 2020 (after meeting domestic consumption).⁶⁰⁵ These countries are expected to be competitive if oil prices remain in the range of US\$45–55 and import tariffs are zero. The bottlenecks to realizing this potential are the large investments required to expand feedstock production, and to upgrade both the processing capacity and transport infrastructure, a large part of which will have to come from foreign direct investment (FDI). South–South FDI and technology transfer will be part of the solution. Illovo Sugar, a South African firm, for example, already controls the sugar production capacity in Zambia and has dominant positions in Malawi, Mozambique, Swaziland and Tanzania. The participation of

601 Smeets *et al.*, *Sustainability of Brazilian Bioethanol*, pp.38–40.

602 In India, the cost price of ethanol is around US\$ 0.15 (of the same order as in Pakistan and Brazil), but the premium of US\$ 0.18 per litre is encouraging many sugar mills to shift to ethanol production. International Energy Agency, *Biofuels for Transport: An International Perspective* (Paris: IEA, 2004), p.164. Available at www.iea.org/textbase/nppdf/free/2004/biofuels2004.pdf.

603 Consultancy and Research for Environmental Management, *Dutch Import of Biomass: Producing Countries' Points of View on the Sustainability Biomass Exports* (Amsterdam: CREM, 2006). See also B. Batidzirai, A.P.C. Faaïj and E. Smeets, 'Biomass and bioenergy supply from Mozambique', in: *Energy for Sustainable Development*, vol. X, no.1 (2006), pp.54–81.

604 Sweet sorghum grows faster than sugarcane, and has much lower water requirements and a better drought resistance. It is also a more flexible crop than sugarcane as it is grown from seed, rather than from plantings. See F. Johnson, V. Seebaluck, H. Watson and J. Woods, 'Bio-ethanol from sugarcane and sweet sorghum in Southern Africa: Agro-industrial development, import substitution and export diversification', in: *ICTSD, Linking Trade, Climate Change and Energy* (Geneva: ICTSD, 2006).

605 *Ibid.*

600 See IEA, *Biofuels for Transport*, chapter 6. The European Environment Agency estimates that the EU can technically produce significant amounts of biomass to realize ambitious targets, 'even if strict environmental constraints are applied'. EEA, *How Much Bioenergy can Europe Produce without Harming the Environment*, EEA Report 7/2006). Available at http://reports.eea.europa.eu/eea_report_2006_7/en/eea_report_7_2006.pdf.

foreign sugar companies might be expanded and broadened. The market value of the reduction of GHG emissions could be leveraged to finance investments.⁶⁰⁶

The range of problems to be overcome is well illustrated in the case of Zambia. Although at present Zambia is one of the five most efficient sugar producers, its global competitiveness is severely limited by the high costs of transporting sugar overland to a seaport.⁶⁰⁷ These costs will have to be diminished by infrastructure development financed by public and/or private investors. As the infrastructure improves, so will the connections between neighbouring countries, leading to regional integration, in which the Common Market of Eastern and Southern Africa (COMESA), the East African Community (EAC) and SADC, supported by donors, are the natural lead organizations. Once these regions and the EU conclude Economic Partnership Agreements, the EU might play an important role in this programme.

2.4.2 Trade flows and trade barriers: MFN, GSP and EBA; regional trade agreements

Imports of ethanol into the EU averaged 150 million litres per year in 1999–2001, more than 250 million litres in 2002–2004, and a record of almost 600 million litres in 2005.⁶⁰⁸ These imports are administered under CN code 2207, which has two subcategories, undenatured alcohol (code 2207 10) and denatured alcohol (code 2207 20). Although both types can be used for biofuels, more than 93 per cent of ethanol imports were in the form of undenatured alcohol.⁶⁰⁹ Increasing quantities of imported bioethanol are also blended with other fuels such as petrol, under code 3824. These quantities of bioethanol escape statistical observation, reducing the reliability of the figures. To remedy this situation, the European Commission is now considering a proposal to create a separate code for biofuels in the combined nomenclature (CN).

The two categories of ethanol are subject to different import tariffs: € 19.2 per hl⁶¹⁰ for undenatured, and € 10.2 per hl for denatured alcohol. Given that in the most competitive countries (Brazil and Pakistan) production costs are around US\$15 per hl, these tariffs are very substantial (more than 100 per cent for the undenatured variety, depending on transport costs). However, a large part of ethanol imports enter the EU on a preferential basis.

The Generalized System of Preferences (GSP) classifies ethanol as a sensitive product. Under the GSP that applies from 1 January 2006 to 31 December 2008, preferences for alcohol under code 2207 have been completely removed; before 2006 the MFN tariff was reduced to 15 per cent. Under the special drugs regime of the GSP that was applicable before 2006, a number of countries (Bolivia, Colombia, Costa Rica, Ecuador, Guatemala, Honduras, Nicaragua, Panama, Peru, Pakistan, El Salvador and Venezuela) had duty-free access for alcohol.⁶¹¹ Under the GSP+ incentive scheme for sustainable development and good governance that more or less replaced the drugs regime, these countries now enjoy duty-free and quota-free (DFQF) access. Georgia, Moldova, Mongolia and Sri Lanka were also added to the group, while Pakistan was removed. Thus, imports of ethanol from Pakistan have been subject to the full MFN tariff since 1 January 2006. In the first five months of 2006, EU imports of ethanol from Pakistan were 8.7 million litres, compared with 50.3 million litres in the same period in 2005.⁶¹² These two examples – the exclusion of bioethanol from the GSP and the exclusion of Pakistan from the GSP+ – show that these trade preferences are rather unreliable, and are unlikely to create a favourable climate for investment in bioethanol production in developing countries.

The LDCs also have DFQF access to the EU market, including the three Southern African LDCs with the greatest bioethanol export potential (Malawi, Mozambique and Zambia). This group of LDCs partly overlaps with the ACP countries that enjoy tariff-free access under the Cotonou Agreement until 1 January 2008, when new arrangements – Economic Partnership Agreements – have to be in place. The EU has proposed to expand DFQF access under the Economic Partnership Agreements, which will give all ACP countries access to the EU (with a temporary exception for rice and sugar). South Africa is in an exceptional position as it concluded a separate bilateral Trade, Cooperation and Development Agreement (TCDA) with the EU in 1999 that does not provide for preferential treatment for alcohol; as a result, South African ethanol exports are subject to the full MFN tariff. Imports that pay the MFN tariff originate mainly from Brazil, the USA and – since 1 January 2006 – Pakistan.

606 *Ibid.*

607 J. Pilegaard, 'Symbolic and effective? An LDC perspective on duty-free and quota-free market access', in: G. Faber and J. Orbie (eds) *European Union Trade Politics and Developing Countries: Everything but Arms Unravelling* (London: Routledge, 2007), chapter 8.

608 European Commission, *An EU Strategy for Biofuels*. Communication of the Commission SEC(2006)142, 8 February 2006. Available at http://ec.europa.eu/agriculture/biomass/biofuel/com2006_34_en.pdf.

609 *Ibid.*

610 1 hectolitre = 100 litres.

611 This special GSP regime was to stimulate the countries concerned to export goods other than drugs. The drugs regime was abandoned in 2006.

612 Data retrieved from the Eurostat Comext database. The European Commission has tried to play down the effect of imposing the MFN tariff on ethanol from Pakistan by saying: 'Pakistan might ... be expected to continue to be able to export significant quantities of ethanol to the EU, albeit not at the same pace as before, thus utilizing the increased production capacity built over the last couple of years'. European Commission, *An EU Strategy for Biofuels*, pp.28

Table 2 Average annual EU imports of ethanol (CN code 2207) under the various preferential trade regimes, 2002–2004

Import regime	Average annual imports, 2002–2004 (million litres)	Share of total imports, 2002–2004 (%)
GSP normal	23.2	9.0
GSP+	117.8	47.5
ACP/Cotonou Agreement	23.8	9.0
Everything but Arms	4.5	1.5
Others	12.2	4.0
Total preferential	199.8	70.0
Total MFN	112.5	30.0
Grand total	312.2	100.0

Source: European Commission (2006).

Future trade policy developments with respect to biofuels will depend on the outcome of regional and global negotiations. In the framework of the Doha Development Agenda (DDA), negotiations are underway to reduce tariffs and non-tariff barriers in general, and to establish a list of environmental goods and services for which trade barriers will be reduced or eliminated. Biofuels are candidates on the list of 'environmentally preferred goods'.⁶¹³ This might lead to a gradual phasing out of tariffs on biofuels, maybe to zero. On a bilateral level, the EU–Mercosur negotiations on a free trade agreement (FTA) have dragged on for many years, mainly as a result of differences of opinion on agricultural trade liberalization. Whether these two negotiating processes will yield results in the near future remains to be seen.

2.5 Conclusions with respect to measures that relate to the provision of the EU with sustainably produced bioethanol

At present the European Union obtains bioethanol from domestic production (950 million litres in 2005) and imports (312 million litres in 2004). Bioethanol from both sources accounts for less than 2 per cent of gasoline consumption (the EU goal for 2005).⁶¹⁴ By 2010 the share of biofuel in transport fuels should rise to 5.75 per cent,

according to the EU Biofuels Directive.⁶¹⁵ Thus, the market is growing rapidly. The Commission has indicated that Member States will have to introduce more binding measures, such as compulsory blending and tax measures. On the supply side, the EU market for biofuels is highly distorted by the Common Agricultural Policy,⁶¹⁶ the subsidies for innovative fuels and the EU's common trade policy. As a result, the price of bioethanol in the EU does not reflect its relative scarcity globally. We have shown that bioethanol from tropical countries has a high potential to reduce greenhouse gas emissions in the short run in an effective and efficient way. In order to realize this potential, the EU will have to devise a coherent trade policy with respect to bioethanol. Today this policy is highly segmented.

There is stable free access for ACP and least developed countries, economies that have significant potential but small export capacities at the moment. A group of developing countries have free access on a temporary and unilateral GSP+ basis, as long as they meet specific conditions for sustainable production and good governance. Competitive producers in other countries pay a very high MFN tariff (50 or 100 per cent or more). This patchwork of policy interventions does not constitute a consistent climate policy. In order to make bioethanol a competitive alternative to mineral fuels, the trade barriers for the two should be equalized over a defined time path, which means falling tariffs for bioethanol. A gradual erosion of tariff preferences will occur. If this is implemented according to a plan, the potential of developing countries that are well-endowed with the natural resources for biofuel production could be further developed.

613 This was proposed by Brazil. See R. Howse and P.B. van Bork, *Options for Liberalizing Trade in Environmental Goods in the Doha Round*, Report no. 2, ICTSD Project on Environmental Goods and Services (Geneva: ICTSD, 2006).

614 Consumption of gasoline in the Netherlands amounted to 5466 million litres in 2005. If the EU objective of 2 per cent biofuel had been realized, more than 100 million litres of bioethanol would have been consumed. In 2006 a compulsory blending requirement of 2 per cent entered into force.

615 EU Directive 2003/30/EC on the promotion of the use of biofuels or other renewable fuels for transport, 8 May 2003 (*OJ*, L 123, vol. 46, 17.5.2003).

616 Special aid for energy crops (€ 45 per ha) was introduced by the 2003 CAP reform. Sugar beet grown for bioethanol is exempt from quotas. Investments in biomass processing can be supported under the Rural Development Policy. European Commission, *An EU Strategy for Biofuels*. COM(2006)34 final. For the full report, a background memo and press release of 8 February 2006, see http://ec.europa.eu/agriculture/biomass/biofuel/index_en.htm.

The European Commission has studied two scenarios for the biofuel supply in the EU, one based on current MFN tariffs and one on zero tariffs. In the latter case, all bioethanol consumed in the EU in 2010 would be imported (although the EU would retain a sizeable biodiesel production capacity). This scenario offers the highest greenhouse gas savings.⁶¹⁷

This trade policy that is coherent with climate objectives should be complemented with a programme to develop the untapped potential for biomass and biofuel production in Africa. Support will be necessary to improve the physical infrastructure for export, to finance feasibility studies, and to create a favourable climate for private investment in biomass production.

Finally, it has been proposed to make the import of bioethanol conditional upon sustainability criteria. The Dutch government intends to incorporate sustainability criteria in its policy instruments related to biomass production. The project group 'Duurzame productie van biomassa' (the Cramer Commission) has proposed criteria related to the production and processing of biomass for energy, fuels and chemicals, that should be 'measurable and broadly supported'. These Cramer criteria cover the themes of GHG balance, competition with other crops (including food crops), biodiversity, welfare, well-being and the environment.⁶¹⁸ Apart from the question of whether international obligations under EU and WTO law forbid the imposition of such conditions on imports, do these criteria make sense? In this discussion we keep in mind that biofuels are used as a means to reduce GHG emissions. For this objective, bioethanol from developing countries is an effective and efficient instrument, taking into account GHG emissions on a well-to-wheels basis.

We have already shown that allowing bioethanol imports from developing countries (free) entry to the EU would meet the condition of a very high GHG balance. With regard to the other criteria, it is questionable whether it would be wise to impose these conditions. The broad objective to produce in a sustainable way (preserving biodiversity, the environment, benefiting all segments of society, etc.) applies

economy-wide. It is related not only to the way of development, but also to the level of development. The idea that making particular imports conditional upon sustainability criteria would contribute to the realization of the stated goals may be misleading, for several reasons.

First, an importing country has a potential impact on part of the production only (the EU imports only 1 per cent or less of all bioethanol produced in Brazil). Even if the exporting country meets the sustainability criteria for that small part of the production, little will change in the sector. The exporting country may also respond by shifting its exports to less demanding markets.⁶¹⁹ Thus, trying to encourage an entire economy to adopt more sustainable methods of production by imposing conditions on a tiny part of its production, would be a case of the tail wagging the dog. Second, even if the exporter were to adapt the production process throughout sector, there would then be one sector where the regulatory situation would differ significantly from the rest of the economy. This will greatly distort relative prices and wages. It cannot be assumed that the sustainability and welfare of the exporting economy as a whole would improve; it might even deteriorate. Research into the issue of child labour has made it clear that import constraints on goods produced using child labour do not necessarily improve the lot of the children in the exporting economy.⁶²⁰

Third, the exporting developing countries may perceive these criteria as eco- or labour protectionism. Given the experiences of these countries in the recent past, and the imminent risk that regulatory systems are captured by rent-seeking groups, this perception is not without grounds. The practical effect of the implementation of the criteria will be an increase in the cost of production. Although it is difficult to give the precise cost-increasing effect as a simple percentage, it is clear that it will be substantial. For ethanol produced in the São Paulo region (where 60 per cent of Brazilian sugar and ethanol are produced), for example, it is estimated that total production costs could rise by 24–56 per cent, increasing the cost per litre by € 0.12 (see *Box 1* below). This would come on top of the EU import tariff of € 0.19 per litre. Taken together, the impression of protectionism is difficult to refute, and the opportunity to introduce an effective and efficient climate policy based on ethanol will be lost – given the earlier cited conclusion that 'no prohibitive reasons were identified why ethanol from São Paulo principally could not meet the Dutch sustainability standards set for 2007'.⁶²¹

617 European Commission, *Annex to the Communication from the Commission, An EU Strategy for Biofuels: Impact Assessment*, SEC(2006)142. However, the Commission does not make a clear choice. While on the one hand it proposes to 'develop a coherent Biofuels Assistance Package that can be used in developing countries which have a potential for biofuels', on the other, it wants to pursue a 'balanced approach' in market access that respects 'the interests of both domestic producers and EU trading partners ...' (p.38). Available at http://ec.europa.eu/agriculture/biomass/biofuel/sec2006_142_en.pdf.

618 *Toetsingskader voor duurzame biomassa* (Cramer report). Final report of the project group 'Duurzame productie van biomassa', chaired by Professor Jacqueline Cramer, 2007. Available at www.vrom.nl/docs/20070427-toetsingskader-duurzame-biomassa.pdf.

619 In a seller's market such as the bioethanol market, this is a realistic scenario.

620 For a literature review and the findings of their empirical research, see E. Edmonds and N. Pavcnik, *Does Globalization Increase Child Labor? Evidence from Vietnam*, NBER Working Paper Series, no. 8760 (Cambridge, MA: National Bureau of Economic Research, 2002).

621 Smeets *et al.*, *Sustainability of Brazilian Bioethanol*, p.2.

Box 1 *The costs of sustainability criteria for bioethanol*

The Cramer Commission has proposed that imports of bioethanol should be conditional on a number of sustainability criteria in the exporting country, including biodiversity, social conditions, etc. While there are serious doubts as to whether an importing country should try to have an impact on the regulatory climate of an exporting country by imposing conditions for imports of only one product, here we look only at the impacts of such criteria on production costs, and the costs of monitoring, testing, traceability and certification.

With regard the likely increase in the costs of producing bioethanol as a result of sustainability criteria, the estimates vary widely, depending on a number of factors:

- the precise sustainability conditions applied;
- local physical conditions affecting production (e.g. weather conditions, slope of terrain, geographical situation, etc.); and
- the scale of production, soil fertility, etc.

In a study of the impacts of sustainability criteria on bioethanol production in Brazil and the Ukraine, Smeets *et al.* (2006) estimated that total production costs would increase by between 35 and 88 per cent.⁶²² Of this, a maximum of 29 percentage points would be due to meeting the environmental criteria. For ethanol produced in the São Paulo region (where 60 per cent of Brazilian sugar and ethanol are produced), they estimated that total production costs would rise by 24–56 per cent, increasing the cost per litre by € 0.12.⁶²³

The costs of certification will depend on the complexity of the scheme, including the number of benchmarks, the frequency of controls, the nature of the supply chain, and the characteristics of production. The last aspect is important: if production is scattered over large area, or over many small enterprises, inspectors will have to control many units, thus increasing the

costs of certification per unit of product. In the case of bioethanol in Brazil, production is concentrated geographically, but a substantial share of the sugarcane is grown by smallholders (30–35 per cent in the São Paulo region). Smeets *et al.* estimate that the costs of certification in relation to the sustainability criteria would be 0.1–1.2 per cent of the cost of production.⁶²⁴

We do not easily dismiss the concerns that gave rise to the proposed Cramer sustainability criteria. Our conclusion is, however, that imposing these criteria on one product, in combination with a very high import tariff, is not a promising way of putting these principles into practice. There are more effective and efficient ways to contribute to achieving these objectives: by concluding international agreements, through international cooperation to support aspects of sustainable production by financial means, and via transfer of technology.

3 **Labelling for animal welfare**

In this section we define the objective of animal welfare as the desire to guarantee a minimum standard of welfare in the living conditions of animals that are reared for human consumption. If the majority of consumers share this desire, then the problem is asymmetrical information: the standard of animal welfare cannot be determined from the product. Labelling schemes are a means to resolve this problem. There are two forms of labelling: compulsory and voluntary. In the former case, producers are obliged to indicate particular data on their products (such as the ingredients and nutritional content of food products). A voluntary system does not have this obligation. In practice, however, a voluntary system may be compulsory. This is the case if consumers come to regard non-labelled goods or products as inferior,⁶²⁵ or if producers in a supply chain have no alternative outlets for non-labelled products. Although this section focuses on voluntary labelling, most of the conclusions apply equally to compulsory labelling schemes.

The concern for the welfare of animals in the agro-food industry is a rather recent phenomenon in the EU, yet the EU is a frontrunner in the area compared to other countries. As incomes in OECD countries have risen, the preferences of consumers

622 E. Smeets, A. Faaij and I. Lewandowski, *The Impact of Sustainability Criteria on the Costs and Potentials of Bioenergy Production*. Report no. NWS-E-2005-6 (Utrecht: NOVEM, 2005), p.67. Smeets *et al.* applied socio-economic criteria (related to child labour, wages, employment, health care and education) and environmental criteria (related to soil erosion, fresh water use, pollution stemming from the use of fertilizers and other agricultural chemicals).

623 Smeets *et al.*, *Sustainability of Brazilian Bioethanol*, pp.74–78. A large part of the increase is due to 'green' manual harvesting. If mechanical harvesting is used, total costs would increase by 'only' 24 per cent (or € 0.05 per litre).

624 *Ibid.*, p.88.

625 This argument applies to voluntary and compulsory systems. For example, the National Organic Program (NOP) has introduced a label for organic products. One of the criteria is that the products do not contain GMOs. Thus, the NOP label is also a 'non-GMO label'. K. Giannakas and A. Yiannaka, 'Agricultural biotechnology and organic agriculture: National organic standards and labelling of GM products', in: *AgBioForum*, vol. 9 no. 2 (2006), pp.84–93.

have shifted towards goods produced in accordance with minimum standards of social, environmental and animal welfare. The concern for animal welfare is a global one that does not stop at the borders of the Netherlands or the EU. As a result of trade liberalization, a rising share of consumption stems from imports. The falling costs of transportation and communication have enabled firms to segment geographically the supply chains of many products.

3.1 Effectiveness

Labelling has an impact on domestic and imported goods. The impact of labelling in general may be limited in the sense that firms may turn out much larger quantities of goods that are not produced in accordance with animal welfare standards, and some may not produce goods that require to be labelled at all. Thus, while (voluntary) labelling schemes may guarantee that the labelled product has been produced in an animal-friendly manner, it does not guarantee that domestic and foreign producers have converted their entire production processes to meet the required standard of animal welfare. This depends on a number of factors, including the share of production destined for markets where labelling is necessary, and the possibility to have labelled and non-labelled production lines next to each other (such as the cost of separating the two varieties). One may argue that labelling one variety of a product implicitly also labels the other variety as non-labelled. This may increase the effectiveness of the label, as argued above. The label would be more effective if producers were to adopt the animal welfare standard of the label for their entire production process.

Credibility of labels is essential. Certification is required to build up the reputation of labels. Labels prescribed by public authorities are generally monitored by public or semi-public agencies. In case of voluntary labels, certification is done by specialized agencies, such as NGOs or private certification agencies for the private labels of particular retailers, or for a group of private firms in the same industry.

Private parties (both firms and not-for-profit organizations) that try to communicate particular characteristics of their products or certify these attributes in labels, have to invest substantial funds in building up the reputation of their brand name or label, by adapting the production process of their own plants or the plants of third parties, by setting up a monitoring organization and through marketing campaigns. In large part, these investments can be regarded as sunk costs – the investing organization cannot retrieve the investment without incurring substantial losses. As a result, the investor has an interest in continuing to build his reputation, and will monitor the supply chain to ensure that products meet the criteria, or will keenly guard the quality of its certification. For the same reason, a retailer will only adopt a particular standard, such as for animal welfare, if the marketing benefits clearly outweigh the costs of creating the label. Sufficient consumers should be

willing to pay a premium on the price of the normal product. NGOs play an important role in making consumers aware of the processes involved in the production of many consumer goods, and regularly report on different aspects of these 'non-trade concerns'.⁶²⁶ Thus voluntary labels, once established, have the advantage that the organization that has adopted a standard has a strong incentive to maintain and improve its credibility.

Do labels effectively diminish the information asymmetry? To find out, the European Commission's Energy, Environment and Sustainable Development programme recently conducted an EU-wide survey of consumers to evaluate the success of environmental product information schemes.⁶²⁷ The results of the surveys were mixed. Consumer awareness of established national 'eco-labels' was high in Norway (White Swan, 70 per cent) and Germany (Blue Angel, 70 per cent), while in Italy and Spain awareness of eco-labels was very low. The EU Flower eco-label was known by only a few consumers.⁶²⁸ Recognition of the Fair Trade label also varies widely, from 90 per cent in the Netherlands, to 25 per cent in the UK in 2003. The Energy Star label for electrical appliances, a joint initiative of the US Environmental Protection Agency and the US Department of Energy launched in 1992, is now recognized by 63 per cent of respondents. Information campaigns may increase the level of awareness of such labels, although full awareness is not realistic. A significant proportion of consumers (20–50 per cent in the Netherlands) are not interested in information on the food supply chain, believing that this is a task for the government and producers.⁶²⁹ Our conclusion is that labels can be very effective *in resolving the information asymmetry*, although they are not always entirely successful. This may be because the labels themselves do not communicate information effectively, or may be due to disinterest on the part of the target group.

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- 626 A recent report by the OECD Trade Committee contains many sector studies. See *Informing Consumers of CSR in International Trade, Part II: Case Studies* (Paris: OECD, 2006). NGOs play an important role in the creation of labels and brands that communicate Corporate Social Responsibility (CSR) in the production processes for cut flowers, clothing and cosmetics. Examples of private labels in animal welfare include those of the Body Shop and other large cosmetics firms. The Coalition for Consumer Information on Cosmetics, established by the largest US animal protection groups, has developed the internationally recognized Corporate Standard for Compassion for Animals and issues a label, the 'leaping bunny'.
- 627 European Commission, Energy, Environment and Sustainable Development (EESD) programme, available at <http://cordis.europa.eu/eesd>.
- 628 European Commission, summary of the EESD research programme: *Developing Effective and Efficient Product Information Schemes*, available at http://cordis.europa.eu/data/PROJ_FP5/ACTIONeqDndSESSIONeq112362005919ndDOceq485ndTBLeqEN_PROJ.htm.
- 629 Stichting Natuur en Milieu, *Van grond tot mond. Transparantie van de voedselmarkt* (Utrecht: SNM, 2004).

The effectiveness of (voluntary) labels *in terms of market share* is limited. Products that have been produced in accordance with the standards of corporate social responsibility (CSR), and are labelled as such, have ‘relatively modest but usually growing market shares’, according to the OECD.⁶³⁰ A relatively large share of the products consumed does not meet the conditions of CSR. For animal welfare, some voluntary labels have been relatively successful in terms of market share, particularly cosmetics. For meat, they have been less successful, for a number of reasons. First, consumers must be willing to pay a premium for meat products from animals reared according to animal welfare standards. When asked, consumers overwhelmingly say they are willing to pay ‘a little extra’ for ‘ethical alternatives’.⁶³¹ In practice, however, consumers take into account many factors when making spending decisions. Although many care for ethically responsible production conditions, only a minority rank them above other factors such as design and taste (5 per cent of the British public did in 2000). If products (plywood articles) are sold in two varieties that are equal in all respects (including price), except that one carries an eco-label and the other does not, the majority will buy the former.⁶³² For meat, the price difference between labelled and non-labelled products may be substantial.⁶³³

A second reason why labels on meat have not been successful is that the label may not communicate information effectively. Consumers sometimes distrust the claims of socially responsible production methods as they fear that commercial interests are the main motive. Alternatively, the labels may provide an overload of information, there may be different labelling systems for the same product, or discontinuities in labels. Third, voluntary labels are difficult to implement in particular sectors. The nature of the product (the animal origins of intensively processed products and of non-food products may be difficult to recognize) and the organization of the sector (small-scale production and retailing is costly to certify, and free riding is attractive and easy if the price premium is substantial and if the supply chain is complex) play a role.

The question is whether other steps should be taken if the market share of the preferred product remains relatively low despite the fact that a voluntary label has solved the problem of information asymmetry. One might say that, apparently, the concern for animal welfare is not generally supported by consumers to the extent necessary to stop production processes that fall short of animal welfare standards. Or, to put it differently, as the willingness to pay for the labelled product is insufficient to make the labelled product the dominant product, there is no externality. This view can be challenged. A voluntary label enables consumers to take away only part of the externality they face. As far as consumer welfare is determined by the living conditions in animal husbandry in general, buying animal welfare labelled products has a small effect if the conventional production process remains dominant.

Animal welfare is said to have the characteristics of a public good: it is non-excludable and non-separable, which makes it impossible to collect payments for the supply of the good.⁶³⁴ Before governments take measures to produce the public good of animal welfare (by mandatory labelling and/or regulation), the size and valuation of the public good should be clear. This is required to make an informed trade-off between benefits and costs. Much research has been devoted to the question of negative external effects of caged hens. The significantly greater willingness to pay for eggs from free-range hens is interpreted as an indication of a negative external effect. These studies do not distinguish between the individual welfare effect of consuming food that meets high standards of animal welfare and the collective welfare effect of a general application of these standards. In a research setting that made this distinction (for eggs), Carlsson *et al.* found that there is no significantly higher willingness to pay for the regulation solution (the collective welfare improvement).⁶³⁵ They concluded that ‘... if a choice is made to impose higher welfare standards in farming, it must be based on criteria other than economics’.⁶³⁶ However, before a definite conclusion can be drawn more empirical research is required.

As far as mandatory labelling of *negative attributes* is concerned, the following reasoning may be adopted, based on the question of whether a standard is generally accepted as the norm. Swinbank argues that in this case mandatory labelling for animal welfare for negative attributes is acceptable where a country can demonstrate that ‘there is a clear expectation that consumers expect to be

630 OECD, *Informing Consumers of CSR in International Trade*, Part I (Paris: OECD, 2006) p.9.

631 A survey by Co-op UK in 2004 indicated that 84 per cent of respondents answer this question in the affirmative in 2004, compared to 62 per cent in 1994. See *Shopping with Attitude* (Manchester: Co-op, 2004), available at www.pdf.co-operative.co.uk/pdfs/shopping_with_attitude.pdf.

632 R.C. Anderson and E.N. Hansen, ‘Determining consumer preferences for ecolabeled forest products: An experimental approach’, in: *Journal of Forestry*, vol. 12, no.4 (2004), pp.28-32. For a review of research, see OECD, *Informing Consumers of CSR in International Trade*, Part I, pp.14–16.

633 For free-range chicken breast the price premium may be almost 50 per cent above the the price of conventional chicken (as observed by the author in a Dutch butcher’s shop in December 2006).

634 Farm Foundation, *The Future of Animal Agriculture in North America* (Oak Brook, Ill.: Farm Foundation, 2006) ch. 8, pp.133-151.

635 F. Carlsson, P. Frykblom and C.J. Lagerkvist, *Farm Animal Welfare: Testing Market Failure*. Working Papers in Economics no. 19, Department of Economics, Göteborg University, 2003.

636 Farm Foundation, *The Future of Animal Agriculture in North America*, p.140.

warned when the norms are not respected, and that equivalent or more stringent standards apply to domestic production ...'.⁶³⁷ Thus, the decision on domestic regulation on animal welfare is one of collective decision making on ethical grounds. Once a regulation on animal welfare has been adopted, this might develop into a norm. Swinbank is of the opinion that this proposal should not undermine the concept of 'like' products and that the proposal does not extend to climatic advantage or geographical location. He accedes that the inclusion of labour standards would be highly controversial. One might add that the discussion as to the minimum standards for animal welfare in the EU has been going on for many years already, and is likely to continue. It cannot be concluded that the EU rules for animal welfare have developed into a norm, let alone that consumers expect to be warned if these standards have not been respected.

3.2 Efficiency

Labelling is a way to communicate to the buyer that a product (or service) has a particular attribute that is not visible. As such, labelling diminishes the asymmetry in information between sellers and buyers. This enables buyers to purchase those goods that better match their preferences. This is welfare enhancing. It is a different issue whether voluntary labelling is an efficient system.

As indicated above, voluntary labelling is practised by firms that consider the label to be a device for communicating the special nature of a product. Labels are a way of product differentiation. This gives the seller some influence in the market for his particular variety of product. Depending on the level of competition in the market concerned, firms will minimize the cost of production. The need for cost-effective production applies for the whole supply chain. The firm that is responsible for the label's validity (usually the retailer or owner of the brand name) has to take care that it observes the label's conditions at competitive cost levels. As the consumer markets where animal welfare labels are relevant are rather competitive, particularly in the medium to long run, labels have to be upheld in efficient ways. In addition, improved control systems for labels may lead to reduced product and raw material wastage, improved product-cost accounting and increased efficiency and competitiveness.⁶³⁸

637 A. Swinbank, 'Like products, animal welfare and the World Trade Organization', in: *Journal of World Trade*, vol. 40, no.4 (2006), p.707.

638 S. Jaffee and S. Henson, 'Agro-food exports from developing countries: The challenges posed by standards', in: M.A. Aksoy and J.C. Beghin (eds) *Global Agricultural Trade and Developing Countries* (Washington, DC: World Bank, 2004), chapter 6.

Voluntary labelling may give rise to inefficient outcomes, i.e. produce labels at cost levels that are higher than necessary. This may happen in particular circumstances. For example, if the label is a company label and gives the firm a monopoly position, excessive profits will result, at the expense of consumer welfare. Such a situation is rather special and will not hold in the long run. One may think of a sudden illness among livestock in the 'normal' production process that makes the public turn *en masse* to the animal welfare labelled product.

3.3 Conclusions on the effectiveness and efficiency of labelling for animal welfare

Labels as such are extensively used, as consumers in high-income countries want to have a broad choice among different varieties of a product and are increasingly attaching value to products that have been produced in socially responsible ways. Voluntary labelling schemes are increasingly being used and are taking different forms. Labelling is an effective way of reducing information asymmetries. The effectiveness in terms of market shares of existing voluntary labels is considerable in some cases, although for most products market shares remain in the order of 1–5 per cent. Considerable funds have to be invested to create, certify and communicate labels; these investments have the nature of sunk costs. This is an incentive to guarantee the credibility of the label. The effectiveness may be limited by unwillingness to pay for the labelled product quality where many other product qualities are taken into account. An overload of information may make the consumers disinterested in a label. The efficiency of voluntary labels is relatively high, as the private parties that introduced and maintain the label have to compete with non-labelled varieties. Sometimes the chain control mechanism leads to cost reductions that would not have otherwise occurred. Compulsory labelling has some different aspects. Its effectiveness might be somewhat greater as it covers all products sold. On the other hand, compulsory labels often are less flexible, as long bureaucratic procedures are involved in their formulation. This may reduce the efficiency of these systems in the long run.

3.4 Labelling and developing country agro-food exports

3.4.1 General aspects: problems and opportunities

Developing countries have been rather reluctant with respect to labelling initiatives. The suspicion of protectionism and the cultural and economic distance between high- and low-income countries largely explain this attitude. With the ongoing globalization of supply chains, consumers in rich countries are showing increasing concern about the safety and other (hidden and apparent) qualities of products. Both public and private bodies have reacted by introducing technical norms and standards. Labelling and certification are part of this development. For

exporters in developing countries, the required new product qualities may indeed be difficult to realize. This may be due to their complexity, the number of different labels and their certification (lack of harmonization), the lack of administrative, technical and scientific capacities of the exporting countries' firms and public agencies.⁶³⁹ In a recent paper, Chen *et al.* examined the impact of foreign standards on the export performance of developing country firms, measured by the share of production that is exported and the number of export markets a firm enters.⁶⁴⁰ Their empirical results – based on the World Bank Technical Barriers to Trade Survey database – indicate that testing procedures and lengthy inspections reduce exports by 9 per cent and 3 per cent, respectively. In addition, they find that differences in standards cause diseconomies of scale, which reduces the entry into new markets. Although this research covers a broader set of standards and technical regulations than labelling, it is relevant as public and private labelling has the same effect for exporting firms: if they do not meet the labelling requirements, there are markets or segments of markets that they cannot enter. A limitation of their approach is that they assume that compliance with the standards has no effect on demand. Other authors take demand into account. They argue that the emerging public and private standards offer an opportunity for developing countries to improve their competitiveness, as many of these standards are a 'bridge between increasingly demanding consumers requirements and the participation of distant (and international) suppliers ... The process of standards compliance could conceivably provide the basis for a more sustainable and profitable trade over the long-term, albeit with some particular winners and losers'.⁶⁴¹

A distinction can be made between (1) the cost of meeting the criteria of a label, (2) the certification cost, (3) the issue of who pays the cost, and (4) the impact on the primary suppliers in developing countries.

The costs of upgrading production to higher standards differ enormously. These costs may depend on such factors as the criteria of the label, the production process, the quality of existing production facilities, the scale of production and management techniques used. If sustainability criteria were to be introduced for bioethanol production in Brazil (see Box 1 above), it is estimated that total production costs could rise by 24–56 per cent, increasing the cost per litre by up to € 0.12. Similarly, complying with sustainability criteria for willow production in the Ukraine (for biomass) could increase total production costs by 14 per cent. In a brief survey, the Federation of Indian Chambers of Commerce and Industry

(FICCI) found that the cost per farmer of meeting EurepGAP conditions is € 1700, a certificate of the British Retailers' Consortium € 4500, and a Kosher Certificate € 3500.⁶⁴² For the production of fruits and vegetables, the costs of meeting EurepGAP conditions at the level of individual firms are estimated at about € 100,000 in Tanzania and Guinea for initial expenditures, and ongoing annual costs of € 20,000 to € 30,000 (see Box 2 below). In order to meet new compulsory hygiene standards for shrimps, which were introduced following detentions of the product in the US and a ban by the EU, Bangladeshi industries had to make investments equal to 2.3 per cent of the total value of the country's shrimp exports over the period 1996–98. For Nicaragua, this figure was 0.61 per cent over the period 1997–2002.⁶⁴³ It has also been reported that sustainability criteria have lowered cost levels per unit as a result of better process management. The cost indications presented here are difficult to compare. What they do indicate, however, is that the compliance costs may be substantial in relative terms. An increase in the cost per unit of 10–50 per cent is not uncommon.

As long as the product that meets the criteria fetches an equivalent price premium for the producer, the higher standard may create an attractive market segment. Whether this happens will depend on the power relations in the supply chain. If upstream producers are numerous and not globally organized – as is the case for many standardized commodities, fruits and tropical beverages – large trading houses and retailers are likely to have a dominant position in the supply chain. As far as this is the case, the price premium for the labelled product will accrue to the retailer. In a case study on Ugandan coffee, it was reported that farmers had an incentive to invest in lower-quality coffee as regulatory penalties are low compared to the high cost of investment in better processing investment in the presence of a very low price premium for high-quality coffee.⁶⁴⁴ The same source reports case studies in Kenya and Uganda for the flower and fish industries, where investments in quality appear to lead to higher market prices. In the case of fish exports by Uganda, the investments in higher quality have resulted in a higher market share. 'It appears that these premiums, if any, accrue to producers of high-end value commodities or marketing agents closer to the retail end of the production process (i.e. retailers and supermarkets in Europe)'. Small farmers and small and medium enterprises (SMEs) in developing countries are in a difficult position to pocket whole or part of the price premium. NGO-inspired labels such as FairTrade are an exception, as the existence

642 FICCI, *High Cost of Standard Compliance Making Exports to EU Difficult: FICCI Survey* (New Delhi: FICCI, 2006). Available at www.ficci.com/press/highcost-20march.doc.

643 S. Jaffee and S. Henson, 'Agro-food exports from developing countries'.

644 J.S. Wilson and V.O. Abiola (eds), *Standards and Global Trade: A Voice for Africa* (Washington, DC: World Bank, 2003). Available at [http://wbi018.worldbank.org/eurvp/web.nsf/pages/standards+in+global+trade+b/file/executive+summary+\(english+version\).pdf](http://wbi018.worldbank.org/eurvp/web.nsf/pages/standards+in+global+trade+b/file/executive+summary+(english+version).pdf).

639 *Ibid.*

640 M.X. Chen, T. Otsuki and J.S. Wilson, *Do Standards Matter for Export Success?* Policy Research Working Paper 3809 (Washington, DC: World Bank, 2006).

641 *Ibid.*, pp.6-3.

of these labels relies on the prices primary producers receive.

The certification costs of a particular production process will vary over different processes, the number and strictness of criteria, the ease of measurement, etc. Normally, there are fixed and variable costs. Skal (a third-party certification institute) charges fixed and variable fees for organic certification for processors and importers that want to participate in the certification programme 'Organic Production in the Netherlands'. The variable fee is related to turnover,⁶⁴⁵ and applies to processors and agricultural producers. After initial certification, annual audits are required to maintain certification. In general, the scale of production is a determining factor in the per unit cost of certification.

For small-scale producers, group certification is an option. This requires a local organization of producers that has the means to enforce compliance. If the criteria are simple and straightforward, the certification costs are modest, as in the case of ISO norms. More complex criteria (such as biodiversity or Forest Stewardship Council norms) are more costly to certify. As indicated in *Box 2* below, the costs of certification for bioethanol in the São Paulo region are rather modest, around 1 per cent of total production costs.

Box 2 *EurepGAP and developing country exports of fruits and vegetables*

EurepGAP is a private certification system established by 22 large European retailers. There is a technical committee for fruits that has formulated a standard for fruits and vegetables. Although suppliers are represented in the committee, none of them are African suppliers. There is no labelling scheme, but certification is required in order to gain access to the large retailers.

The standard has 250 control points. Food safety and traceability are the main subjects. Other areas are labour and environmental conditions in production. 'Non-trade concerns' such as provisions for workers (toilets, washing facilities) are part of the EurepGAP protocol for fruits and vegetables.

In a recent report, UNCTAD tried to establish the burden of this set of private standards on local producers in Tanzania, Mozambique and Guinea.⁶⁴⁶

The report includes an inventory of the institutions that need to be in place, and the investments required at the macro-level. It also includes estimates of the costs of EurepGAP compliance and certification for private firms, based on interviews

645 Skal (2006) Tariff paper 2006 (available at www.skal.nl, click on 'costs').

646 UNCTAD, *Costs of Agri-Food Safety and SPS Compliance: United Republic of Tanzania, Mozambique and Guinea: Tropical Fruits* (Geneva: UNCTAD, 2005). Available at www.unctad.org/en/docs/ditccom20052_en.pdf.

and discussions with producers and officials, as shown in the table below.

Costs of complying with EurepGAP conditions in Tanzania, Mozambique and Guinea (in US\$, 2005)

Country	Macro costs (x 1000)*	Micro: setup costs**	Micro: ongoing costs**
Tanzania	2520	98,690	20,500
Guinea	3142	2,197,200	27,000
Mozambique	9250	109,400	23,600

* at the national level

** at the level of the firm

The macro costs consist of the costs of setting up the legal framework, developing certification, inspection and quarantine capacities, participation in international standard-setting bodies, etc. Producers also incur costs, including setting up traceability systems, investing in worker health, safety and welfare provisions, and introducing management systems in several areas (waste, pesticides, fertilizers, soil and substrates). The macro costs can vary significantly, depending on whether countries have already made some progress in creating the institutions needed, and on the size of the sector and geographical dispersion of producers. The cost of EurepGAP compliance is substantial for many producers in the countries concerned as 'it demands a shift from manual and low-skilled labour practices in agriculture and light manufacturing to more sophisticated best practices comparable to those found in developed countries'.⁶⁴⁷ This is not a problem for foreign investors who usually bring their know-how on producing according to EurepGAP standards to their affiliates in developing countries. For small and medium-sized local companies and farmers, the costs of meeting the standards (the micro-costs in the table in Box 2) will be prohibitive. Only organizing themselves into associations of sufficient size will give them the scale that is necessary, but the organization costs (monitoring, training, etc.) will be substantial.

The UNCTAD report also describes the experiences in Kenya in adopting EurepGAP standards in order to improve the competitiveness of the horticultural sector. Many large farms are already certified and more than 50,000 small outgrowers are said to be moving towards compliance. Smallholder groups are often associated with exporting companies. A local certification company for EurepGAP has been set up, and training programmes and advisory services have been introduced to help smallholders in matters such as traceability and allowed farm inputs.

647 J.S. Wilson and V.O. Abiola, *Standards and Global Trade*, p.xxi.

3.4.2 Animal welfare labels and developing country exporters

The costs of upgrading animal farming to higher standards in developing countries have not been well researched. Some studies in developed regions, particularly the EU, show that these costs include more and different fodder, more labour, higher capital investment in buildings and more land needed for free-ranging animals. These costs will be different in developing and industrialized countries. In some countries labour will be cheaper and land prices lower, while capital may be more expensive. The increases in cost in the EU give some indication, but care should be taken in applying these data to developing countries. It has been estimated that the production cost of chickens ('broilers') increases by 5 per cent if the stocking density is decreased from 38 to 30 kg/m². The same increase applies for slower growth of broilers (from 40 to 50 days).⁶⁴⁸ Free-range chicken breast fetches a much higher price premium, which may be as much as 50 per cent.⁶⁴⁹ Complying with animal welfare standards may increase the cost of pig production in the UK by approximately 10 per cent (free range compared to minimum standards), which is covered by a price premium.⁶⁵⁰

The effects of labelling schemes on animal food producers in developing countries will vary depending on the type of product, and for producers who operate under very different regional conditions, use different technologies, etc. Research carried out in Brazil by the Dutch Agricultural Economics Research Institute (LEI), suggested 'that it may not be very difficult for Brazilian chicken meat exporters ... to adapt to European 'sustainability' standards that affect market access'.⁶⁵¹ For exporters in other countries, such as Thailand, however, complying with the labelling standards may be more difficult or expensive, according to the LEI report. These exporters would probably remain in the unlabelled market segment (e.g. in the EU if there is no mandatory labelling for negative attributes), or other markets where labelling obligations are less strict.

Thailand is an interesting case. The EU is importing increasing quantities of cooked chicken from Thailand (from 61,105 tonnes in 2003 to 106,503 tonnes in 2005). The import tariff on cooked chicken is 10.9 per cent (*ad valorem*). In the summer of

2006, the EU started negotiations with Thailand on a tariff quota, the idea being to increase the out-of-quota tariff to € 102 per 100 kg, the tariff for frozen poultry. It is difficult to justify an increase in tariff and quantitative barriers on a product imported from a particular country and subsequently to impose mandatory labelling on top of that. As in the case of the sustainability criteria for bioethanol (see section 2.5 above), motives of protectionism are difficult to refute.

3.5 Conclusions with respect to labelling for animal welfare

From the foregoing discussion of the impacts of labelling on animal welfare standards and developing country exports, we can draw the following conclusions.

First, modern consumers demand a large choice among differentiated products, adequate information and a guarantee for a few credence attributes (mainly concerning health aspects). These attributes have the nature of a public good and should be regulated by official standards and/or mandatory labels. It is far from clear, however, whether animal welfare standards have this public good nature. For credence attributes that do not have a public good nature, voluntary labelling is a sufficient and efficient solution to solve the problem of market failures due to information asymmetry.

Second, developing country producers are having to comply with a rapidly increasing number of technical norms and standards. Primary producers in developing countries may be able to profit from higher standards as long as they are able to invest in upgrading their production processes, in certification and marketing. However, financial systems in developing countries might not cater to these investment needs as the firms may be small and lack collateral, and local banks may not operate along the lines of market incentives. Thus higher standards (including voluntary private sector schemes such as EurepGAP) may favour large production companies and retailers.

Third, small producers may benefit if the right institutions are in place to provide training, information and certification at reasonable prices.

Fourth, given the potential problems developing country exporters have in complying with higher norms and standards, which are increasingly being demanded by private importers in rich countries, and often come on top of high tariffs and binding quotas, governments should practice utmost restraint in making decisions that will only add to the regulatory barriers to imports from developing countries. International coordination should prevent the proliferation of different standards, as this will only add to the costs to developing country producers of meeting those standards.

648 J. Moynagh, 'U regulation and consumer demand for animal welfare', in: *AgBioForum*, vol. 3, no. 2&3 (2000), pp.107-114. See also: Farm Foundation, *The Future of Animal Agriculture in North America*, pp.133-151.

649 As observed by the author in a small butcher's shop in the Netherlands in 2006.

650 H.L.I Bornett, J.H. Guy and P.J. Cain, 'Impact of animal welfare on costs and viability of pig production in the UK', in: *Journal of Agricultural and Environmental Ethics*, vol. 16, no. 2 (2003), pp.163-186.

651 D.J.F. Eaton, J. Bourgeois and T.J. Achterbosch, *Product Differentiation under the WTO: An Analysis of Labelling and Tariff or Tax Measures concerning Farm Animal Welfare* (The Hague: Agricultural Economics Research Institute (LEI), 2005), p.54.

In addition, development cooperation can play an important role in stimulating the export performance of domestic firms in developing countries. Technical and financial support for research, local extension services, and monitoring and testing facilities could assist small and medium-sized firms in setting up and improving export ventures, and help small producers in organizing collective initiatives in labelling, certification and marketing.

CONCLUSIONS

Conclusions

This study has focused on three main issues:

- the consistency of unilateral nPR PPM measures addressing non-trade concerns with the obligations under the *WTO Agreement* (Part 1);
- the relevance of other international agreements for unilateral nPR PPM measures addressing non-trade concerns (Part 2); and
- the economic effectiveness and efficiency, as well as the impact on developing countries, of unilateral nPR PPM measures addressing non-trade concerns (Part 3).

These issues are examined primarily with regard to existing, proposed or still purely hypothetical measures to give effect to the Cramer criteria for the sustainable production of biomass or the protection and promotion of animal welfare. With regard to the WTO consistency of these measures, the table below indicates the most relevant WTO provisions and refers to the legal analysis presented in this report.

Unilateral nPR PPM measures	Relevant WTO provisions	Relevant analysis
Import prohibition on products not produced consistently with nPR PPMs (e.g. an import prohibition on biomass not produced consistently with the Cramer sustainability criteria; or an import prohibition on livestock products not produced consistently with the Cramer sustainability criteria)	Article XI of the GATT 1994	See p.85.
Animal welfare requirements (e.g. an import prohibition on livestock products not produced consistently with the Cramer sustainability criteria)	Article XX of the GATT 1994	See p.89.
Preferential customs duties for products produced consistently with nPR PPMs (e.g. lower customs duties for biomass produced consistently with the Cramer sustainability criteria; or higher customs duties for meat from animals that have not been kept, fed, transported or slaughtered in accordance with specific animal welfare requirements)	Article I.1 of the GATT 1994	See p.18.
Enabling Clause (e.g. lower customs duties for biomass imported from countries that have been certified as requiring that the production of biomass conforms to the Cramer sustainability criteria and equivalent criteria)	Enabling Clause of the GATT 1994	See p.132.
Country-specific customs duties for imports from countries that have national legislation incorporating specific nPR PPMs (e.g. lower customs duties for biomass imported from countries that have been certified as requiring that the production of biomass conforms to the Cramer sustainability criteria and equivalent criteria)	Article I.1 of the GATT 1994	See p.18.
Enabling Clause (e.g. lower customs duties for biomass imported from countries that have been certified as requiring that the production of biomass conforms to the Cramer sustainability criteria and equivalent criteria)	Enabling Clause of the GATT 1994	See p.132.

Unilateral nPR PPM measures	Relevant WTO provisions	Relevant analysis
Domestic prohibition on the use or sale of products produced inconsistently with the nPR PPMs (e.g. a prohibition on the use in the production of biofuels of biomass produced inconsistently with the Cramer sustainability criteria; or a prohibition on the sale of foie gras of geese that were force-fed)	Article III:4 of the GATT 1994 Article XX of the GATT 1994	See p.51. See p.89.
Technical regulations (mandatory) setting out nPR PPMs for products used or sold (e.g. a technical regulation stipulating that eggs must be produced in conditions where battery cages do not hold more than 8 laying hens per m2)	Article III:4 of the GATT 1994 (and the <i>TBT Agreement</i> ?) Article XX of the GATT 1994	See p.51 and p.136. See p.89.
Government or private standards (voluntary) setting out nPR PPMs for products used or sold (e.g. a standard agreed upon by oil and electricity companies that the biomass they use must meet the Cramer sustainability criteria; or a standard agreed upon by retailers that they will only sell animal-welfare-friendly products)	The <i>TBT Agreement</i> and Article III:4 of the GATT 1994?	See p.51 and p.136.
Compulsory blending requirements specifying that the products blended must be produced consistently with nPR PPMs (e.g. a regulation excluding from the compulsory blending of fossil and biofuels, biofuels from biomass not produced consistently with the Cramer sustainability criteria)	Article III:4 and III:5 of the GATT 1994 (and the <i>TBT Agreement</i> ?) Article XX of the GATT 1994	See p.51 and p.72 (and p.136). See p.89.
Mandatory or voluntary labelling regarding nPR PPMs (e.g. labelling on livestock products indicating whether they are produced consistently with specific animal welfare requirements)	The <i>TBT Agreement</i> and Article III:4 of the GATT 1994	See p.51 and p.136.
Voluntary certification programmes or schemes regarding nPR PPMs (e.g. a government or private organization certifying that specific biomass has been produced consistently with the Cramer sustainability criteria; or that livestock products have been produced consistently with animal welfare requirements)	Article III:4 of the GATT 1994 (and the <i>TBT Agreement</i> ?) Article XX of the GATT 1994	See p.51 and p.136. See p.89.

Unilateral nPR PPM measures	Relevant WTO provisions	Relevant analysis
Tax reductions, exemptions or rebates for products produced consistently with nPR PPMs (e.g. a reduction in excise duties on biofuels from biomass produced consistently with the Cramer sustainability criteria; or a reduction in VAT on animal-welfare-friendly products)	Article III:2 of the GATT 1994, the <i>SCM Agreement</i> and the <i>Agreement on Agriculture</i> Article XX of the GATT 1994	See p.27, p.158 and p.160. See p.89.
Border tax adjustments levied on imported products to offset nPR PPM-based domestic taxation	Article II:2 of the GATT 1994 Article XX of the GATT 1994	See p.74. See p.89.
Government procurement requirements favouring products produced consistently with nPR PPMs (e.g. a requirement that public buses must use biofuels from biomass produced consistently with the Cramer sustainability criteria; or a requirement that public hospitals and schools may only buy meat from livestock produced consistently with animal welfare requirements)	Article III:8 of the GATT 1994 and the WTO <i>Agreement on Government Procurement</i>	See p.73.
Direct subsidies to assist producers with the additional cost incurred in meeting nPR PPMs (e.g. payments to oil companies or electricity companies to offset the additional costs of using biomass or biofuels from biomass produced consistently with the Cramer sustainability criteria; or payments to farmers to offset the additional costs resulting from compliance with animal welfare requirements)	The <i>SCM Agreement</i> and the <i>Agreement on Agriculture</i>	See p.158 and p.160.
Export refunds to overcome the competitive disadvantage that producers have on the world market as a result of stricter domestic regulation setting out nPR PPMs (e.g. export refunds for meat and livestock products to compensate for the higher production costs resulting from compliance with animal welfare requirements)	The <i>SCM Agreement</i> and the <i>Agreement on Agriculture</i>	See p.158 and p.160.
Reporting requirements relating to nPR PPMs (e.g. the requirement for industrial users of biomass (oil and electricity companies) to report whether biomass they use is produced consistently with the Cramer sustainability criteria (and subsequently leaving it to the consumers/civil society to act on the basis of that information)	Article III:4 of the GATT 1994 (and the <i>TBT Agreement</i> ?) Article XX of the GATT 1994	See p.51 and p.136. See p.89.

As the Appellate Body stated in 1996 in *Japan – Alcoholic Beverages II*, WTO Members are free to adopt or maintain unilateral nPR PPM measures addressing non-trade concerns as long as, in doing so, they act consistently with their obligations under WTO law. This report shows that some of the existing, proposed or still purely hypothetical measures to give effect to the Cramer criteria for the sustainable production of biomass or measures to protect and promote animal welfare are clearly WTO-consistent, while others are definitely WTO-inconsistent. For a significant number of measures, however, there is confusion and uncertainty with regard to their WTO consistency. Their WTO conformity will depend, *inter alia*, upon:

- whether, and to what extent, nPR PPMs are relevant in determining whether products are ‘like’;
- whether there is a jurisdictional limitation on the application of Article XX; and
- whether measures setting out nPR PPMs fall within the scope of application of the *TBT Agreement*.

Relevance of other international agreements for unilateral nPR PPM measures addressing non-trade concerns

Various international agreements on environmental and labour standards and human rights contain trade provisions to further their objectives. Out of the 200 multilateral environmental agreements (MEAs) currently in force, the WTO has identified 14 agreements with trade-related provisions. Common features of these agreements are import and/or export restrictions both between Parties and with regard to non-Parties. In most cases their trade provisions relate to product-related processes and production methods (PR PPMs). But Parties may sometimes choose to adopt unilateral measures addressing non-product-related PPMs in furtherance of the objectives of an environmental agreement. The majority of the trade-related environmental treaties also restrict or prohibit trade with non-Parties to the agreements and/or promote the transfer of environmentally sound technology to developing countries. Both types of measures potentially conflict with relevant WTO rules. Since they violate a priori the GATT non-discrimination obligations (Articles I and III) or the prohibition on quantitative restrictions (Article XI), they must be held against the requirements of the general exceptions and the chapeau of Article XX of the GATT 1994.

Unlike environmental agreements, most human rights agreements do not contain explicit trade-restrictive provisions. The type of human rights measures of concern for the current discussion generally relates to labour standards and is a typical example of non-product-related PPMs. Because of the jurisdictional limitations arguably ‘implied’ by the WTO dispute settlement bodies thus far, it seems extremely difficult – if not impossible – to justify trade restrictions relating to human rights concerns under Article XX of the GATT 1994. Article XX of the GATT 1994 also lacks an explicit social clause.

The present report notes that a dispute over conflicting obligations under environmental or human rights agreements, and WTO law has not yet arisen. However, there is a need to find proper solutions in order to avoid such disputes in future. An increasing number of regulatory programmes addressing non-product-related social and environmentally sound production is being developed at the international level. The two main conflict rules of Article 30 of the *Vienna Convention on the Law of Treaties* that relate to the aspects of *temporality* and *speciality* are applicable but they may not be able to solve all (potential) problems. A balanced approach to the WTO as a legal system should take into account its place within the wider corpus of international law. Besides using environmental and human rights agreements to determine the ordinary meaning of the terms of the *WTO Agreement*, dispute settlement bodies of the WTO should use these agreements as a factual reference in their interpretation of Article XX of the GATT 1994. If a measure was taken pursuant to a widely ratified environmental or human rights agreement, it should be considered relevant factual evidence that the measure was legitimate. Yet, in the current state of legal doctrine, the direct application of non-WTO norms as ‘legal norms’ by the WTO dispute settlement bodies is considered a bridge too far.

The best way to address non-product-related PPM concerns remains the negotiation of broad multilateral agreements that expressly contain trade measures to further their objectives. These agreements must be open to all WTO Members and must impose equal obligations on countries ‘where the same conditions prevail’, so as to avoid discrimination.

Economic effectiveness and efficiency of unilateral nPR PPM measures and their impact on developing countries

The present report has also considered the economic effectiveness and efficiency and possible impact on developing countries of addressing non-trade concerns. It has done so by focusing on and analysing existing, proposed or still purely hypothetical measures that intend to give effect to sustainability criteria for the production of biomass and the protection and promotion of animal welfare. Bioethanol from tropical countries, for example, is deemed to be a product of high potential in order to reduce greenhouse gas emissions in an effective and efficient way. At present it is being precluded from fully realising this potential in the EU because of incoherent trade and agricultural policies. With regard to most unilateral nPR PPM measures, it is questioned whether such measures could ultimately achieve their intended objectives, given the limited leverage of export requirements on the regulatory situation in the economies of exporting countries. Developing countries have good reason to fear forms of eco- or labour protectionism where regulatory systems of importing countries may be captured by rent-seeking groups pursuing other hidden objectives.

It is far from clear whether most animal welfare aspects have a public good nature. For credence attributes that do not have a public good nature, voluntary labelling would seem a sufficient and efficient solution to solve the problem of market failure due to information asymmetry. Primary producers in developing countries may be able to profit from higher standards as long as they are able to invest in upgrading their production processes, and in certification and marketing programmes. Certification of small firms is relatively expensive; collective certification could be a solution but requires costly organization and monitoring/sanctioning. Big, international firms are often in a more favourable position. To address these problems, international harmonization could prevent the proliferation of different standards, as the latter is adding to the costs to developing country producers of meeting those standards. Development cooperation can play an important role in stimulating the export performance of domestic firms in developing countries.

APPENDIX 1

TERMS OF REFERENCE FOR A SCOPING PAPER

1 TOR drawn up by BZ/DGIS/CE (Ministry of Foreign Affairs, Directorate-General for International Cooperation, Coherence Unit) and agreed with LNV/IZ (Ministry of Agriculture, Nature and Food Quality, International Affairs Department), EZ/BEB/Directie Handelspolitiek (Ministry of Economic Affairs, Foreign Economic Relations, Trade Policy Department), VROM/DIZ (Ministry of Housing, Spatial Planning and the Environment, International Affairs Directorate), SZW/IZ/IA (Ministry of Social Affairs and Employment, International Affairs Department).

Non-trade concerns in the EU and WTO: opportunities and threats for developing countries

Introduction

Non-trade concerns (NTCs) are generally regarded as an important topic of discussion within the WTO and the EU and in the dialogue with developing countries. At the same time, however, there is a great deal of confusion about the precise definition of the term. “NTCs” serves as a collective term for all kinds of societal developments, concerns and wishes in both developed and developing countries, though nearly always in relation to the consequences of regulation and side effects on the liberalisation of world trade. Non-trade concerns thus put additional pressure on WTO negotiations. The preamble to the WTO *Agreement on Agriculture* (AoA) explicitly refers to non-trade concerns, including food security and the need to protect the environment. According to article 20 of the AoA, non-trade concerns should be taken into account in the continuation of the reform process. This is reiterated for agriculture in paragraph 13 of the Doha Ministerial Declaration (November 2001) and in Annex 2, paragraph 2, of the Doha framework agreement (August 2004), without any further definition of non-trade concerns being provided. Paragraph 6 of the Doha Ministerial Declaration also states that an open and non-discriminatory multilateral trading system, protection of the environment and the promotion of sustainable development must be mutually supportive aims. Similarly, the specific form and substance of various trading aspects in relation to non-trade concerns is also determined in other international conventions and declarations (WSSD Declaration (*World Summit on Sustainable Development*), decisions within the framework of the *Convention on Biological Diversity* (CBD), *Biosafety Protocol*, CITES (*Convention on International Trade in Endangered Species*), etc.). In some cases explicit reference is made to the interaction with the WTO.

The EU is the biggest advocate of non-trade concerns in the WTO, particularly in relation to *agriculture*, but also in relation to the *environment* and *labour standards*. In its negotiating proposal of January 2003 for the WTO Committee on Agriculture² the European Commission states that its proposals to liberalise trade and decrease trade-distorting domestic support are conditional upon non-trade concerns being adequately addressed in the negotiations. Explicit reference is made to food safety (in particular the precautionary principle), mandatory

2 “The EC’s Proposal for Modalities in the WTO Agriculture Negotiations”, Brussels 27/1/03 (133 Committee, MD: 625/02 REV4).

labelling,³ food security for developing countries, environmental protection, rural development (including the economic and social viability of rural areas, conservation of biodiversity, etc.) and animal welfare.

With regard to *animal welfare*, however, the European Commission recognises in a 2002 Communication to the Council of Europe and the European Parliament⁴ that achieving consensus in the WTO agriculture negotiations will be difficult due to ethical, cultural, economic and political differences. There is, in fact, little or no support in the Doha Round, especially in relation to market access, with developing countries and the US the chief opponents. Recently the European Commission has even been reticent in seeking acceptance of non-trade-distorting subsidies devoted to animal welfare under the “Green Box” for fear that this might lead to calls to impose a cap on permitted “Green Box” subsidies. As alternative options with regard to animal welfare, it therefore mentions the development of international standards by the World Organisation for Animal Health (OIE), bilateral and multilateral agreements, labelling (either voluntary or mandatory) and scientific work on the link between animal welfare and food safety.

In the context of the Doha Round, non-trade concerns play a part not only in the agriculture negotiations, but also in the fields of trade and the environment through negotiations on greater market access for environmental goods and services and clarification of the relationship between existing WTO rules and specific trade obligations set out in multilateral environmental agreements (MEAs). With regard to environmental goods and services, the aim is further tariff reductions and the elimination of non-tariff trade barriers (paragraph 31 (iii) of the Doha Ministerial Declaration). The EU is the main driving force behind these negotiations, and is first of all seeking to draw up a list of environmental goods and services. Some developing countries are against the list approach, however, and advocate instead a project-based approach with the emphasis on “environmentally preferable goods.” This focuses attention on the fundamental discussion concerning the definition of environmental goods: should only the inherent characteristics of the end product be taken into account or should the manufacturing process also be considered?

With regard to the second element (paragraph 31 (i) of the Doha Ministerial Declaration), the negotiations are unfortunately limited in scope to the applicability of existing WTO rules on trade measures among the parties to an MEA. A legal

solution to the serious difficulty raised in terms of international law – i.e. the situation of non-overlapping memberships of the WTO and the MEA in question, where the WTO rights of a WTO member who is not a party to this MEA are at issue – is even explicitly excluded. For some considerable time now the Committee on Trade and Environment (CTE) within the WTO has been the forum for an intense debate on this political/legal issue. The Netherlands supports the EU’s active commitment in this area. The basic principles are the equivalence of the WTO and MEAs as international agreements, attempts to seek mutual support between the WTO and MEAs and the promotion of a broad-based approach to international and transboundary environmental issues (source-based measures, trade measures where necessary, technology transfer and technical and financial assistance). As a solution to potential tension in trade matters, the EU has proposed an approach based on a “favourable prejudice” in possible WTO dispute settlement for trade measures taken by a WTO-MEA party if this is specifically authorised by an MEA that enjoys broad support. Discussions in the CTE have so far produced little in the way of results due to resistance from developing countries and the US.

Non-trade concerns in relation to *labour standards* did not come up for discussion in the Doha Round. Attempts on the part of the US, in particular, to establish a direct link in a WTO context between compliance with minimum labour standards and the ability to impose trade sanctions met with fundamental resistance from all the developing countries. This even extended to granting the International Labour Organisation (ILO) observer status at the WTO. Paragraph 8 of the Doha Ministerial Declaration merely re-confirms the Singapore Ministerial Declaration (December 1996), which talks about commitment to comply with the internationally recognised “core labour standards” and designates the ILO as the organisation responsible for developing and promoting these standards.

Within the EU, meanwhile, specific legislation is being drafted that relates directly to or touches on non-trade concerns. Some is of an internal nature, such as minimum animal welfare requirements for producers in the EU and specific “Green Box” subsidies. Other requirements concern product-related process and production methods (PPMs) for products from both within and outside the EU. Often this involves environment-related measures such as end-of-life management of electrical and electronic equipment (WEEE), use of hazardous heavy metals (RoHS), eco-design of electrical equipment (EuP) and registration and authorisation of chemicals (REACH). The proposed legislation also concerns mandatory labelling, as in the case of the draft EU Regulation on biological production. More recently the EU has also been exploring ways to make non-product-related PPMs compulsory for imported products. One example is the EU action plan for animal welfare, which includes investigating the possibility of mandatory labelling for both locally produced and imported meat products in accordance with “objective and measurable” animal welfare indicators.

3 Two years previously, in its negotiating proposal for the Committee on Agriculture, the EU spoke about “consumer concerns”, presenting better provision of information through labelling as a solution (G/AG/NG/W/90 of 14/12/2000). By January 2003 the EU was no longer talking about “consumer concerns”, but mentions mandatory labelling as an independent NTC.

4 COM(2002) 626 of 18/11/02.

The fundamental position of the Dutch government is that attention should be devoted to non-trade concerns for two reasons: because of their intrinsic importance and because insufficient attention may undermine public support for the multilateral trading system. The government must actively consider the extent to which non-trade concerns can and must be respected, what role it can and must play here and what instruments can best be deployed.⁵ The guiding principle⁶ is that measures that are needed to achieve the underlying non-trade concern objective may not be unnecessarily trade-restrictive or discriminatory in terms of their implementation and must fulfil our WTO obligations. With regard to developing countries, an effort must also be made to ensure that the consequences for these countries are specifically taken into account in the formulation and implementation of such measures (in line with the coherence test in article 178 of the EC Treaty). We must exercise caution in imposing trade sanctions to enforce compliance with environmental protection, animal welfare and public health standards, and instead give priority to positive measures.⁷

The Dutch government is in regular dialogue with civil society and the business community on the subject of non-trade concerns. In response to the 2006 Budget Memorandum and National Budget, the Dutch Federation of Agricultural and Horticultural Organisations (LTO-Nederland), for instance, has argued that import tariffs should not be lowered for products that do not comply with European production standards in the areas of environment, welfare, labour and hygiene: “If this were to happen, it would lead to EU products being supplanted by products that do not meet society’s requirements,” is LTO-Nederland’s view. In parliamentary committee meetings with members of government about European agricultural policy and the Doha Round, non-trade concerns often come up for discussion and the possibility of mandatory legislation on PPMs is raised. In a motion by Dutch MPs Kris Douma and Corien Jonker, which was subsequently carried, the government was asked to urge the EU to focus its efforts in the next WTO round on getting non-trade concerns on the agenda.⁸

For discussion purposes, it is enlightening and, indeed, essential to make a

distinction between product-related and non-product-related PPMs. Appendix 1 contains a conceptual framework drawn up by the OECD for environmental measures; this is also applicable to measures relating to animal welfare and labour standards. Environmental measures may be product-related or non-product-related PPMs, while animal welfare and labour standards are non-product-related PPMs as a rule. Whereas product-related PPMs are essentially covered by the Sanitary and Phytosanitary (SPS) and Technical Barriers to Trade (TBT) agreements, this is debatable as far as the second group is concerned.⁹ As a result, there is much greater uncertainty about the scope for non-product-related PPMs. The consequences for developing countries are also far from clear when it comes to non-product-related PPMs. Does linking them to market access lead to economic benefits and opportunities for these countries or to new *de facto* and possibly insurmountable trade barriers?

The progressive policy in Brussels with regard to product-related and non-product-related PPMs and the growing debate in the Netherlands about non-trade concerns require the government to take a clear and unequivocal stance.¹⁰ It is no longer enough to make general statements about related measures having to satisfy our obligations within the WTO and towards developing countries. It must be absolutely clear exactly which measures are legally feasible and effective, and also sensible in relation to developing countries. Although much has already been written on this subject, for example by the Agricultural Economics Research Institute (LEI)¹¹ and the Centre for World Food Studies (SOW)¹² in the Netherlands, the findings are equivocal, to some extent contradictory and do not span the entire

5 “De WTO in de Winkel”, policy document on the relationship between the world trade system and consumers, Ministry of Economic Affairs, 1999.

6 Sources: De WTO in de Winkel”, Ministry of Economic Affairs, 1999; Memorandum on Coherence between Agricultural and Development Policy, Ministry of Foreign Affairs/Ministry of Agriculture, Nature and Food Quality, 2001; final report of the Interministerial Policy Review on the reorientation of agricultural policy, 2002; final report of the Interministerial Policy Review on the effectiveness and coherence of development cooperation, 2003.

7 “De WTO in de Winkel”, Ministry of Economic Affairs, 1999

8 Ministerial Conference of the World Trade Organisation (WTO): Motion by MPs Douma and Jonker, House of Representatives of the States General, 2004-2005, 25074, no. 92.

9 The *SPS Agreement* refers to PPMs, but covers only measures to protect human, animal and plant life or health in the country implementing these measures. In most cases, therefore, these will be product-related PPMs. The *TBT Agreement* lays down rules for technical requirements, which may cover, for example, product characteristics and product-related PPMs. This also includes labelling requirements that are applicable to products or PPMs. The interpretation of the reference to labelling and PPMs is the subject of discussion among WTO members.

10 It should be mentioned here that not only the government is confronted with non-trade concerns, but also the business sector. Businesses respond to this with Corporate Social Responsibility activities and private standards containing environmental, labour and/or animal welfare components. As a consequence, the business sector frequently goes further in its PPMs than the statutory national or EU requirements, and new government measures sometimes have only a limited impact. In this context it is worth mentioning the OECD Guidelines for Multinational Enterprises, which contain standards not only on labour and the environment, but also regarding reporting, combating corruption, consumer interests, science and technology, competition and payment of taxes.

11 “Product differentiation under the WTO: An analysis of labelling and tariff or tax measures concerning farm animal welfare”, LEI, report 6.05.11, June 2005.

12 “Labeling and the realization of cultural values” by Michiel Keyzer, *De Economist*, 150, 487-511, 2002.

spectrum of possibilities. There is therefore a need for an up-to-the-minute scoping paper that can catalyse discussions between ministries and with stakeholders.

Purpose of the paper

The scoping paper should help clarify which NTC-related EU instruments are legally feasible within the present WTO framework, and effective in relation to the NTC objectives set, focusing specifically on non-product-related PPMs. This does not affect the commitment of the Netherlands or the EU to seek appropriate solutions to the above-mentioned international law difficulties in the WTO-MEA relationship at some point in the future. For each of the instruments identified, the paper should provide insight into the economic consequences, opportunities and threats for developing countries, with due regard for the diversity of these countries.

Research questions

General:

- What kinds of non-trade concerns can be identified, and what is the range of possible EU instruments that may be linked to these?
- What are the WTO, MEA and other disciplines corresponding to these EU instruments?
- Which of these EU instruments are legally feasible and effective in relation to the NTC objectives set, particularly as regards non-product-related PPMs and, more specifically, non-product-related PPMs that also relate to products from third countries and have only a national impact in these countries (category B-4 in the conceptual framework in Appendix 1)?
- What scope is there for labelling (mandatory or otherwise) to provide consumers with information, particularly about such things as non-product-related PPMs of the product?

In relation to developing countries:

- Which of these EU instruments is of particular importance in relation to developing countries, particularly as regards non-product-related PPMs?
- For which developing countries does the use of such instruments have economic consequences, and what are the opportunities and threats for these countries?
- What are the anticipated implementation costs for the government and for producers in these developing countries?
- What kind of support, in the form of technical assistance and capacity building, can developed countries give these developing countries, and what sort of transition period and/or phased introduction is needed?

Methodology

The paper will be written using available data, academic publications, relevant treaties, agreements and conventions (GATT, SPS, TBT, Subsidies and Countervailing Measures (SCM), Anti-Dumping (AD), MEAs, ILO, etc.), WTO and EU case law, relevant policy documents of the EU and the Netherlands, relevant economic and other studies conducted by the OECD, and other relevant secondary material. The International Centre for Trade and Sustainable Development (ICTSD) must be contacted in order to check to what extent its most recent work on non-trade concerns can be used as input for the paper.

The paper will be written by an interdisciplinary team with the relevant legal and economic expertise and knowledge concerning WTO and EU discussions about non-trade concerns.

Output

The paper will be written in English and will be 25-50 pages in length (including footnotes and references, but excluding appendices). It will also contain a lengthy abstract for policy and discussion purposes ("policy brief").

Procedure and timetable

- The Ministry of Foreign Affairs, after reaching consensus with the ministries of Economic Affairs, Agriculture, Nature & Food Quality, Housing, Spatial Planning & the Environment and Social Affairs & Employment, will ask selected authors to submit proposals by mutual agreement. On the basis of these proposals, it will conclude a contract with each author.
- A maximum budget of € 25,000 is available for writing the paper.
- The contracts will be administered by DGIS/CE (Directorate-General for International Cooperation, Coherence Unit), which will also act as go-between for the authors. DGIS/CE will coordinate internally with the departments involved (DDE/IM (International Markets Division), DIE/EX (European Integration Department), DMW (Environment and Water Department), DES (Economic and Ecological Cooperation Department), DSI (Social and Institutional Development Department)) and externally with other ministries.
- The authors will be responsible for dividing tasks among themselves and for coordinating individual contributions.

- No later than three months after signing the contracts, the authors will deliver a draft version of the paper to the Ministry of Foreign Affairs. DGIS/CE will circulate this internally and to the other ministries involved, and will pass on all the comments received to the authors. A closed meeting may be convened with the authors and the ministries involved to discuss the draft paper. The authors may incorporate the comments received at their own discretion.
- Within one month of receiving the comments, the authors will deliver the final version of the paper to the Ministry of Foreign Affairs (joint narrative report, accompanied by a financial report per author).
- The aim is to complete the task by the beginning of September.
- The authors may not distribute the report themselves and cannot assert copyright.
- The authors must be available for any follow-up required (e.g. participation in a possible discussion meeting with representatives from Dutch civil society and the business community). Interministerial discussions will take place in due course concerning details of the procedure to be followed.

Conceptual framework

(based on a classification of PPMs according to their environmental effect)

- * Consumption externality: environmental impact is transmitted by traded products
- ** Production externality: environmental impact is not transmitted by traded products
- *** This may sometimes link to transboundary or global environmental issues

Source: OECD, *Processes and production methods (PPMs): conceptual framework and considerations on use of PPM-based trade measures*, No. OECD/GD(97)137. Paris, 1997

Category A		Category B			
Environmental externality	Consumption externality*	B-1	B-2	B-3	B-4
PPM requirement	Product-related: - PPM which affects product characteristics - TBT and SPS Agreements cover this category				Production externality**
Environmental effect	National*** Imported products pollute or affect domestic human and animal health and the environment. (e.g. plant pests, hazardous wastes and chemicals, pine nematode infested timber)	Transboundary pollution The environmental effect is transmitted to other jurisdictions or areas beyond national jurisdiction (e.g. transmittted air, water or land pollution)	Transboundary species and shared living resources The environmental effect involves more than one jurisdiction or areas beyond national jurisdiction. (e.g. conservation and management of migratory animals, birds and fish and other shared living resources)	Global concerns The environmental effect has global consequences (e.g. depletion of the ozone layer, climate change, harm to biodiversity, effects on threatened or endangered species)	National The environmental effect is limited to the country using the PPM.
Harmonisation of PPM requirement	National -International requirements are desirable. Countries may deviate, under certain conditions, from such requirements. Transboundary and global -Harmonisation is desirable to the extent possible.	Transboundary and global -Harmonisation could be relevant.			National -Harmonisation is highly problematic and may be undesirable.
Trade policy aspects	-The trade-restrictive measures would represent enforcement of national product requirements. -GATT rules require equal (non-discriminatory) treatment and transparency.	-Trade measures designed to impose PPM requirements used in importing country on exporting country may have extra-jurisdictional effects. -Multilateral environmental agreements may identify trade measures as an appropriate tool under certain circumstances.			A country can take the primary responsibility for setting any PPM requirement within its jurisdiction through non-trade policy measures
- Trade restrictive measures					
- Like-product issue	Product differentiation based on product requirements is allowed within multilateral trading rules.	Objective methods for product differentiation based on criteria which are not physically embodied in the products have yet to be developed. Method might include examination of whether implemented or proposed measures/requirements are transparent, predictable, feasible or are disguised restrictions on trade.			

