International Trade Law

Teaching Material

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The Developer would like to thank also Mr. Mathew for having made use of the material (i.e. 1.14.6, Chapter Seven, he left behind incomplete, as this task had been assigned to him. I deeply thank as well Ms. Yemisirach Gebru for allowing me to make use of the paper she wrote on the political and diplomatic aspects of International Trade (Chapter Eight), with particular emphasis on International Property Right (IPR, Chapter Nine).
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I would also thank my wife for standing aloof, my sons, Yohannes and Nathaniel, for their excitement and Eyoel, for his bewilderment.

Course Introduction

This teaching material is developed with a view to provide instructors and students launching pad for further reading and inquiry into the relevant features of International Trade Law, as an aspect of Public International Law. It was the developers own wish to supplement it with Private Business International Law, which, unfortunately, within the domain of Private International Law, and for which reason a separate syllabus and curriculum have to be devised.

Part I of this teaching material attempts to bring in focus some fundamental concepts of Economics found to be prerequisite for the perusal of this course, and which is primarily meant to for the students to revise the basic economic concepts they learn in the course Inter-disciplinary I, and not for the Teacher to go into. Part II discusses the core concepts that underlie the General Agreement on Tariff and Trade (GATT), as well as the basic framework of operation of the World Trade Organization (WTO).

The four fundamental principles of international trade are thoroughly outlined and extensively elaborated. This is partly because understanding the subject matter essentially requires an in depth understanding of these principles. Besides, some of the excerpts included herein are taken from reference materials that surely would not be within reach to most persons and institutions in the near future.

Part III deals about issues of common concern in international trade such as multilateral agreements and formation of trade blocks, General Agreement on Trade in Services, etc .., as these are comparatively new trends in international trade practices. As the previous parts of this teaching material has lain down the basic principles and their essential suppositions, students would surely be capable to weigh and evaluate these and other new trends with a hind sight to what would always be sought to be achieved through international trade.

A considerable portion of this last part deals about Least Developed Countries (LDCs), i.e. like ours, and Developing Countries. Here, attempt is made to draw the attention of the students to certain special and differential treatments (S&DT) afforded to such countries in international trade, which they would, hopefully, delve into further on.

As a concluding note, the developer of this textbook would like to remind students to make good use of this teaching material for it would help you – students – to *think globally* and understand the ever more globalizing world in real terms.

Part I

Free Trade: Effects and Challenges

Chapter One

Conceptual Framework

1.1 Basic Concepts of Economics

Prior to proceeding into the Law of International Trade, let us first mention some essential concepts of economics that would be of interest to the course at hand. According to Paul A. Samuelson, the Novel Prize winner, the world knows of three kinds of economic systems. He begins by describing the three fundamental problems every human society is confronted with.[1]

A. Problems of Economic Organization[2]

Every human society – whether it consists of an advanced industrial nation, a centrally planned communist society, a Taos commune, or an isolated island society – must confront and answer three fundamental and interdependent economic problems.

- *What* commodities are to be produced and in what quantities? How much of each of the many possible goods and services should the economy make? And when will they be produced? Should we produce piazzas or shirts today? A few high-quality shirts, or many cheap shirts? Should we produce many consumption goods (like pizzas and concerts), or few consumption

[1] In this regard, the presenter of this Textbook would like to remind students that as early as the 1970s, one theory - Keynesian Economic Theory – attempted to categorize economic systems in a new way. Today's Keynesian Economic Theory seems not to refute that there exist only three economic systems. Since the economic recession of the 2008/2009, this theory seems to have gained considerable acceptance the world over. This theory claims that "free economy" must be given some kind of formidable governance or regulation for it to bring about the "fair and smooth" running of the economic systems.

[2] Paul A. Samuelson and William D. Nordhaus, Economics, (13th Ed., McGraw-Hill International Books Co Singapore), 1989, p. 24.

goods and many investment goods (like pizza factories and concert halls), allowing more consumption tomorrow?

- *How* shall goods be produced? By whom and with what resources and in what technological manner are they to be produced? Who hunts, and who fishes? Is electricity to be generated from oil and coal, or waterfalls and atoms, or sun and wind? Handicrafts, or mass production? In large, privately owned corporations or in state-owned companies? If it is from all these sources, in what quantities from each?
- *For whom* shall goods be produced? Who is to enjoy and get the benefit of the nation's goods and services? Or, to put it another way, how is the national product to be divided among different individuals and families? Are we to have a society in which a few are rich and many poor? Or in which all share the nation's output equally? Shall high earnings go to muscles or to IQ? Shall selfish go-getters inherit the earth? Shall the lazy eat well?

These three problems are fundamental and common to all economies. But, as we will see later, different societies try to solve them using different institutions.

Inputs and Outputs[3]

Now that we have outlined three major economic tasks, we can say that all these three problems are really about the limitations and choices among an economy's *inputs* and *outputs*.

Inputs are commodities or services used by firms in their production processes. Inputs are combined to produce outputs, while **outputs** consist of the varied array of useful goods or services that are either consumed or used for further production.

For example, when a cook makes an omelet, the eggs, salt, heat, frying pan, and the chef's skilled labor are the inputs. A fluffy omelet is the output.

[3] Ibid.

We classify inputs, also called *factors of production*, into three broad classes: natural resources, labor and capital.

Restating the three economic problems, a society must decide: (1) *what* outputs to produce, and in what quantity; (2) *how* to produce them – that is, by what techniques should inputs be combined to produce the desired outputs; and) 3) *for whom* should the outputs be produced and distributed.

Alternative Economic Systems:

Custom, Command, and Market[4]

The three economic problems faced by societies are universal, but the solutions vary from place to place. The study of *alternative economic systems* is concerned with the different mechanisms that a society can use to allocate its scarce resources.

Custom rules every facet of behavior in many primitive civilizations. *What, how,* and for *whom* may be decided by traditions passed on from elders to youths. In ancient Egypt and even sometimes today in India, a son unswervingly adopts the trade of his father. Sometimes the customs appear bizarre to outsiders; the Kwakiutl Indians consider it desirable not to accumulate wealth but to give it away in the potlatch – a roisterous celebration.

However strange many customs look to outsiders, they often are efficient at performing the three functions of organizing the economy. In some cases, though, customs may be so unyielding that societies become extinct defending their traditions.

Another system is a command economy – one in which the government makes all decisions about production and distribution. Such a government might be dictatorial or it might be democratic; in the extreme it would tell people what to eat and drink, how food and steel should be made, and who should live well or poorly.

[4] Id, p. 25.

A final approach, developed at length in Chapter3, is the **market economy**. Here, a system of prices of wards determines *what, how*, and *for whom*. Firms produce those commodities that yield the highest profits (*the what*) by the techniques of production that are least costly (*the how*), and people's consumption arises from their decisions about how to spend the wages and property incomes generated by their labor and property ownership (the *for whom*).

No economy today is one of these pure forms. Rather, societies are of mixed economies, with elements of market, command, and custom. There has never been a 100 percent market economy (although nineteenth-century England came close). In American capitalism today, the government has an important role in setting the legal framework for economic life, producing education and police services, and regulating pollution and business. But most decisions in the United States today are made when markets determine prices and quantities.

The Law of Scarcity[5]

Why are we concerned with the fundamental questions of what, how, and for whom? These problems arise because people want to consume far more than an economy can produce. If infinite quantities of every good could be produced, or if human desires were fully satisfied, people would not worry about the efficient use of scarce resources. Nor would business managers lose sleep over wasteful use of labor or energy. Moreover, since all of us could have as much as we pleased, no one would care about the distribution of incomes among different people or classes.

In such an Eden of prosperity, there would be no **economic goods** – that is, no goods that are scarce or limited in supply. There would be no need to economize on consumption, and indeed economics would no longer be a vital science. All goods would be free, like sand in the desert or water at the beach.

[5] Id., pp. 25-26.

Limited goods but no society has reached a utopia of limitless possibilities. Goods are limited while wants seem unbounded. Even in the United States, the most productive society yet known, annual production in the mid-1980s has averaged around 80 million tons of steel, 8 million cars, and 3.2 billion barrels of oil. The country has but a few hundred miles of sandy beaches. Ski areas and concert halls have limited capacity, and our rock idols can hardly sing more than 300 live concerts a year. Our national output would have to be many times larger before the average American could live at the level of the average doctor or lawyer. And outside the United States, particularly in Africa and Asia, hundreds of millions of people suffer from undeniable hunger and material deprivation.

When compared with the poor nations or early civilizations, unlimited wants in advanced industrial economies seem very wealthy. But higher incomes bring in their train higher consumption standards and…

Opportunity Cost[6]

Life is full of choices. Because resources are scarce, we are constantly deciding which good we want to buy or which activity we will pursue. Should we go to a movie or read a book? Should we take a vacation or get some extra work done? Should we take a year off from college to travel or try out a job? In each of these cases, making a choice in a world of scarcity requires us to give up alternative activities, in effect costing us the opportunity to do something else. That alternative forgone is called the *opportunity cost*. To take a simple example, say that, after necessary expenses, your income is $100. With that sum you can either take a trip to Chicago. Economists would say that the opportunity cost of your trip was the pleasure of enjoying the new radio.

In the end, the opportunity cost concept reinforces the point made by the no-free-lunch doctrine. Often, the real costs of our actions – whether going to college or building roads or increasing military outlays–are subtle and go far beyond the actual dollar outlays. This central lesson of economics will reappear again and again in the chapters that follow.

[6] Id., pp. 32-33.

The Law of Diminishing Returns[7]

We can also use the production-possibility frontier to illustrate one of the most famous economic relation-ships: the law of diminishing returns. This law concerns the relationship between inputs and outputs in the productive process. More specifically, the law of diminishing returns holds that we will get less and less extra output when we add successive doses of inputs while holding other inputs fixed.

As an example of diminishing returns, consider the following controlled experiment: Given a fixed amount of land, say 100 acres, we shall first have no labor at all. We note that with zero labor input there is no corn output.

Now we make a second related experiment. We add 1 unit of labor to the same fixed amount of land. How much output do we now get? Say we observe that we now have produced 2000 bushels of corn.

Now make a third controlled experiment. We still hold land fixed. Once more we vary the labor input, adding exactly the same extra unit of labor as before. That is, we now go from 1 unit of labor to 2 units of labor to match our earlier increase from 0 labor to 1 labor. We await the outcome of the experiment in terms of extra corn produced.

We can now observe whether diminishing returns has set in – that is, we can now see whether the quantity of extra output declines as equal-sized doses of additional inputs are added. Do we have proportional returns, with an extra output of 2000 bushels added to the original output of 2000 bushels? Or do we find diminishing returns, with the additional inputs adding less than the original 2000 bushels of output?

The second extra unit of labor added only 1000 bushels of additional output, which is less than what the first unit of labor added. A third extra unit of labor adds even less output than does the second and the fourth unit adds yet a bit less. The hypothetical experiment, thus, would show numerically what happens when the law of diminishing returns holds.

[7] Id., pp. 33-34.

The law of diminishing returns is an important and often-observed economic relationship. But it is not valid for all technologies. Often the law holds only after a number of units of inputs have been added. Put differently, the first units of inputs might actually yield increasing extra returns, since we may need a minimum amount of labor just to walk to the field and pick up a shovel. But, ultimately, decreasing returns will prevail at high levels of inputs for most technologies. After reminding these economic concepts to students we now proceed in to the main topic of the course – The Law of International Free Trade.

Economies of Scale[8]

Our standard theory of international trade assumed constant returns to scale for each firm. The major alternative theories of international trade use the existence of economies of scale as major departure. The discussion of the basis for intra-industry trade and the discussion of global oligopolies both suggested a key role for scale economies. **Economies of scale** or increasing returns to scale exist if increasing expenditures on all inputs (with input prices constant) increase the output quality by a larger percentage so that the average cost of producing each unit of output declines. For instance, economies of scale exist if doubling all input amounts (labor, capital, and so forth) more than doubles output. Economies of scale are often not easy to measure precisely, but they appear to be of some importance in many industries.

In discussing scale economies, several distinctions are important. First, scale economies can be internal to each firm, or they can be external to the individual firm. Scale economies are internal if the expansion of the size of the firm itself is the basis for the decline in its average cost. Large firms may be able to reduce average cost through greater use of specialization by their workers, use of more specialized machines, or the spreading of fixed costs, such as research and development or production set-up costs, over more units of output.

[8] Thomas A. Pugel and Peter H. Lindert, International Economics, (11th Ed., McGraw-Hill Higher Education Co., Inc.), pp. 103-104.

Scale economies external to the individual firm relate to the size of the entire industry within a specific geographic area. The average cost of the typical firm declines as the output of the industry within this area is larger. External scale economies can arise if concentrating the industry geographically gives rise to better input markets, including specialized services for the industry or specialized kinds of labor required by the industry. External economies can also result as new knowledge about product and production technology diffuses quickly among firms in the area, through direct contacts among the firms or as skilled labor transfers from firm to firm. External scale economies appear to explain the clustering of some industries-high technology semiconductor, computer, and related producers is Silicon Valley, banking and finance in New York City, stylish clothing, shoes, and accessories in Italy, or watches in Switzerland. We will discuss the relationship of external scale economies to international trade in the last section of this chapter.

A second major distinction is the size or extent of scale economies, especially for economies that are internal to the firm. How much does average cost decline as output expands? How large must a form be to exploit all (or most) economies arises on the seller side of the market.

If scale economies are modest or moderate, then there is room in the industry for a large number of firms. If, in addition, products are differentiated, then we have a mild form of imperfect competition called **monopolistic competition**, a type of market structure in which a large number of firms compete vigorously with each other in producing and selling varieties of the basic product. Because each firm's product is somewhat different, each firm has some control over the price that it charges for its product. This contrasts with the perfectly competitive market structure used in standard trade theory. With perfect competition, each of the many small firms takes the market price as given and believes that it has no direct control or influence on this market price.

If scale economies are substantial over a large range of output, then it is likely that a few firms will grow to be large in order to reap the scale economies. If a few large firms

dominate the global industry, perhaps because of substantial scale economies, then we have an **oligopoly**. The large firms in an oligopoly know that they can control or influence prices. A key issue in an oligopoly is how actively these large firms compete. If they do not compete too aggressively, then it is possible for the firms to earn economic (or pure) profit, profit greater than the normal return to invested capital. In the extreme, the industry could be a global monopoly, in which one firm dominates the world industry.

Monopolistic Competition and Trade[9]

International trade with product differentiation and monopolistic competition has been analyzed in the past two decades by Paul Krugman, Elhanan Helpman, and others. To set the stage for this type of analysis, we turn first to monopolistic competition within a closed national economy, using a model pioneered by Edward Chamberlin in the 1930s. As the hybrid name suggests, monopolistic competition is somewhat like monopoly and somewhat like competition. It is like monopoly in that the individual firm has some control over the price that it charges, because it produces a unique differentiated good that consumers consider being somewhat different from the varieties offered by other firms in the industry. The firm faces a downward-sloping demand curve for its product. It is like competition in that the entry and exit of firms eventually push each firm toward zero pure profit. Although some scale economies exist that are internal to the firm, they are moderate so entry is fairly easy and a large number of firms compete in the overall market. The firm's product competes so closely with the other varieties that the firm cannot extract pure profits above all costs, at least not for very long.

Diagram 1 imagines a firm, say Honda, facing monopolistic competition in Japan's national market for compact cars. Like a monopolist, Honda bases its profit-maximizing decision points marginal revenue curve (MR1) because it is aware that expanding its own production and sales requires lowering its price, which eats into its total revenue. It will only expand its production out to a point where the marginal revenue it gets from extra cars, taking and selling them. That point, where profits are maximized, is the output of 4 million cars a year, where marginal revenue equals marginal cost at point C. To get that

[9] Id., pp. 104-105.

many cars sold, it charges "what the traffic will bear," the price of 1.9 million yen dictated by the demand curve at point A.

So far our description of Honda's situation sounds like the pure monopoly case from a basic course in microeconomics. Honda could indeed be a pure

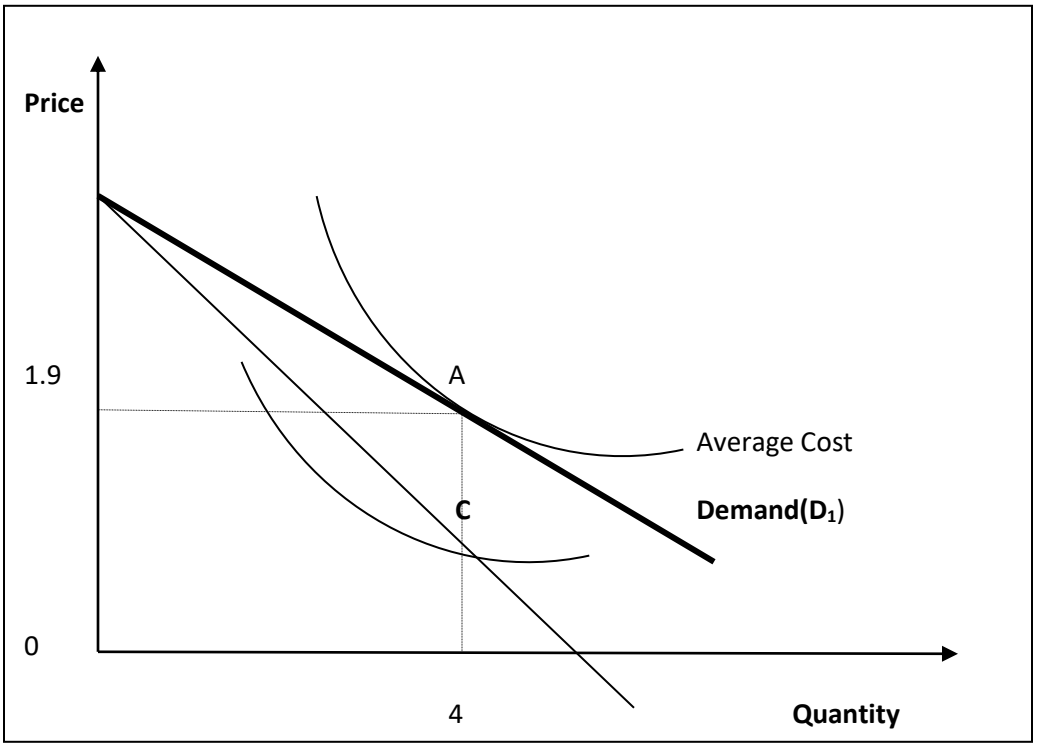


Diagram 1: **Marginal Revenue**

Monopolist for a while carries on, after first entering a market where its unique product hand some advantages. After a while, though, there will be indirect competition from competing cars even if they are not identical to Honda's compact car. Honda may continue to find its maximum profits at optimal points like C, but eventually the entry of new firms into the compact auto industry will drive Honda's pure profits down to zero. Diagram 2 therefore shows an equilibrium in which entry, or even just the threat of entry, by new competing firms has pushed Honda's demand curve down so that it just touches the average cost curve. At point A, with output at 4 million cars per year, price just equals average cost, leaving the firm with no pure profits. Point A's equilibrium is on the

downward slope of the average cost curve, because auto production benefits from some economies of scale.

Oligopoly and International Trade[10]

Oligopoly exists when a few firms supply much of the market. Global oligopoly could occur, for instance, if substantial scale economies internal to each firm give large forms a cost advantage over many smaller rival firms.

Each large firm in an oligopoly knows that it is competing with a few other large firms. It knows that any action that it takes (such as lowering its price, increasing its advertising, or introducing a new product) it likely to provoke reactions from its rivals. Modeling this interdependence among oligopoly firms as a game has led to insights. Consider a simple example that illustrates this kind of application of game theory: picture competition between two dominant, large firms as a choice of completion strategy by each. Each firm can choose either to compete aggressively (for instance, setting low prices or using a lot of advertising) or to restrain its competition (setting higher prices or using advertising moderately). The outcome for both firms together is usually for both to restrain their competition, in which case they both earn substantial economic profits. However, if they cannot cooperate with each other, then the play of the game may result in both competing aggressively. If one firm decides to restrain its competition, then the other often can earn even higher profits by competing aggressively to gain a large market share. In this case the first firm may well suffer losses rather than earn profits. Both know that the other is likely to act in this way, so neither is willing to restrain its competition-both compete aggressively and earn low profits. They are caught in what is called a prisoners dilemma. The solution, of course, is for the two firms to find some way to cooperate in restraining their competition so that they both earn substantial profits (rather than both earning low profits). The cooperation may be by formal agreement (although this is illegal in the United State and many other countries). The cooperation may be tacit or implicit, based on recognition of mutual interests and patterns of behavior established over time.

[10] Id., pp. 109-111.

Unfortunately, there is no one “best” way for firms to play more complex dynamic oligopoly games that are more realistic than this simple tow-firm game, so the application of game theory to oligopoly has its limits. Nonetheless, game theory does highlight that cooperating with rivals is possible (though not assured) in an oligopoly. Firms in an oligopoly can earn economic profits, and theses can be substantial if competition is restrained.

We offer several observations in lieu of a full theory of oligopoly and trade. If substantial scale economies exist, production tends to be concentrated in a few countries in order to take advantage of the scale economies. These countries will then tend to be net exporters of the product, while other countries are importers.

How does this trade pattern get established? History matters. Firms initially chose these production locations for a number of reasons. One prominent reason presumably was that comparative advantage indicated low-cost production with access to required factor inputs at these locations. However, even if the location initially was consistent with comparative advantage, this can change over time. Once the production locations are chosen and high-volume production achieves scale economies in these locations, the pattern of production and trade can persist even if other countries could potentially produce the good more cheaply. Production may not develop at a potentially low-cost location because production volume there must be high enough to achieve the available scale economies. A smaller scale of production would result in higher average cost that can cancel out any other cost advantages to the location. Achieving high production volume in the new location means that the new producer must gain a large share of the market. This may not be possible without an extended period of losses for the entrant because, 1) the increase in supply lowers prices, or 2) previously established firms may fight the entrant using other competitive reactions.

Thus, production in this lower-cost location may fail to develop. This problem for the potential entrant firm and country is an example of an infant-industry situation, which we will discuss further in chapter 9.

Does it matter in which countries the production is located (or, perhaps more precisely, which countries own the oligopoly firms)? The answer is that it can matter to national well-being or welfare, especially of the oligopoly firms earn economic (or pure) profit on their export sales. (This same point applies to the national location or ownership of a global monopoly.) These pure profits arise from the ability to charge high export prices to foreign buyers, thus enhancing the country's terms to trade. (The pure profits can also be seen simply as an addition to national income that comes from foreign buyers.)

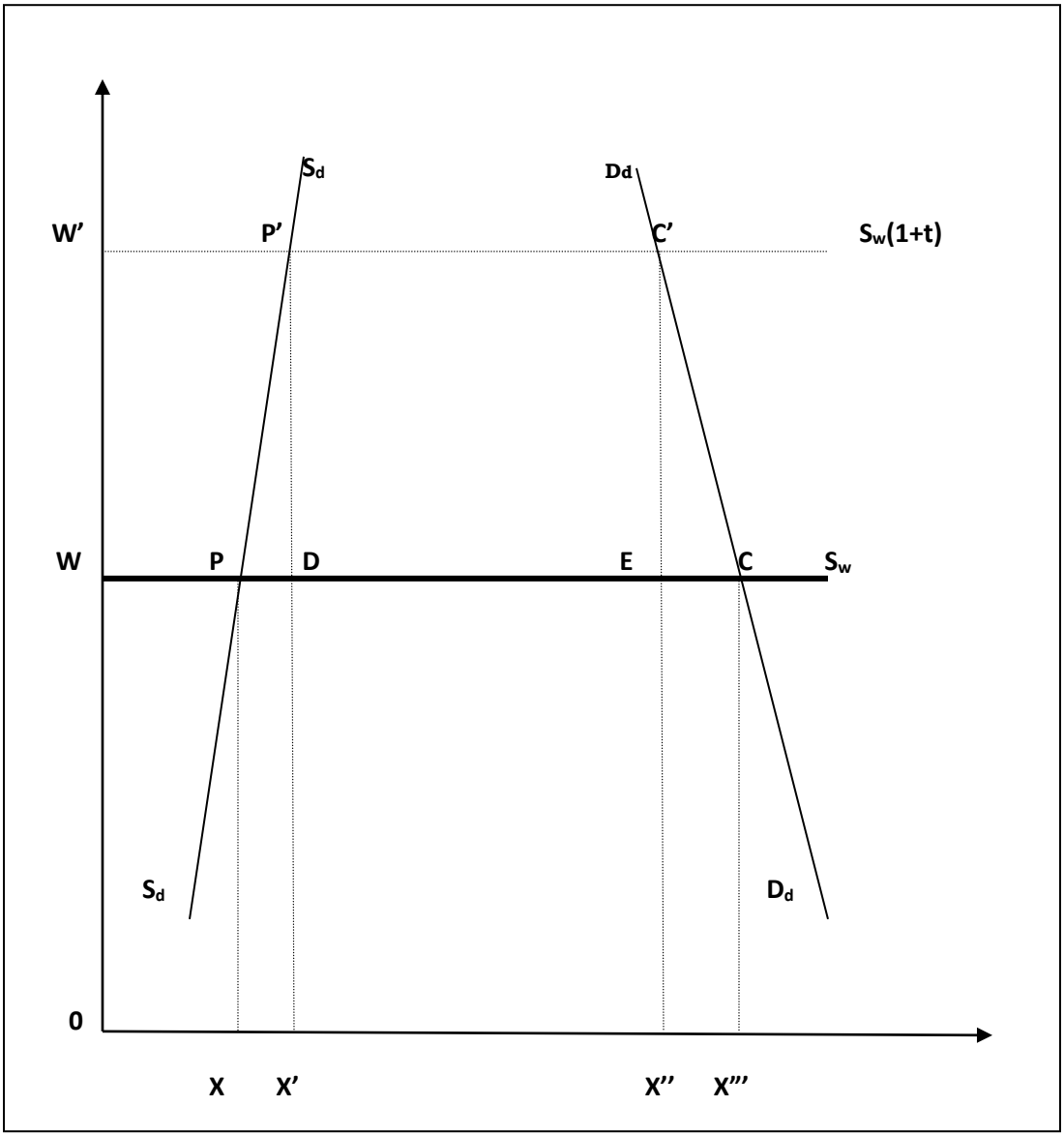
Putting all of this together, we see that the current pattern of national locations for a global oligopoly is somewhat arbitrary, and the small number of countries that have the industry's production obtain additional gains from trade if the firms earn pure profits on their exports. The national gain from having high-profit oligopoly firms in a country is the basis for national governments to use various policies to influence the location decisions (or the global market shares) of the oligopoly firms in favor of domestic production. These issues are taken up further in the discussion of strategic trade policy in Chapter 10.

External Scale Economies and Trade[11]

A final case worth examining is an industry that benefits from substantial external scale economies. External economies exist when the expansion of the entire industry's production within a geographic area lowers the average cost in the long run for each firm in the industry in the area. If there are no or only modest internal scale economies, then a large number of firms can exist in the industry. We have a case in which substantial (external) scale economies coexist with a (perfectly) competitive industry.

Diagram 2

[11] Id., pp. 111-112.



If an expansion of an industry lowers costs for each firm, then new export opportunities (or any other source of demand growth) can have a dramatic effect. Diagram 2 imagines that a national semiconductor industry is competitive, but characterized by external economies of scale. There is an initial equilibrium at point A, with many firms competing to sell 40million units at $19 a unit. Here the usual short-run supply and demand curves (S_1 and D_1) intersect in the usual way. What is new in the diagram is the coexistence of the upward-sloping supply curve S_1 with the down ward-sloping long-run average cost curve. The upward-sloping supply curve is the sum of similar individual firms' view of the market. Each firm operates at given levels of industry production, which it cannot

affect very much. It reacts to a change in price according to its own upward-sloping supply curve, and the sum of these supply curves is shown as S_1. The industry's downward-sloping average cost curve comes in to play when demand shifts. To bring out points about international trade, let us imagine that opening up a new export market shifts demand from D_1 to D_2. Each firm would respond to the stronger demand by raising output. If each firm were acting alone and affected only itself, the extra demand would push us up the supply curve to S_1 to a point like C. Yet the new export business raises the whole industry's output and employment, bringing additional external economies. Also, among other things, the external economies lead to a decline in average cost as industry output expands; say, for example, to point B, as indicated in Diagram 2.

What are the welfare effects of the opening of trade of an industry with external economies? Producers of the product in an exporting country tend to gain producer surplus as a result of the expansion of industry output, although the decline in price will mitigate the gain. Producers in importing countries lose producer surplus. Consumers in importing countries gain consumer surplus as price declines and their consumption increases. Such kinds, similar effects would result in various spheres.

1.2 International Free Trade

Various arguments have been given by numerous scholars in support as well as in contradiction to free trade. In the following sub-sections of this chapter, we try to outline the essential features of each of these schools of economics. Since, nowadays, economists of developing countries and others put great emphasis to the need for establishing a *"Free and Fair Trade System"* the world over, the basic concepts that underlie the theories are discussed in detail; i.e., in the context of *utilitarian* as well as of *right* argumentations. As this textbook is designed to Ethiopian law faculty students, effort would be made, where possible, to include some inquisitive questions of national concern.

1.2.1 Classical Free Trade Arguments: The Attack on Mercantilism[12]

The most classical argument in support of free trade was developed by economists as a means of criticizing the mercantilist practices of governments in the 18th Century. The then practices are indicated by the exact words of Bhala & Harris as:

> .. mercantilists identified a nation's wealth or wellbeing with its stock to precious metals. Accordingly, a country was encouraged to export more than it imported, since the net flow of goods would be matched by an inflow of gold. To stimulate a trade surplus, mercantilists counseled tariffs and export subsidies. The tariff discouraged imports, while the export subsidy encouraged exports."[13]

On the other hand, classical opponents of international trade pointed to the fact that;

> .. [w]hile tariffs and export subsidies could increase the government's stock of precious metals; they would also reduce the economy's consumption alternatives by comparison with a policy of free trade. The classical economists argued that the latter constituted a decrease in the real wealth of the nation, even though the government's gold stock would be increased by trade interventions…"[14]

So, on the grounds that free trade minimizes a country's consumption opportunities, classical economists argued that free trade is not a better policy that should be pursued.

All the same, mercantilist's way of thinking is strongly ingrained in the public's mind that trade balance is routinely referred to as a *favorable* balance of trade, irrespective of whether or not it minimizes a country's consumption opportunity, or whether or not the value of exported goods and services is greater than that it imports in return.

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[12] Melvyn Krauss, How Nations Grow Rich, 1997, pp. 8-11 and 29-32.
[13] Raj Bhala, P. R. Harris (Research Prof. of Law with The George Wash. Univ. Law School), International Trade Law: Theory and Practice with Accompanying International Trade Law Handbook and Teachers Manual, (2nd Ed., Mathew Bender and Company, Inc. one of the Lexis Publishing TM), 2001, p. 1.
[14] Ibid.

In this regard, the reason neo-mercantilists give is that trade surplus generates funds which can be invested abroad in foreign stocks, bonds, real estate, companies, etc... This accumulation of foreign assets is alleged to expand the influence and power of the surplus country, and decrease that of the deficit country.[15]

Actually, balance of trade between two countries may or may not bring about favorable results; i.e., there is nothing inherently favorable about a favorable trade balance. One example to each respective case is cited accordingly.

Example 1. *"Like the eighteenth-century mercantilists who wanted gold to increase their power and influence the world affairs, Romania's ex-dictator Nikolai Ceausescu thought his influence on the world stage would grow in the 1980s if Romania accelerated the pay down of its substantial foreign debt. To the delight of its foreign bankers and consternation of its citizens, Romania generated export surpluses by barring imports and forcing exports to finance the required capital outflow. The mandated increase in domestic savings put intolerable pressure on Romania's already meager living standard and was a prime factor behind the eventual overthrow of the Ceausescu regime and assassination of both Ceausescu and his wife…"*[16]

On the other hand, a nation can gain from importing capital if the rate of return from the use of the imported capital exceeds its cost. Meaning, if, among other things, (a) present day consumption is kept constant, and (b) net interest payments to be paid in the future to investments, loans, etc.. , attracted currently would not exceed national revenues, capital, .. generated thereof.

Example 2. *"The trade deficits of the 1980s, during Reagan years, provide an interesting special case of the principle that trade deficits can work for the general good. U.S. defense spending was high during this period because of*

[15] Ibid.
[16] Id., Op cites, No. 13, pp. 2-3.

> *President Reagan's desire to face down – and close down – the Soviet Empire. The results have been more than gratifying – yet, in part, at least, the U.S. defense buildup was financed by imports of foreign savings. Clearly, the trade deficits that financed the U.S. defense buildup was a worthwhile use of borrowed funds …"*[17]

The second batch, referred to as *neo-mercantilists*, have identical outlooks as they basically believe that "[t]rade policy is good if it leads to trade surplus, bad if it leads to a trade deficit. The reason neo-mercantilists worship the trade surplus is that it gives the surplus nation power to buy the real and financial assets of foreign countries."[18]

Economists do not accept these views since they believe that trade policy should be geared to increasing the domestic living standard rather than increase the nation's power over foreign assets since that could as well lead to conflict or loss of assets if the purchased bonds, companies, .. fall in value.

Neo-mercantilists essentially favor protectionist approaches. In this respect, both theory and practice demonstrate protection has little bearing on the balance of trade. For instance, if a country imposes tariff on imported goods and services, i.e., levies extra-tax on imported goods and services, in view of protecting domestic manufacturers of same items. The import and export trade balance of the items on which tariff has been imposed

> ".. cannot move into surplus, because domestic resources flow out of exports to 'finance' import substitution. Imports fall but so do exports. In the new equilibrium with the tariff, import and exports are balanced though at lower levels than under free trade. The tariff affects the level of trade – both imports and exports are reduced – but not the trade balance."[19]

[17] Ibid.
[18] Ibid.
[19] Ibid.

When we expand the analysis to include savings behavior, it can be shown that the critical determinant of a nation's trade balance is directly related to its savings rate.[20]
For various reasons and circumstances, countries may devaluate the value of their currency. When trading countries want to reach a favorable trade agreement to both, practice has shown that the currency regimes of the agreeing countries should be taken into consideration.[21]

1.2.2 Ricardo's Law of Comparative Advantage[22]

The other arguments relating to free trade are of the British economist Melvyn Krauss, and that of Paul Samuelson and Robert Gilpin. The former two argue that *comparative advantage* is the essential driving force that underlies the need to free trade between countries. In explaining comparative advantage, many college instructors love to illustrate the British economist David Ricardo's insights about the gains from free trade with a story about Woodrow Wilson, who happened to type faster than his secretary. But since the lawyer would be well-off if he hires a typist and deliberates all his time to his legal profession, as his law practice has comparative advantage than typing, he hired a secretary and paid her from what he earned as law practitioner.

Although the mentioned example seems to properly illustrate what is meant by *comparative advantage* in trade relations, the following vital points should be taken note of.

a) Free trade is a positive, not a negative sum game; i.e., both trading countries gain from it. But this does not mean that free trade can equalize the standard of living in the trading countries.
b) Free trade does not create jobs, but actually creates income by reallocating or transferring jobs from the lower-productivity to the higher-productivity sectors. [23]

[20] Id., pp. 4-5.
[21] Id., pp. 5-6.
[22] Melvyn Krauss, Op cites, No. 12, pp. 8-11 and 29-32.
[23] Raj Bhala *et la*, Op cites, No. 13, pp. 5-6.

Therefore, in the mentioned instance, "[t]he argument for free trade.. is an efficient allocation of resources argument. Such reallocation increases income by increasing the average productivity of the nation's stock of productivity resources."[24] For one reason or another, a country might decide to vigorously pursue free trade for the sake of, say, reallocating its human and capital resources as the following writing of Peter Passel shows.

> By the rule of 'comparative advantage,' it made economic sense for Victorian England to break the political influence of its cosseted farmers by opening its borders to wheat from Central Europe and North America. That allowed entrepreneurs to focus more capital and labor on manufacturing, where it could (and did) make Britain the richest country on earth.[25]

In an isolated economy, i.e. an economy that does not trade with the rest of the world, domestic consumption is limited to production. But through international trade, it is possible for the economy's consumption of all goods to increase as some of these consumable goods are beyond its ability to produce.

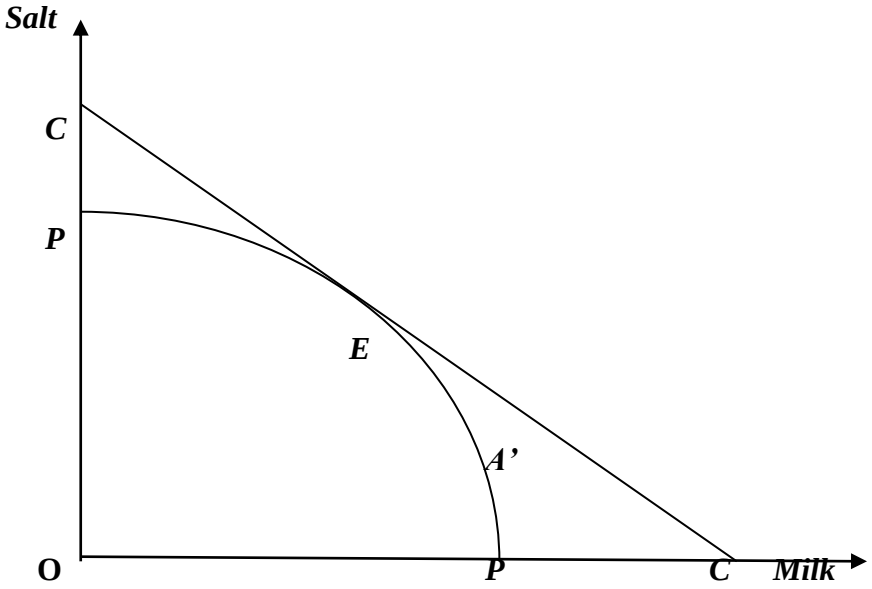


Diagram 3

[24] Ibid.
[25] Id., p. 8.

Let us make use of the above simple diagram to illustrate the so-called gains from international trade. Let us suppose that the economy of a country can produce only table-salt and milk.

Given the economy's supply of land, labor, capital, and the state of its technical skill, the curve *PP* represents the maximum amount of one good that the economy can produce for given amounts of the other goods. The basic law of scarcity is reflected by the fact that *PP* falls from the upper left to the lower right. Let us also suppose that in order to produce increasing amounts of one good, the output of the other must be reduced.

In an isolated economy, *PP* defines both the economy's production and consumption alternatives, assuming full employment. Consumptions at points *A'* and *A"*, for example, clearly lie outside the economy's capabilities. They can be reached only if the economy grows; that is, the curve *PP* shifts outward because of, say, technical progress. However, if the economy has the opportunity to trade at the price ratio given by the slope *CC* (the slope of *CC* shows how many units of milk can be exchanged for a given unit of table-salt in the world market), consumption along the line *CC* is possible if domestic production is adjusted to point *E*. The consumption alternatives available to the economy have expanded from *PEP* to *CEC*, even though the production possibility curve has not altered.

Assume that the economy initially produced and consumed the combination of goods indicated at point *A*. Given the opportunity to trade at the international price ratio indicated by the slope of *CC*, if production shifts to point *E*, consumption at point *A'* is possible. The economy exports *ED* amount of milk and, at the given world price, receives *DA'* amount of table-salt in return. Indeed all points along *CC* can become possible via international trade, including those that lie further to the right of *E*, like for instance those between *A'* and *A"*. All these points, of course, represent increased consumption of both goods by comparison with the initial isolated-economy point *A*. This is the essential argument in favor of international trade as ".. given a fixed stock of 'productive'

resources, free trade permits the 'consumption' possibilities available to the economy to expand beyond the economy's 'production' possibilities."[26]

Generally, free trade is best for the overall economy, even though individual groups may lose from this policy. .. The conflict between the economic interest of specific groups within the community and the economic interest of the community as a whole is the essence of the free trade versus protectionism controversy. Free traders argue from the standpoint of the overall economy; protectionists argue from the standpoint of particular interest groups.[27] …

Present day liberal theory:

a) "..rests ultimately upon the belief that economic specialization produces gains in productive efficiency and national income;
b) " .. believes that trade enlarges consumption possibilities;
c) "International trade thus has beneficial effects on both the demand and the supply sides of the economy."[28]

Moreover, liberal view of international economic relations assumes that *gains from trade* as based on *a harmony of interest* founded on specialization and comparative advantage underlies the political economy of international relations.[29]

1.2.3 Contemporary Arguments for Free Trade

Unlike the classical approach, contemporary arguments are based on dynamic models. As the following discussion shows, such methods of investigation help policymakers to determine the effects of free trade on standards of living, through time.

[26] Ibid.
[27] Id., p. 10.
[28] Ibid.
[29] Robert Gilpin, The Political Economy of International Relations, (1987), pp. 172-174.

***Dynamic Models of the Benefits of Free Trade*[30]**

Do countries which adopt policies encouraging freer trade enjoy more rapid rates of growth in per capita income than otherwise similar countries which do not engage in trade liberalization? The importance of this question becomes apparent when it is realized that the enormous differences in the standards of living between one country and another have emerged as the result of relatively small differences in the rate of economic growth, maintained over decades. Thus, the potential impact of trade liberalization on economic growth, however modest, might have important consequences for standards of living. …
The term "dynamic effects" in the title of this investigation refers to effects on the rate of economic growth that are manifested over an extended period of time. The dynamic effects of trade liberalization are in contrast to the concept of static efficiency gains. In the context of trade liberalization, "static efficiency gains" refers to one-time benefits of liberalization which arise as national prices become more closely aligned with the global price structure, and the resulting reallocation of resources that takes place within the economy in response to these price changes. The method of measuring static efficiency gains by comparing the performance of the economy in two scenarios for a single base year (in this case with and without liberalization), is referred to as comparative statics.

Traditional methods of analyzing trade agreements, relying on comparative statics, generally simulate the effects of the trade agreement at a single point in time, using available data for a single, historical base year, and consider only static efficiency gains from liberalization. However, if trade liberalization influences the rate of economic growth, even by a few tenths of a percentage point annually, its potential consequences would turn out to be substantially greater than those captured by static efficiency gains, since the effects would be both extended and compounded over time. It is, therefore, presumed that measures of dynamic gains from trade might be larger than comparative statics measures of gains from trade. ….

[30] United States International Trade Commission, "*The Dynamic Effects of Trade Liberalization: An Empirical Analysis*", (Investigation No. 332-375, Publication 3069, October 1997), 1-1 – 1-2, 2-1 – 2-6, 2-8 – 2-11, 2-15, 3-1 – 3-2, 3-4 – 3-6, 3-11 – 3-13, 3-17, 3-21 – 3-22.

From the purpose of this investigation, the term trade liberalization is defined broadly to include liberalization of trade in goods and services, capital, and technology. Liberalization of trade in capital (i.e. foreign investment, particularly foreign direct investment (FDI)) is increasingly undertaken or discussed simultaneously with trade liberalization, as in the North American Free Trade Agreement (NAFTA), in the Uruguay Round Agreement on Trade Related Investment Measures (TRIMS), and in the Asia–pacific Economic Cooperation Forum (APEC). Expansion of foreign investment has direct consequences for both economic growth and merchandise trade. In addition, certain types of investment liberalization and trade liberalization coincide in a formal, legal sense (i.e., TRIMS). Trade in technology, such as cross-border licensing of Intellectual Property (IP), has characteristics in common with foreign investment; technology trade is a subject of recent liberalization initiatives, and it is linked both substantively and formally with merchandise trade. Improvement of foreigners' intellectual property protection is being undertaken simultaneously with trade liberalization, and technology trade has potential consequences both for economic growth and for merchandise trade.

The extent of trade liberalization is determined by the economic growth it enhances. As the following discussion reveals, the vital question to be addressed is: Does trade liberalization cause economies to grow more rapidly than those which do not? Small differences in economic growth, maintained for extended periods of times, can lead to dramatic differences in standards of living. These differences help account for the interest of policymakers and analysts in learning whether dynamic gains from trade liberalization really exist.

The effects of sustained differences in the rate of economic growth can be illustrated by the so-called "rule of 72". (According to the "rule of 72," the number of years it will take for a quantity to double can be approximated by dividing the annual growth rate of that quantity into the number 72.) If two economies begin with the same income per person, but growth in income per person in the first economy exceeds that in the second by 2 percent per year, in 36 years the faster-growing economy will enjoy approximately

double the standard of living in the second economy. A dramatic example of the consequences of sustained differences in economic growth rates is provided by a comparison of EI Salvador and Japan. In the mid-1959s, the per capita income of EI Salvador was roughly equal to, or even slightly higher than, that in Japan. In 1993, according to World Bank data, the income of one Japanese person was approximately equal to that of 24 Salvadorians.

The theories given below make extensive use of such dynamic models. The fundamental principles of the respective theories are the following.

Theories of Economic Growth[31]

Many of the most fundamental principles relating to economic growth, international trade, and the relationship between them were anticipated by the classical economists, such as David Hume (1711-76), Adam Smith (1723-90), David Ricardo (1772-1823), and John Stuart Mill (1806-73). These principles include, among others:

- The realization that sustained increases in real wages can be maintained by steady increases in capital per worker;
- The role of saving, or abstaining from consumption, in financing capital accumulation;
- The rule of improvements in the "useful arts," advances in machinery, and extensions of the division of labor (in modern parlance, technological change) in raising living standards: and
- The twin possibilities capital accumulation and technological progress could lead to expansion in international trade, and that international trade could improve the conditions for economic growth. The feedback effects of trade on economic growth were recognized to operate through a number of channels, including the importation of inputs to domestic manufactures; international diffusion of new production techniques and new consumption possibilities; and wider extension of the division of labor, promoting increased economies of scale.

[31] Raj Bhala *et la*, Op cites, No. 13, p. 14.

After languishing for nearly a century, interest in the theory of economic growth revived in the mid-20th century. Plans for the reconstruction of Europe and Japan after World War II, the problem of very low living standards in the newly independent former colonies, and the former Soviet Union's experience of rapid increases in mechanization and industrial output in the Stalin/ Khrushchev years converged to dramatize issues surrounding economic growth. Western attempts at constructing new mathematical theories of economic growth, most notably those of Roy Harrod (1930) and Evsey Domar (1964), relied on assumptions of technologically fixed proportions between labor and capital and fixed rates of saving independent of any human decisions about the appropriate rate of savings. The logical implications of such restrictive assumption were that stable, long-run economic growth was unlikely in market economies, and that chronic growth of either unemployment or idle machinery was very likely.

On the other side we find the neoclassical growth theory of Robert Solow (1956) and Trevor Swan (1956). This theory is generally recognized as the modern beginning of fruitful theorizing about economic growth in market economies. The neoclassical theory overcame the paradoxes of the Harrod/Domar model by recognizing that substitution between labor and capital takes place in response to changes in their relative prices. Profit-seeking firms will employ more machinery per worker if the wage rate rises relative to the user cost of capital, and will employ more workers per machine if the user cost of capital rises relative to the wage rate. This process insures that sustained increases in real income per worker can be maintained consistently with log-run full employment of both labor and capital

Characteristics of the Neoclassical Model[32]

The basic neoclassical model employs the following additional assumptions:

- The economy operates under constant returns to scale, i.e., simultaneously increasing inputs of labor and capital by an identical proportion will increase output by the same proportion.

[32] Id., p. 15.

- There are diminishing returns to both labor and capital. If the stock of capital were somehow to be fixed, employing additional workers would lead to steadily falling additions to output for each additional worker, and thus to falling wages. Similarly, if the labor force were fixed, installing additional capital would lead to steadily falling additions to output for each additional unit of capital, and thus to falling market returns to capital.
- In fact, however, the labor force is constantly growing with population growth, and the stock of capital also grows. Annual investment, which increases the capital stock, is financed out of savings, and a portion of that investment is used to replace the depreciation of old capital. The labor force growth rate, the rate of savings out of national income, and the depreciation rate are "exogenous" in the basic neoclassical model; that is, they are assumed to be fixed by some mechanism operation outside the model, with the model itself making no further attempt to explain the values which they take.
- Technological improvements also take place at a constant rate. Any given combination of labor and capital produces more and more out put as time goes on, because of improvements in the techniques of production. The rate of technological progress is also fixed exogenously, with the model itself making no particular attempt to explain why technological progress might be either fast or slow.

The following predictions have to be met for the Neoclassical Model to effectively be useful in determining growth.

In the Solow/Swan model, per capita incomes may grow both because of increases in capital per worker and because of technological change. Because of diminishing return to capital, however, the impact of addition savings and investment eventually declines to the

point at which the available savings are only sufficient to cover depreciation and growth in the labor force.[33]

One of the most important predictions of the neoclassical model is that of convergence in per capital incomes — i.e., low-income countries should grow through liberalization. (If technological progress is taking place for other reasons, the liberalization induces a period of growth of per capital income in excess of the rate of technological progress, after which the growth rate gradually declines to the rate of technological progress.)

This property of the neoclassical model is often described as a level effect of trade liberalization. Liberalization increases the long-run level of per capita income but not its long-run rate of growth. Any increase in the rate of growth of per capital income takes place only in transition to the new, higher level, and lasts only until sufficient savings and investment has taken place to achieve that higher level. The search for alternatives to the neoclassical growth model has been motivated in part by a desire to demonstrate that trade liberalization could induce growth effects as well; i.e., permanent long-run increases in the rate of growth of per capital income.

Increases in the national savings rate, or reductions in the rate of population growth, also increases the log-run level of per capita income in the neoclassical growth model. As is the case with improvements in technological efficiency, these changes have no long-run impact on the rate of growth of per capita income, but induce increases in the growth rate during the dynamic transition to the new, higher level of per capital income. Typically, those newer economic theories which produce permanent growth effects for trade liberalization also predict permanent growth effects for increases in the national savings rate or reductions in the rate of population growth.[34]

As shown herein above, contemporary arguments of free trade are based on extensive data and detailed researches that take into account numerous variables. Meaning, these

[33] Id., p. 15.
[34] Id., p. 17.

models are better designed in that they help explain economic dynamism under various circumstances. These researches also give significant answers to policy-makers and economic analysts in that they help explain the enormous differences in standards of living in different economies and the effects of sustained economic growth over an extended period of time would have on standard of living.

As the growth effects of human capital on trade liberalization models show,

> ".. countries relatively well-endowed with unskilled labor .. lead(s) .. increased importation of skilled-labor-intensive goods and increased domestic production of unskilled-labor-intensive goods, reducing the incentive to accumulate human capital .."[35]

All the same, in developing countries, as long as the conventional static efficiency gains to trade liberalization outweighs the reduced incentive to accumulate human capital, it usually is not considered as having negative impact. That is because it is supposed that these countries would eventually benefit from the spill-over effects of knowledge resulting in the developed countries.

Another alternative forwarded in response to the neo-classical model relates to differentiation and quality improvements – i.e. expansion in the variety of products and improvements in the quality of products. Both, in terms of economics as well as trade, differentiation and quality improvement are considered of significance so far as these:

a) benefit the consumers, or
b) enhance the efficiency of production to the extent the variety and/or quality of intermediate goods matter for productivity.[36]

Since models of economic growth have been developed incorporating both expansion (differentiation) and quality improvement, required technological advances to meet future

[35] Id., p. 20.
[36] Ibid.

needs, together with relevant research and development activities can carefully outlined and directed. Thus,

> [t]he , models allow for a rich specification of the process of technological change, taking into account the productivity of research laboratories, the intensity of consumers' desire for new and improved products, the rate of return on R&D relative to physical capital, and the ... of intra-national or international technological spillovers.
>
> "As it turns out, there are deep structural similarities between models of economic growth based on variety expansion and those based on quality improvement. In both cases, the public spillovers or 'externalities' generated by technological improvements serve to stave off diminishing returns in physical capital, providing for long-run sustainability of economic growth. [Also] Some properties of the variety expansion or quality improvement models are similar to properties of the learning-by-doing and human capital models. These include the possibility that enhancing the level of efficiency (through trade liberalization or other beneficial policy reform) enhances the long-run growth rate; … "[37]

International transmission of technology and intellectual property rights is the other aspect of trade shown in the new, dynamic economic model. Accordingly, international trade helps enhance international transmission of technology as:-

1. commercial contacts between countries can serve as a source of information about new products and production processes.
2. international trade in technology information itself can take through licensing contracts and joint ventures; such trade is facilitated by strong recognition of foreign intellectual property rights (IPR).
3. an important component of technology is embodied in new capital equipment.
4. international trade in capital through FDI carries with it a component of technology transfer. Technological diffusion and imitation provide a powerful

[37] Id, p. 20.

> reason to expect international convergence of productivity and per capita income, independently of the arguments arising from the neoclassical model.

Researches have established that:

> [s]trong IPRs in the North, and recognition of Northern IPRs in the South [i.e. in developing countries] can increase the monopoly rents to innovators and lengthen the time of the 'product cycle' … Models of this type are said to exhibit 'creative destruction', as new intentions are included by the prospect of market power, which is [gradually] eroded by imitation and competition.." (also known as 'Schumpeterian' effect.)
>
> "In general, these models yield ambiguous predictions about the welfare effects of trade liberalization, ..[a]t the heart of [which] .. is the tradeoff between competition in pricing ..(increases social welfare by cheapening old goods, but reduces the incentive to invent new ones) and temporary monopoly in new innovation to the monopolist, but also prevents useful dissemination of the innovation) … An analogous principle applies to the geographical extension of IPRs…"
>
> "Trade liberalization in markets experiencing innovation subject to imperfect competition also faces this tradeoff… Furthermore, trade liberalization causes expansion of some sectors and contraction of others in accordance with comparative advantage… A country whose underlying comparative advantage was in low-technology goods would experience contraction of the high-technology sector under trade liberalization, and possibly a lower rate of innovation.."[38]

From what has been discussed thus far about neoclassical and endogenous growth theories the following two vital/crucial differences can be discerned.

A. Neoclassical theorists claim that trade liberalization increases economic growth rate only temporarily, during a transitional period;

[38] Id., p. 21.

B. Endogenous theorists claim that trade liberalization might induce permanent economic growth rate.

An interesting point that should be noted occurred when efforts were made to explain the so called 'East Asian Miracle' making use of the economic theories discussed above together with their respective models. In this regard, [39]

> [t]he recent debate about the sources of rapid economic growth in East Asia has some interesting implications for the choice among theories of growth. In a widely cited study, (Alwyn) Young (1995) found that most of the economic growth in Hong Kong, Singapore, South Korea, and Taiwan could be attributed to accumulation of productive inputs, including rising labor force participation rates, improving education, and .. rising rates of investment. After controlling for these factors, the remaining contribution of total factor productivity (TFP) growth is relatively modest, implying rates of technological progress no greater than those in the OECD and Latin America. (Paul) Krugman (1994), basing his argument on Young's estimates, speculated that because of diminishing returns to capital, the East Asian economies could experience rapid deceleration in economic growth in the absence of greater attention to technological performance, drawing analogies to the collapse of growth in the Soviet Union even as rapid accumulation of capital equipment proceeds. ..

Thus, the study on the 'East Asian Miracle' cited above, most of the high economic growth rates witnessed at the time came about: (a) accumulation of productive inputs, (b) rising labor force participation rate, (c) improving education, and (d) rising rates of investment.

Compared with these four growth factors, the contribution of TFP to the economic growth rates of the cited East Asian countries was limited.

[39] Id., pp. 23-24.

On the basis of this study, forecasts were made and suggestions forwarded, some of which have significance to economies of developing countries as ours...(Danil) Rodrick (1997) has pointed out that Young's estimates may be reconciled with high rates of TFP growth for East Asia if substitution between labor and capital is relatively difficult. While potentially rehabilitating the role of technological improvements for East Asian growth (a useful finding for endogenous growth models focusing on R&D), the implied lower rates of substitutability between capital and labor undermine endogenous growth models that depend on high rates of substitutability.

(Jaume) Ventura (1997) offers an alternative interpretation of the 'East Asian Miracle'. Beginning from the observation that the extremely high growth rates in per capita income in East Asia, fueled by high rates of investment, appear inconsistent with the notion of diminishing returns to capital, Ventura argues that such diminishing returns operate at the global level, but can be suspended at the national level for countries engaging aggressively in international trade. If capital can be easily substituted for labor, and the economy is open to trade, then capital per worker can be increased and diminishing returns to capital can be avoided by exporting the additional product of new capital oversees. The high rate of substitutability between labor and capital required to bring this about is consistent with some arguments for endogenous growth, as presented above. However, to the extent that diminishing returns to capital still exist at the global level, Ventura's analysis implies that it is probably infeasible for most countries to simultaneously emulate the East Asian example."[40]

1.2.4 Aggregate Evidence

Studies made in the 1970s have great significance especially to the economies of developing countries as:

> .. several pioneering attempts at systematic multicounty investigation of trade policy and economic performance .. by (Ian) Little, (tabor) Scitovsky, and (Maurice) Scott (1970) for the OECD), and by (Bela) Balassa (1971), calculated

[40] Id., pp. 24-25.

effective rates of protection for several developing countries. These studies concluded that post World War II protectionist policies had artificially encouraged industrialization, suppressed agriculture, and reduced exports by moving countries' production away from cost-based comparative advantages. While these studies did not directly calculate impacts on the rate of economic growth, they did argue that developing-country protectionism had suppressed savings and induced large-scale unemployment of labor and underutilization of capacity, all factors which would be expected to have direct consequences for economic growth. The promotion of relatively high-wage manufacturing at the expense of agriculture, in which most of the poorest individuals were employed, was also believed to have worsened income distribution.

"In a subsequent multivolume study for the National Bureau of Economic Research, (Jagdish) Bhagwati (1978) and (Anne) Kreuger (1978) examined trade regimes of a number of developing economies using the concept of an effective exchange rate. The effective exchange rate was an attempt to summarize in a single measure the net effect of policies such as import tariffs and surcharges, export subsidies and incentives, import licensing, and exchange rate policies. National policy regimes were classed as 'import substituting', 'neutral', or 'export promoting' depending on whether the effective exchange rate for hard currency paid by importers was less than, equal or greater than the corresponding rate paid by exporters.

".. These studies revealed a great degree of institutional detail about developing-country trade and exchange regimes. They were unquestionably influential in formulating the intellectual case that countries undergoing structural adjustment subsequent to the debt crisis of the early 1980s ought to undertake trade and exchange liberalization, and in spurring further research on the linkages between trade regimes and economic performance.

"… Early research .. provided indications that various measures of liberalization were associated with export expansion, and that export expansion was associated with economic growth. More recent work on the export-led growth hypothesis .. employs modern statistical techniques .. These studies find that for many, but not

> all, developing countries, increases in exports are associated with increases in economic growth after a few quarters, or one or two years. Often, the same studies find causation in the reverse direction, from economic growth to export."[41]

Just like the above mentioned evidence gathered on *export-led growth,* the other recent approach relates to "empirical testing .. to add measures of trade, or trade liberalization, to the statistical analysis of cross-country growth .."[42] This approach has led to mixed results as available empirical measures on the one hand and there does not exist a commonly agreed, reliable measures indicating whether a country's trade stance is "open" or "closed". In this respect, research approaches of Jeffrey Sachs and Andrew Warner (1995) obtained:

> "..quite a strong positive effect of openness on economic growth. Their approach is to construct a dummy variable classifying a large number of economies year by year as 'open' or 'closed' using such indicators as tariffs and quotas on intermediate and capital goods, the black market foreign exchange premium, the existence of export marketing boards, and the classification of some countries as 'socialist'. … In a variant of standard regression used to study cross-country growth, Sachs and Warner estimate that annual per capita GDP growth in open economies exceeded that in closed economies by 2.2 percent to 2.5 percent. (Xavier) Sala-i-Martin (1997) finds that the number of years in which an economy has been open according to Sachs and Warner is strongly associated with economic growth."[43]

Another innovative contribution made by Jeffrey Frankel and David Romer (1996), focuses on such aspects that cause difficulties working on empirical data used to link trade with growth simultaneously. Since *"[c]ountries adopting liberal trade policies are likely to adopt other policy reforms simultaneously"*, the resulting cocktail of factors makes it difficult to "statistically demonstrate that countries which trade more also grow faster. Frankel and Romer get around this problem by exploiting the gravity model of

[41] Id., pp. 24-25
[42] Id., p. 25.
[43] Ibid.

trade, which relates bilateral trade flows statistically to the size of countries' economies and the distance between them…"[44]

1.2.5 Trade and Factor Accumulation

Here, "factor accumulation" refers to such economic determinants as investment, national domestic savings, marginal profit gained through export, foreign direct investment (FDI), fair import competition, liquidation of inappropriate trade barriers on productivity, exposure to newer and appropriate technologies, human capital and, to some extent, openness.

As contemporary arguments on free trade have established, trade liberalization induces growth primarily by creating conditions that increase the mentioned factors; i.e. induces growth through indirect channels that enhance factor accumulation. Thus, for example, trade liberalization indirectly enhances investment, which actually is the engine of economic growth.

On the other side, "[i]nvestment, by definition, must involve saving, that is use of current production (and imports) for something other than current consumption (and export). .. Since the rate of domestic savings is a key determinant of the rate of domestic investment, one needs to examine how trade liberalization influences savings ..".[45]

Similarly, one needs to examine how, on the one hand, trade liberalization influences exports and, on the other, savings behaviors. It had been noted that there is minimal research materials analyzing the impact of trade liberalization on savings behavior *"in the context of examining the influence of openness on the savings rate in an economy"*.

Studies investigating the relationship between savings and exports are available. Here,

[44] Id., pp. 25-26.
[45] Ibid.

> [a]ccording to Maizels (1968), variation in exports might result in associated variations in domestic savings because (a) the propensity to save is higher in the export sector than elsewhere, (b) government savings rely heavily on taxes on foreign trade, and (c) a sustained growth in exports could result in a rise in the marginal savings propensities in other sectors. … Maizels' results hypothesis tested whether export income has a higher explanatory power than non export income (GDP minus exports) in the determination of gross domestic savings. Maizels' results confirmed his hypothesis as he got significant results regarding the positive relationship between savings rate and exports."[46]

J. Lee (1971), and P.S. Laumas (1982), employing Maizels' approach, established that in countries where the GDP is more reliant on exports, marginal propensity to save out of exports is much greater than non-export income; specially so in "primary exporting countries", than in "non-primary exporting" ones. The focus of these researches was to assess whether variations in exports resulted in variations in savings behavior and not to test for the influence of openness or trade liberalization on the savings rates.

As mentioned earlier, FDI is the other economic determinant necessary for economic development. "Foreign direct investment .. defined as the investment that a firm headquartered in one country makes in operations in another country, is a component of the total investment in another country(.) .. and includes improved technology. … (A.R.) Rugman (1988) estimates that one-half of all trade and one-fifth of world GDP are attributable to multinationals." [47] As a rule, if FDI does not affect a country's growth rate, it can not be said that it has any dynamic effect on that country's economy. Also, for policy liberalization to have a dynamic effect (i.e. increase FDI in- or out-flow), there must be a linkage between FDI and growth rate.

Trade can help introduce newer and better technologies in to a country. Aside from that,"[i]t has been argued that greater import competition enhances productivity growth

[46] Id., pp. 26-27.
[47] Id., p. 28.

by forcing less efficient firms to operate more efficiently and by rewarding more efficient domestic firms with an increase in market share…"[48]

Of the 'accumulation factors' mentioned at the beginning of this sub-section, the linkages between human capital and economic growth as well as growth and openness have been extensively researched and documented.

Human capital at the aggregate and individual levels comprises education, training and experience of workers. The components of human capital at a national level includes:-

a) the size of the labor force and its participation rate;
b) the ratio of the prime-age labor force to the "dependent" segments of the population.

Solow growth models of David Gould and Roy Ruffin (1995) demonstrated that human capital can be an "engine of growth" as investment in human capital increases output. Also, along with ordinary physical capital and labor, human capital can have an independent effect in the economy; i.e. (the higher) the level of the human capital, the better the output.

Besides, human capital has an enhanced effect on growth in more open economies. As J.C Barthelemy, S. Dessus and A. Varoudakis (1997) also have found human capital has contributes to growth and to the openness of the economy to world trade in that human capital enhances the ability of a country to benefit from the exposure to new technologies that comes with openness to trade.[49]

[48] Ibid.
[49] Id., p. 29.

1.2.6 The New Trade Theory[50]

As discussed earlier on, Ricardo explained the international free trade in terms of "comparative advantage". As would be discussed herein below, the newer theories go deeper in identifying the determining the factors of international free trade.

The motive for individuals to specialize in different professions is because they have different talents and aptitudes, on the one hand, and the fixed cost and necessary time required, on the other. Division of labor is the result of that. Likewise, *"*nations must specialize and trade both because their underlying differences and because increasing returns make specialization advantageous per se."[51]

All traditional trade theories discussed earlier begin by making *".. big untrue assumption – constant returns, perfect competition"*, on which basis they presume that comparative advantage is the essential factor for trade. The new trade theory, founded by the Swedish economists Eli Heckscher and (the 1997 Nobel Prize winner) Bertli Ohlin, on the other hand, takes into account the changes in a country's endowment of factors of production. It states that endowment of factors of production is the determining cause for trade between countries.[52]

Generally, international trade is the result of two forces, namely,

a) difference between countries; this gives rise to comparative advantage, and
b) economic scale; this provides an additional incentive for specialization.

Increasing returns at the level of a plant or an enterprise involves a distinction between *intra*-industry and *inter*-industry trades. At the level of the national or even regional industry, the model of increasing returns acquires another dimension as it requires testing for external economies.

[50] Paul Krugman, Empirical Evidence on the New Trade Theories: The Current State of Play, in New Trade Theories: A Look at the Empirical Evidence, (Center for Economic Policy Research, Bocconi University, Milan Ed.), 1994, pp. 12-23.
[51] Raj Bhala *et la*, Op cites, No. 13, p. 29.
[52] Paul Krugman, Op cites, No. 50, pp. 12-23.

As the concept of *intra*-industry trade existed prior to the emergence of the new trade theory, some aspects of the literature needs closer examination. It seemed natural to choose assumptions under which the term *inter*-industry was caused by differences in factor endowments, while *intra*-industry trade represented the effects of economic scale. *"Thus the study of intra-industry trade has come to be regarded as one of testing the importance of scale economy."*[53]

As to the conceptual side of the issue,

> "[m]easures of intra-industry trade may be a deeply misleading guides to the causes of trade .. On the one side, it is by no means clear that an 'industry' as defined in the data correspondence at all to the industries that appear in the models. In a monopolistic competition trade model .. an industry is a group of differentiated products all produced with the same factor proportions . As a result, there is by construction no comparative advantage operating within an industry.
>
> "In reality, however, an industrial classification is usually based on other criteria – the material out of which goods are made (iron and steel products) or the end use to which they are put.." like, for example an iron gate or a window frame. "The factor proportions of goods within an industrial classification are likely to be more similar than those of a group of randomly chosen products, but by no means identical. So trade within an industrial category may well be due to ordinary comparative advantage."[54]

Examples of products of the industrialized world and consequent arguments thereof are expressed as follows.

> It is easy to think of examples of products that will usually be classified together but that require very different factor proportions and/or levels of technical skill: analog and digital watches, fashionable footwear and running shoes, supercomputer and PCs. It is even easier to see how intra-industry trade can arise out of the vertical disintegration of production processes: if, as becomes

[53] Samuelson *et la*, Op cites, No. 2, p. 32.
[54] Raj Bhala *et la*, Op cites, No. 13, p. 31.

> increasingly common, manufacturers split off labour-intensive parts of the value-added chain and have them done in the Third World, some 'intra-industry' trade may well result that has nothing at all to do with economies of scale.
>
> "On the other hand, there is no reason why economies of scale should always lead to specialization that fits within industrial categories. … It is convenient for the sake of simple models to suppose that there are industries consisting of many differentiated products produced with identical factor proportions; in real life it needn't be so, and economies of scale may well produce specialization in terms of the industries as actually defined.
>
> ".. Conceptually, then, the data on intra-industry trade are very ambiguous tool for investigating economies of scale and trade. Nonetheless, they are there, and it is to be hoped that they contain some useful information; so it is inevitable that a literature studying them has risen."[55]

Keeping these conceptual issues in mind, when we come to *macro evidences*, studies loosely group intra-industry trade into two kinds and see whether each shows the respective characteristics of the model.

A. Overall level of intra-industry trade both as an indicator of the importance of non-comparative-advantage specialization;
B. Details of intra-industry trade.

The results obtained from such models have proven that the amount of intra-industry trade of the industrial world as a whole amounts to about 25%, which constitutes a significant but not overwhelming fraction of trade. Besides, "[a] clear prediction of the models is that intra-industry trade should be greater, the more similar countries are in their factor endowments. Thus we might expect more intra-trade between similar countries, and the fraction of such trade to increase as countries become more similar over time. Both of these expectations are confirmed in the data."[56]

[55] Id., p. 33.
[56] Id, pp. 33-34.

Intra-industry trade looked at from a *micro* perspective, shows two kinds of weaknesses. These are,

A. failure of measured industries to correspond to the concept of industry in the theory, and
B. weaknesses of the simplifying assumptions made by the standard models.

Because of these weaknesses, micro data demonstrate some unfriendly patterns to the intra-industry trade hypothesis.

"First, measured intra-industry trade typically occurs not in the differentiated 'consumer' products of most Dixit-Stiglitz-type models, but in intermediate goods. .. [This] suggests that misclassification may be a large part of the intra-trade story."

"Second, economies of scale as measured by the size of plants are 'negatively' correlated with the level of intra-industry trade across sectors. … To be more precise: on the one hand, the standard models assume a single manufacturing sector, making it difficult to say what one expects to see in a multi-sector model. On the other, in Dixit-Stiglitz-type models the relevant 'scale' parameter is actually the differentiability of products on the demand side, not the fixed cost in production. Still, if the empirical relationship had run the other way we would doubtless be claiming it as favorable evidence, so this is something of a negative result."[57]

Since 'increasing returns' at the national level requires that conditions of 'external economies' be taken into account, we now take a closer look at these factors of trade.

Previously, sufficient studies on external economies were not made because:-

1. The existing tradition of external economy models suggested that they were analytically very awkward.
2. The whole thrust of the theory was towards trying to model the role of imperfect competition, as a way of saying something new.

[57] Ibid.

3. External economies, which by definition don't leave a paper trail, were thought to be empirically very elusive.

Today, all these three no more create difficulties. As the new trade theory has won respectability, many useful approaches have emerged for identifying cases in which external economies may be significant, such as 'geographical evidence' and 'technological trajectories'.

"One approach of assessing the role of external economies in trade involves looking for geographical concentrations of industry. Geographers, urban economists and regional scientists have, of course, long been aware of the importance of external economies in explaining agglomeration and regional specialization…

"Much credit for recognizing the importance of regional concentrations for trade goes to the business strategist Michael Porter, whose 'The Competitive Advantage of Nations' (1990) is in large an essay on agglomeration. Porter's team of researchers noticed many instances in which national competitive advantages are associated with localized cluster of firms, without any obvious resource reason for the concentration…"

"I note here only briefly another possible way to identify the role of external economies in trade. To the extent that these represent dynamic externalities, say in the creation of a knowledge base, they may be identifiable by looking at the evolution of technology within countries. (it has been) argued, .., that countries tend to reinforce over time whatever technological advantages they have. If this could be documented and measured more fully, it would represent another way of gauging the importance of at least this kind of external economy."

"… [O]ften external economies .. arise through market-size effects, but still external rather than internal in terms of the way they affect international specialization…" [58]

[58] Id., pp. 35-36.

1.3 Jurisprudential Arguments for Free Trade: "Right Order" and the "Rule of Law"[59]

Right Order as relates to allocation of resources, benefits, .. to society, regions, is and would increasingly become dependent on International Economic Law as time progresses. The subsequent paragraphs are adopted from Bhala et al.

> "The centrality of justice to the analysis and construction of international economic law is evident in the nature of the concept of justice. … The corner stone of civic life is the peaceful resolution of disputes. In turn, non-violence assumes losing parties understand outcomes as "right" in the sense of being consistent with fundamental values, with justice. The concept of justice, or "Right Order", is, therefore, relevant to the individual soul and the polis. Indeed, the two are inextricably linked. For there to be Right Order in the polis, there must be Right Order in the individual souls that make up the polis. But, what 'Is' Right Order in either context? It is a direct link to a theory of value, of what is Good…
>
> "Therefore, it is necessarily true that every time the question of the proper order of a given aspect of international economic relations arises, one is considering a question of justice. Moreover, where law is a primary tool for establishing the social order, questions of justice in economic relations will arise as questions of international economic law. International economic law does indeed affect fundamental decisions about the allocation of social benefits among states and among and among their citizens, including benefits such as economic advantages, preferences, and opportunities; wealth and property rights; information; and the protection of the law itself. International economic law also involves mechanisms for the identification and correction of improper gain through dispute resolution mechanisms, on the interstate and private levels. Such influence on the part of international economic law must therefore be evaluated –in terms of theories of distributive and corrective justice.

[59] Frank J. Garcia, "*Trade and Justice: Linking the Trade Linkage Debates*", (19 University of Pennsylvania Journal of International Law), 1998, pp. 391, 404-406, 411-413.

> "The importance of recognizing this link between trade and justice increases with the globalization of the world economy and the development of international economic law. The greater the scope and importance of international economic law as a feature of international economic relationships, and the deeper its impact throughout the societies of trading states beyond traditional economic issues such as tariff rates and investment rules, the more we must be concerned with its normative impact and implications. In other words, the broader the law's ordering power, and the more its 'order' impinges on our attempts and our ability to 'order' other aspects of our society, the more we must be concerned with the 'Rightness' or the 'justice' of the resulting international economic order."[60]

Once view of the nature and force of the actual claims of justice as reflected on factual international economic law will depend on one's position on the law of morality in general, and one's substantive theory of justice.

> "..[F]rom a Western standpoint, the claims of justice will affect the threshold question of the rule of law in international economic relations, and on this there is agreement. Fundamental to any conception of Western justice is a commitment to the rule of law. Such a commitment is also recognized by traditional trade theorists as a cornerstone of our [i.e. Western] attempts to regulate international economic relations through international economic law. This commitment to the rule of law .. necessarily implies that international economic law systems, in particular their institutional mechanisms, are subject to evaluation according to how effectively they uphold, advance, or undercut the rule of law in international economic evaluations.
>
> "… [T]he core trade and integration commitment to liberalize trade naturally reflects the principles of trade economics, in which liberalized trade contributes to increased welfare due to gains in efficiency and the unfettered operation of comparative advantage. In doing so, however, liberalized trade also contributes directly to the achievement of the core aim of liberalized justice, in that such

[60] Raj Bhala *et la*, Op cites, No. 13, pp. 36-37.

> welfare increases are a necessary pre-condition to a more just distribution of wealth and an improved standard of living for the least advantaged. …"[61]

1.3.1 Morality and Rights[62]

Critical analysis has helped to show that such arguments have numerous weaknesses, while practice has demonstrated that most protectionist policies have consistently failed in the past. All the same, the case for protectionism is strong and deep rooted in history. Political leaders also continue to advocate protectionist policies as such measures protect the interest of one or some special group; i.e. even if it does so at the expense of the general public, as it is known that protectionism adds cost of products.

Evaluating the issue in real terms, the strongest argumentations against protectionism are actually that of moral than economic or utilitarian. Speaking in general and economic terms, when some kind of protectionist law gets instituted by a government, then, few would benefit out of the resulting condition (most probably certain producers) at the expense of the many (i.e. consumers). In this regard, *"*Robert Nozick and others believe that the state is going beyond its legitimate function when it redistributes wealth – that is, when it takes from some and gives to others."[63]

'Individual right' advocates consider the issue of free trade from the following, other perspective.

> "The rights view of free trade begins with the premise that individuals own their own bodies. From that premise, it follows that individuals own the fruits of their labor. As owners, they have the right to trade the fruits of their labor for the fruits of the labor of others. Any restriction on this activity violates their rights. This

[61] Id., pp. 37-38.
[62] Robert W. McGee, *"An Economic Analysis of Protectionism in the United States with Implications for International Trade in Europe*", (26 George Washington Journal of International Law and Economics), 1993, pp. 539-542, 551-552.
[63] Raj Bhala *et la*, Op cites, No. 13, p. 38.

> view is in keeping with the classical liberal view of government, which restricts government activity to the defense of life, liberty, and property."[64]

So, they argue, if the government goes beyond these parameters, places quotas, say on imported cars, or levies tariffs on certain types of products to protect local producers, etc .., then it must have necessarily taken from some to benefit others, which would be parasitical.

1.3.2 Fairness[65]

Of recent arguments in favor of protectionism, seems to be the one that claims that trade should be "fair" rather than only "free". Proponents of "fair trade" mostly argue that it is unfair that some countries dump not salable, i.e. not permissible for sale, products of their own countries on others, or subsidize their local industries. "What advocates of this position fail to see is that fairness is a process, not an outcome. Because of this failure .., they fall into all other fallacious arguments."[66]

Such arguments are prone to mislead the essential issue of contention towards unwanted directions. Like, for example, some argue that it is unfair that some countries are richer than others. But this argument seems not to take into account the back history of the countries in question. Some others argue that it is unfair that some individuals are richer than others. But, what if the rich individuals became rich by their efforts, through justifiable means? Some others argue that women earn lesser than men – though, in most cases, women prefer to take up jobs of least risk (which, by the way, is quite natural).

> "Fairness should be seen as a process. A transaction is fair if consenting adults are free to enter into it without being coerced. .. It is unfair if some special interest group .. uses force of government to increase the price that consumers must pay for the goods and services of their choice. We cannot determine fairness by looking at the way things are [only]; we must look [also] at how things got that

[64] Id., p. 39.
[65] Robert W. McGee, A Trade Policy for Free Societies, 1994, pp. 13-14.
[66] Raj Bhala *et la*, Op cites, No. 13, p. 40.

> way. If the current arrangement is the result of coercion, such as tariffs or quotas, it is unfair. If it is the result of consumer choice, it is fair."[67]

Erecting trade barriers as a means of retaliation for a trade barrier set by others is not necessarily right because two wrongs do not make a right.

> "A corollary of the fair trade argument is that we should reduce our trade barriers only for countries that reduce their trade barriers for us. Using this line of logic, .. [some] might argue that the U.S. government should continue to make consumers pay an extra 10% or 20% or 50% for a Japanese radio or automobile – by keeping our high tariff – until Japan drops its tariff barriers against U.S. beef or fish or textiles. ..[U.S.] government will, thereby, reduce the standard of living of the millions of Americans who buy Japanese products until Japan's government lowers its tariffs for U.S. textiles and food companies. .."[68]

Walter Block and Michael Walker point out at another aspect of the fair trade argumentation – that some in the modern, industrialized country (first world) argue for fair trade. They also point out that it is unfair to expect a company in a first-world country to compete with a company in a third-world country that has the advantage of lower wage rates. So,

> "[t]he logical conclusion is that first-world countries should compete with first-world countries and third-world countries should compete with third-world countries. Yet if such a policy were followed to any great extent, the economies of the first-world countries would stagnate because they would have to pay more for many products, and third-world countries would also suffer because many of their major markets would be closed to them."[69]

[67] Ibid.
[68] Id, p. 41.
[69] Ibid.

Summary

The theories discussed herein above, together with the concepts of Economics, have laid the fundaments of *international Free trade*. Considerable time had elapsed until economists managed to work out modeling methods that help to predict the outcome of one or the other approach in free trade practices. Moreover, these dynamic models helped quantify as well as evaluate the benefits of *free trade*.

As can be understood from our discussion, Ricardo's *Law of Comparative Advantage* has proven right in determining the factor each trading partner relies on while venturing in to an agreement with another country.

On the other hand, the New Trade Theory helps discerns an array of economic factors that affect sound international free trade between partners. Today, governments give due attention to such economic determinants as investment, national/domestic savings, marginal profit gained through export, foreign direct investment (FDI), fair import competition, liquidation of inappropriate trade barriers on productivity, exposure to newer and appropriate technologies, human capital and openness in trade related issues. These, collectively known as "factor accumulation", play a significant role in enhancing the economy of a nation, since no two countries with equal comparative advantage but differing factor accumulation would have equal gains through free international trade; i.e. the one with better factor accumulation would benefit more than the other. In view of these facts, international free trade, and agreements thereto, should eventually enable the trading country in creating a better national economy; i.e. an "economy of scale" with a higher degree of "factor accumulation".

From a point of view of the Law, every argument over free trade is weighed against morality and rights. Seen in light of what is right or wrong, rather than what is profitable and not, all protectionist trends in trade practices seem unjustifiable. All the same, such practices do exist; some having their roots centuries back.

Unlike the contemporary approach of "fair trade" argumentation, which seems to have taken little recognition to the need of having "free trade" practices in place for "fair trade" to come about, Keynesian Theory seems to gain ground as it claims that there is a need for having some kind of regulation for any economic systems to run "fair and smooth".

Questions to ponder:

1. From what has been discussed thus far, could trade be partly used as one means of the steering mechanism of unskilled labor force abundant in Developing Countries and in LDCs like Ethiopia?

2. Does importing technological equipments necessarily lead to creating "scale economy"? Under what circumstances can importing higher and better technologies of the industrialized world help create skilled labor force in the local market? Explain.

Note to Q.3:- In view of the fact that multinational oligopolies of the developed countries transfer their industries to developing countries after the product's life cycle has substantially declined, the production line has sufficiently been automated, etc .., discuss:

3. What kind of opportunities to growth could arise if a manufacturing plant gets transferred from a developed country to a developing country or even to a LDC like Ethiopia? Outline the conditions that should be met for such an instance to substantially create economic gains to such kinds of recipient countries. (For example, what benefit(s) would arise if, under existing conditions, a micro-chips manufacturing/coffee processing and packaging foreign company would relocate one of its plants to Ethiopia?)

4. After reading the following argument, answer the question below.

Surely Ethiopian economists would classify gold, silver, tantalum, precious gems, charcoal and iron as extracts of mining. On the other hand leather, oil-seeds, coffee, sugar-cane, cotton are all raw-materials of agricultural origin.

a) To which would you classify "salt"?

5. In light of the following assertion, express your view in line with what had been discussed thus far on issues expressed under 5a and 5b.
   "Gold or silver, processed as a wedding ring or a bracelet with precious gem, steel-iron of industrial use, iodized table-salt, a pair of leather shoes, sugar, distilled ethanol as supplement for car-fuel, .., all can not be considered having the same value as the raw material they are made from. In other words, certain value(s) has (have) been added to each of these in terms of 'factor proportion' and/or 'expertise'." Thus:

5a) Can and should the law in any way make pronouncements that, in effect, ascertain that trade practices give due economic value to each and the respective levels of 'factor proportion' and/or 'expertise'?

b) On what basis does Ethiopia's "Yirga-Alem" brand coffee get special market treatment? Is it because of:
   a) International Law,
   b) International Regulation, or
   c) International Agreement?
   Explain.

6. In which way would "Free and Fair Trade" come about sometime soon in the future? Would it be through: a) enacting laws? b) negotiations? Explain.
   (Here, consider intentions currently under consideration to provide some form of payment for countries trying to reduce CO_2 levels.

7. Can the "Law" ever become a tool by which standards of payment for 'value-added-products' becomes regulated through the evaluation of

a) differences in factor proportions,
b) utilization of natural resources, and
c) requirement of professional expertise?

8. LDCs like Ethiopia strive to broaden their manufacturing, processing facilities in view of creating an "economy of scale" and, consequently, build a cohesive, local industry. What legal conditions would facilitate/enhance that task? Explain.

9. Would free international trade of cereals boost Ethiopia's agricultural output? Explain.

10. Would free international trade of cereals minimize the cost of essential food stuffs in the local market?

Chapter Two
Effects of Free Trade

2.1 on Pattern of Trade[70]

Economists try to construe a generalized picture of the effects of trade on a wide range of variables like trade patterns, infant industry, labor the environment and even national security and sovereignty. The theories below outline some of the basic outlooks and the arguments raised by advocates of free-trade and their counterparts – protectionists.

2.1.1 Heckscher-Ohlin Theorem and the Leontief Paradox

The traditional answer to the question: What determines whether a country imports or exports a particular product? is based on Ricardo's law of comparative advantage, which states: "If a country has a comparative advantage, in terms of cost, .., then it will export that good. If not, then it will import the good." [71] But "..., this answer fails to account for changes in a country's endowment of factors".[72]

The Heckscher-Ohlin theorem attempted to rectify this defect in the classical model; tried to identify the effect of change of a country's endowment of factors would have on its comparative cost – i.e. comparative advantage in trade.

> To reach their result, Heckscher and Ohlin needed to make several simplifying assumptions, three of which were particularly critical. First, countries differ in their factor endowments. Second, they assumed that production functions for different goods make use of factors of production in different proportions. .. For example, more labor was used in the production of Persian carpets than in growing wheat, but more land was used in harvesting wheat than weaving carpets. .. [T]hird, .. for any particular good (i.e. carpets or wheat), the production function

[70] Raj Bhala *et la*, Op cites, No. 13, pp. 42-51.
[71] Id., p. 42.
[72] Ibid.

> was the same in every country in which that good was produced. Thus, the production function for Persian carpets was the same in Iran, Turkey, and Pakistan, and the production function for wheat was the same in the United States, Canada, and Australia. Another way to put this assumption is that each country has the same production technology for a particular good."[73]

The Heckscher-Ohlin Theorem remains a celebrated predictive tool for identifying the effects of trade liberalization on trade patterns. Also,

> [i]t is logically compelling, or to put it bluntly, it makes good sense. Stated succinctly, the Theorem posits that a country will export goods whose production uses intensively the factors with which the country is relatively well endowed. The country will import those goods that use intensively in their production factors with which the country is not relatively well endowed. .. [i.e.] The labor-abundant country should concentrate its production on the labor-intensive good and import the land-intensive good and vise versa for the labor-abundant country. .."[74]

Though logical, empirical tests conducted by 1973 Nobel-Prize winner, Russian-born economist, Professor Wassily Leontief of input–output analysis could not ascertain Heckscher-Ohlin Theorem. As discussed below, other adjustments were necessary to verify the theorem.

> "Using data from 200 American industries for the year 1947, Professor Wassily Leontief came to the conclusion that America exported labor-intensive goods and imported capital-intensive goods.
>
> "The result was startling. America in 1947 was capital abundant. Thus, the Heckscher-Ohlin Theorem would predict that America's export industries would be capital-intensive, and its import-competing industries would be labor-intensive. Fittingly, the conclusion is memorialized by the name the 'Leontief Paradox'.

[73] Ibid..
[74] Id., pp. 43-44

> "Even Professor Leontief was worried. He tried immediately to resurrect the Heckscher-Ohlin Theorem. He suggested that the importance of American labor was underestimated in his model because American workers are three times as productive as foreign workers. If their superior productivity was included in the calculation – i.e., if each unit of labor were multiplied by three – then America would come out as a labor-abundant country; hence, the pattern of labor-intensive exports would be consistent with the theorem.
>
> "It was a nice try, but the sad truth is the productivity of American workers is not as superior as Professor Leontief would have it. ..Indeed, in accounting for these missing factors, studies by two economists, Jaroslav Vanek and Donald Keesing, are particularly renowned. In 1959, Professor Vanek called attention to the importance of non-agricultural land – i.e., raw materials – in American imports. He argued that physical capital and land are complementary factors with respect to the production of raw materials. (As a simple example, coal mining is made possible by both land and proper equipment.) .. Professor Vanek suggested the ostensible importance of capital-intensive output in America's import-competing industries might reflect the land-intensive nature of that production. Professor Leontief had too simplistic a model [i.e., considering only two factors of production – physical capital and labor], and had not sufficiently dis-aggregated the data, to capture this effect.
>
> ".. [Similarly] Professor Keesing focused on labor. ..[He] divided the American labor force according to skill levels, and found that export production is more skill-intensive than import-competing production. Accordingly, the United States should be seen as a skill – i.e., human-capital, abundant country. When Professor Keesing examined the data in this way, the Paradox was reversed: the United States exported capital-intensive goods."[75]

So, the bottom line of the Heckscher-Ohlin Theorem is that it is a starting point and not the finishing line for explaining the effect of free trade on patterns of trade. In particular, in seeking the effects of trade on one or the other country's economy, one should identify

[75] Id., pp. 45-46.

the result of "augmentation factors" would have on that particular country's economy; i.e., factors that enhance labor productivity such as technology, know-how, etc... "..[O]ne American worker may be worth five Portuguese workers, simply because the American worker has access to state-of-the-art technology. .."[76]

Since, among other things, the Heckscher-Ohlin Theorem cannot account for intra-industry trade – i.e., trade in the same item between countries – other theories and models thereof were devised. Some of these will be discussed in the next sub-section of this Chapter.

2.1.2 Other Theories: The Product Life Cycle (Hypothesis)

Since World War II, trade in same items (e.g. car export/import between U.S.A. and Japan) between countries expanded rapidly. Such reasons as taste and consumer preference were not sufficient reasons for explaining the phenome-non. An English economist, Edward H. Chamberlin, tried to explain why intra-industry trade flourished.[77] The explanation he offered says that firms trading on same item try to compete with each other through differentiation rather than producing identical items – as that helps the firms gain monopoly power; i.e., through imperfect competition, firms ultimately monopolize the market.

"Finally, the Heckscher-Ohlin theory of international trade patterns says nothing about two other post Second World War phenomenon, namely, intra-firm and inter-firm trade. The former refers to trade within different constituent parts of a single multinational corporation. The latter concerns trade within several firms cooperating through joint venture or sub-contracting relationship. To explain such trade, it seems necessary to examine the rise of multinational oligopolies, as well as the globalization of production through FDI."[78]

[76] Id., p. 47.
[77] Id., p. 48.
[78] Ibid.

This issue, as it seems, falls within the purview of political economists than within that of business school scholars as long as the item for trade is of strategic importance.

Relating to these issues, a more accurate theory of international trade patterns than that of the Heckscher-Ohlin Theorem seems to be the Product Life Cycle Hypothesis. Put forward by Professor Raymond Vernon in 1966, studied and tried to explain how, why developed countries often change from being a net exporter of a particular good to a net importer of that good after the production of that good becomes standardized.

> Three points are worth noting about the Product Life Cycle Hypothesis. First, observe that its applicability is limited to trade in the manufacturing sector, or perhaps more accurately, to trade in the manufacturing sector, or perhaps more accurately, to trade in certain types of products. There must be some degree of technical sophistication – invention, followed by design, followed by development – in the product for there to be a life cycle.
>
> Second, the Hypothesis does not explain trade patterns in all sophisticated products. The United States does not seem to have surrendered its comparative advantage in particularly sophisticated products like aircraft, medical instruments, and certain types of computer equipment and pharmaceuticals. These are mature products, yet the United States remains the world leader in their production. The problem, then, is that the Hypothesis is of limited generalizability. That is, it cannot predict well either (1) when or (2) to what products the location of comparative advantage will change.
>
> "Third, the Hypothesis can be used to explain (in part) the Leontief Paradox. Presumably, the United States is an innovating country, creating many new products a year. By definition, the production of newly designed products is not yet standardized and, therefore, is quite labor-intensive. Businesses do not want to invest in physical capital equipment to produce a new product until its features are settled, the exact market is identified, and the best way to automate production is determined. Until production is standardized, therefore, exports of the product

> will be labor-intensive. Perhaps Professor Leontief's data reflected this phenomenon. "[79]

2.1.3 The Theory of Competitive Advantage

Another theory that tries to explain the state of condition of *intra*- and *inter*-firm trades is based on "competitive advantage". Here, students should note that this topic is not the same as that of Ricardo's, i.e. "comparative advantage". This theory on "competitive advantage" deals about the effects of international free trade on trade regimes within industries at local as well as outside the local market; i.e. specialization of manufacturing/processing plants on the basis of their skilled human and other resources, etc .., which, in turn would result in creating segmented markets in the import, export sectors.

Developed by Professor Michael Porter,[80] the theory attempts to move beyond comparative advantage based on relative cost differentials toward

> a rich conception of competition that includes segmented markets, differentiated products, technology differences, and economies of scale. Quality, features, and new product innovation are central in advanced industries and segments. Moreover, cost advantage grows as much out of efficient-to-manufacture product designs and leading process technology as it does out of factor costs or even economies of scale. .."[81]

Professor Michael Porter argues that nations better-off than others at creating an environment that allows its firms and industries to obtain and maintain a competitive advantage remain more successful in international trade.

> This process is 'highly localized,' and ..'[d]ifferences in national economic structures, values, cultures, institutions, and histories contribute profoundly to competitive success'. No single strategy accounted for competitive advantage in a

[79] Id., pp. 48-49.
[80] Prof. Michael Porter, The Comparative Advantage of Nations, 1990.
[81] Raj Bhala *et la*, Op cites, No. 13, p. 50.

particular industry, and ‘only strategies tailored to the particular industry and to the skills and assets of a particular firm succeed’. Rather, the structure of an industry, and the competitive positions of firms within an industry, determined what strategies would generate a competitive advantage.

Professor Porter’s analysis assumes that the ‘basic principles of competitive strategy apply whether a firm is competing domestically or internationally.’ Accordingly, he engages in four basic inquiries. First, what are the sources of domestic competitive advantage? The answer is the ‘value chain,’ which is the way in which a firm creates value for its customers by performing critical discrete activities. ‘Primary activities’ are the production, marketing, delivery, and servicing of a product, whereas ‘support activities’ include the provision of inputs, technology, human resources, and other infrastructural factors such as general management and finance. A firm gains competitive advantage by developing new ways of to conduct its primary and support activities through the use of new procedures, technologies, inputs, and by ensuring that linkages in its value chain are optimal, coordinated, and well managed. Ultimately, the competitive advantage may take the form of a cost advantage.

“Second, how is domestic competitive advantage created? Professor Porter suggests that a firm creates competitive advantage ‘by perceiving or discovering new and better ways to compete in an industry and bringing them to market.’ In other words, innovation is the key to creating competitive advantage. A firm must strive to improve its use of technology and find better ways to conduct its activities. In this respect, adaptability is a crucial trait. ‘successful firms not only responds to their environment but also attempt to influence it in their favor,’ and ‘(o)ne nation’s firms supplant another’s in international competition when they are in a better position to perceive or respond to such changes.’

“Third, how is domestic competitive advantage sustained? The answer depends on the source of the advantage, the number of sources that generate the advantage, and the extent to which a firm seeks to improve and upgrade its advantage. With respect to the sources, a ‘lower-order’ advantage like low labor cost or cheap raw material is easy for other firms to imitate. In contrast, a ‘higher-order’ advantage,

like an intellectual property right or brand reputation based on cumulative marketing efforts, is relatively more durable, particularly when a firm engages in sustained and cumulative investment in that advantage. Clearly, the larger the number of sources of a competitive advantage the more sustainable that advantage. Finally, a firm that rests on its laurels and fails to improve and upgrade its sources of competitive advantage is sure to lose the advantage.

Fourth, how is competitive advantage created through an international strategy, and what role does the nation play in fostering a competitive advantage in the global context? Global configuration and coordination are the answers. Professor Porter focuses on the way in which a firm spreads its 'activities among nations to serve the world market' and its ability to coordinate the dispersed activities. A firm gains competitive advantage in the global arena by configuring its value chain activities in an appropriate manner, and ensuring that these activities are properly integrated. Further, a firm may enter into a strategic alliance – a long-term agreement with another firm or firms that falls short of a formal merger – to conduct its global strategy. Airlines furnish a good example of this behavior. In turn, a nation succeeds in the global arena if its environment supports the pursuit of proper configuration and coordination strategies.

"… At the bottom line of Professor Porter's theory.. is a common-sense argument in favor of a market economy supported by enlightened government policies. .. [T]he implication for international trade law of Porter's theory seems to be this: a government should ensure entrepreneurs operate in a free trade environment so that they are both challenged to adapt and reward for their innovations."[82]

2.1.4 On Infant Industries[83]

Drawing an analogy between human and industrial developments, one of the older arguments for protection is the so-called "infant-industry". Milton Freeman writes,

[82] Raj Bhala *et la*, Op cites, No. 13, pp. 50-51.
[83] Melvyn Krauss, Op cites, No. 12, pp. 28-29.

> [t]he infant industry argument is a smoke screen. The so-called infants never grow up. Once imposed, tariffs are seldom eliminated. Moreover, the argument is seldom used on behalf of true unborn infants that might conceivably be born and survive if given temporary protection. They have no spokesmen. It is used to justify tariffs for rather aged infants that can mount political pressure."[84]

This seems to be true, as:

> *[*f]or industries to survive and prosper in today's competitive marketplace, it must be able to innovate – and government subsidy dulls the appetite for innovation. … The skill of [any government] of picking winners and avoiding losers, after all, is so rare that the market pays those blessed with its extraordinarily high incomes. … Infant-industry arguments .. must be rejected therefore because (1) governments have no skill in picking winners and avoiding losers, and (2) even if they did, the effect of protection would be to rob the potentially competitive industry of its incentive to innovate."[85]

Some Notes on the link between Jobs and Wages[86]

Like the infant-industry argument of protectionists, others in favor of fair-trade raise the issue of cheap labor as a reason for the need to protect the local labor market.

> Critics of the North American Free Trade Agreement (NAFTA), for example, base their opposition to the trade pact with Mexico partly on the grounds that American labor cannot compete with cheap Mexican labor.
>
> "NAFTA critics do have a point. High-cost unskilled American labor cannot compete with low-cost unskilled Mexican labor. But what the NAFTA critics miss is that this actually helps, not hurts, the American economy. The reason is that the U.S.–Mexican labor disparity forces a beneficial reallocation of American Labor from lower to higher skill tasks…
>
> "Similarly, it is the availability of cheap foreign labor that allows advanced industrial economies like the United States to concentrate its production on high-

[84] Raj Bhala *et la*, Op cites, No. 13, p. 52.
[85] Ibid.
[86] Melvyn Krauss, Op cites, No. 12, pp. 28-29

> skill goods…As the New York times correctly points out to its readers: 'The purpose of trade is not to raise unemployment or to rock (trade) surpluses. Its purpose is to steer workers into high-productivity jobs: into computer and software production and out of textiles.' The reason this 'steering process' through trade works is precisely because high-cost unskilled American labor cannot survive competition with lower-cost substitutes from abroad.
>
> "NAFTA critics .. make a mistake when they argue that the flight of U.S. firms to Mexico to take advantage of cheap wages is a bad thing for the U.S. economy .. [as the] low-skill jobs to Mexico can be expected to raise, not lower, U.S. national income because it is a part of the re-distribution of jobs within the United States from low to high productivity .. What [the] critics fail to appreciate is that balancing the export of low-skill jobs .. will be an increase in U.S. high-skill jobs emanating from the increased export of high-skill goods also to Mexico. .."[87]

Protectionists make a similar type of fallacy when arguing about the unemployment factor.

> There are two versions of the unemployment fallacy for protection. One is that protectionism creates employment – the other is that free trade creates unemployment. Both equate to the same thing – and both are examples of bad economics.
>
> "Of course, trade restrictions like tariffs and import quotas <u>can</u> increase employment <u>in the protected industry</u>. This is not disputed. But unless the employment gains come out of previously unemployed resources, increases in employment in the protected industry must come at the expense of employment decreases elsewhere in the economy. .. But unlike free trade, national income is reduced by protection, because the job redistribution process takes workers out of higher productivity and puts them into lower-productivity uses …
>
> "Import restrictions even can destroy jobs in the protecting country if they are imposed on imports that serve as inputs in the production of other goods. Protection makes the output of the protected sector more expensive. "..This must

[87] Raj Bhala *et la*, Op cites, No. 13, p. 53.

> have a contradictory effect on outputs – and therefore factor employments – of other domestically produced goods that use the protected output as an input in their own productive processes. Again, the employment gains in the one industry are matched by employment losses in the other industries. …"[88]

Labor, in developing countries, and especially the LDCs like Ethiopia, is very much immobile for various social and other reasons. On the other hand, most trade theories, actually, assume that factors of production, i.e., labor, capital, .., to be mobile. In reality, labor can be "sticky" as between different skills, geographic regions, employers, etc ... So, some critics of free trade argue that, "[f]ree trade under conditions of labor immobility .. , does create unemployment as jobs lost in the contracting import-substitute industries are not necessarily made up elsewhere in the economy."[89]

This approach – especially in countries with developed economies – is actually not considered as a real and/or viable argument. It is taken note of as not merely against free trade *per se*, but as a presumptuous argumentation that actually is against all and any form of changes in the economy; i.e., one that denies resource redirection as a mechanism of generating economic gains to the society. It is also taken as to imply that no new income transfer programs be initiated, since these would lead to resource re-allocation, which, in the process, would create some unemployment.

"Free trade under conditions of labor immobility does create unemployment" kind of argumentation could be taken as to be a contradicting type of argument to government policies; i.e. argumentation that tries to reduce flexibility of the domestic economy, without which any government cannot do. It could also be directed against such governmental policies that restrict mobility of persons with welfare benefits, persons of certain occupational activities, or geographic area or territory.

[88] Id., p. 54.
[89] Id., p. 55.

As the effect of trade liberalization on jobs and wages is one of the hotly debated topics in international trade, let us now briefly turn to this issue. Among others, one of the most outspoken commentators on the subject is the MIT economist Professor Paul Krugman. From the extensive discussions he and opponents of free trade made over the issue of declining wage of American blue-collar workers (i.e., technicians, daily laborers, ..) in the years from 1973 to 1989, reveal that due attention should be given that growth in real earnings keeps pace with productivity growth. Aside from that, as the digital divide is a very real phenomenon, less skilled American workers, for example, are increasingly left behind; i.e., computer and related technologies made it easier for companies to retain fewer workers and attain higher outputs.[90]

Some Notes on other Theorems

Both 'Factor Price Equalization' and 'Stopler-Samuelson Theorems' emerge from the Heckscher-Ohlin Theorem we considered previously, focus on *inter*-industry, not *intra*-industry, trade. The former theory tries to explain how wages of both skilled and unskilled workers of two trading countries would tend to be over time. The Stopler-Samuelson Theorem, on the other hand, tries to explain the effect of trade on the price of the scarce factor of production.

Let us suppose that a country with abundant and cheap labor, but little capital trades freely with another country having a comparative advantage in capital and capital-intensive goods. As the comparative advantage of the former is based on cheap labor, it would naturally export labor-intensive goods en-mass. According to *Factor Price Equalization Theorem* the resulting circumstance would facilitate that the wage of unskilled workers in the exporting sector starts to rise. If the trade between the two countries is so intensive, even skilled workers would gradually but surely get compelled to take-up those, no skill demanding works available at the exporting sector.

The developed country with a comparative advantage of capital-intensive goods at its disposal will export technology products to the less developed, and import the labor-

[90] Id., pp. 56-61.

intensive products the former can supply. On the other side, the wages of the skilled workers specially engaged in the labor-intensive, export oriented, high-tech (manufacturing) industry of the developed country starts to rise.

The question *Factor Price Equalization Theory* essentially tries to explain and forecast is: How high or low would the wages of the workers rise/fall in the respective countries? In an example based on NAFTA reached by U.S. America, Canada and Mexico, the resulting economic phenomenon is explained as follows.

> ..[I]n response to demand from Mexico, businesses will make more capital-intensive goods. Thus, American businesses will need more machine tools, and less labor. Returns to capital will rise, but the price for labor (i.e., wages) will fall.
>
> "In Mexico, the opposite reactions will occur. Factor resources, in particular labor, shifts to the advantaged labor-intensive export sector. .. Their demand for labor will rise, causing an increase in wages, but the demand for capital will fall, causing a drop in the return to capital.
>
> Observe that the Heckscher-Ohlin Theorem does not require complete specialization. Quite the contrary ... The United States still makes some labor-intensive goods, and Mexico still produces some capital-intensive goods. Specialization, then, is a focus or emphasis, but not an all-or-nothing proposition. Why not? Because of increasing opportunity costs, production in the advantaged industry will continue to increase as long as the relative cost of this expansion is lower than, or just equal to, the relative price. .. At some point, adding more and more of the abundant factor of production will yield less-than-proportional increases in output, suggesting that the additions of the input are not paying off. Better to keep those inputs in the other industry. Hence, that other industry will survive, in a diminished state, and compete with imports. There would be complete specialization only in the highly unusual case in which the price of a country's exported good rises to such a high level that all of that country's factors are attracted to producing exportables.
>
> "Now, juxtapose the pre-and post-NAFTA scenario. Before NAFTA, labor commanded a premium in the United States, whereas capital did not. After

> NAFTA, American wage rates fell, but owners of capital enjoyed higher returns. In Mexico, opposite events occurred .. The end result is a convergence – ultimately, equalization – of factor prices. Mexican wages rise, while American wages fall, and the two eventually equalize. Returns to capital in the United State rise, while in Mexico they fall and eventually move to the same level. This is factor price equalization: in the absence of free mobility of factors of production across geo-political boundaries, free trade causes a long-run convergence in the incomes of each factor of production. In each country, the price of the abundant factor goes up, and the price of the scarce factor falls, because free trade impels each country to use its abundant factor all the more. Or, to put it concisely: free trade is a perfect substitute for factor mobility and leads to the equivalence of factor prices…
>
> "Another way of explaining the justification for equalization is to consider what the goods exported by each country embodies. The answer is the abundant factor of production. When the United States exports capital intensive goods to Mexico, it is exporting some of its abundance of capital. .. Conversely, when Mexico exports labor-intensive goods to the United States, it is exporting the good that is produced with a high ratio of capital to labor. .. In brief, when countries trade they do more than exchange goods. They exchange the factors of production embodied in those goods…"[91]

For *Factor Price Equalization Theorem* to hold true, all the following conditions have got to be met.

1. Complete free trade is needed.
2. Transport costs should be negligible or none existent.
3. There must be no factor reversals, i.e., there must be no differences in the rankings of countries with respect to the factor requirements needed for a particular good.

[91] Id., pp. 61-63.

4. The Theorem relies on the assumption that relative factor endowments across countries are not wildly different.[92]

The Stopler-Samuelson Theorem mentioned previously, is all about the income distribution effects of trade. *"In political terms, it is about the winners from free trade. As such, it helps explain why certain groups support, and others oppose, free trade."* Published in 1941, it emerges straight from the Heckscher-Ohlin Theorem, and focuses solely on *inter*-industry trade.

> The question Professor Stopler and Samuelson began with is this: If free trade occurs, what is the effect on the price of the scarce factor of production. Their answer: that price must fall. The intuitive reasoning is simple. In the United States-Mexico example above, .. Mexicans demanded capital-intensive goods from the United States.. They knew the United States had a comparative cost advantage, .., in these goods.
>
> "The result was that the captains of American industry .. knew that the demand for capital-intensive goods, fueled by the Mexican market, was increasing. Given this export demand, the price of capital-intensive goods would rise, and thus so too would returns to capital. After all, an increase in the price of capital-intensive goods has to lead to an increase in the income of the factor used intensively in the production of the capital-intensive good. As for American wage rates – the returns to the scarce factor of production - .. would tumble. .. In contrast, in Mexico, businesses hired workers, knowing that America had an appetite for Mexican labor-intensive goods. Given this export demand, the price of Mexico's labor intensive goods inevitably would rise. There would be a concomitant increase in the returns to the factor used intensively in producing those goods i.e., Mexico labor, in that Mexico wages would rise. But, Mexican businesses did not increase their demand for capital. Returns to capital - Mexico's scarce factor of production – thus would tumble.
>
> ".. Even with free trade between the United States and Mexico, there will be some businesses hiring labor to make labor-intensive goods. And, some Mexican

[92] Id., pp. 64-65.

businesses will employ capital for capital-intensive goods. What is the fate of these enterprises? Not good, if the free market forces are not allowed to operate. American workers making labor-intensive goods will face stiff import competition, as will Mexican capital that produces capital intensive goods. Neither of these will be able to exploit their 'scarcity power' in their respective countries if they are forced to compete with their cohorts across the border. Not surprisingly, American labor and Mexican capital will oppose free trade. .. At the least, American labor and Mexican capital may demand adjustment assistance packages to cope with vicissitudes.

"Here, then, is the Stopler-Samuelson Theorem. Trade liberalization leads to an increase in the relative price of labor in the labor-abundant country e.g., Mexico), and a decrease in the relative price of labor in the capital-abundant country (e.g., United States). These results occur because of the effect of trade liberalization on the relative demand for factor inputs…

"One clear implication of the Stopler-Samuelson Theorem is that the share of each factor of production in a country's national income accounts will change. In the example, the share of Mexico's GDP accounted for by labor will rise, while the share accounted for by capital will fall. In the United States, the share of capital in national income will rise, whereas the share of labor w*ill fall… "*[93]

2.1.5 On the Environment[94]

As the following discussion would demonstrate, trade can be made to bring good than harm to the environment. Though, usually, trade helps decrease pressure on the environment by introducing new and better technology and by reducing poverty, lack of appropriate environmental policies, laws and enforcing procedures and mechanisms might lead to inadvertent results.

[93] Id., pp. 65-67.

[94] Thomas J. Schoenbaum, *"Trade and Environment:- Free International Trade and Protection of the Environment – Irreconcilable Conflict?"*, American Journal of International Law, 1992, pp. 700-704.

In connection to such conditions,

> [t]he global multilateral trading system and its centerpiece, the General Agreement on Tariffs and Trade (GATT), are facing new challenge from a quite unexpected quarter. .. [The environmentalists] ..charge that interna-tional free trade blindly fosters the exploitation of natural resources. ..
>
> "The response to (environmental) concerns is to adopt restrictions on international trade in the name of environmental protection. Thus, national and international efforts to protect the planet's environment and resources clash with the goal of free international trade. This conflict is exacerbated by misunderstanding; .. We should not be forced to choose between environmental protection and free trade; both values are essential to our future survival and well-being.
>
> ".. (T)here is no fundamental conflict between GATT rules and the need to protect environmental quality. Analysis shows that there is virtually no constraint on the ability of a nation to protect its own environment and resources against damage caused by either domestic production or domestically produced or imported products. GATT rules can also be made consistent with efforts to preserve regional and global environmental quality. Furthermore, trade liberalization, .., will actually help the environmentalists' cause by (1) fostering common standards for environmental protection that must be observed even by certain developing countries that currently ignore environmental concerns; (2) terminating subsidies, particularly in agriculture, that are environmentally destructive, as well as inefficient; and (3) ensuring economic growth, which will create the financial means, particularly for developing countries, to control pollution and protect the environment…
>
> ".. [T]rade restrictions in the name of environmental quality may be grouped into four categories. The first category includes regulations on imports and exports adopted by all nations to safeguard their domestic resources and environment and to protect public health and safety. The imposition of such restrictions has traditionally been considered the prerogative of each sovereign state. Indeed, environmental standards actually contribute to economic efficiency since they correct environmental abuses .. external costs on society bound to result in a

> misallocation of resources; therefore, such standards lead to increased efficiency and welfare…
>
> "A second category of trade restrictions is increasingly used as a policy tool to enforce environmental standards in international agreements. ..[i.e.] agreements to protect the earth's ozone layer, safeguard endangered species of plants and animals, and restrict the international movement of hazardous wastes, as well as in proposed agreements to protect tropical forests and stem global warming…
>
> "A third set of trade restrictions for environmental purposes is even more controversial. Increasingly, states with stringent environmental controls are questioning the adequacy of environmental controls in other nations. This concern is based not only on environmental considerations, but also on apprehensiveness about unfair competition from foreign companies that are not subject to strict pollution controls."[95]

Unfortunately, several types of restrictions or bans on various categories of imports/exports have been imposed by several countries, which led to retaliatory measures by their counterparts. Such kinds of restriction in the name of environment protection rise:

> .. important concerns under international law. Should a country be permitted to impose its own notion of environmental quality on other nations? Are trade restrictions a legitimate way to retaliate for inadequate environmental standards?"
>
> "A fourth category of environmental trade restrictions consist of controls on the export of hazardous products, technologies and waste. Events such as the accidental explosion at the Union Carbide factory in Bhopal, India, in 1984 have stimulated the search for new international standards to govern export of hazardous chemicals, wastes and pesticides to developing countries.
>
> "Although .. such reforms may seem useful and uncontroversial, serious questions lurk beneath the surface. For example, how should 'hazardous' be defined in drawing up restrictions on the export of technologies and products? What are the appropriate risk assessment methods? Is there a need to harmonize the rules in

[95] Raj Bhala *et la*, Op cites, No. 13, pp. 68-70.

> this regard? Should these questions be determined unilaterally or by multinational conventional regimes? What is the appropriate method of regulation: a tax, a ban or prior informed consent?"[96]

These four categories of environmental trade restrictions are currently in place. Governments and countries are entitled to make use of them by incorporating laws, regulations, etc .., within their respective systems of law.

All the same, there still are concerns over liberalization of trade and investment. That is because some believe that liberalization of trade and investment may fundamentally be inimical to the environment; i.e., the very nature of the practice, like for example trade competition, may lead investors to disregard environmental degradation, depletion, etc... As it is occasionally witnessed, some trade practices give little or no heed to environment concerns. That must be why some people tend to believe that liberalization of trade and investment eventually culminates in insisting that environmental standards be set at the lowest bottom-line for anyone in the business sector. Investors, too, would be attracted by '*pollution heavens'*. But, as the following passage demonstrates, that should not necessarily be the case.

> Trade and investment liberation, by promoting a more efficient use of resources and sustaining growth, can make vital contribution towards creating the conditions necessary for environmental improvement. The evidence shows that there is a positive link between countries' environmental performance and rising per capita income levels, security of property rights and administrative efficiency. That is reflected, for example, in the fact that standards for air and quality in OECD countries are much higher today than they were fifty years ago, and it is these countries that today apply the most stringent environmental regulations…
>
> "The wealth creation to which liberalization contributes should also help reduce poverty, which is often the underlying cause of environmental degradation in many developing countries. .. Studies show that pollution intensity has grown

[96] Ibid.

> most rapidly in those countries that remained most closed to world market forces…
>
> "There have been concerns that, with liberalization, investors will be increasingly attracted by 'pollution heavens'. .. However, experience shows that openness to trade and investment generally translates into increased pressures for more stringent environmental standards. ..
>
> ".. Trade and investment liberalization are not the root causes of environmental problems. Under trade agreements such as the WTO, governments retain the sovereign right to set their own environmental objectives. .. In fact, the real problems that arise can in many cases be traced to situations where the use of environmental resources is not properly priced and reflected in the prices of goods and services consumed by firms and people. .."[97]

One other issue discussed relates to effects of free trade to national security. This would be dealt with in latter chapters, in detail.

2.2 Challenges to Free Trade Theory

2.2.1 Some of the Challenges

Some, like David Morris and Herman E. Daly,[98] have refuted the advantages "free trade" could bring about, citing contemporary examples. In reading the following challenges of concern, the question one should ask him-/herself is whether the mentioned outcomes are the direct results of free trade or other factors?

David Morris writes,

> *"For most of us, after a generation of brain washing about its supposed benefits, the tenets of free trade appear self-evident:*
>
> - *Competition spurs innovation, raises productivity, and lowers prices.*

[97] Id., pp. 70-71.
[98] David Morris, Free Trade – The Great Destroyer, in the Case against the Global Economy, (Jerry Mender & Edward Goldsmith Eds.), 1996, pp. 219-228.

- *The division of labor allows specialization, which raises productivity and lowers prices.*
- *The larger the production unit, the greater the division of labor and specialization, and thus the greater the benefits."*[99]

Another argument against free trade focuses on the purported benefits of free trade, such as higher standards.

> It is time to re-examine the validity of the doctrine of free trade and its creation, the planetary economy. To do so, we must begin by speaking of values. ..
>
> "We should not confuse change with progress. Bertrand Russel once described change as inevitable and progress as problematic. Change is scientific. Progress is ethical. We must decide which values we hold most dear and then design an economic system that reinforces those values.
>
> " … [P]rice is actually no measure of real efficiency. In fact, price is no reliable measure .. In the planetary economy, the prices of raw materials, labor, capital, transportation, and waste disposal are all heavily subsidized. For example, wage-rate inequities among comparably skilled workforces can be as disparate as 30 to 1. ..
>
> ".. Many developing nations have no minimum wage, maximum hours, or environmental legislation [or enforcing mechanisms]. As economist Howard Watchel notes, 'Differences in product cost that are due to totalitarian political institutions or restrictions on economic rights reflect no natural or entrepreneurial advantage. Free trade has nothing to do with incomparable political economic institutions that protect individual rights in one country and deny them in another. .."[100]

Similar, free international trade distorting practices can be witnessed in the developed countries. The price of goods in developed countries is also highly dependent on subsidies; e.g. agricultural subsidies, etc …

[99] Raj Bhala *et la*, Op cite, No. 13, p. 79.
[100] Id., pp. 79-83.

Here, the writer suggests, among other things, "technology" and "know-how" transfer as a remedy. The other challenger – Herman Dally[101] - contests the fruits of free trade by raising the following five argumentative points.

> International free trade conflicts sharply with the national policies of:
>
> A. getting prices right,
> B. moving toward a more just distribution,
> C. fostering community,
> D. controlling the macro economy, and
> *E.* keeping scale within ecological limits*."*[102]

These are the five conflicts that H. Dally described and explicitly discussed as conflicts that inevitably arise from free international trade. Here, allow to include some of the points he wrote as follows.

> ... C) Even with uniformly high wages made possible by universal population control and redistribution, and with uniform internalization of external costs, free trade and free capital mobility still increase the separation of ownership and control and the forced mobility of labor which are so inimical to community. .. The point is that they [communities of foreigners with whom you believe to have no common language, history, culture, ..] are far removed from the life of the community that is affected significantly by their decisions. Your life and your community can be disrupted be decisions and events over which you have no control, no vote, no voice. .."
>
> "D. Free trade and free capital mobility have interfered with macroeconomic stability by permitting huge international payments imbalances and capital transfers resulting in debts that are unrepayable in many cases and excessive in others. … Inflation, plus the need to export to pay off loans, leads to currency devaluation, giving rise to foreign exchange speculation, capital flight, and hoot money movements disrupting the macro-economic stability that adjustment was supposed to foster. …"

[101] Herman E. Daly, The Case Against Free Trade: From adjustment to sustainable Development – The Obstacle of Free Trade, (1993), pp. 124-130.
[102] Raj Bhala *et la*, Op cites, No. 13, p. 84.

> "E. .. [P]art of the free trade dogma of adjustment thinking is based on the assumption that the whole world and all future generations can consume resources at the levels current in today's high-wage countries without inducing ecological collapse. So, in this way, free trade sins against the criterion of sustainable scales. .. "Sustainable development means living within environmental constraints of absorptive and regenerative capacities. These constraints are both global (greenhouse effect, ozone shield), and local (soil erosion, deforestation).Trade between nations or regions offers a way of loosing local constraints by importing environmental services (including waste absorption) from elsewhere. .. Carried to extremes in the name of free trade it becomes destructive. ...."[103]

One of the other challenges relates to issue of providing protection to infant industries. In this regard, Robert Gilpin asserts that both liberals as well as nationalists agree on the need for giving appropriate, formidable protection to infant industries lays out the points over which controversies arise between the various outlooks as follows.[104]

In principle, both liberals and nationals accept the rationale for protecting infant industries. Both acknowledge that an industrial economy may have particular advantage over a non-industrial economy. There may also be factors that make it very difficult for the latter to establish its own industries. In the words of John Stuart Mill, *"*there may be no inherent advantage on one part, or disadvantage on the other, but only a present superiority of acquired skill and experience. A country which has this skill and experience yet to acquire, may in other respects be better adapted to the production than those which were earlier in the field."[105]

Liberals and nationals disagree fundamentally, however, on the specific purpose of protectionism as it relates to infant industries. Economic nationalists tend to regard protectionism as an end in itself. The traditional nationalist defense of infant industry protection has been joined, in recent years, by the prospect of strategic trade policy,

[103] Id., pp. 84-89.
[104] Robert Gilpin, The Political Economy of International Relations, 1987, pp. 184-187.
[105] Raj Bhala *et la*, Op cites, No. 13, p. 90.

whereas infant industry protection is largely defensive, strategic trade policy is essentially offensive. Though Robert Gilpin confirms that every country has protected its industries to some extent in the early stages of industrialization, he cautions that it does not follow that protectionism necessarily leads to success as, for example, import-substitution strategies have made many less developed countries bankrupt. He also mentions that "[t]he success of strategic trade policy, as exemplified by the commercial difficulties of the European Airbus consortium, has yet to prove its worth. [So, t]he issue of free trade versus protection does not lend itself to easy answers."[106]
Another issue similar to protectionism, but somewhat different relates to revitalizing industries.[107]

2.2.2 Fair Trade[108]

Most countries (especially in the developing world) seem anxious to see that the international trade system becomes "fair and free". Unlike these, there are some who wish to make trade simply "freer", while still others wish to make it "fair". The following paragraphs are taken from what Patrick Low has written about the arguments in favour of "free" and "fair" trades.

One of the clearest manifestations of current difficulties in the trading system, and of disquiet in the United States, has been the attempts to replace the objectives of "free" or "freer" trade with demands for "fair" trade. Fair trade, an altogether more subjective concept, is increasingly employed to justify government actions aimed at protecting domestic industry or pressing for foreign trade liberalization. Together with reciprocity, it has become the foundation upon which the case for interventionist policy is built.

The clamor for fair trade has shifted the ground of the trade-policy debate in two ways. First, the suggestion that fair trade must be pursued as an explicit policy objective has

[106] Id., p. 90.
[107] Congressional Budget Office, *"Has Trade Protection Revitalized Domestic Industries?"*, November 1986, ix-xi.
[108] Patrick Low, Trading Free, 1993, pp. 27-30.

forced the U.S. government into bilateral and unilateral actions in the trade field, going beyond or simply ignoring GATT rules. This implies that multilateral provisions and processes have been unable to produce equitable outcomes, and all that is left is self-help. The threat of increased protection backs up the demand for trade liberalization.

Second, conclusion may also be drawn that the absence of "fairness" in trade relations bespeaks (necessitates) the need for greater intervention and planning in the domestic economy to avoid the privations that will follow from foreign foul play. This kind of response leads to the inconsistency of practicing planning at home and pillorying it abroad. The case for market sharing must be based on the belief that markets systematically fail or that governments are systematically nefarious. Either or both conditions would make a market-oriented, rules-based system for mediating trade relations enviable.

Earlier on, the following four main reasons of non-discrimination and reciprocity were considered to be compatible.

> Firs, only a few countries were involved in multilateral trade negotiations, and they shared similar objectives.
>
> Second, the United States was willing, in its role as prime mover and inspiring force behind the multilateral trading system, to cut its tariffs by more than its trading partners (actually) did. This gave the multilateral process momentum.
>
> Third, because negotiations were only about tariffs and not rules, they avoided all the complications that have since bedeviled GATT negotiations on norms.
>
> Fourth, some de facto discrimination was possible through the selection of products for tariff-reduction offers.

In practice, because principal suppliers were the ones with which tariff reductions were negotiated, any free-riding behavior would have been considered of minor consequence.
This simplicity and convenience of this situation began to break in the 1970s. In the Tokyo Round negotiations involving non-tariff measures, no built-in mechanisms were left to protect the principle of nondiscrimination. Although discriminatory trade policy

only emerged in isolated areas as a result of the Tokyo Round non-tariff negotiations, an important principle of the system had been called in to question in the name of reciprocity. This was also the first time, since the founding of GATT, that the United States explicitly contemplated the conditional application of the most-favored-nation (MFN) principle. The MFN principle is the cornerstone of the GATT system, since it is the basic provision that guarantees nondiscrimination.

Since the end of the Tokyo Round in 1979, trade policies based on reciprocity have increased while other negotiations involving substantive norms has created pressures toward the standardization of laws at the international level. With the extension of protectionist attitudes in the 1970s and 80s, and with the extension of trade negotiations into more and more areas of trade and trade-related policy, a new feature of reciprocity has emerged. This is the notion that reciprocity is about equal market access in terms of outcomes rather than equality of opportunities. The term "effective" market access springs to mind in this context.

What does this new meaning of reciprocity imply for international trading arrangements?

> First, it requires a much more sectoral and country-specific focus on trade policy than has traditionally been the case. Ideas such as the forced balancing of bilateral trade flows have been mentioned in this connection.
>
> Second, it creates the need for some kind of ex-post reckoning (i.e., means of knowing afterwards) of whether effective market access has been reciprocally achieved as a result of negotiated policy changes.

After, thus, explaining how the term "reciprocity" came to be linked with "fair trade", Patrick Low writes:

> *[*i]n short, this kind of reciprocity is about the search for 'fair' trade, about discrimination, and about market sharing. It is not about operating in open, competitive markets, according to predetermined rules and disciplines. The

increasingly restricted and literal meaning given to reciprocity in trade negotiations is, in effect, fully consistent with a system of managed trade."[109]

2.2.3 Strategic Trade Policy and Managed Trade

As has been discussed earlier, increasing returns is the essential cause to international trade, specifically – to investment. Comparative advantage, which is determined by factors of production, mostly explains what kind of goods and services a country would trade with another.

As Paul Krugman[110] explains, policy-makers and economic advisers try to identify and target at the most promising industry to their respective countries.

Which industries should a country try to promote? One criterion is the potential for technological spillovers. Another criterion for industry targeting is referred to as "strategic trade policy" (i.e., to which governments would probably make such interventions as offering subsidies and strive to get the monopoly profit thereof).

The strategic trade policy story is not, at base, an argument for protection *per se*. It is really an argument for a limited government industrial policy consisting of carefully targeted subsidies, not for tariffs and import quotas. Yet it provides advocates of protectionism with a new intellectual gloss (high-light) to justify their position, and it has picked up enthusiastically by advocates of "managed trade" like Clyde Prestowitz and Robert Kuttner. As Kuttner puts it, *"*the New View radically alters the context of debate, for it removes the premise that nations such as Japan which practice strategic trade could not, by definition, be improving their welfare."[111] In fact none of the international economists responsible for the new trade theory has come out as an advocate of Kuttnerian trade policy because the actual prospects for a successful strategic trade policy are not very good.

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[109] Id., p. 94.
[110] Paul Krugman, The Age of Diminished Expectations, 1990, pp. 110-112.
[111] Raj Bhala *et la*, Op cites, No. 13, pp. 94-95.

Once again, this is partly a matter of economics, partly one of politics. On the purely economic side, there just isn't any evidence that an aggressive strategic trade policy can produce large gains. Technological spillovers could be important, but they are difficult to measure. As for the possibility of capturing monopoly profits through strategic trade policy, the result of a good deal of technical analysis of the prospects for such policy in particular industries over the past few years is fairly discouraging. Likewise, the likely gains from strategic trade policies are even smaller than the conventional estimates of the costs of protection.

Others, Peter van Bergeijk and Dick Kabel, have written on varying aspects of strategic trade policy, which will be discussed herein below.

The call for more protection, i.e., strategic proposition[112], appears to have found its justification in the concept of strategic trade policy. This involves the creation of competitive advantages (with government intervention) for companies operating in markets in which major economies of scale can be realized and where – partly for this reason – there is little competition. The fact that the strategic trade policy can be theoretically justified and therefore used to legitimize measures to combat unfair trade practice by other countries makes it far more politically acceptable than traditional protectionism.

Recent developments in trade theory relate to a) internal economies of scale and imperfect competition, and b) external economies.

A) Internal economies of scale, i.e., factors like high expenditures on research and development at start-up or due to significant learning effects that lead to more efficient production, reduction of shedding and wastage, lead to a reduction of the costs per unit as a firm's output rises. Internal economies of scale lead to markets characterized by imperfect competition, such as monopolies, oligopolies or monopolistic competition. Monopolistic competition can occur when producers

[112] A.G. Peter van Bergeijk and Dick L. Kabel, World Trade: Strategic Trade Theories and Trade Policies, 1993, pp. 176-177, 180-185.

succeed in marketing products which are close substitutes (detergents, cigarettes). Monopolistic competition can also occur when producers succeed in marketing their products as unique; e.g., by appealing to the personal characteristics and, in particular the lifestyle of potential buyers. If the level of monopoly profits is above normal, new companies will enter the market to manufacture their own "unique" products.

B) In situations where external economies of scale occur, the cost per unit of production does not depend on the size of the company but on that of the industry as a whole. Since external economies of scale do not get a price, they should be regarded as externalities.[113]

In respect of strategic trade policy these two can have the following effects.

The strategic trade theory used the concept of economies of scale to argue that governments have a lot to gain by increasing market access for their own producers and restricting market access for foreign competitors. After all, if the monopoly profit can again be shifted at the expense of other countries. Hence by protecting the domestic market, the government can create a competitive advantage for its own domestic industry. According to the strategic trade theory, unilateral steps towards free trade could increase the potential market for foreign competitors. This damages the competitive position of domestic industry. According to strategic trade theorists, this is particularly likely in situations where very high initial investments must be made, and in which it is therefore only theoretically possible for one company to operate on the international market. This may occur if the optimum least-cost output level of a company is larger than half of the market or relevant market segment; a kind of natural monopoly. Proponents of the strategic trade theory assert that a government can ensure that a domestic company will enjoy a strategic advantage over its foreign competitors by deploying trade policy instruments. .. Entry, however, to this market is still possible for a foreign company, if that company is supported by its own government, which subsidizes part of the entry cost. In this way, it is claimed, trade policy could contribute to industrial policy be

[113] Raj Bhala *et la*, Op cites, No. 13, p. 96.

supporting sectors considered to be strategic and by creating defensible competitive position. ..

2.2.4 Free Trade and Nationhood

The topics discussed hereafter in this chapter highlight some of the arguments forwarded by those in favor of enabling nations to protect and even enhance their respective national interests through free trade; expressed in a better way – free trade should serve the enhancement of nationhood, and should not endanger national security, etc...

***Defending Economic Nationalism*[114]**

Robert Gilpin writes that economic nationalists emphasize the costs of trade to particular groups and states. They also are in favor of protectionism and insist on control over international trade. The criticisms they raise against liberal trade theory can be broadly categorized in to:-

1. The implications of free trade for economic development and the international division of labor,
2. Relative rather than absolute gains – i.e. because of the distributive effects of trade, and
3. The effect on national autonomy and impact on domestic welfare.[115]

A Report presented by Alexander Hamilton to the U.S. House of Representatives in 1791 contains the intellectual origins of modern economic nationalism and the classical defense of economic protectionism, and the modernized 18th Century mercantilist thesis which he then developed in to a dynamic theory of economic development that takes as its basis the superiority of manufacturing over agriculture. He set forth what we today would call an "import-substitution" strategy of economic development:

> Not only the wealth, but the independence and security of a country, appear to be materially connected with the prosperity of manufacturers. Every nation, with a

[114] Robert Gilpin, The Political Economy of International Relations, 1987, pp. 180-183.
[115] Raj Bhala *et la*, Op cites, No. 13, p. 117.

> view of these great objects, ought to endeavor to possess within itself, all the essentials of national supply. These comprise the means of subsistence, habitation, clothing, and defense…" [116]

From then on, nationalists have argued that the location of economic activities should be a central concern of state policy.

He and his proponents also argued that governments can transform the nature of their economies and thus their position in the international economy through what are now called "industrial policies". The transfer of the factor of production, as well as the migration of especially skilled labor, importation of foreign capital and the establishment of a banking system so as to provide investment capital should be encouraged to expedite industrialization. Thus, Alexander Hamilton's *Report* set forth a dynamic theory of comparative advantage based on government policies of economic development.

At the end of the 18th Century, proponents of economic nationalism again challenged the liberal assumption that comparative advantage is relatively static. They argue that the law of comparative advantage is primarily a rationalization for the existing international division of labor and advocate a trade policy that encourages the development or preservation of domestic industry. On the one hand, nationalist emphasis on industrialization has, in* the less developed economies, focused on the adoption of an "import-substitution" development strategy. On the other hand, a number of advanced countries have adopted industrial policies designed to develop specific industrial sectors.
Whereas economic liberals emphasize the absolute gains in global wealth from a regime of free trade, economic nationalists of the 19th and 20th Centuries stress the international distribution of the gains from trade; i.e. nationalists stress that trade just distributes gains acquired through industrialization. Nationalists note that in a world of free trade, the term of trade tend to favor the most industrially advanced economy. Economic nationalists also believe that free trade undermines national autonomy and state control over the economy by exposing the economy to the vicissitudes and instabilities of the world

[116] Ibid.

market. Likewise, it exposes the (nation's) economy to exploitation by other, more powerful economies. They also argue that specialization, especially in commodity exports, reduces flexibility, increases the vulnerability of the economy, and threatens domestic industries on which national security, established jobs, or other values are dependent.

Robert Gilpin, in his final note, reminds that all these arguments are important in the formulation of economic policy of any nation to date.[117]

***Protecting National Security*[118]**

> As George Washington University Professor Henry R. Nau points out in Trade and Security (1995), America's international trade policy ought not to be isolated from its broader foreign policy interests. Trade is not about the narrow-minded pursuit of exports and high-wage jobs. Rather, it is inextricably linked to national security."[119]

In view and in line with this assertion, and depending on its level of development, any country would strive to protect that particular industry it sees of its national security interest; e.g., its defense industry.

However, as Clyde Prestowitz explains, the distinction and links it sets to Section 232 of the 1962 Act, as amended, 19 U.S.C. § 1862, the above argument seems to be in disagreement with America's – say – "national security" and "economic security".

> While the economic doctrine of the United States does not assign greater significance to one industry over another, its military doctrine does. The continued existence in the United States of certain industries and technologies has long been deemed critical to America's military forces. In particular, reliance on other countries for the most advanced technologies has always been thought to be

[117] Id., p. 118.
[118] International Trade Law Handbook References: Sections 232-233 of the 1962 Act, as amended, 19 U.S.C. §§1862, 1864.
[119] Raj Bhala *et la*, Op cites, No. 13, p. 119.

> desirable. That the consequence of pure free-trade doctrine might conflict with the exigencies of military requirements has long been recognized. .. [S]ection 232 .. provides that a president may extend protection to critical industries if their ability to supply national defense needs is likely to be impaired by imports."[120]

The key insight is that an industry may be vital to a country's economy, but insignificant militarily. Protecting an industry because of its relationship to defense is a different matter.

But, how to draw this distinction? Consider Hollywood, which is a big business in America. Hollywood serves no military purpose. Or consider semiconductor chips. Modern weapon systems rely on computer chips. In his book, *Japan that Can Say No*, Shinaro Ishihara explained how the Pentagon had become dependent on his country's companies:

> While U.S. companies may already have the technological know-how for the advanced chips, only Japan electronic firms have the mass-production and quality-control capability to supply the multi-megabit semiconductors for the weapons systems and other equipments.
>
> "In short, without using new-generation computer chips made in Japan, the U.S. Department of Defense cannot guarantee the precision of its nuclear weapons. ..
>
> "Japan now has a decisive technological advantage. I believe that Ronald Reagon, Mikhail Gorbachev, and their advisers realized the absurdity of the situation.. and agreed to call off the arms race."[121]

After arguing that the banking, oil textile and food-chain industries show similar discrepancies in standing alone, i.e., outside the global market, the discussion on protecting national security points out that it has been suggested that no choice need be made between economic and military significance, as economic and military strength are integrally related.

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[120] Ibid.
[121] Id., p. 120.

The key issue is to identify what industries are "strategic" in a joint economic-military sense. In other words, which industries contribute more than others to America's pre-eminence around the globe, and its sense of security at home? However, as Martin Libicki of the National Defense University points out, this question pre-supposes an answer to another – more fundamental – question:

> .. What makes industries strategic? [Is it] .. size? Is it power? Is it high technology? None of these criteria truly addresses national security and well-being. ..
>
> "High technology, as indicated by the ratio of research and development (R&D) to sales, tends to identify promising sectors, …['Strategic' industries are those that] best foster the systematic application of knowledge to generate more and better outputs from inputs".[122]

In other words, the focus is on increased productivity, a better match between products and needs, and ultimately an increase in the deterrence power of the military. Observe that this decision can encompass industries as diverse as agriculture and fiber optics.

The next step is to identify which, if any, industries that do supply essential ordnance are located partly or wholly overseas? Here, what exactly is meant by "overseas"? For instance, in view of the fact that U.S.A. is a world super power, can such a factory of an American multinational company located in Indonesia be considered as being "overseas"?

Whatever the response to this question, the follow-on question is extraordinarily difficult: what countries are problematic? So, as long as there are nation-states and international trade, the argument will exert a powerful grip on the minds of policy-makers.[123]

As certain, regularly published, special, governmental reports indicate, security threats may come not simply from countries, but rather from popular movements, and may be

[122] Id., p. 121.
[123] Id., p. 122.

privately sponsored. Citing new concerns like conflicts in and around the region of Horn of Africa[124] and elsewhere, as well as evolving geopolitical nature of the post-Cold World War era, the discussion culminates by assuring that national security – manufacture and acquisition of ordnance and equipments of strategic importance included – continues to remain the concern of every policy-maker, of any nation-state, worldwide.

***Maintaining Sovereignty*[125]**

Sovereignty is a hallmark of any nation-state. Therefore, every government would be determined to uphold the sovereignty of the State. This also applies during the new age of globalization, where technological advancements like PCs coupled with other international trade practices made it possible to mankind to perceive the world as a village. As Wolfgang Reinicke points out in the following passages, governments might resort to *defensive* or *offensive interventions* in order to maintain sovereignty of the State.[126]

Policymakers can intervene defensively or offensively in globalization. By maintaining or restructuring barriers to globalization through protective economic measures such as tariff and non-tariff barriers, capital controls, or other national regulatory measures in the domains of transport, communications, and information, *defensive intervention* would in principle return internal sovereignty to the national government. This, in turn, would force companies to recognize along national lines, much as they did before they adopted global strategies.

An alternative strategy to defensive intervention is *offensive intervention*. Here countries themselves become global competitors, striving to provide the most attractive environment possible for the strategies of global companies within their own territorial boundaries, or to lobby other countries on behalf of their domestic corporations in support of their overseas strategies. In the early 1990s offensive intervention was advocated by some geo-economists, who argued that in a post-cold war world, economic

[124] Id., p. 123.
[125] Wolfgang H. Reinicke, Global Public Policy, 1998, pp. 76, 78-85.
[126] Raj Bhala *et la*, Op cites, No. 13, p. 123.

competition would replace military competition. Although the notion of economic warfare has declined in popularity somewhat over the years, some of its aspects continue to influence the public policy debate.

Offensive intervention can take place through a variety of economic channels; e.g., deregulating an industry or lowering taxes to attract business activity within ones territory, subsidies, aggressive export promotion campaigns, generous export insurance guarantees, and the tying of foreign aid to exports (mainly) by means of gathering information and industrial espionage through national intelligence agencies.

Intervention can be taken further if the national jurisdiction to which it is applied is inappropriate or cannot address the particular challenge at hand. Under these circumstances political rather than economic instruments are used in an effort to reassert internal sovereignty. For example, policymakers intervene offensively through the extraterritorial application of national law, unilaterally seeking to broaden the reach of their internal sovereignty to match the economic geography of global corporate networks. Offensive political intervention is likely to be used only by countries or regions that are politically powerful and economically large enough to expect that other countries might yield to their pressure.

Under the current norms of the international economic system, defensive intervention by one country, even when designed to preserve internal sovereignty, is most likely to lead to retaliation by others, resulting in the progressive disintegration of the world economy, with all the economic, social, and political costs that would entail. The use of offensive strategies will not advance integration, but rather will divert scarce public funds from important public policy goals. Extra-territoriality is no friend of deeper integration either.[127] It disregards the territorial constraints of internal sovereignty and, by definition, invades the political geography of other nations, challenging their internal sovereignty. It could also set a dangerous procedural precedent in handling many similar global issues – e.g., the Helms-Burton Act.

[127] Id., p. 124.

Finally, even if defensive and offensive economic intervention appeared feasible in theory, there is mounting evidence that international economic integration has already come so far that both forms of intervention have lost their practical effectiveness in a globalizing economic environment. Global firms, with the help of flexible networks that spread across borders, are in a much better position to circumvent or absorb the costs that a resurgence of restrictive trade measures would impose upon them. Similarly, where governments have erected barriers to foreign investment in the form of antitrust laws or restrictions on foreign ownership, collaborative linkages give firms the political advantage of being a local firm almost anywhere, again overcoming national political boundaries in what from a firm's perspective is a global market.

Not only have defensive and offensive intervention become less effective and more difficult, they are also likely to have unintended consequences that could even accelerate globalization.

To sum up, all forms of *defensive* and *offensive interventions* reemphasize territoriality as an ordering principle of international relations. As such, they respond only indirectly to the challenge to internal sovereignty by relying on and attributing renewed weight and importance to external sovereignty – a condition that integration has worked so hard to overcome and that, with the end of the cold war, appeared to have been secured. Thus, defensive and offensive intervention not only would halt, and reverse the trend toward globalization, but would also amount to an assault on the established principles of cooperative competition and its norms and institutions, which have been and remain the cornerstones of economic interdependence.

Yet, even though these interventionist strategies cannot answer for any sustained period the challenge that globalization presents to national governments, they are attractive and popular, as they provide policymakers the appearance of being in control – of effectively keeping, ensuring national sovereignty; to which, actually, policymakers should be given a viable other alternative.

Summary

Free international trade affects pattern of trade, infant industries and the environment. The Nobel Prize winning Heckshler-Ohlin Theorem tried to quantitatively express the effect of free international trade on a *country's endowment of factors*, which, naturally, would affect the cost of production of exportable goods/services; i.e. would affect its comparative advantage in trade.

Thus, a country will export goods those goods/services which especially make use of those factors that country is relatively well endowed with; i.e. as long as that "factor endowment" does not get depleted or makes production cost more expensive than that in another country. Though it got challenged by a counter-argument forwarded by another Nobel-Prize winner, Professor W. Leontief, the Heckschler-Ohlin Theorem remains a feasible Theorem to date. Some of the detailed analysis that helped re-instate the Heckschler-Ohlin Theorem proposed the "Product Life Cycle Hypothesis". According to this hypothesis, a newly devised and produced good of valuable scientific/technological innovation would have a considerable comparative advantage until it gets imitated or replaced by a similar or better product.

Another theory developed by Prof. Michael Porter attempts to move beyond comparative advantage in that it tries to give a rich conception of competition that includes segmented markets, differentiated products, technology differences, and economies of scale. This "Theory of Competitive Advantage" argues that cost advantage grows as much out of efficient-to-manufacture product designs and leading process technology as it does out of factor costs or even economies of scale.

Prof. M. Porter argues that those nations that are better-off in creating an environment that allows its firms and industries to obtain and maintain a competitive advantage remain more successful in international trade. He also pointed out that "Competitive Advantage" is highly localized. Meaning, the "Competitive Advantage" encountered between industries trading in the international market on the same kind of goods is determined on

differences in national economic structures, values, cultures, institutions, and histories, among other things. According to the Theory, no single strategy would account for the "Competitive Advantage" witnessed in a particular industry, but rather strategies specifically tailored-out to that particular industry, that is compatible with the skills and assets available thereto.

Although significant progress has been made in explaining the factors and effects of international trade, there still are a number of challenges to free trade. These relate to needs of national interest; like, for example, ensuring economic stability, ensuring sustainable economic development, safeguarding the living standard of the society through job creation, maintaining/enhancing wage/salary earnings in real terms, avoiding environmental degradation, protecting infant industries of strategic importance, maintaining national sovereignty as well as internal peace and security. This is to say that measures should be in place that effectively restrains any adverse effects of unregulated, free international trade practices.

Questions of Concern

From your Inter-Disciplinary Course and readings thereof, try to answer the following questions.

1. What is consumer surplus? Using real-world data, what information would you need to measure consumer surplus for a product?

2. What is producer surplus? Using real-world data, what information would you need to measure producer surplus for a product?

3. How can a country's supply and demand curves for a product be used to determine the country's supply-of-exports curve? What does the supply-of-exports curve mean?

4. How can a country's supply and demand curves for a product be used to determine the country's demand-for-imports curve? What does the demand-for-imports curve mean?

Questions to ponder

1. Should trade between States be treated in a similar manner as trade between trading parties? Explain in reference to the principles discussed herein above. (Here, consider trade relations between an oligopoly and a country, or between a foreign company and a local company.)

2. If "Nationhood" could be described as follows, how would you describe "Statehood" of a constituent state within a country?
   Nationhood is a stage of development whereby a homogeneous society – sharing the same social and cultural values – advances a political system of common interest and benefit to that nation on the basis of one economic system.

Part II

The Need for Curving Out International Trade Regime

Chapter Three

WTO and GATT

Background: Forging Agreements and Implementation Mechanisms

3.1 Introductory Note

In a concise manner, in the absence of a single government, the need for international cooperation sprang from the need to develop and create international customary law[128] – enforce treaties, prevent monopolies and discourage protectionism.[129] After the end of World War I, the world economy embarked upon very difficult times. Primarily, state treasuries were highly depleted by the costs of war. Furthermore, the previously longstanding hegemonic power, Britain, could no longer maintain a position at the centre of the international economy. Due to these conditions, at times of crisis, States went about practicing *'beggar thy neighbour'* policies – protectionist policies persisted, irrespective of the side effects on other countries.[130]

The cataclysmic effects of these *'beggar thy neighbour'* policies of the 1930's (the Great Depression) made policy makers realise that sustained cooperation among states without international institutions was difficult, even though states were aware of the fact that non cooperation would have an adverse effect to each and all of them.[131]

On the other hand, others like Hoekman and Kostecki have presented another argument. They pointed out the notion of 'prisoners' dilemma' –a condition where every country

[128] Customarily per se and treaty.
[129] Goldstein, Joshua S., Internatinal Relations, (4th Ed., New York: Longman Publishing), 2001, p. 374.
[130] Peet, Richard, Unholy Trinity: The IMF, World Bank and WTO, (London and New York: Zed Books Ltd.), 2003, p. 30.
[131] Narlikar, Amrita, The World Trade Organization: A Very Short Introduction, (New York: Oxford University Press), 2005, p. 3.

imposes restrictions and the outcome of such unilateralist behaviour was, more often than not found ineffective and inefficient. Practically all the trading states ended up in a situation where they would have gained more had they been upheld and bound by free trade policies.[132] The 'prisoners' dilemma' could be overcome by putting in place the principle of reciprocal reductions in trade barriers and by improving world welfare through multilateral negotiations.[133]

Moreover, multilateral liberalisation is believed to ensure greater access to foreign markets and in so doing ensures that domestic firms even out the protectionist firms. Therefore, this renders trade liberalisation not only economically feasible but also politically wise and politically achievable as well.[134]

In contrast to the failing classical laisser-faire economy, communism, on the other hand was proving to be immune to the problems that were plaguing the western world and had begun to be seen as a practicable alternative by the working class. Soon, fascism and Nazism coming to the world arena presented another alternative.[135] So, the western world was faced with two obstacles (i) lessening the effects of the Depression and; (ii) to protect the capitalist system from the external threats presented by communism fascism and Nazism.[136]

After the trauma of Great Depression, in the Bretton Woods Conference, western countries wanted to create a stable economic order that would prevent a return to the destructive economic nationalism of 1930s. Hence, the Bretton Woods Conference was launched in 1944 to create a stable world economic order.[137] It was a product of American-British cooperation that led to the creation of (i) the International Monetary Fund (IMF), so as to supervise the operation of the monetary system and provide

[132] Hoekman, Bernard M. and Michel M. Kostecki, The Political Economy of the World Trading System: The WTO and Beyond. (New York: Oxford University Press), 2001, p. 26.
[133] Id., p. 28.
[134] Narlikar, Op cites, No. 131, p. 5.
[135] Bhaumik, T.K., The WTO: A Discordant Orchestra, (New Delhi: Sage Publications), 2006, p. 28.
[136] Peet, Op cites, No. 130, p. 30.
[137] Gilpin, Robert, The Political Economy of International Relations, (Oxford: Princeton University Press), 1987, p. 131.

"medium term lending" to countries experiencing temporary balance of payment deficits;[138] (ii) the International Bank for Reconstruction and Development (IBRD), which later became the World Bank, was initially designed to provide loans for Europe's Post-war Reconstruction Programmes. During the 1950's, however, its purpose was expanded to fund various industrial projects in developing countries around the world,[139] and; (iii) the International Trade Organisation (ITO) that would regulate trade, while complementing the other two organisations.[140]

The important outcome of this conference was the conclusion of the Havana Charter, a draft agreement for the formation of the ITO, signed by 53 countries out of the 56 that had taken part. Nevertheless, ITO never materialised due to the fact that the US Congress, despite its support for the Charter, was unwilling to ratify it. Richard Gardner had this to say about the *"ignominious fate"* of the ITO: *"It didn't have a chance to die; it was simply stillborn"*.[141]

Furthermore, by logrolling the diverse and often contradictory demands of all the prospective members of the ITO, the negotiators of the Havana Charter ended up with a final package that satisfied no one. Detailed exceptions to the principle of laisser-faire were included in the charter and the list of exceptions kept on growing where developing as well as developed countries were able to include exceptions of their own.[142]

Luckily, the US was able to come up with another solution. As early as 1945, while negotiations on ITO were undergoing, the US proposed that a multilateral commercial treaty on tariff reductions be negotiated among the participating countries. The rationale behind this was the recognition by the US administration that though the ITO being a multilateral organisation would need ratification by the Congress, a trade agreement however could easily be negotiated and implemented. As a result of the Geneva

[138] Gilpin, Op cites, No. 137, p. 132.
[139] Steger, Manfred B., Globalization: A Very Short Introduction. London: Oxford University Press), 2003, p. 38.
[140] Encarta Encyclopaedia, 2006.
[141] Narlikar, Op cites, No. 131, p. 12.
[142] Id., p. 13.

Conference of 1947, the General Agreement on Tariffs and Trade (GATT)[i] was concluded.[143] This was an interim agreement until ITO was realised. It was signed by 23 countries out of which 11 were developing ones and it was to provide a provisional basis for multilateral cooperation until an international organisation entrusted with trade affairs came into existence.[144]

3.1.1 The Transition from GATT to WTO

The GATT, established in 1948, had the fundamental purpose of promoting freer trade through the reduction of tariffs and elimination of other trade barriers.[145] From 1947-1994, the GATT Secretariat was known as the Interim Commission for the International Trade Organisation (ICITO) created during the ITO negotiations. It was technically a UN body, as ITO negotiations took place under UN auspices. Over the years, it expanded to include more members and *"gradually evolved to a de facto WTO"*.[146]

Under the auspices of GATT Secretariat, a succession of rounds of multilateral trade negotiations started to take place. The first five rounds concentrated on reform of import tariffs and quotas. The participation was limited only to 25 countries and sensitive areas of trade like agriculture and textiles were excluded from the agenda of the negotiations.[147] The succeeding rounds were also about tariffs and quotas but the scope was broadened. The Kennedy Round (1964-67) dealt with anti-dumping codes. The Tokyo Round (1975-79) covered a much wider range of issues, including non tariff measures such as subsidies and countervailing measures, technical barriers to trade, import licensing, customs valuation, government procurement and trade in civil aircraft.[148] Since not all the members formally subscribed to these agreements, they were informally called 'codes'.[149]

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[143] Krueger, Anne O., "Introduction." In her The WTO as an International Organization, (Chicago: The University of Chicago Press), 1998, p. 3.
[144] Encarta Encyclopaedia, Op cites, No. 140.
[145] Gilpin, Op cites, No. 137, p. 190.
[146] Hoekman and Kostecki, Op cites, No. 132, p. 38.
[147] Jawara, Fatoumata and Aileen Kwa, Behind the Scenes at the WTO: The Real World of International Negotiations, the Lessons at Cancun, (London: Zed Books Ltd), 2003, p. 8.
[148] Jawara *et la*, Op cites, No. 147, p. 8.
[149] Bhaumik, Op cites, No. 135, p. 36.

The Uruguay Round (1986-94), the most important round was the first 'comprehensive' round of multilateral trade negotiations, covering agreements on "tariffs, non trade barriers, textiles and clothing, agriculture, trade in services, TRIPS, TRIMS, the GATT system, GATT articles, subsidies, dispute settlement, anti dumping and the Tokyo Round codes",[150] but most importantly it created the WTO. At Marrakech, Morocco, 124 state and government representatives met in April 1994 to sign the agreements that were concluded as a result of the Uruguay Round. Consequently, the Marrakech agreement established the WTO formally which came into force on 1st January, 1995.[151]

3.1.2 Functions and Basic Principles of WTO

Generally, the WTO is an international body that promotes and enforces the provisions of trade laws and regulations. Referring in encyclopaedia reveals that "[i]t has the authority to administer and police new and existing free trade agreements, to oversee world trade practices, and to settle trade disputes among member states."[152] The main role of WTO, like its predecessor, is to ensure that member governments keep their trade policies within the agreed limits. WTO member countries often sign agreements to this effect, following a long process of negotiations.[153] After the signing of these agreements, they would have a binding effect to which member countries are expected to abide by. What is more, the Preamble of the Marrakech Agreement states that trade liberalisation is not an end by itself, rather a means towards the larger objective of improving the living standards of WTO member nations.[154]

The overriding purpose of the WTO system is to help trade flow as freely, fairly, smoothly and predictably as possible."[155] The other important side to the WTO is that it helps in settling disputes. The purpose behind this objective is to interpret the agreements and resolve differences through some neutral procedure based on an agreed legal

[150] Jawara *et la*, Op cites, No. 147, p. 9.
[151] Ibid.
[152] Encarta Encyclopaedia, Op cites, No. 140.
[153] Jawara *et la*, Op cites, No. 147, p. 9.
[154] Ibid.
[155] WTO, Understanding the WTO, (3rd Ed. Geneva: World Trade Organisation), 2005, p. 10.

foundation.[156] Therefore, the WTO has these four main functions viz. facilitating the implementation and operation of the Multilateral Trade Agreements; providing a forum for negotiations on already covered or new issues; administering the understanding reached on Dispute Settlement and TPRM; and finally, cooperating with the World Bank and the IMF to achieve greater coherence in global economic policy making.[157]

The WTO agreements are quite lengthy and complex dealing with delicate and intricate questions possessing multiple facts. Be that as it may, the fundamental five principles instilled in all of these documents serve as the basic foundation of the multilateral trading system and at the same time, which make the organisation's functions achievable.

Non-Discrimination

In essence, this principle has two components, namely the Most-Favoured-Nation (MFN) rule and national treatment, where their precise nature and scope differ across different agreements of the organisation.[158] The enclosure of MFN clauses could be traced back to the Havana Charter which was supposed to establish the ITO. This same clause was adopted in GATT in the first paragraph of Article I and required that a product made in one member country be treated no less favourably than a like or similar good that has originated from any other country.[159] In other words, a concession made by one party to another must be applicable or 'multilateralised' to all other parties.

The MFN rule is unconditionally applicable save from certain exceptions. These include exceptions made in case of formation of Free Trade Areas or Customs Union or in circumstance of other preferential trading arrangements undertaken by the signatories which in most cases comprises of developing countries.[160]

The second component of non-discrimination, i.e. national treatment is provided in Article III paragraph 2 of the GATT. In view of the similarities between tariffs and

[156] Ibid.
[157] Hoekman and Kostecki, Op cites, No. 132, p. 38.
[158] Id., p. 29.
[159] Narlikar, Op cites, No. 131, p. 28.
[160] Krueger, Op cites, No. 143, p. 4.

internal taxes, this article indicates the priority position given to the problem of internal taxes.[161] It requires that foreign goods that have fulfilled the necessary border measures should not be treated less favourably than domestically produced like or directly comparative goods.[162] This means that foreign goods must be subject to internal taxes and charges of the country that apply to the like or similar goods produced domestically and that it would give greater certainty to foreign suppliers with regards to the environment in which they operate. In the same way, as provided in the GATT Article III paragraph 4, the same obligations are applicable in cases of non-tax policies.[163] The sole exception concerning national treatment is trade in services.

Reciprocity

This concept is not a new one. Almost all agreements concluded before or after the WTO agreements, international or otherwise, have reciprocity as one of their vital features. In the organisation's multilateral trade agreements, it was basically put forth to limit the scope for free riding that might have otherwise become abundant due to the MFN rule.[164] It requires that if one country made tariff concessions, then the other country should do the same.[165] The principle that each country should offer concessions on its own tariffs so that it could get tariff reductions from its trading partners complemented international trade theory which had for long demonstrated that tariffs hurt most of the countries that had imposed them.[166] This principle has important political economy implications, i.e. when bargaining is reciprocal then it will suit the interests of exporters of a given country and their support will make it politically acceptable, which would not have been the case if the country had undertaken unilateral tariff reductions.[167]

Enforceable Commitments

Liberalisation commitments and agreements will not be practical if they are not enforced. The MFN rule and national treatment are quite important in ensuring that market access

[161] Raj Bhala *et la*, Op cites, No. 13, p. 423.
[162] Hoekman and Kostecki, Op cites, No. 132, p. 30.
[163] Ibid.
[164] Id., p. 31.
[165] Peet, Op cites, No. 130, p. 150.
[166] Krueger, Op cites, No. 143, p. 5.
[167] Ibid.

commitments are implemented and maintained. These tariff commitments made by the WTO members are listed in schedules and established ceilings.[168] In the case of goods, these binding commitments amount to ceilings on customs tariff rates.

As Article X of the GATT states, once these tariff commitments are bound and ceilings are established, they could not be nullified nor impaired unless the trading partners first negotiate to this effect. The result of these enforceable commitments is that traders will be able to secure a higher degree of market access and they would also contribute in improving the predictability and stability of international trade.[169]

Transparency

Another way to improve the predictability and stability of international trade is through making trade rules as clear and public (transparent) as possible, as provided in Article X of the GATT.[170] The exchange of information and views must be allowed and the resolution of potential conflicts in an efficient manner must be permitted. WTO members must publish their trade policies, establish and maintain institutions that regulate administrative decisions concerning trade, respond to requests of information by others and notify changes in trade policies to WTO.[171] The regular inspection of national trade policies through the TPRM provides a further means of encouraging transparency, both domestically and at the multilateral level.[172]

Safety Conditions

Through this principle, one could see that the WTO is not entirely a 'free trade' institution. The system, according to this principle, allows tariffs and in extreme circumstances, other forms of protection. Member governments are required to restrict trade in specific conditions presented in these three provisions.

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[168] Hoekman and Kostecki, Op cites, No. 132, p. 33.
[169] WTO, Op cites, No. 155, p. 12.
[170] Ibid.
[171] B. Hoekman and M. Kostecki, Political Economy of The World Trading System: From GATT to WTO, (New York, Oxford University Press), 1995, p. 33.
[172] WTO, Op cites, No. 155, p. 12. (Also available electronically from WTO Web-Page.)

The first are articles that allow the use of trade measures to attain non-economic objectives. These include policies formulated to protect public health or national security and those that protect industries that could be harmed by competition from imports.[173]

The second are articles set forth for ensuring 'fair competition'. These provisions give the right to impose "countervailing duties on imports that have been dumped".[174] The objective of fair competition, however, is in direct conflict with market accessibility because governments, in order to attain 'fairness' usually implement trade barriers.[175]

The third articles are those that allow intervention in trade for economic reasons which are considered serious like balance of payment deficits or government desire to support infant industries.[176]

3.2 WTO Objectives Challenged

The objectives of WTO are laid down in the Preamble of the agreement that formed the organisation. As per this text, the main goals of the institution include raising standards of living, ensuring full employment and that these aims will be attained consistently with those of sustainable development and environmental protection. The organisation further ensures that developing countries, particularly LDCs, will have a proper share in the growth of international trade.[177]

In line with these objectives, the WTO claims that the trading system that it administers will bring about the following benefits to its participants. Primarily, the WTO/GATT system contributes to international peace, since the smooth flow of trade will result in a more prosperous world. The system provides for a convenient means of settling disputes through the Dispute Settlement Mechanism and since the system is also based on rules

[173] Id., p. 36.
[174] Ibid.
[175] Krueger, Op cites, No. 143, p. 7.
[176] B. Hoekman and M. Kostecki, Op cites, No. 171, p. 36.
[177] 3D-Trade, *Human Rights and Equitable Economy: "Objectives and Organisation of the WTO"*, (A study prepared for a 3D Asian forum), 2004, p. 9.

rather than on a power-based approach, decisions are made by consensus where all the agreements apply for all the members, thus conferring upon poorer countries an increased bargaining status.[178]

Furthermore, freer trade minimises the costs of living because lowering of trade barriers as introduced by the WTO reduces the cost of production, prices of finished goods and services, and ultimately the cost of living. Trade conducted in this manner broadens consumer choice when the quality of locally produced goods improves due to the competition from imports. Trade also boosts incomes and accelerates economic growth through creating more jobs and the lowering of barriers permits the further growth of trade that in due course, accrues to national and personal incomes.[179]

The basic trading principles enshrined in the WTO make the system economically more efficient. These principles obligate the contracting parties to charge the same duty rates on all imports and locally produced items. So, "sourcing components" like companies find it easier to conduct trade and hence become more efficient. Finally, the system safeguards governments from narrow interests thereby encouraging good governance. The GATT/WTO system aids governments in taking a more balanced view of trade policy and the irreversibility of these rules puts off the undertaking of unwise policies.[180] Since its creation, the WTO's emphasis has slipped from concentrating on the public interest goals as laid down in its objectives, to seeing itself primarily as "an organization for liberalizing trade", and declaring that "the system's overriding purpose is to help trade flow as freely as possible". This has been the source of one of the fundamental tensions surrounding the mandate and activities of the organization. Some (such as developing countries and non-governmental organizations) would like to see added emphasis on the public interest goals, whilst others (private companies and some industrialized countries, for instance) favour faster removal of obstacles to free trade.[181]

[178] Ibid.
[179]Ibid.
[180] Ibid.
[181] Ibid.

As an institution, WTO portrays itself as a neutral arena where decisions and agreements are reached and disputes resolved in an equitable manner. Yet, there is no such neutrality upheld in the organisation. Rather it is quite evident that WTO is *"*passionately against protectionism and just as profoundly for trade liberalisation".[182] Therefore, any of the agreements or decisions reached will ultimately be in favour of this reality.

The WTO claims to conduct trade 'fairly' by making conditions of trade stable, predictable and transparent. Nonetheless, the organisation seems to define these conditions within the limits of interests of the few are generally attained at the expense of the rest (winner takes all, loser ends up with nothing). A fitting example of this outcome would be to examine the WTO's benefit of growth in incomes. The organisation has estimated that the 1994 Uruguay Round agreement has added between $109 billion to $510 billion to the world income, depending on the assumption behind the calculations. It readily accepts this doubtful estimation – doubtful because the higher figure is about five times greater than the lower – as an evidence of the soundness of free trade regarding its positive effects on growth in incomes. However, when it comes to the effects of free trade on workers and unemployment, the organisation states that it would depend on the worker's adaptability and the producer's competitiveness. In other words, it depends on how workers react to the 'challenges' of rapid change – *"challenge being the neo-liberal euphemism for losing one's job"* – or, generally how the fittest survive. Peet refers to this as: "Social Darwinism in a brave new globalised world!"[183] Therefore, the notion that all will benefit from a free trade system that increases personal incomes, lowers prices and costs of living and broadens consumer choices can only be realised in a society where all are considered as consumers and not workers and where consumption overrides the importance of labour.[184]

The idea that trade produces economic growth and results in higher incomes for poor countries was probed by a UNCTAD Report on 2002. This report questioned why developing countries keep on earning less even though they have been trading more than

[182] Peet, Op. cites, No. 130, p. 160.
[183] Id., pp. 161-162)
[184] Id., p. 162.

they used to in the past. The reason why these countries were unable to benefit from their increased openness to trade was because many of these countries' economies heavily rely on the production of primary commodities. The prices of these kinds of commodities have been increasingly dwindling in international markets except for the prices of oil. Those countries that have been able to shift their production from primary products to manufactures emphasised on resource-based, labour-intensive products, which generally lack dynamism in world markets and have a lower value-added to them. This leads to further falling of prices and as a result developing countries end up competing for foreign direct investment (FDI).[185]

Nevertheless, FDI may find its way out of a country and so will cause a huge amount of capital flight, which in extreme cases results into a crash of economy, like the 1998 Asian economic crisis. Secondly, when FDI enters into a country where there are domestic firms producing for export items, foreign investment may take away investment opportunities that would have been available for these domestic firms. Thirdly, crucial sectors that need to be under effective control for social, political and strategic reasons may fall in the hands of foreign control.[186]

Therefore, the UNCTAD has concluded that large amounts of FDI do not necessarily ensure growth and so should no longer be the sole focus of development policies and agencies. Rather, developing countries and development agencies that impose conditionalities upon them should make sure that trade policies must be formulated to maximise domestic growth and development, which nay not involve lowering trade barriers.[187]

In addition to this, the WTO also claims to bring about these general benefits. It is generally accepted that the organisation may create more access to foreign markets and bring with it export opportunities. Nevertheless, in most WTO member countries

[185] Id., p. 163.
[186] Merso, Fikremarkos, Ethiopia's WTO Accession: A Strenuous Step for a Poor Nation Seeking Economic Prosperity, (Addis Ababa: ActionAid Ethiopia Publications), 2005, p. 36-37.
[187] Peet, Op cites, No. 130, p. 164.

protectionism persists and the issue of market access, especially for agricultural products, remains to be contentious.[188]

Today, an increasing number of voices are being raised to underline that free trade should not be an end by itself, but rather a tool to achieve equitable development and a better world. That the WTO's public interest objectives remain out of reach of many has drawn criticism that the organization is dominated by rich countries, functions in a secretive manner, and helps feed the greed of the rich in the name of trade liberalization.

Major concerns relate in part to the transparency of process, and a perception that governments have sold out to multinational business, seeking to conclude agreements that are detrimental to the environment and to the workers. Matters such as environment and labour standards, food safety regulation, intellectual property, consumer protection, business ethics and corruption are all issues that concern the citizens of many WTO members. Some would argue that these concerns are totally inappropriate given that the WTO is probably the most democratic international organisation, in that it operates by consensus and, if voting occurs, it is on the basis of one-member one-vote. Others argue that there are valid concerns relating to the perceived legitimacy of the WTO, and if these worries are not addressed then the WTO will find it difficult to pursue its mandate – liberalisation of trade.[189]

Opposition from all directions, from farmers, labour unions and environmentalists began to build. Most of these resistances were centred on the loss of national sovereignty to this organisation. A number of NGOs also sounded their concerns regarding trade administered by WTO. The Seattle demonstrations against the WTO Conference of 1999 began a new kind of radical activism which has continued to this day to such a degree that almost all major international economic meetings have attracted massive protests.[190] These movements either (i) contest limitations on state authority to make sovereign decisions, (ii) insist on self determination rights of indigenous peoples and peasants and

[188] Merso, Op cites, No. 186, p. 35.
[189] Hoekman and Kostecki, Op cites, No. 132, p. 70-71.
[190] Peet, Op cites, No. 130, p. 192.

recognition of the solidarity of all oppressed peoples altogether; or (iii) opt for the radical restructuring of the global economic order to the re-localisation of livelihood ideals and a return to local sovereignty. Apart from these movements, the general public would like to see trade opened to a broader, democratic process, where social benefits are prioritised, under which workers get a living wage and where environments are actively protected. Otherwise, the WTO would remain to be "a dangerous new form of global state" as perceived by many.[191] (For your in depth study, find in the Annex Section the WTO Agreement[ii] at the end of this Textbook.)

Recapitulation

What Does "GATT" Mean?

The acronym "GATT" stands for the "General Agreement on Tariffs and Trade". It is an agreement between States aiming at eliminating discrimination and reducing tariffs and other trade barriers with respect to trade in goods.

The GATT was originally, and is still today, only concerned with trade in goods, although its main principles now also apply to trade in services, and intellectual property rights as dealt with respectively by the *General Agreement on Trade in Services* and the *TRIPS Agreement.* The GATT is a WTO agreement that deals exclusively with trade in goods, but it is not the only one.

All the agreements listed in Annex 1A to the *Marrakesh Agreement Establishing the World Trade Organization* (hereinafter the "*WTO Agreement*") concern particular aspects or sectors of trade in goods. The so-called WTO "goods agreements" in Annex 1A to the *WTO Agreement* consist of:[192]

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[191] Id., pp. 197-199.

[192] Prepared by Mrs. Stéphanie Cartier, (Copyright © United Nations, All rights reserved, UNCTAD/EDM/Misc.232/Add.33), 2003, p. 3. (Module was prepared at the request of the United Nations Conference on Trade and Development (UNCTAD), whose views and expressed opinions are not necessarily those of the United Nations, WTO, WIPO, ICSID, UNCITRAL or the Advisory Centre on WTO Law; *Please refer to Module 3.1, Section 1.1. Several of these agreements are dealt with in separate Modules of this course.)* **[Note:-** This as well as all the other 'Modules' contained herein **can only** be used for educational purposes; i.e. **not** for commercial or other purposes**!]**

- Agreement on Agriculture
- Agreement on the Application of Sanitary and Phytosanitary Measures
- Agreement on Textiles and Clothing
- Agreement on Technical Barriers to Trade
- Agreement on Trade-Related Investment Measures
- Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994 (also known as the Anti-Dumping Agreement)
- Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade 1994 (also known as the Agreement on Customs Valuation)
- Dispute Settlement
- Agreement on Pre-Shipment Inspection
- Agreement on Rules of Origin
- Agreement on Import Licensing Procedures
- Agreement on Subsidies and Countervailing Measures
- Agreement on Safeguards

The GATT was concluded in 1947 and is now referred to as the GATT 1947. The GATT 1947 was last amended, last in 1965. Later on, additional disciplines were agreed to in side agreements, such as the Tokyo Round agreements, which did not amend the GATT 1947 as such, but only bound the GATT\ Contracting Parties that became a party to these side agreements.[193] The GATT 1947 was terminated in 1996. However, the provisions of the GATT 1947 as well as all legal instruments concluded under the GATT 1947 are integrated into the GATT 1994, subject to clarifications brought about by Understandings which also form integral parts of the GATT 1994.

The acronym "GATT" is sometimes confusingly used to describe a number of different things. It is sometimes referred to as the "GATT disciplines", or "GATT disputes", to mean the current WTO obligations or disputes relating to trade in goods. However, it may also be referred to as the "GATT" to mean the old multilateral trading system and/or

[193] Id., p. 4.

Secretariat preceding the WTO. In this Module, "GATT" only means the current obligations under the GATT 1994.

Scope of Application of the GATT 1994

The GATT 1994 is one of the multilateral agreements annexed to the *WTO Agreement.* It is an international treaty binding upon all WTO Members. The GATT 1994 is only concerned with trade in goods. The GATT 1994 aims at further liberalizing trade in goods through the reduction of tariffs and other trade barriers and eliminating discrimination.

In *EC – Bananas III*, the question arose whether the *General Agreement on Trade in Services* (hereinafter the "GATS") and the GATT 1994 were mutually exclusive agreements. The Appellate Body said:

> … The GATS was not intended to deal with the same subject matter as the GATT 1994. The GATS was intended to deal with a subject matter not covered by the GATT 1994, that is, with trade in services. Thus, the GATS applies to the supply of services. It provides, inter alia, for both MFN treatment and national treatment for services and service suppliers. Given the respective scope of application of the two agreements, they may or may not overlap, depending on the nature of the measures at issue. Certain measures could be found to fall exclusively within the scope of the GATT 1994, when they affect trade in goods as goods. Certain measures could be found to fall exclusively within the scope of the GATS, when they affect the supply of services as services. There is yet a third category of measures that could be found to fall within the scope of both the GATT 1994 and the GATS. These are measures that involve a service relating to a particular good or a service supplied in conjunction with a particular good. In all such cases in this third category, the measure in question could be scrutinized under both the GATT 1994 and the GATS.
>
> However, while the same measure could be scrutinized under both agreements, the specific aspects of that measure examined under each agreement could be different. Under the GATT 1994, the focus is on how the measure affects the

goods involved. Under the GATS, the focus is on how the measure affects the supply of the service or the service suppliers involved. Whether a certain measure affecting the supply of a service related to a particular good is scrutinized under the GATT 1994 or the GATS, or both, is a matter that can only be determined on a case-by-case basis.[194]

Structure of the GATT 1994

The GATT 1994 is a bizarre agreement. It "assembles" legal provisions from different sources. It consists of the provisions of the GATT 1947, of legal instruments concluded under the GATT 1947, of Understandings concluded during the Uruguay Round on the interpretation of the provision of the GATT 1947, and of the Marrakesh Protocol of Tariff Concessions.

Provisions of Legal Instruments concluded under the GATT 1947:

- protocols and certifications relating to tariff concessions;
- protocols of accession;
- waivers granted under Article XXV of the GATT 1947 and
still in force on the date of entry into force;
- other decisions of the CONTRACTING PARTIES to the GATT 1947.

Understandings concluded during the Uruguay Round on the interpretation of certain provisions of the GATT 1947

The GATT 1994 incorporates *as is* the provisions of the GATT 1947, and yet, it clarifies the nature and extent of some obligations set out in the GATT 1947 through the so-called "Understandings" and other legal instruments, including "other decisions" of the Contracting Parties to the GATT, which also form part of the GATT 1994. Furthermore, it changes the wording to be used when referring to the provisions of the GATT 1947. For instance, the phrase "Contracting Parties" in the GATT 1947 is now deemed to read

[194] Id., pp. 4-5; (Appellate Body Report, European Communities – Regime for the Importation, Sale and Distribution of Bananas ("EC – Bananas III "), WT/DS27/AB/R, adopted 25 September 1997, DSR 1997:II, 591, para. 221.)

"Members". In particular, the "Explanatory Notes" of Paragraph 2 stipulate:

Explanatory Notes

(a) The references to "contracting party" in the provisions of GATT 1994 shall be deemed to read "Member". The references to "less-developed contracting party" and "developed contracting party" shall be deemed to read "developing country Member" and "developed country Member". The references to "Executive Secretary" shall be deemed to read "Director-General of the WTO".[195]

Provisions of the GATT 1994 Paragraph 1(a) of the language incorporating the GATT 1994 into the *WTO Agreement* provides that:

1. The General Agreement on Tariffs and Trade 1994 ("GATT 1994") shall consist of :

(a) the provisions in the General Agreement on Tariffs and Trade, dated 30 October 1947, annexed to the Final Act Adopted at the Conclusion of the Second Session of the Preparatory Committee of the United Nations Conference on Trade and Employment (excluding the Protocol of Provisional Application), as rectified, amended or modified by the terms of legal instruments which have entered into force before the date of entry into force of the WTO Agreement; …"[196]

The provisions of the GATT 1947, now the provisions of the GATT 1994, consist of 38 articles – numbered in roman digits – which are split up into four "parts".

Part I of the GATT 1994 contains Articles I, enshrining the most-favored nation treatment obligation, and Article II, setting out the obligations applicable to the Schedules of Concessions of each WTO Member.

[195] Id., p. 6.
[196] Ibid.

Part II of the GATT 1994 comprises Articles III through XXIII. Article III establishes the national treatment obligation. Articles IV to Article XIX cover mainly non-tariff measures, such as unfair trade practices (dumping and export subsidies), quantitative restrictions, restrictions for balance-of-payments reasons, state-trading enterprises, government assistance to economic development, and emergency safeguards measures. In addition, this Part also deals with numerous technical issues relating to the application of border measures. Articles XX and XXI deal with the possible exceptions to the GATT 1994, namely the general exceptions and those for security reasons.

Articles XXII and XXIII provide for dispute settlement procedures, which are further elaborated in the *Understanding on the Principles Governing the Settlement of Disputes* (hereinafter the "DSU").

Part III of the GATT 1994 consists of Article XXIV through Article XXXV.

Article XXIV concerns mainly customs unions and free trade areas and the responsibility of Members for the acts of their regional and local governments.

Articles XXVIII and XXVIII (bis) deal with the negotiation and renegotiation of tariff concessions.

Finally, Part IV of the GATT 1994 is entitled "*Trade and Development*" and aims to increase trade opportunities for developing country Members in various ways.

The provisions that deal with the entry into force, accession, amendments, withdrawal, non-application and joint action are no longer valid because they have been superseded by the relevant provisions of the *WTO Agreement*.

Legal Instruments Adopted under the GATT 1947

Paragraph 1(b) of the language incorporating the GATT 1994 into the *WTO Agreement* provides the following:

1. The General Agreement on Tariffs and Trade 1994 ("GATT 1994") shall consist of:

> …
>
> (b) the provisions of the legal instruments set forth below that have entered into force under the GATT 1947 before the date of entry into force of the WTO Agreement:
>
> > (i) protocols and certifications relating to tariff concessions;
> >
> > (ii) protocols of accession (excluding the provisions (a) concerning provisional application and withdrawal of provisional application and (b) providing that Part II of GATT 1947 shall be applied provisionally to the fullest extent not inconsistent with legislation existing on the date of the Protocol);
> >
> > (iii) decisions on waivers granted under Article XXV of GATT 1947 and still in force on the date of entry into force of the WTO Agreement;
> >
> > (iv) other decisions of the CONTRACTING PARTIES to GATT 1947; …"[197]

The effect of incorporating by reference the provisions of these legal instruments into the GATT 1994 is to maintain their prior status under the GATT 1947, and to bind all WTO Members.

In *US – FSC*, the Appellate Body said:

> "… The inclusion of these 'legal instruments' in the GATT 1994 recognizes that the legal character of the rights and obligations of the contracting parties under the GATT 1994 is not fully reflected by the text of the GATT 1994 because those

[197] Id., pp. 7-8.

> rights and obligations are conditioned by the 'protocols', 'decisions' and other 'legal instruments' to which paragraph 1(b) refers.[198]

In *Japan – Alcoholic Beverages II*, the Appellate Body stated that not every decision of the Contracting Parties to the GATT 1947 constituted an "other decision" within the meaning of paragraph 1(b)(iv) of the language incorporating the GATT 1994 into the WTO Agreement.[199] In that case, the Appellate Body concluded that adopted panel reports do not constitute such "other decisions".[200] In *US – FSC*, the Appellate Body confirmed the Panel's finding that "other decisions" did not include a Council action adopting a panel report as a result of the parties' agreement.[201]

Understandings and the Marrakesh Protocol

Paragraphs 1(c) and 1(d) of the language incorporating the GATT 1994 into the WTO Agreement provide:

> 1. The General Agreement on Tariffs and Trade 1994 ("GATT 1994") shall consist of:
>
> …
>
> (c) the Understandings set forth below:
>
> (i) Understanding on the Interpretation of Article II:1(b) of the General Agreement on Tariffs and Trade 1994;
>
> (ii) Understanding on the Interpretation of Article XVII of the General Agreement on Tariffs and Trade 1994;
>
> (iii) Understanding on Balance-of-Payments Provisions of the General Agreement on Tariffs and Trade 1994;

[198] Appellate Body Report, United States – Tax Treatment for "Foreign Sales Corporations" ("US – FSC"), WT/DS108/AB/R, adopted 20 March 2000, para. 107.)

[199] Ibid. (Appellate Body Report, Japan – Taxes on Alcoholic Beverages ("Japan – Alcoholic Beverages II"), WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, adopted 1 November 1996, pp. 12-15. See also Appellate Body Report, US – FSC, para. 108.)

[200] Ibid. (Appellate Body Report, Japan – Alcoholic Beverages II, pp. 12-15. See also Appellate Body Report, US – FSC, para. 108. The Appellate Body reasoned that adopted panel reports "are not binding, except with respect to resolving the particular dispute between the parties to that dispute". The Appellate Body finally said that the decision to adopt a panel report was not intended by the GATT 1947 Contracting Parties to "constitute a definitive interpretation of the relevant provisions of GATT 1947.")

[201] Ibid. (See also Appellate Body Report, US – FSC, paras. 22 and 114. The reasoning of the Appellate Body is set out in paragraphs 107 to 113.)

Appellate Body Report, United States – Tax Treatment for "Foreign Sales Corporations".[202]

Appellate Body Report, Japan – Taxes on Alcoholic Beverages. .. The Appellate Body reasoned that adopted panel reports "are not binding, except with respect to resolving the particular dispute between the parties to that dispute".

The Appellate Body finally said that the decision to adopt a panel report was not intended by the GATT 1947 Contracting Parties to "constitute a definitive interpretation of the relevant provisions of GATT 1947."[203]

(iv) Understanding on the Interpretation of Article XXIV of the General Agreement on Tariffs and Trade 1994;

(v) Understanding in Respect of Waivers of Obligations under the General Agreement on Tariffs and Trade 1994;

(vi) Understanding on the Interpretation of Article XXVIII of the General Agreement on Tariffs and Trade 1994; and

(d) the Marrakesh Protocol to GATT 1994.

The six Understandings are legal documents which have been concluded during the Uruguay Round with a view to clarifying some obligations set out in the GATT 1947. They concern six particular GATT provisions, namely, the ones relating to the schedules of concessions, state-trading enterprises, balance-of payments exceptions, regional trade agreements, waivers and the withdrawal of concessions.

Some of these Understandings aim to introduce further "transparency" obligations, while others seek to refine terms or paragraphs of the concerned GATT article. For instance, the

[202]Id., pp. 8-9. ("US –FSC", WT/DS108/AB/R, adopted 20 March 2000, para. 107.)
[203]Ibid. ("Japan – Alcoholic Beverages II", WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, adopted 1 November 1996, pp. 12-15. See also Appellate Body Report, US – FSC, para. 108. 6 Appellate Body Report, Japan – Alcoholic Beverages II, pp. 12-15. See also Appellate Body Report, US – FSC, para. 108 (See also Appellate Body Report, US – FSC, paras. 22 and 114. The reasoning of the Appellate Body is set out in paragraphs 107 to 113.)

Understanding on Article II:1(b) requires that the nature and level of any "other duties or charges" levied on bound tariff items, as referred to in that provision, be recorded in the Schedules of Concessions annexed to GATT 1994 against the tariff item to which they apply.

The *Understanding on Article XVII* (on state trading enterprises) sets out notification procedures and provides for subsequent reviews. The *Understanding on Balance-of-Payments Provisions* essentially aims to clarify the existing obligations under the provisions of the GATT 1994, but it also provides for transparency measures and consultation requirements. The *Understanding on Article XXIV* regarding regional trade agreements clarifies some of the subparagraphs to Article XXIV. The *Understanding on Waivers* sets out the elements to include in the request for a waiver and explains when and how it is possible to challenge the application of a waiver by a Member.

Finally, the *Understanding on Article XXVIII* (concession withdrawal) defines the phrase "principal supplying interest" of Article XXVIII of the GATT 1994. With respect to the Marrakesh Protocol to the GATT 1994, it is the legal instrument that incorporates the Schedules of Concessions and Commitments on Goods negotiated under the Uruguay Round into the GATT 1994. It confirms their authenticity and sets out their implementation modalities.

The Relationship between the GATT 1994 and Other WTO Agreements

The provisions of the GATT 1994 apply to a disputed measure even where the provisions of other WTO agreements are applicable, to the extent that the provisions of the GATT 1994 do not conflict with any of the provisions of the other applicable WTO agreements. In other words, if there is no conflict, the measure at issue should be examined against all the relevant provisions of the different WTO agreements, including the GATT 1994.

The Appellate Body defined the term "conflict" in *Guatemala – Cement I.*[204]

[204] Id., p.10. (Appellate Body Report, Guatemala – Anti-Dumping Investigation Regarding Portland Cement from

There is a conflict when adherence to one provision will lead to a violation of another provision. Following the terms of the Appellate Body, an interpreter must identify an inconsistency or a difference between the provisions examined before determining which one of the provisions will prevail.[205]

In the event of a conflict, and to the extent of that conflict, the GATT 1994 never prevails. The other WTO agreements on trade in goods contained in Annex 1A to the *WTO Agreement* always prevail over the GATT 1994.

Moreover, the *WTO Agreement* always prevails over any of the multilateral trade agreements, including the GATT 1994 and all the other agreements on trade in goods included in Annex 1A to the *WTO Agreement*.

The Relationship between the GATT 1994 and the WTO Agreement

The relationship between the GATT 1994 and the *WTO Agreement* is regulated by Article XVI:3 of the *WTO Agreement*, which provides: *"In the event of a conflict between a provision of th[e WTO] Agreement and a provision of any of the Multilateral Trade Agreements, the provision of th[e WTO] Agreement shall prevail to the extent of the conflict."*

Annex 1A to the *WTO Agreement*, which includes all multilateral agreements on trade in goods, is introduced by a "General interpretative note" giving prevalence to the other agreements on trade in goods over the GATT 1994 in the event of a conflict, and to the extent of that conflict.

General interpretative note to Annex 1A

In the event of a conflict between a provision of the [GATT 1994] and a provision of another agreement in Annex 1A to the [WTO Agreement], the provision of the other agreement shall prevail to the extent of the conflict.

Mexico ("Guatemala – Cement I "), WT/DS60/AB/R, adopted 25 November 1998, para. 65…)

[205] Id., p. 11. (Appellate Body Report, Guatemala – Cement I, para. 65.)

A number of disputes have raised the issue of conflict between the GATT 1994 and other multilateral agreements on trade in goods in Annex 1A to the WTO Agreement.[206] Provided that there is no conflict between the GATT 1994 and the other goods agreement, the measure at issue should be examined against both the provisions of the GATT 1994 and the provisions of the other goods agreement.

THE WORLD TRADE ORGANIZATION (WTO)

Origins of the WTO

General Agreement on Tariffs and Trade of 1947

Article XVI:1 of the *Agreement Establishing the World Trade Organization* states:

> "Except as otherwise provided under this Agreement or the Multilateral Trade Agreements, the WTO shall be guided by the decisions, procedures and customary practices followed by the CONTRACTING PA-RTIES to GATT 1947 and the bodies established in the frame-work of GATT 1947."[207]

The origins of the WTO undisputedly lay in the General Agreement of Tariffs and Trade on 1947 ("GATT 1947"). As is clear from Article XVI:1, quoted above, these origins remain relevant because the decisions, procedures and customary practices of the GATT 1947 still guide the WTO in many of its actions.

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[206] Id., p. 12. (See, for instance, Appellate Body Report, EC – Bananas III, para. 155; Appellate Body Report, Argentina – Safeguard Measures on Imports of Footwear ("Argentina – Footwear (EC) "), WT/DS121/AB/R, adopted 12 January 2000, paras. 81 et 83; and Appellate Body Report, Brazil – Measures Affecting Desiccated Coconut ("Brazil – Desiccated Coconut "), WT/DS22/AB/R, adopted 20 March 1997, p. 16.)

[207] Prepared by Mr. Peter Van den Bossche, (Copyright © United Nations, All rights reserved, (UNCTAD/EDM/Misc.232/Add.11), 2003, p. 3. (Module was prepared at the request of the United Nations Conference on Trade and Development (UNCTAD), whose views and expressed opinions are not necessarily those of the United Nations, WTO, WIPO, ICSID, UNCITRAL or the Advisory Centre on WTO Law; *Please refer to Module 3.1, Section 1.1. Several of these agreements are dealt with in separate Modules of this course.)* **[Note:-** This as well as all the other 'Modules' contained herein **can only** be used for educational purposes; i.e. **not** for commercial or other purposes**!]**

In 1946 negotiations were started in London at the initiative of the United States on the establishment of an international organization for trade to complete the Bretton Woods structure of international economic institutions already consisting at the time of the World Bank and the International Monetary Fund. The negotiations on the Charter of the International Trade Organization (the "ITO") were continued in Geneva in 1947. In parallel with the negotiations on the ITO Charter, countries also negotiated in Geneva on the reduction of tariffs and on general clauses to protect the agreed tariff reductions. The latter negotiations were successfully concluded in Geneva and resulted in the General Agreement on Tariffs and Trade of 1947. While the GATT 1947 was intended to be the first agreement concluded under the auspices of, and administrated by, the ITO, the negotiators were not able to reach agreement on the ITO Charter in Geneva in 1947. It was decided, however, to apply the GATT 1947 on a provisional basis while waiting for the completion of the negotiations on the ITO Charter. In Havana in 1948, agreement was reached on the ITO Charter. However, in the following years the United States Congress refused to approve the Charter and consequently the ITO was never established.

The demise of the ITO left an important gap in the Bretton Woods structure of international economic institutions. To handle problems relating to their trade relations, countries would as from the early 1950s onwards, turn to the only existing multilateral "institution" for international trade, the GATT 1947.

Although the GATT was conceived as a multilateral *agreement* for the reduction of tariffs, and *not* an international *organization*, it would over the years successfully "transform" itself - in a pragmatic and incremental manner – into a *de facto* international organization. In particular with regard to the reduction of tariffs the GATT was very successful. However, it was less successful with respect to the reduction of non-tariff barriers. Negotiations on the reduction of non-tariff barriers are much more complex and, therefore, required among other things a more "sophisticated" institutional framework than the GATT offered. Furthermore, the GATT was only concerned with trade in goods.

However, in view of the ever increasing importance of services in the economic activity of many countries, it was clear from the early 1980s that for trade in services multilateral GATT-like disciplines would need to be agreed upon and administered.

Uruguay Round Negotiations *(1986-1993)*[208]

In September 1986, the GATT Contracting Parties decided in Punta del Este, Uruguay, to start a new round of negotiations on the further liberalization of international trade. The agenda for these negotiations was very broad and ambitious and included for the first time trade in services, as well as the very controversial issues of trade in agricultural products and trade in textiles. Also, the improvement of the institutional mechanisms of the GATT and its dispute settlement system was on the agenda. The establishment of a new international organization for trade however, was initially not on the agenda of the Round.

It was only in 1990 that the first proposals for the establishment of a new international trade organization were tabled by Canada and the European Community, followed in 1991 by a joint proposal by Canada, the European Community and Mexico. Initially many developing countries were quite critical with respect to the idea of establishing a new international organization for trade, partly because they considered that UNCTAD could and should fulfill this function. Also the United States objected to the establishment of a new international trade organization. In the course of 1992, however, most developing countries became convinced of the appropriateness and the timeliness of a new international trade organization. Only in the final stages of the Uruguay Round negotiations in 1993 did the United States agree to such a new organization.

More than seven years after its start in Punta del Este, the Uruguay Round was finally concluded successfully in Geneva in December 1993. In April 1994 the *Agreement Establishing the World Trade Organization* was signed in Marrakesh, Morocco. On 1 January 1995, the *WTO Agreement* entered into force and the WTO became operational.

[208] Id., p. 4.

The Agreement Establishing the World Trade Organization[209]

The Marrakesh *Agreement Establishing the World Trade Organization* (the "*WTO Agreement*"*)* is the most ambitious and far-reaching international trade agreement ever concluded. It consists of a short, 16-article long basic agreement establishing the WTO *and* numerous agreements and understandings included in the annexes to this agreement.

ANNEX 1A: *Multilateral Agreements on Trade in Goods*

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

ANNEX 1B: *General Agreement on Trade in Services and Annexes*

ANNEX 1C: *Agreement on Trade-Related Aspects of Intellectual Property Rights*

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

ANNEX 3: Trade Policy Review Mechanism

ANNEX 4: Plurilateral Trade Agreements

Agreement on Trade in Civil Aircraft
Agreement on Government Procurement

[209] Id., 4-5.

On the relationship between the *WTO Agreement* and its Annexes as well as on the binding nature of the Annexes, Article II of the *WTO Agreement* states in relevant part:

2. *The agreements and associated legal instruments included in Annexes 1, 2 and 3 (hereinafter referred to as "Multilateral Trade Agreements") are integral parts of this Agreement, binding on all Members.*
3. *The agreements and associated legal instruments included in Annex 4 (hereinafter referred to as "Plurilateral Trade Agreements") are also part of this Agreement for those Members that have accepted them, and are binding on those Members. The Plurilateral Trade Agreements do not create either obligations or rights for Members that have not accepted them.*

Furthermore, Article XVI:3 of the *WTO Agreement* provides: "*In the event of a conflict between a provision of this Agreement and a provision of any of the Mul-tilateral Trade Agreements, the provision of this Agreement shall prevail to the extent of the conflict."*

Most of substantive WTO law is found in the agreements contained in Annex 1. This Annex consists of three parts. Annex 1A contains 13 multilateral agreements on trade in goods, Annex 1B contains the *General Agreement oTrade in Services* (the "GATS") and Annex 1C the *Agreement on Trade Related Aspects of Intellectual Property Rights* (the "*TRIPS Agreement*"). The most important of the 13 multilateral agreements on trade in goods, contained in Annex 1A, is the *General Agreement on Tariffs and Trade 1994* (the "GATT 1994"). The GATT 1994 consists of the provisions of the GATT 1947, the provisions of the legal instruments that have entered into force under the GATT 1947, six Understandings on particular GATT provisions and the *Marrakesh Protocol* on tariff concessions. The plurilateral agreements in Annex 4 also contain provisions of substantive law but are only binding upon those WTO Members that are a party to these agreements. Annexes 2 and 3 hold respectively, the *Understanding on Rules and Procedures Governing the Settlement of Disputes* and the *Trade Policy Review Mechanism,* and also contain procedural provisions.

Objectives of the WTO[210]

The policy objectives that the WTO is to pursue are set out in the Preamble of the *WTO Agreement.* According to this Preamble, the Parties to the *WTO Agreement* agreed to the terms of this agreement and the establishment of the WTO:

> "Recognizing that their relations in the field of trade and economic endeavor should be conducted with a view to raising standards of living, ensuring full employment and a large and steadily growing volume of real income and effective demand, and expanding the production of and trade in goods and services, while allowing for the optimal use of the world's resources in accordance with the objective of sustainable development, seeking both to protect and preserve the environment and to enhance the means for doing so in a manner consistent with their respective needs and concerns at different levels of economic development, Recognizing further that there is need for positive efforts designed to ensure that developing countries, and especially the least developed among them, secure a share in the growth in international trade commensurate with the needs of their economic development, …"

The *ultimate* objectives of the WTO are thus the raising of standards of living, the attainment of full employment, the growth of real income and effective demand, and the expansion of production of, and trade in, goods and services.

However, it is clear from the Preamble that in pursuing these objectives the WTO must take into account the need to preserve the environment as well as the needs of developing countries. The Preamble stresses the importance of *sustainable* economic development and of the integration of developing countries, and, in particular, least-developed countries, in the world trading system. Both these aspects were absent from the preamble of the GATT 1947.

The statements in the Preamble of the *WTO Agreement* on the objectives of the WTO are not without legal significance. In *US – Shrimp*, the Appellate Body stated:

[210] Id., pp. 6-7.

> (The language of the Preamble of the WTO Agreement) demonstrates recognition by WTO negotiators that optimal use of the world's resources should be made in accordance with the objective of sustainable development. As this preambular language reflects the intentions of negotiators of the WTO Agreement, we believe it must add colour, texture and shading to our interpretation of the agreements annexed to the WTO Agreement, in this case, the GATT 1994. We have already observed that Article XX(g) of the GATT 1994 is appropriately read with the perspective embodied in the above preamble."[211]

The preambular statements of the objectives of the WTO contradict the contention that the WTO is only about trade liberalization without regard to environmental degradation and global poverty. The Preamble also indicates how these objectives are to be achieved. It states: [212]

> Being desirous of contributing to these objectives by entering into reciprocal and mutually advantageous arrangements directed to the substantial reduction of tariffs and other barriers to trade and to the elimination of discriminatory treatment in international trade relations, Resolved, therefore, to develop an integrated, more viable and durable multilateral trading system encompassing the General Agreement on Tariffs and Trade, the results of past trade liberalization efforts, and all of the results of the Uruguay Round of Multilateral Trade Negotiations, Determined to preserve the basic principles and to further the objectives underlying this multilateral trading system …"

According to the Preamble of the *WTO Agreement* the two main instruments, or means, to achieve the objectives of the WTO are agreements on the reduction of trade barriers and the elimination of discrimination. These were also already the two main instruments of the GATT 1947 but the *WTO Agreement* aims at constituting the basis of an integrated, more viable and more durable multilateral trading system.

[211] Id., p. 7. (Appellate Body Report, United States – Shrimp, para. 153)
[212] Ibid.

Functions of the WTO[213]

In the broadest of terms, the primary function of the WTO is to:

> ... provide the common institutional framework for the conduct of trade relations among its Members in matters related to the agreements and associated legal instruments included in the Annexes to [the WTO] Agreement."[214]

More specifically, the WTO has been assigned five widely defined functions.
These functions are set out in Article III of the *WTO Agreement and are described below.*

Implementation of the WTO Agreements

A first function of the WTO is to facilitate the implementation, administration and operation of the *WTO Agreement* and the multilateral and plurilateral agreements annexed to it. The WTO is also entrusted with the task of furthering the objectives of these agreements. A concrete example of what this function of "facilitating" and "furthering" entails is the work of the WTO Committee on Sanitary and Phytosanitary Measures (the "SPS Committee"). Article 12 of the *SPS Agreement* states that the SPS Committee shall *inter alia*:

> "… encourage and facilitate ad hoc consultations or negotiations among Members on specific sanitary or phytosanitary issues. The Committee shall encourage the use of international standards, guidelines or recommendations by all Members and, in this regard, shall sponsor technical consultation and study with the objective of increasing co-ordination and integration between international and national systems and approaches for approving the use of food additives or for establishing tolerances for contaminants in foods, beverages or foodstuffs."

This function of facilitating the implementation, administration and operation of the WTO agreements and furthering the objectives of these agreements is an *essential* function of the WTO. It involves most of its bodies and takes up much of their time.

[213] Id., pp. 8-12.
[214] Article II:1 of the WTO Agreement.

Cooperation with other Organizations[215]

A fifth and final function of the WTO is to cooperate with international organizations and non-governmental organizations.

Article III:5 of the *WTO Agreement* refers specifically to cooperation with the IMF and the World Bank. Such cooperation is mandated by the need for greater coherence in global economic policy making. The WTO has concluded agreements with both the IMF and the World Bank to give form to this cooperation.[216]

Pursuant to Article V of the *WTO Agreement*, which is entitled "Relations with Other Organizations", the WTO is also to cooperate with other international organizations and may cooperate with non-governmental organizations ("NGO's"). The WTO has concluded cooperation arrangements with, *inter alia*, the International Labour Organization, the World Intellectual Property Organization and UNCTAD. The WTO and UNCTAD jointly operate and finance the International Trade Centre (the ITC), which works with Agreement between the developing countries and economies in transition to set up effective trade promotion programmes, with a focus on the private sector.

The WTO Secretariat also keeps close links with numerous NGO's concerned with trade matters. On 18 July 1996 the General Council adopted a set of guidelines clarifying the framework for relations with NGOs.[217] In these guidelines the General Council "recognizes the role NGOs can play to increase the awareness of the public in respect of WTO activities." It is important for the WTO to maintain an informal and positive dialogue with the various components of civil society. To date, "cooperation" with NGOs has essentially focused on attendance by NGOs of Ministerial Conferences, symposia for NGOs on specific issues, regular briefings for NGOs on the work of the WTO and the

[215] Mr. Peter Van den Bossche, Op. cites, No. 2007, pp. 11-12.
[216] Agreement between the International Monetary Fund and the World Trade Organization, contained in Annex I of WT/GC/W/43 and the Agreement between the International Bank for Reconstruction and Development and the World Trade Organization, contained in Annex II of WT/GC/W/43.
[217] Guidelines for arrangements on relations with Non-Governmental Organizations, Decision adopted by the General Council on 18 July 1996, WT/L/162, 23 July 1996.

day-to-day contact between the WTO Secretariat and NGOs. The WTO Secretariat also forwards regularly to WTO Members a list of documents, position papers and newsletters submitted by NGOs. This list is also made available on a special section of the WTO Website, devoted to NGOs and WTO activities organized for the benefit of NGOs.

The institutional structure of the WTO[218]

The institutional structure of the WTO includes, at the highest level, the Ministerial Conference, at a second level, the General Council, the DSB and TPRB, and, at lower levels, specialized Councils, Committees and working groups. Furthermore, this structure includes quasi-judicial and other nonpolitical bodies as well as the WTO Secretariat.

The Ministerial Conference is the supreme WTO body. The Ministerial Conference is composed of minister-level representatives of all Members. The Ministerial Conference has decision-making powers on all matters under any of the *multilateral* WTO agreements. The Ministerial Conference is, however, not often in session. Since 1995, there have been four sessions of the Ministerial Conference, each lasting only a few days: Singapore (1996), Geneva (1998), Seattle (1999) and Doha (2001). Since the Ministerial Conference is required to meet at least once every two years, the next session of the Ministerial Conference will take place before the end of 2003.

The sessions of the Ministerial Conference are major media events and thus focus the minds of the political leaders of the WTO Members on the current challenges to, and the future of, the multilateral trading system. The "Ministerials" offer a much-needed bi-annual opportunity to give political leadership and guidance to the WTO and its actions.

General Council

The General Council is composed of ambassador-level diplomats and normally meets once every two months. All WTO Members are represented in the General Council. As all other WTO bodies, except the Ministerial Conference, the General Council normally meets at the WTO headquarters in Geneva.

[218] Mr. Peter Van den Bossche, Op. cites, No. 2007, pp. 12-17.

The General Council is responsible for the continuing, day-to-day management of the WTO and its many activities. In between sessions of the Ministerial Conference, the General Council exercises the full powers of the Ministerial Conference. In addition to the powers of the Ministerial Conference, the General Council also carries out a few functions specifically assigned to it.

The General Council is responsible for the adoption of the annual budget and the financial regulations.[219] The functions assigned to the General Council also concern dispute settlement and trade policy review. As Articles IV:3 and 4 of the *WTO Agreement* state, the General Council convenes as appropriate to discharge the responsibilities of the Dispute Settlement Body (the "DSB") and the Trade Policy Review Body (the "TPRB") respectively. The General Council, the DSB, and the TPRB are in fact the same body although they each have their own chairperson and rules of procedure. The DSB and the TPRB are the *alter ego* of the General Council. The DSB has a regular meeting once a month but may have additional meetings in between. The TPRB normally also meets (at least) once a month.

Specialized Councils, Committees and Working Groups

At the level below the General Council, the DSB and the TPRB, there are three, so-called specialized Councils: the Council for Trade in Goods; the Council for Trade in Services; and the Council for TRIPS. All WTO Members are represented in these specialized Councils although many Members, in particular developing country Members, may find it difficult to attend all of the meetings. Under the general direction of the General Council, these specialized Councils oversee the functioning of the multilateral agreements in Annex 1A, 1B or 1C respectively. They assist the General Council and the Ministerial Conference in carrying out their functions. They carry out the tasks that the General Council or provisions of the relevant agreements have entrusted to them. The *WTO Agreement* itself explicitly stipulates, for example, that the Ministerial Conference and the General Council can only exercise their authority to adopt authoritative interpretations of the multilateral trade agreements of Annex 1 on the basis of a

[219] Article VII:1-3 of the WTO Agreement

recommendation of the specialized Council overseeing the functioning of the agreement at issue.[220] The specialized Councils also play an important role in the procedure for the adoption of waivers and the amendment procedure.[221]

Apart from three specialized Councils, there is a number of committees and working groups to assist the Ministerial Conference and the General Council in carrying out their functions. The *WTO Agreement* itself provides for three such committees: the Committee on Trade and Development, the Commit-tee on Balance-of-Payments Restrictions and the Committee on Budget, Finance and Administration. The Committee on Trade and Development (the "CTD") is the body in which any WTO Member can bring up any matter relating to international trade and development. Its core functions are to review continuously the participation of developing countries in the multilateral trading system and take initiatives to expand the trade opportunities of developing countries. The CTD also reviews the application of the special and differential treatment provisions for developing country Members provided in the WTO agreements. The Sub-Committee on Least-Developed Countries assists the CTD on trade and development issues relating to those countries.

In 1995 the General Council established the Committee on Trade and Environment (the "CTE"). In November 2001, the Doha Ministerial Conference established a Trade Negotiations Committee (the "TNC") to supervise the conduct of the new trade negotiations mandated in the Doha Ministerial Declaration.[222] Most of the actual negotiations are conducted in two newly established negotiating groups, one on market access and one on rules, *and* six already existing standing WTO bodies that meet in special session.

A number of the Multilateral Agreements on Trade in Goods also provide for a committee to carry out certain functions relating to the implementation of the particular

[220] Article IX:2 of the WTO Agreement.
[221] Article IX:3(b) and Article X:1 of the WTO Agreement.
[222] Para. 46 of the Doha Ministerial Declaration.

agreement. By way of example, we mention here the SPS Committee. Article 12.1 of the *SPS Agreement* states *inter alia*:

> A Committee on Sanitary and Phytosanitary Measures is hereby established to provide a regular forum for consultations. It shall carry out the functions necessary to implement the provisions of this Agreement and the furtherance of its objectives, in particular with respect to harmonization. The Committee shall reach its decisions by consensus.

Quasi-judicial and Other Non-political Bodies

All the above WTO bodies are political in nature. The WTO also has a number of quasi-judicial and other non-political bodies. Most prominent among these bodies are the *ad hoc* dispute settlement panels and the standing Appellate Body, which are discussed in detail below.[223] However, the WTO also has other bodies that are, if not quasi-judicial in nature, definitely non-political. The best example of such a body is the Textile Monitoring Body (the "TMB").[224]

The TMB is composed of nationals of Members who sit not as representatives of their country but in their personal capacities.

WTO Secretariat

The WTO has a Secretariat based in Geneva, Switzerland, with a staff of some 550 officials.[225] This makes it undoubtedly one of the smallest Secretariats of the main international organizations. A Director-General, who is appointed by the Ministerial Conference, heads the Secretariat.28 The Ministerial Conference also adopts regulations setting out the powers, duties, conditions of service and term of office of the Director-General. The current Director- General, Dr. Supachai Panitchpakdi, of Thailand, took office on 1 September 2002.

[223] Mr. Peter Van den Bossche, Op. cites, No. 207, p. 16.
[224] Article 8:1 of the Agreement on Textiles and Clothing.
[225] Mr. Peter Van den Bossche, Op. cites, No. 207, p. 16.

The Director-General and WTO staff are independent and impartial international officials, who shall not seek or accept instructions from any government or any other authority external to the WTO. The Members of the WTO are under an obligation to respect the international character of the responsibilities of the Director-General and of the WTO staff and must not seek to influence them in the discharge of their du-ties.

As WTO Members often point out, the WTO is “a Member-driven” organization. The Members, and not the Director-General or the WTO Secretariat, take decisions. Neither the Director-General nor the WTO Secretariat has any decision-making powers. The Director-General and the WTO Secretariat act primarily as an “honest broker” in, or a “facilitator” of, the decision-making processes in the WTO. They will seldom be the initiator of proposals for action or reform. In that seemingly modest role, the Director-General and the WTO Secretariat can, however, make an important contribution to helping the Members to come to an agreement or decision. The main duties of the WTO Secretariat are to provide technical and professional support for the various WTO bodies, to provide technical assistance for developing country Members, to monitor and analyse developments in world trade, to advise governments of countries wishing to become Members of the WTO, and to provide information to the public and the media. The Secretariat also provides administrative support and legal assistance in the dispute settlement process.

The WTO Secretariat is organized into divisions with a functional role (e.g., the Agriculture and Commodities Division, the Services Division and the Market Access Division), divisions with an information and liaison role (e.g., the Information and Media Relations Division) and divisions with a support role (e.g. the Administration and General Services Division and the Language Services and Documentation Division). Divisions are normally headed by a Director who reports to one of the WTO’s four Deputy Directors-General or directly to the Director-General.

Decision-Making by the WTO[226]

> *"With respect to decision-making by WTO bodies, there is a distinction between the normal decision-making procedure, which applies as the default procedure, and a number of special procedures for specific decisions."*

Normal Procedure

> *"The normal decision-making procedure for WTO bodies is set out in Article IX: 1 of the WTO Agreement, which states: The WTO shall continue the practice of decision-making by consensus followed under GATT 1947. Except as otherwise provided, where a decision cannot be arrived at by consensus, the matter at issue shall be decided by voting. At meetings of the Ministerial Conference and the General Council, each Member of the WTO shall have one vote. […] Decisions of the Ministerial Conference and the General Council shall be taken by a majority of the votes cast, unless otherwise provided in this Agreement or in the relevant Multilateral Trade Agreement.*
>
> *"A WTO body is deemed to have decided by consensus on a matter submitted for its consideration, if no Member present at the meeting when the decision is taken, formally objects to the proposed decision.[227] In other words, unless a Member explicitly objects to the proposed decision, that decision is taken*
>
> *"If consensus cannot be achieved, Article IX:1 of the WTO Agreement provides for voting on a one-country/one-vote basis.[228] Under the normal procedure, decisions are then taken by a majority of the votes cast. As under the old GATT, however, it is very exceptional for WTO bodies to vote.*

[226] Id., pp. 20-21.
[227] Footnote 1 to Article IX of the WTO Agreement.
[228] Whereas each WTO Member has one vote, Article IX:1 of the WTO Agreement provides that when the European Communities exercises its right to vote, it shall have a number of votes equal to the number of the EU Members States which are Members of the WTO.

..*Special Procedures*

> *"The WTO Agreement sets out a number of decision-making procedures that deviate from the normal procedure discussed above. For example, all decisions taken by the DSB are taken by consensus; resort to voting is not possible."*[229]
> *"Decisions of the Ministerial Conference or the General Council to adopt an interpretation of provisions of the WTO Agreement or the multilateral trade agreements are taken by a three-fourths majority of the Members.*[230] *"Decisions to waive an obligation imposed on a Member are taken by the same majority if Members do not reach a consensus within an agreed maximum time period of 90 days.*[231] *Decisions on accession are taken by a two-thirds majority of the Members.*[232] *Decisions on amendments require in most cases also a two-thirds majority of the Members, if Members do not succeed in reaching a consensus within a time period, which will normally be 90 days.*[233] *Finally, decisions on the budget and on financial regulations require a two-thirds majority of the votes comprising more than half of the Members."*[234]

Questions of Concern

1. What is the difference between the GATT 1994 and the GATT 1947? Does the GATT 1994 apply to trade in services?

2. What are the constituent elements of the GATT 1994?

3. How does an interpreter determine whether there is a conflict between the provisions of the GATT 1994 and the provisions of other WTO Agreements? In the event of a conflict between provisions of the GATT 1994 and those of other *WTO Agreements*, which provisions prevail?

[229] Article 2.4 of the DSU.
[230] Article IX:2 of the WTO Agreement..
[231] Article IX:3 of the WTO Agreement.
[232] Article XII:2 of the WTO Agreement.
[233] Article X of the WTO Agreement.
[234]Article VII:3 of the WTO Agreement.

4. What are the historical origins of the WTO and to which extent are these origins still relevant today?

5. How many different agreements make up the *WTO Agreement*? Which agreement prevails in case of conflict? What is the difference between the multilateral and the plurilateral trade agreements annexed to the *WTO Agreement*?

6. What are the WTO's policy objectives according to the Preamble of the *WTO Agreement* and what are the two main instruments to achieve these objectives?

7. Which are the five key functions of the WTO? To which of these functions does the Doha Development Round relate? What is the objective of the trade policy review mechanism? Does the WTO involve in any way NGOs in its activities?

8. What are the main bodies of the WTO? Are all Members represented in these bodies? Does the frequency of meetings raise particular problems for developing country Members?

9. Is membership of the WTO limited to States? Is accession to the WTO comparable to accession to the United Nations? How does a State become a member of the WTO?

10. How do WTO bodies normally take decisions? When does a WTO body resort to voting? Do the United States, the European Communities, India, Costa Rica and Burkina Faso have the same number of votes?

Chapter Four
GATT Round of Talks

4.1 Tokyo and Uruguay Rounds

For almost half a century, GATTs' basic legal principles remained much as they were in 1948. There were additions in the form of a section on development added in the 1960s and "plurilateral" agreements (i.e. with voluntary membership) in the 1970s, and efforts to reduce tariffs further continued. Much of this was achieved through a series of multilateral negotiations known as "trade rounds" — the biggest leaps forward in international trade liberalization have come through these rounds which were held under GATT's auspices.

In the early years, the GATT trade rounds concentrated on further reducing tariffs. Then, the Kennedy Round in the mid-sixties brought about a GATT Anti-Dumping Agreement and a section on development. The Tokyo Round during the seventies was the first major attempt to tackle trade barriers that do not take the form of tariffs, and to improve the system. The eighth, the Uruguay Round of 1986-94, was the last and most extensive of all. It led to the WTO and a new set of agreements.

GATT trade rounds

Year	Place/name	Subjects covered	Countries
1947	Geneva	Tariffs	23
1949	Annecy	Tariffs	13
1951	Torquay	Tariffs	38
1956	Geneva	Tariffs	26
1960-1961	Geneva Dillon Round	Tariffs	26
1964-1967	Geneva	Tariffs and anti-dumping measures	62

	Kennedy Round		
1973-1979	Geneva Tokyo Round	Tariffs, non-tariff measures, "framework" agreements	102
1986-1994	Geneva Uruguay Round	Tariffs, non-tariff measures, rules, services, intellectual property, dispute settlement, textiles, agriculture, creation of WTO, etc	123

4.1.1 The Tokyo Round

The Tokyo Round lasted from 1973 to 1979, with 102 countries participating. It continued GATT's efforts to progressively reduce tariffs. The results included an average one-third cut in customs duties in the world's nine major industrial markets, bringing the average tariff on industrial products down to 4.7%. The tariff reductions, phased in over a period of eight years, involved an element of "harmonization" — the higher the tariff, the larger the cut, proportionally.

In other issues, the Tokyo Round had mixed results. It failed to come to grips with the fundamental problems affecting farm trade and also stopped short of providing a modified agreement on "safeguards" (emergency import measures). Nevertheless, a series of agreements on non-tariff barriers did emerge from the negotiations, in some cases interpreting existing GATT rules, in others breaking entirely new ground. In most cases, only a relatively small number of (mainly industrialized) GATT members subscribed to these agreements and arrangements. Because they were not accepted by the full GATT membership, they were often informally called "Codes". The Tokyo Round *codes* were:

- Subsidies and countervailing measures — interpreting Articles 6, 16 and 23 of GATT

- Technical barriers to trade — sometimes called the Standards Code
- Government procurement
- Import licensing procedures
- Customs valuation — interpreting Article 7
- Anti-dumping — interpreting Article 6, replacing the Kennedy Round code
- Bovine Meat Arrangement
- International Dairy Arrangement
- Trade in Civil Aircraft

They were not multilateral, but they were a beginning. Several codes were eventually amended in the Uruguay Round and turned into multilateral commitments accepted by all WTO members. Only four remained "plurilateral" — those on government procurement, bovine meat, civil aircraft and dairy products. In 1997 WTO members agreed to terminate the bovine meat and dairy agreements, leaving only two.

GATT was provisional with a limited field of action, but its success over 47 years in promoting and securing the liberalization of much of world trade is incontestable. Continual reductions in tariffs alone helped spur very high rates of world trade growth during the 1950s and 1960s — around 8% a year on average. And the momentum of trade liberalization helped ensure that trade growth consistently out-paced production growth throughout the GATT era, a measure of countries' increasing ability to trade with each other and to reap the benefits of trade. The rush of new members during the Uruguay Round demonstrated that the multilateral trading system was recognized as an anchor for development and an instrument of economic and trade reform.

But all was not well. As time passed new problems arose. The Tokyo Round in the 1970s was an attempt to tackle some of these but its achievements were limited. This was a sign of difficult times to come.

GATT's success in reducing tariffs to such a low level, combined with a series of economic recessions in the 1970s and early 1980s, drove governments to devise other forms of protection for sectors facing increased foreign competition. High rates of unemployment and constant factory closures led governments in Western Europe and North America to seek bilateral market-sharing arrangements with competitors and to embark on a subsidies race to maintain their holds on agricultural trade. Both these changes undermined GATT's credibility and effectiveness.

The problem was not just a deteriorating trade policy environment. By the early 1980s the General Agreement was clearly no longer as relevant to the realities of world trade as it had been in the 1940s. For a start, world trade had become far more complex and important than 40 years before: the globalization of the world economy was underway, trade in services — not covered by GATT rules — was of major interest to more and more countries, and international investment had expanded. The expansion of services trade was also closely tied to further increases in world merchandise trade. In other respects, GATT had been found wanting. For instance, in agriculture, loopholes in the multilateral system were heavily exploited, and efforts at liberalizing agricultural trade met with little success. In the textiles and clothing sector, an exception to GATT's normal disciplines was negotiated in the 1960s and early 1970s, leading to the Multifibre Arrangement. Even GATT's institutional structure and its dispute settlement system were causing concern.

The temporary arrangement of the GATT had not only survived for 47 years, it had flourished. Admittedly, it was a far less ambitious project than the ITO, and its lack of organisational structure generated several problems, especially as far as developing countries were concerned. But the same weaknesses of the GATT also ensured its political viability. The limited mandate of the GATT meant that it was not ridden with the many contradictions and impossible political compromises that the ITO was, while countries showed a greater willingness to commit to a treaty than have their hands tightly bound by a much more intrusive organisation with a powerful dispute settlement mechanism. Developing countries, despite their frequent complaints about the

exclusionary GATT system, were falling over each other to accede to the organisation. Here was a model for a multilateral trade regime – if not an organisation – that seemed to be working. Yet, in 1995, due to the aforementioned reasons, GATT members became convinced that a new effort to reinforce and extend the multilateral system should be attempted. That effort resulted in the Uruguay Round, the Marrakech Declaration, and the creation of the Word Trade Organisation.

4.1.2 The Uruguay Round: the Birth of the WTO

The Uruguay Round (1986-94), the most important round was the first 'comprehensive' round of multilateral trade negotiations, covering agreements on "tariffs, non trade barriers, textiles and clothing, agriculture, trade in services, TRIPS, TRIMS, the GATT system, GATT articles, subsidies, dispute settlement, anti dumping and the Tokyo Round codes", but most importantly it created the WTO. At Marrakech, Morocco, 124 state and government representatives met in April 1994 to sign the agreements that were concluded as a result of the Uruguay Round. Consequently, the Marrakech agreement established the WTO formally which came into force on 1st January, 1995.

The seeds of the Uruguay Round were sown in November 1982 at a ministerial meeting of GATT members in Geneva. Although the ministers intended to launch a major new negotiation, the conference stalled on agriculture and was widely regarded as a failure. In fact, the work programme that the ministers agreed formed the basis for what was to become the Uruguay Round negotiating agenda.

Nevertheless, it took four more years of exploring, clarifying issues and painstaking consensus-building, before ministers agreed to launch the new round. They did so in September 1986, in Punta del Este, Uruguay. They eventually accepted a negotiating agenda that covered virtually every outstanding trade policy issue. The talks were going to extend the trading system into several new areas, notably trade in services and intellectual property, and to reform trade in the sensitive sectors of agriculture and textiles. All the original GATT articles were up for review. It was the biggest negotiating

mandate on trade ever agreed, and the ministers gave themselves four years to complete it.

Two years later, in December 1988, ministers met again in Montreal, Canada, for what was supposed to be an assessment of progress at the round's half-way point. The purpose was to clarify the agenda for the remaining two years, but the talks ended in a deadlock that was not resolved until officials met more quietly in Geneva the following April.

Despite the difficulty, during the Montreal meeting, ministers did agree a package of early results. These included some concessions on market access for tropical products — aimed at assisting developing countries — as well as a streamlined dispute settlement system, and the Trade Policy Review Mechanism which provided for the first comprehensive, systematic and regular reviews of national trade policies and practices of GATT members. The round was supposed to end when ministers met once more in Brussels, in December 1990. But they disagreed on how to reform agricultural trade and decided to extend the talks. The Uruguay Round entered its bleakest period.

Despite the poor political outlook, a considerable amount of technical work continued, leading to the first draft of a final legal agreement. This draft "Final Act" was compiled by the then GATT director-general, Arthur Dunkel, who chaired the negotiations at officials' level. It was put on the table in Geneva in December 1991. The text fulfilled every part of the Punta del Este mandate, with one exception — it did not contain the participating countries' lists of commitments for cutting import duties and opening their services markets. The draft became the basis for the final agreement.

Over the following two years, the negotiations lurched between impending failure, to predictions of imminent success. Several deadlines came and went. New points of major conflict emerged to join agriculture: services, market access, anti-dumping rules, and the proposed creation of a new institution. Differences between the United States and European Union became central to hopes for a final, successful conclusion.

In November 1992, the US and EU settled most of their differences on agriculture in a deal known informally as the "Blair House accord". By July 1993 the "Quad" (US, EU, Japan and Canada) announced significant progress in negotiations on tariffs and related subjects ("market access"). It took until 15 December 1993 for every issue to be finally resolved and for negotiations on market access for goods and services to be concluded (although some final touches were completed in talks on market access a few weeks later). On 15 April 1994, the deal was signed by ministers from most of the 123 participating governments at a meeting in Marrakech, Morocco.

The delay had some merits. It allowed some negotiations to progress further than would have been possible in 1990; e.g. some aspects of services and intellectual property, and the creation of the WTO itself. But the task had been immense, and negotiation-fatigue was felt in trade bureaucracies around the world. The difficulty of reaching agreement on a complete package containing almost the entire range of current trade issues led some to conclude that a negotiation on this scale would never again be possible. Yet, the Uruguay Round agreements contain timetables for new negotiations on a number of topics. And by 1996, some countries were openly calling for a new round early in the next century. The response was mixed; but the Marrakech agreement did already include commitments to reopen negotiations on agriculture and services at the turn of the century. These began in early 2000 and were incorporated into the Doha Development Agenda in late 2001.

Though WTO is an institutional organ in the true sense, it still had similarities with its predecessor. The basic principles remained the same and like GATT, WTO operates by consensus of its members. Yet, major changes have also taken place. The coverage or scope of WTO is much broader. It is more important for developing countries than the GATT was. WTO embodies a stronger dispute settlement body. It furthermore operates with greater transparency and supervisory functions are accorded to the Secretariat granted through the Trade Policy Review Mechanism (TPRM).

4.1.3 Implementation Issues

Although the Uruguay Round resulted in some far-reaching improvements in the world's trading system, it left some issues and concerns unresolved. They include the following:

- Effective enforcement.
- The relationship between the provisions of the Uruguay Round and other agreements made before the Uruguay Round was completed, such as NAFTA;
- Whether safeguard provisions will result in serious inequities in market access and industry protection;
- Whether safeguard provisions can be applied effectively when perishable commodities are dumped;
- Whether the U.S. government will aggressively pursue trade dispute settlement when phytosanitary restrictions or trade issues conflict with other political or non-economic objectives;
- How the United States can protect itself if abuses occur under the developing nation exemptions that favor competitors over U.S. producers;
- Whether U. S. rules on country of origin marking can be made consistent with GATT rules;
- Whether agricultural intellectual property rights will be effectively protected; and
- What impact the agreement will have on the U.S. government budget and the U.S. trade policy debate.

***Enforcement*:** Under section 301 of the U.S. Trade Act of 1974, as amended, the U.S. Trade Representative (USTR) may take action to enforce U.S. trade agreement rights or eliminate trade practices unfairly burdening U.S. commerce. The Uruguay Round sustains this use, subject to due restraint, to enforce a WTO decision that a U.S. trading partner is violating its commitments. There are no restrictions on applying Section 301 procedures against countries that are not part of the WTO or in areas where there are no agreed WTO rules. A question arises, however, as to whether the United States can use

the section 301 remedy to enforce existing bilateral agreements such as the canned fruit agreement or the wine accord with the EU.

***GATT and NAFTA*:** The provisions of the Uruguay Round do not supersede those of the North American Trade Agreement. They are simply a different set of obligations and commitments. If the Uruguay Round calls for lower trade barriers than NAFTA, the Uruguay Round applies; if it calls for less, then NAFTA provisions apply. All signatory nations must comply with the new Uruguay Round disciplines on tariffs, non-tariff barriers and subsidies but the new tariff rules are not as demanding as those of NAFTA. Therefore, the NAFTA rules on tariffs apply between the United States, Canada and Mexico. On the other hand, the Uruguay Round requirements on non-tariff barriers are generally more extensive and more restrictive than those of NAFTA and would prevail if a dispute arose. Thus, the Uruguay Round cannot weaken the agreements between the US, Canada and Mexico, but could augment them in some areas.

***Reciprocal access*:** Article 5 of the Uruguay Round contains a Special Safeguard Provision which can be utilized by countries that have converted border measures, such as quotas and variable import levies into tariffs. This provision will permit such countries to assess an additional duty if the level and price of covered imports unreasonably damages domestic suppliers. The price and volume conditions under which this remedy is available are carefully identified.

Fruit and vegetable commodities imported into the United States are not subject to border measures other than ordinary tariffs. Hence, the safeguard provision available to countries that had more restrictive barriers is not available to the U.S. under the same price and volume conditions. Therefore, this provision of the agreement is not reciprocal; rather, it continues the imbalance in market access between producers of like products in the U.S. and Europe, which has converted its border measures into tariffs. This inequity can be resolved only in future GATT negotiations.

***Perishable commodities*:** The agreement is not well designed to deal with perishable commodities because remedies for unfair trade rules often cannot be applied quickly enough to prevent serious economic damage. In seasonal agricultural markets, imported sales below costs over relatively short periods of time can cause serious and lasting harm to domestic industries. This lack of expedited anti-dumping (safeguard) procedures for perishable commodities could be rectified by speeding up WTO procedures in the case of perishable commodities.

This might be done without waiting for the next round of GATT negotiations if sufficient member pressure is put on WTO to alter its administrative procedures.

***Phytosanitary barriers*:** With the reduction of tariff and other non-tariff barriers, sanitary and phytosanitary barriers will become the last major device for countries seeking to artificially restrict access to their markets. The agreement calls for all phytosanitary restrictions to be based on sound scientific measures. To be effective however, the United States must aggressively and rapidly address questionable barriers and pursue the dispute settlement mechanism to seek their removal. The concern among many U.S. producers is that the government will not use the dispute settlement procedures forcefully when there is a violation of the agreement, particularly when there are important non-trade considerations. The remedy lies in effective political action by affected commodity groups.

***Developing country subsidies*:** The agreement defines and establishes rules and disciplines on subsidies and identifies those subsidies that are not subject to countervailing actions by GATT members. It also provides special conditions, such as a longer phase-out period or specific exemptions, for subsidies provided in developing countries. This presents a problem where such subsidies are abused or where developing country industries are fully mature and competitive with industries in developed countries. In these instances, imports from such a developing country may gain an unfair advantage over domestic or other foreign suppliers. The U.S. has little recourse in this

situation other than to express its intent to take aggressive action under the WTO dispute settlement mechanism.

***Country of origin marking*:** The agreement establishes a three-year work program to harmonize rules of origin among GATT members. However, rules in the United States vary between states and considerable internal standardization will be required before an international standard can be agreed to. Such action may be stimulated by the GATT harmonization objective.

***Agricultural Intellectual Property Rights*:** The agreement establishes improved standards for the protection of a full range of intellectual property rights (IPRs) and the enforcement of those standards both internally and at the border. The agreement does not cover IPRs for seed and plant development. Whatever remedies existed in the past for agricultural IPRs are still available, but clearly the same case can be made for agricultural IPRs that the U.S. has made successfully for non-agricultural IPRs. This issue needs to be addressed in the next GATT round, because it cannot be changed by unilateral action.

***Domestic Policy Impacts*:** Reductions in government revenue will occur because of lower import tax collections and reductions in other trade related items. This is a concern because, to meet federal deficit targets, either offsetting reductions in expenditures will be required or taxes must be increased.

Environmental questions, labor rules, patent and copyright laws, and genetic property rights are important concerns to many. Such issues as antidumping and countervailing duties, fast track negotiating authority, Section 301 trade law, and the powers of the World Trade Organization occupied much of the discussion between the administration and Congress on the implementing language for the Uruguay Round legislation. Some interest groups remain dissatisfied and skeptical of the outcome. Concerns such as these will continue to be part of the Presidential and Congressional policy debates, will form the basis for grievances filed with the WTO, and will provide input for the next GATT round.

Recapitulation

***Basic Rules of WTO Law and Policy*[235]**

Non-Discrimination

There are two principles of non-discrimination in WTO law: the most-favoured-nation (MFN) treatment obligation and the national treatment obligation.[236]

The MFN treatment obligation requires a WTO Member that grants certain favourable treatment to another country, to grant that same favourable treatment to all other WTO Members. A WTO Member is not allowed to discriminate between its trading partners by giving some countries more favourable treatment than others in terms of, for example, market access or the application of domestic regulation. The MFN treatment obligation is the single most important rule in WTO law. Without this rule the multilateral trading system would and could not exist. It applies both to trade in goods (Article I of the GATT 1994) and to trade in services (Article II of the GATS).[237]

The national treatment obligation requires a WTO Member to treat "like" foreign and domestic products, services or service suppliers equally. Where the national treatment obligation applies, foreign products, services or service suppliers may, once they have entered the domestic market, not be subject to less favourable taxation or regulation than "like"[238] domestic products, services or service suppliers. Pursuant to the national treatment obligation, a WTO Member is not allowed to discriminate between its own products, services or service suppliers *and* foreign products, services or service suppliers.

[235] Mrs. Stephanie Cartier, Op cites, No. 192, pp. 23-26.
[236] Ibid., (i.e. Modules 3.5); see as well as WTOs' 3.6 and 3.8 Modules, electronically (by internet) available at its Web-Page.
[237] Ibid. (Also the TRIPS Agreement provides in Article 4 for a MFN treatment obligation.)
[238] Ibid. (With respect to taxation, the national treatment obligation also applies to "directly competitive or substitutable" foreign and domestic products.)

For trade in goods, the national treatment obligation has *general* application (Article III:2 and III:4 of the GATT 1994). For trade in services, the national treatment obligation applies to the extent WTO Members have explicitly committed themselves in respect of specific services to treat foreign and domestic services and service suppliers equally (Article XVII of the GATS). Such commitments are made in a Member's Schedule of Specific Commitments.[239]

Market Access

WTO law contains three main groups of rules regarding market access: rules concerning customs duties, i.e., tariffs; rules concerning quantitative restrictions, such as quotas; and rules concerning (other) non-tariff barriers, such as technical regulations and standards, sanitary and phytosanitary measures, customs formalities and government procurement practices.

Furthermore, the principles of transparency and "justiciability" are important for effective market access.[240] Under WTO law the imposition of customs duties on trade in goods is not prohibited but WTO law calls upon countries to negotiate the mutually beneficial reduction of customs duties. These negotiations result in tariff concessions or bindings, which are listed in a Member's Schedule of Concessions. For those products for which such a tariff binding exists, the customs duties applied may no longer exceed the level at which they were bound (Article II:1 GATT 1994).[241]

While customs duties are in principle not prohibited (but may not exceed the level at which they are bound), quantitative restrictions ("QRs") on trade in goods are, as a general rule, forbidden. Unless one of many exceptions applies, WTO Members are not allowed to ban the importation or exportation of goods or to subject them to quotas (Article XI:1 GATT 1994) With regard to trade in services, a Member who has undertaken market-access commitments with respect to a specific sector may generally

[239] Ibid. (The TRIPS Agreement provides in Article 3 for a national treatment obligation.)
[240] Ibid. (See also WTOs' Modules 3.5, 3.6 and 3.8.)
[241] Ibid. (Customs duties are not imposed on trade in services and the GATS therefore does not provide for rules on customs duties.)

speaking not maintain or adopt quantitative restrictions in that sector, unless otherwise specified in its Schedule (Article XVI:2 GATS).

Non-tariff barriers to trade ("NTBs") such as technical regulations and standards, sanitary and phytosanitary measures, customs formalities and government procurement practices are today more important barriers to trade than customs duties or quantitative restrictions for many products and many countries. Rules on these and other non-tariff barriers are set out in a number of GATT provisions (e.g., Article VIII GATT 1994) and specific WTO agreements, such as the *Agreement on Sanitary and Phytosanitary Measures* (the "*SPS Agreement*") and the *Agreement on Technical Barriers to Trade* (the *"TBT Agreement*"). The latter agreements not only prohibit measures that discriminate between "like" foreign and domestic products. The *TBT Agreement*, for example, also requires in respect of technical regulations that these regulations are *not more trade-restrictive than necessary* to fulfill one of the legitimate policy objectives mentioned in the Agreement (e.g., the protection of human health and safety).[242] The *SPS Agreement* requires *inter alia* that sanitary and phytosanitary measures are based on scientific principles and are not maintained without sufficient scientific evidence (except when the measures are only provisional in nature).[243]

The obligation on Members to publish all trade laws, regulations and judicial decisions in such a manner as to allow governments and traders to become acquainted with them (the principle of transparency) is important to ensure effective access to foreign markets.[244] Likewise, the obligation on Members to maintain or institute judicial, arbitral or administrative tribunals for the purpose, *inter alia*, of the prompt, objective and impartial review of administrative decisions affecting trade in goods or services is essential to guarantee security and predictability in international trade (the principle of "justiciability").[245]

[242] Ibid. (See also WTOs' Module 3.9.)
[243] Ibid. (See also WTOs' Module 3.7.)
[244]Ibid. (See, e.g., Article X:1 of the GATT 1994 and Article III:1 of the GATS.)
[245] Ibid. (See, e.g., Article X:3(b) of the GATT 1994 and Article VI:2(a) of the GATS.)

Generally, Members must ensure that all measures of general application affecting trade in goods and services are administered in a reasonable, objective and impartial manner.[246]

Protection Against Unfair Trade[247]

WTO law does not have general rules on unfair trade practices, but it does have some highly technical and complex rules that relate to specific forms of "unfair" trade. These rules concern dumping and subsidies.

Dumping, i.e., to bring a product onto the market of another country at a price less than the normal value of that product, is condemned but not prohibited in WTO law. However, when the dumping causes or threatens to cause material injury to the domestic industry of a country, WTO law allows that country to impose anti-dumping duties on the dumped products in order to offset the dumping. The relevant rules are set out in Article VI of the GATT 1994 and the *Anti-Dumping Agreement*.[248]

Subsidies, i.e., a financial contribution by a government or public body that confers a benefit, are subject to a complex set of rules. Some subsidies, such as export subsidies and subsidies contingent upon the use of domestic over imported products are, as a rule, prohibited. Other subsidies are not prohibited but when they cause adverse effects to the interests of other countries, the subsidizing country should withdraw the subsidy or take appropriate steps to remove the adverse effects. If the subsidizing country fails to do so, countermeasures commensurate with the degree and nature of the adverse effect may be authorized.[249]

If a prohibited or other subsidy causes or threatens to cause material injury to the domestic industry of a country producing a "like" product, that country is authorized to impose countervailing duties on the subsidized products to offset the subsidization.

[246] Ibid. (See, e.g., Article X:3(a) of the GATT 1994 and Article VI:1 of the GATS.)
[247] Mr. Peter Van den Bossche, Op. cites, No. 207, pp. 25-26.
[248] Ibid. (See also WTOs' Module 3.11.)
[249] Ibid. (Until 1 January 2000, there was a third category of so-called "non-actionable subsidies" regulated in Articles 8 and 9 of the SCM Agreement. However, the WTO Members failed to agree on the extension of the application of these provisions and these provisions therefore lapsed (see Article 31 of the SCM Agreement).)

The rules applicable to subsidies and countervailing duties are set out in Articles VI and XVI of the GATT 1994 and the *Agreement on Subsidies and Countervailing Measures* (the "*SCM Agreement*").[250] Subsidies relating to agricultural products are subject to different (more lenient) rules set out in the *Agreement on Agriculture*.

Trade and Competing Interests and Values[251]

Apart from the above basic rules and principles, WTO law also provides for a number of general exceptions to these basic rules and disciplines to allow countries in certain circumstances to take account of economic and/or noneconomic interests and values that compete with free trade.[252]

Competing Non-Economic Interests and Values

The non-economic interests and values include the protection of the environment, public health, public morals and national security. Pursuant to Article XX of the GATT 1994 or Article XIV of the GATS, Members may take measures that are "necessary", for example, to protect public health, provided the application of these measures does not constitute arbitrary or unjustifiable discrimination or a disguised restriction on international trade.

Article XXI of the GATT 1994 and Article XIV *bis* of the GATS allow Members to take measures to protect national security interests. It also allows the taking of measures to give effect to UN mandated trade embargoes or sanctions.

Competing Economic Interests and Values

Economic interests that may compete with trade include the protection of a domestic industry from serious injury inflicted by an unexpected and sharp surge in imports. Article XIX of the GATT 1994 and the *Agreement on Safeguards* allow Members to take safeguard measures (in the form of the imposition of customs duties above the binding or

[250] Ibid. (See also WTOs' Module 3.12.)
[251] Id., p. 26.
[252] Ibid. (See also WTOs' Modules No. 3.5, No. 3.6, No. 3.8 and No. 3.13.)

the imposition of quotas) giving temporary protection to the domestic industry.[253] Other economic interests that may compete with trade are the safeguarding of the balance of payments[254] and the pursuit of regional economic integration.[255] These exceptions may be invoked by all countries and will allow these countries, if they meet certain specific conditions, to deviate from the basic rules and disciplines.

Questions of Concern:

1. Which basic rules of WTO law and policy constitute the foundation of the multilateral trading system?

2. What do the MFN treatment obligation and the national treatment obligation have in common? In what do they differ?

3. How do the basic WTO rules on customs duties and quantitative restrictions differ? Do WTO rules on non-tariff barriers only prohibit discrimination between domestic and foreign products?

4. Do WTO rules prohibit dumping or subsidization of imported products? Do WTO rules allow Members to take action against dumped or subsidized imports?

5. Generally speaking, in which circumstances may WTO law justify deviation from the basic rules of non-discrimination and market access? Does free trade prevail over the protection of public health under WTO law?

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[253] Ibid. (For safeguard measures relating to trade in services, see Article X of the GATS.)
[254]See Article XII of the GATT 1994 and Article XII of the GATS.
[255] Ibid. (See Article XXIV of the GATT 1994 and Article V of the GATS.)

Chapter Five
Basic Principles of GATT[iii]

5.1 The First Principle: MFN Treatment[256] and GATT Article I

As to the beginnings of MFN, it is noted that an embryonic version of an MFN clause has been traced as far back as 1417. But the Most-Favored-Nation commitments in international commercial matters are generally considered to stem mainly from the Seventeenth and Eighteenth Centuries. In the view of one author, MFN became the "common commercial law of the Great European Powers" at1860; thus, becoming a convenient shorthand to incorporate advantages of previous grants, and the notion of non-discrimination. Nevertheless, the extent of MFN application could vary greatly. The United States MFN policy until 1922 was "conditional"; i.e., concessions negotiated with A would be applied to B only if B granted compensatory concessions.

As explained below, MFN was given importance in drafts of the League of Nations in the early years of the 20th Century.

> One of (President Woodrow) Wilson's fourteen points in 1918 urged 'that establishment of an equality of trade conditions among all the nations consenting to the Peace', which was explained to mean 'whatever tariff high or low it should apply to all foreign nations'. The League of Nations Covenant likewise mentioned the goal of 'equitable treatment for the commerce of all members' …
>
> In 1936, the League published a study that included legal language for a recommended MFN clause, as well as a discussion of various problems, ambiguities and policy questions of scope. … In 1930, the United States enacted the infamous Smoot-Hawley tariff.. a preferential trade system for the British Commonwealth. ..

[256] John H. Jackson, World Trade and the Law of GATT, 1969, pp. 249-264. International Trade Law Handbook References: GATT Article I.

> One of the prime post-World War II objectives of the United States was the dismantling of trade preferences, especially the commonwealth system. … Failure to achieve this result has been blamed as one of the causes for the failure of the United States to accept the Havana Charter, thus causing the ITO to fail to materialize."[257]

The Most-Favored-Nation (MFN) clause actually got included in the International Trade Organization (ITO) Charter and, thereafter, in GATT, as major powers contemplated to include it in multilateral trade agreements since the earliest years of post-World War II, and United States considering it as "absolutely fundamental".

> The 1947 preparatory work on Article I falls into four groups: (1) attempts to add language to broaden MFN scope (all of which failed; (2) striking the sentence of an original draft dealing with government contracts; (3) problems of defining language in the MFN clause; and (4) the sticky questions of existing preferences.[258]

It has been noted that the original sentence on government contracts, i.e., in the MFN proposal, had the following words:

> The principle underlying this paragraph shall also extend to the awarding by Members of governmental contracts for public works, in respect of which each member shall accord fair and equitable treatment to the commerce of the other Members. [259]

Defining the phrases "originating in" and "like products" was particularly very troublesome. Later on, some agreed that "like products" should mean "same" products as would be discussed latter on in the coming chapters.

[257] Raj Bhala *et la*, Op cites, No. 13, pp. 249-250.
[258] Id., p. 251.
[259] Ibid.

As to what relates to preferences, the United States hoped that 1) freezing of existing preference margins, and 2) provision for gradual reduction and elimination of preference margins through negotiations be agreed upon at the 1947 summit; which were achieved.

5.1.1 MFN as an Obligatory Principle

As it is noted, the MFN appears in GATT in Article I. This clause of non-discrimination consists:

- Specific MFN-type clauses that apply to cinema films – Article IV, paragraph (b);
- Internal mixing requirements – Article III paragraph 7;
- Transit of goods – Article V, paragraph 2,5 and 6;
- Marks of origin – Article IX, paragraph 1;
- Quantitative restrictions – Article XIII, paragraph 1;
- State trading – Article XVII, paragraph 1;
- Measures to assist economic development – Article XVIII, paragraph 20; and;
- Measures for goods in short supply – Article XX, paragraph (j).[260]

These clauses are often framed as to require that goods of any contracting party be given "no less favorable" treatment than that given to any other contracting party.

The major GATT, MFN clause in Article I, paragraph 1, is devisable into two concepts, namely: (1) the scope of the clause – i.e., to what activity it applies; and (2) the obligation of the clause – i.e., what it requires. Of these two, the scope is set out in a series of clauses that establish that the following come within the MFN obligation in addition to the special matters elsewhere enumerated in GATT, above. These are:

5. Customs duties and charges of any kind imposed on or in connection with:
    a) importation,
    b) exportation,
    c) internal transfer of payments for imports or exports;
6. The method of levying such duties and charges;

[260] Ibid.

7. All rules and formalities in connection with:
   a) importation, and
   b) exportation.
8. All matters referred to in Article III, paragraph 2 and 4 – i.e., those covering internal taxes and regulatory laws;
9. All of the above apply only to products.

The second or obligatory part of the clause reads as follows.

> (A)ny advantage, favor, privilege or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined obligation for the territories of all other contracting parties.[261]

This clause contains numerous interpretive problems as enumerated below.

A. **As refers to *"advantage, favour, privilege or immunity"*:** A case arose in GATT when excise tax rebates were given by India for exports to some GATT contracting parties, but not for exports to Pakistan (1952), which was refuted by the latter. As Pakistan's claim got accepted, the parties settled their differences according to a chairman's ruling. His ruling states that Article I, paragraph 1, barred this type of discrimination.[262]
B. **As refers to some *"any product"*:** It was deliberately chosen to exclude various intangible questions like for example IPRs and services, because it was desired to confine GATT to "goods", leaving other problems to other agreements.
C. **As refers to *"originating in"*:** As this problem relates to rules of origin, the draftsmen noted that each country has a right to determine its own practice as to "origin of goods".
D. **As refers to *"any other country"*:** Though it was suggested but rejected at the 1947 Geneva meetings that GATT benefits should apply only to GATT members,

[261] Raj Bhala *et la*, Op cites, No. 13, p. 253.
[262] See GATT, II B.I.S.D. 12, 1952.

the second part of the clause states that any advantage granted by a GATT contracting party to any other country must be granted to all contracting parties. From this follows that trade advantages granted by a government/State is as well granted to:

a) a party of GATT member country; and
b) a party of a non-GATT member country.

E. As refers to *"like products"*: This phrase of the passage led to various interpretations as relates to:[263]

a) identification of goods produced, manufactured, imported and exported from any country, so as countries can devise a law and issue a regulation.
b) the degree permissible for framing by law or a regulation in general terms between imported goods from two countries; e.g., levying special customs fee on goods from countries having per capita national income over $2,500,- per annum. As several practical cases have demonstrated,[264] such kind of special custom's fee on goods have no valuable grounds; i.e., are considered as "discriminatory" and against GATT.

As GATT is a legal instrument primarily concerned with products and not services or IPRs, the crucial issue here relates to setting a formidable methodology that clearly identifies and classifies products.

5.1.2. The Conventional Wisdom about Unconditional MFN Treatment[265]

Conditional vs. Unconditional MFN Treatment

The answer we get to the question "What distinguishes the conditional from the unconditional MFN obligation?" is that "[t]he hallmark of the conditional MFN

[263] Ante, Op. cites, No. 244.
[264] See Belgium Family Allowances .., GATT B.I.S.D. (1st Supp.) at 59, 1953; adopted 7 November, 1952. See as well Treatment by Germany of Imports by Sardines, GATT B.I.S.D. (1st Supp.) at 53, 57, 1953; adopted 1952 and The Australian Subsidy on Ammonium Sulfate, GATT, II B.I.S.D., 188, 191, 1952; adopted 3 April, 1950, Brazilian Internal Taxes, GATT, II, B.I.S.D. 181, 183, 1952; adopted 30 June, 1949.
[265] Raj Bhala and Kevin Kennedy, World Trade Law, 1998, pp. 62-64.

commitment is reciprocity..", whereas that of unconditional MFN is non-discrimination; i.e., not requiring reciprocity. Thus,

> [u]nder a conditional MFN commitment, Country A will extend to Country B the trade concession that Country A has granted to Country C, provided that Country B reciprocates by granting to Country A concession that are the same as or equivalent to those that Country C granted to Country A. Euphemisms for reciprocity include 'effective access' and 'equivalent competitive opportunity'.[266]

Though this seems "fair", and United States' trade law was based on the conditional principle for 150 years till 1934, several arguments have been advanced in support of "unconditional" MFN trade policy. At the heart of the several "unconditional" MFN trade policy arguments lies the notion that

> .. pursuing international trade on a nondiscriminatory basis .. helps suppress aggression in international relations .. promotes the development of multilateralism and acts as a prophylactic against discriminatory trade barriers ...[267]

***Public Choice Theory and the Need for the MFN Obligation*[268]**

Here, any student should take note of the following fact.

> The normative economics of discrimination in international commercial policy has been a subject of many decades, and is reasonably well understood at least for competitive markets. But little work has been done on the positive economics of trade discrimination generally, or of the MFN obligation and its exceptions within the WTO/GATT system in particular.
>
> The usual normative analysis of international trade rests on conventional welfare economics. An 'optimal' policy will thus strive to maximize the

[266] Raj Bhala *et la*, Op cites, No. 13, p. 257.
[267] Id., p. 258. (Also read 259.)
[268] Warren F. Schwartz and Alan O. Sykes, Economic Dimensions in International Law: The Economics of the most Favored Nation Clause, (Jangdeep S. Bhandari and Alan O. Sykes Eds.) 1987, pp. 45-53, 58-65.

> sum of producer and consumer surplus, as well as government tariff revenue if not otherwise distributed to consumers or producers. This maximization can be carried out at a multilateral level to characterize an optimal cooperative agreement among trading nations, or at the national level to characterize optimal behavior by a national government in a non-cooperative setting.
>
> If national governments in fact pursued policies to maximize national economic welfare, or nations acting cooperatively pursued policies to maximize joint economic welfare, most tariffs that survived in a non-cooperative environment, such as those imposed by large countries seeking to improve their terms of trade, would have been abolished by international agreement as nations covenanted to eliminate all beggar-thy-neighbor policies. ..[269]

It has become common knowledge that (specially small) trading partners have no opportunity to influence policy directly through offers of concessions or threats of retaliation, but rather by change in attitude of the domestic polity; i.e., how much the domestic polity cares about the well-being of those citizens in other countries. Thus, unilateral incentive to discriminate in order to raise tariff revenues by a small, importing country is pointless. But,

> [f]or 'large' countries.. [with] an upward-sloping import supply curve, it has long been recognized that an opportunity to exploit market power exists ..[as it can] behave as a monopolist (a single buyer) ...[270]

***Political and Moral Exceptions to the MFN Obligation*[271]**

As discussed earlier on, the MFN obligation on the one hand helps to protect the value concessions against future erosion, while it exacerbates the "free-rider" problem, on the

[269] Raj Bhala *et la*, Op cites, No. 13, p. 260.
[270] Id., pp. 262.
[271] International Trade Law Handbook References: 19 U.S.C. §§ 2136, 2431-2434.

other, as GATT obliges nations to extend trade concessions to all other countries.[272] Some exceptions are in place to this MFN obligation.

> There are a number of instances in which a WTO Member needs not to extend MFN treatment to another Member. For example.. under Article XXXV:1 of GATT and Article XIII of the WTO Agreement, a Member may elect non-application, and thereby not apply GATT-WTO obligations such as MFN to a newly acceding Member. (The converse is also possible.) RTAs, established pursuant to GATT Article XXIV:5 .. are a second and very common example where the MFN obligation is breached. Obviously, members of an FTA or customs union extend to each other better-than-MFN (namely, duty-free) treatment. A third example concerns preferential treatment accorded by developed Members to third World Members. Programs providing special benefits, authorized under Part IV of GATT and various other GATT-WTO provisions, .. Finally, preferential schemes maintained by former colonial countries.. were grandfathered by GATT Article I:2.
>
> These four illustrations are, of course, condoned by GATT. A fifth instance of breach is perhaps not so easily excused, ..: politics, and more specifically, fighting Communism and promoting freedom and emigration. .."[273]

Under Title IV, there are two amendments restricting MFN obligation on political and moral grounds; namely Section 401 (19 U.S.C. § 2431), which relates to non-market economies and was enacted 3 January 1975, and Section 402 (19 U.S.C. § 2432) under the same Title, which can be enforced by the U.S. President on conditions that the country has a non-market-economy and:

a) was ineligible for such treatment as of the date of enactment;
b) denies or seriously restricts the right of its citizens to emigrate.

[272] Students are strongly advised to read 263-266, plus 267-270 and 270-271 from Raj Bhala *et la*, Op cites, No. 13.
[273] Raj Bhala *et la*, Op cite, No. 13, pp. 272-273.

This last amendment – Section 402 – is known as the "Jackson-Vanik Amendment" and reads as follows.

> The political concern underlying the Amendment was the intolerable treatment of ethnic and religious minorities, Doubtless this concern is laudable. But, whether trade is the appropriate vehicle to express it, and if so whether it is the only political demand that ought to be made through trade policy, is open to debate.
>
> A country denied MFN treatment by the United States under section 401 [e.g. Ethiopia] can obtain such treatment under two circumstances. First, it must conclude a bilateral commercial agreement (pursuant to Section 405, 19 U.S.C. §2431(b)). The statute sets forth criteria for such an agreement. For example, it must provide for reciprocal non-discriminatory treatment as regards tariffs and NTBs of each country's imports from the other country. In addition, the agreement must contain provisions on safeguards against disruptive imports, protection of IPRs, trade promotion, and dispute settlement. The agreements can remain in force for up to 3 years … They must be terminable at any time for national security reasons.
>
> Second, the target country must comply with the Jackson-Vanik freedom-of-emigration requirements. … The terms of the 1974 Act require the President to provide Congress with a compliance report twice a year .., for every country that received a favorable determination. Congress, by joint resolution, can override a favorable determination and thereby rescind a country's MFN status.[274]

The President of the United States and the Congress can waiver MFN treatment on grounds that a country does not fulfill the requirements set by the Jackson-Vanik Amendment.

> ".. A country may qualify for a waiver if the President (1) determines that a waiver will substantially promote the objective of freedom of emigration

[274] Id., pp. 273-274.

> and (2) has received assurances from the country that its emigration practices will lead substantially to the achievement of this objective…"[275]

As indicated below, a number of conditions seem to cast doubt on the future of the Jackson-Vanik Amendment.

> "First, the legislation rests on an increasingly outmoded distinction between market economies and NMEs [i.e., New Market Economies]. ..
>
> "Second, as more and more countries accede to the WTO, the United States cannot deny MFN treatment under the legislation without running afoul of its GATT Article I commitment. ..
>
> "Third, since the 1989 Tiananmen Square incident, and particularly Clinton's 1994 decision to de-couple trade and human rights, exercise of the waiver authority has been distorted beyond recognition. ..
>
> "Fourth, the fact that despite all of the loud opposition, the president's waiver authority, and thereby China's MFN status, has been renewed annually. …"[276]

5.2 Second Principle: Tariff and Non-Tariff Barriers

5.2.1 Tariffs

***The Economics of Tariffs*[277]**

The main reason for levying "tariff" is to protect the local manufacturer, producer by imposing a limited amount of additional import tax to that of existing sales tax on identical items produced locally. By imposing tariff on imported goods, and thereby creating economically advantageous conditions to the local manufacturer/producer, the government tries to protect and enhance industrialization at the local level.

> "The tariff is a tax on imports that, at given world price, raises the internal, or domestic, price of the import good in proportion to the rate at which the tariff is

[275] Ibid. (Students are advised to read waiver cases for Romania, Central Europe, former Soviet Union, Cambodia and China; i.e., pp. 274-283.)
[276] Id., p. 284.
[277] Melvyn Krauss, The New Protectionism, 1978, pp. 6-13, 27-31.

> imposed. This means that domestic consumers must pay a higher price for the import good and that domestic producers of import substitutes receive a higher price for their output than would be the case were free trade pursued."[278]

At first glance, this might seem favorable, in a sense that it enables the government to collect revenue, enables local producers earn more as well as have a certain degree of economic protection. Besides that, if the local manufacturers are engaged in producing import-substitute utilities of advanced technology, the condition gives them some opportunity of growth; i.e., enhances the trickle effect of technology cited above.

Nonetheless, there are some arguments based on factual evidences that ascertain that ".. tariff induces too much domestic production of the import good and too little consumption of it.

"What too much domestic production of Import substitutes means is that, given the world price of these goods, it is cheaper for the country to import the additional domestic output of import substitutes induced by the tariff than to produce it at home. .."[279]

In other words, levying tariff might help the government to collect revenue and provide some sort of protection to local industrialists. But, the benefit thereof would not be of surmount the amount attained, if the prices of those goods under question fall considerably in the global market than their identical types manufactured locally.

Instead of advancing the overall economic well-being of the nation, levying tariff mostly ends up in transferring income "outside the market-place" and allocating resources. Tariff actually could improve domestic economic well-fare to a "price maker" country if imposed at a correct rate – the "optimal tariff".

Tariff as a tax has been an important income by the less developed country.

[278] Raj Bhala, p. 287.
[279] Ibid.

> "Ideally, a tax should be imposed in such a way that the loss of real income by the private community is exactly equal to the tax revenue gained by the collective authority. But if the tax distorts prices in the process of affecting the real resource transfer to government, the loss imposed upon the private community will be greater than the tax revenue gained by the government."[280]

In developed countries, tariff is employed for nonrevenue objective.

> "There is at least one case where the tax revenue aspects of redistribution have been important in determining the intervention mechanism and that is in the Common Agricultural Policy of the European Economic Community (EEC). The tariff is used to redistribute income to farmers in the EEC, with the consequent tariff revenue financing certain EEC projects that would not be financed by the individual national governments; …"[281]

***"Bound" Tariff*[282]**

Tariff barriers are permissible under GATT. For that matter, tariffs and related charges (i.e., Sur-Tax) are the sole form of trade restrictions that are not considered incompatible with the GATT system; i.e., measures not considered as obstruction of free trade.

However, there are certain provisions as to how tariffs could and should be employed. As stated earlier, the need for setting tariff, i.e., extra or additional tax on import items manufactured locally, is to protect local manufactures, processors, factories, etc … One of the crucial issues here relates to setting tariff margins. This is to mean that tariff rates/levels should be set in accordance with the laws of economics so as these become measurable and – most importantly – justifiable. (Look at Diagram 4 and explanation given, above.)

As noted in the International Trade Law books,

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[280] Id., p. 290.
[281] Id., pp. 290-291.
[282] Kenneth W. Dam, The GATT, 1970, pp. 17-18, 25-27, 29-32, 40-41. (Also see:- International Trade Law Handbook References: GATT Article II, and NAFTA Article 302.)

> ".. [n]o contracting party is required to lower any tariff, or even to refrain from raising any tariff, in the absence of special agreement. Such tariff concessions are normally made only in tariff conferences and, under the principle of reciprocity, … Once a tariff concession is made on a particular item, that item is bound against increase above the agreed level (Article II)…
>
> "Just as a tariff on a bound item may not be raised above the level of binding, so a contracting party making a tariff concession is committed, except as otherwise specifically provided, not to impose their duties or charges that would tend to undercut that concession (Article II). Moreover, a great many of the substantive provisions of the General Agreement are designed to assure that other types of trade measures, including those of a nonfinancial character, do not operate to offset the effect of tariff concessions.
>
> "Contracting parties are required not only to abide by tariff concessions but also to apply those concessions to all contracting parties and not just to the contracting party with which the concession was negotiated (except in the case of certain preferences). ..
>
> "..[T]he General Agreement contains a number of provisions designed to provide flexibility .. [like u]nder certain conditions contracting parties may withdraw operative concessions, so long as new, compensating concessions are made (Article XXVIII). And if an operative concession leads unexpectedly to serious injury to a domestic industry, the contracting party affected may .. withdraw that concession .. [while the other party] is then entitled to withdraw equivalent concessions (Article XIX ..). .."[283]

Introduction of Sur-Tax to currently duty-free items is also envisaged as the legitimate right of any country. But,

> ".. any such limitation upon the liberty with respect of tariff items must come from a special agreement. Such a special agreement is called, in GATT jargon, the 'binding' of a duty rate."

[283] Raj Bhala et la, Op cites, No. 2, pp. 294-295.

> ".. (G)overnments have turned increasingly .. to imposing surcharges that involve across-the-board increases of most if not all tariffs by a certain ad valorem percentage … Import surcharges are preferred to quantitative restrictions by the countries facing payments imbalances because they are thought to have a less distorting effect on trade and to be easier to administer than direct controls. .."[284]

As relates to the technical provisions of Sur-Tax, individual contracting parties have – in principle – the right to set their own, specific tariff rates. In order to do so, existing international practices require that countries should have "Harmonized Tariff Schedules" or in short – HTS.

> ".. (Thus, information on tariff rates applicable to particular items is found in a tariff schedule. Every WTO Member and NAFTA Party has its own tariff schedule using the standardized HS nomenclature. This schedule is to be distinguished from a schedule of concession, ..).
>
> "In addition to being free from customs duties 'in excess of' those set forth in the GATT schedules, bound items are to be 'exempt from all other duties or charges of any kind imposed or in connection with importation in excess of those imposed on the date of the (General) Agreement or those directly and mandatorily required to be imposed thereafter by legislation in force in the importing territory on that date' (Article II:1). …"[285]

5.3 Non-Tariff Barriers: 'Unfair' Trading Practices

Introductory Note

As you would learn in our discussion of safeguard measures, the WTO categorizes trade-distorting measures in 'fair' and 'unfair' practices. For now, it would suffice to mention that under WTO categorization, safeguard actions are generally considered 'fair' because they are designed to temporarily adjust the domestic market in the face of increased imports. In contrast, subsidization and dumping are considered 'unfair' because they may

[284] Id., p. 296.
[285] Id., p. 298-299. (Students are advised to also read pp. 300-330.)

have serious market-distorting effects. Under WTO rules, countries have the option of combating dumping with anti-dumping measures, and they may combat distorting subsidization by implementing countervailing duties.

Subsidies and Countervailing Measures:

a. Introduction to Subsidies and Countervailing Measures

Few issues have been as divisive in the international economics debate as the use of subsidies. Some subsidies may be fully supported by some countries while fervently objected to by others, oftentimes depending on what type of subsidy is being used, for what industry, or the size of an import or export market. This chapter will introduce the basic economic effects of subsidies, and the policy debate surrounding subsidies. It will then discuss some specific legal issues surrounding WTO members' obligations when it comes to subsidies, before moving on to discuss countervailing measures.

b. The Economic Effects of Subsidies

The economic debate surrounding subsidies generally has to do with identifying what are considered 'legitimate' versus 'unfair' subsidies. Before exploring the economic effects of subsidies and countervailing measures, it is important to clarify subsidies and countervailing measures, and the different shapes they may take. A subsidy is *"financial or in-kind assistance by governments to producers or exporters of commodities, manufactures and services."*[286] An example of a subsidy would therefore be if a government gave $100 dollars for every computer a company produced. [Note: The definition of 'subsidy' under the GATT was not always universal. The modern definition above is derived from (and summarizes) the legal definition of 'subsidy' which is found in Article 1 of the SCM Agreement, and interpreted by the WTO Appellate Body in *Canada—Civilian Aircraft*.[287]]

[286] Trade Dictionary, page 341.
[287] See Canada—Measures Affecting the Export of Civilian Aircraft (August 20, 1999) WT/DS70/AB/R [149]-[161].

There are generally two types of subsidies: *domestic* subsidies and *export* subsidies. Domestic subsidies are subsidies that are given to an industry for its domestic production, essentially for domestic consumption.[288] For example, a government transfers $10 to any domestic producer for any computer produced. An export subsidy is a financial or in-kind assistance granted to a product contingent on its exportation.[289] For example, a government transfers $10 to any domestic producer for any computer produced *and* exported.

The economic effects of subsidies can be both similar to, and different from, the economic effects of tariffs. First, subsidies are similar to tariffs in that they distort resource allocation. Recall that tariffs create a situation where domestic producers can compete with foreign producers because the price of the domestic product is lower than the price of the imported product, even if it is produced less efficiently. Therefore, all else being equal, consumers will purchase the domestic product. The two main economic concerns with this scenario are that (1) resources are misallocated toward a less-efficient producer, and (2) prices increase for *both* domestic and imported goods.

Subsidies can have the exact same effect on resource allocation as tariffs, because they cause the price of the subsidized good (whether it is sold in the domestic market or an export market) to be lower than the unsubsidized good, even if it is produced less efficiently. Thus, producers will shift resources into production of the subsidized good, which is a resource misallocation. This is one of the basic economic rationales against subsidies in general—ie, they may lower overall economic welfare in the long run do to this resource-misallocating effect.

Notice one important difference between the economic effects of tariffs and subsidies. Tariffs have the tendency to increase prices in the domestic market. However, subsidies have the tendency to *lower* prices in the market in which the subsidized goods are sold. Thus, subsidies also cause economic welfare benefits through lower prices.

[288] Jackson page, 767.
[289] More precise definitions of these concepts are discussed below.

The following tables highlight this difference. The first table illustrates a situation where good X costs the domestic producer $105 to produce and $100 for the foreign producer to produce, and a 10% tariff *ad valorem* is applied:

Table 1: Price Effect of 10% Tariff *ad valorem* on Good X in Domestic Market

	Price of Good X B*efore* Tariff	Price of Good X *After* Tariff
Domestic Good	$105	$105<P<$110
Imported Good	$100	$110

As you can see, the price of the imported product will increase by 10%, but also the price of the domestic product will increase to any amount as long as it is below the price of the imported product. Thus, overall prices increase, and the consumer experiences the overall welfare costs that accompany income decreases.

Now consider the second table which illustrates a situation the same situation, except that instead of a 10% tariff, the government offers a 10% subsidy on each product X that is produced by domestic producers.

Notice in this situation the price of the imported product does not change, while the price of the domestic product actually decreases to a level that is below $100. The domestic consumer experiences a price decrease, and the welfare benefits that accompany the accompanying income increases.

Table 2: Price Effect of 10% domestic subsidy on Good X in Domestic Market

	Price of Good X B*efore* Subsidy	Price of Good X *After* Subsidy
Domestic Good	$105	$94.5<P<$100
Imported Good	$100	$100

This difference lies at the heart of the debate about subsidies, and whether and to what extent they should be allowed under WTO rules. At a very basic level, the WTO prohibits export subsidies and allows domestic subsidies. However, the economic justification for prohibiting export subsidies is less obvious as other prohibitions found in WTO rules. In other words, why should WTO rules prohibit a practice that has the effect of lowering prices in the *export market*, i.e., to foreign consumers?

At first glance, the answer seems clear—we should allow practices that have the effect of benefitting consumers in export markets. However, there are some very serious problems with this practice. Namely, even if the welfare losses due to misallocations of resources inside the export market are minimal, welfare losses could be sever when multiplied in the world economy. Also, there is still a widely-held belief by the public that domestic producers are more entitled to domestic markets.[290] It is difficult to convince a public that domestic industries are losing out not because they cannot compete with a foreign industry, but because they cannot compete with a foreign government's treasury. Thus a prohibition on export subsidized is more feasible at the international level then, say, tariff bindings, because it enjoys more domestic political support.

Although economically suspect, this argument has very serious implications when dealing with some specific, vital industries, such as agriculture. Subsidized agricultural production is at the heart of today's international debates about poverty reduction, and will be discussed at the end of this Unit.

c. Obligations Under WTO Rules

There are many sources of legal obligations under WTO rules with regards to subsidies. Until the Uruguay Round, subsidies where governed only by Article XVI of the GATT. The Uruguay Round produced two important agreements dealing with subsidies: The Agreement on Subsidies and Countervailing Measures (SCM Agreement), and the Agreement on Agriculture (AA). Even though Article XVI of the GATT is still technically in force, it has practically been replaced by the SCM Agreement. We will

[290] Hufbauer, Jackson, p. 768.

concentrate on the SCM Agreement, giving brief mention to the basic obligations of GATT Article XVI, followed by a more detailed discussion on the Agreement on Agriculture. In doing so, we will track the evolution of subsidies rules which will provide a lens through which to view competing policies and their effects on economic development today.

5.3.1 Subsidies Under GATT 1947

Until 1955, subsidies were governed only by Article XVI:1 of the GATT. This Article proved toothless, as it contained only a loose reporting requirement. Members were (and still are) required to notify the other members of *"*the extent and nature of the subsidization, of the estimated effect of the subsidization on the quantity of the affected product or products imported into or exported from its territory and of the circumstances making the subsidization necessary."[291] If the subsidization caused or threatened to cause serious prejudice to the interests of other members, the subsidizing party was required to "discuss" the possibility of limiting the subsidization.[292]

After the review session of 1954-55, Article XVI was amended to include two more key obligations, in what is now the modern text of Article XVI. First, members are now prohibited from subsidizing the export of primary products which results in that country having more than an "equitable share" of the world market.[293] Here, "primary products" means any product of farm, forest or fishery, or any mineral.[294] Can you see why it might be problematic for a country to have more than an equitable share of the world market of a primary product? How might this issue be of special importance to developing countries?

Secondly, members are prohibited from creating "bi-level pricing"— i.e. subsiding products in such a way that the exported product is sold at a price below its like product

[291] Art. XVI GATT.
[292] Id.
[293] GATT Art. XVI:3
[294] GATT Add. Art. XVI Section B(1).

counterpart in the domestic market.[295] Can you see why bi-level pricing might be undesirable?

Also, please note that the introduction of a new subsidy on a product that has been bound for the purpose of a member's Article II tariff schedule is considered a *prima facie* nullification or impairment of a benefit accruing to other members for the purposes of Article XXIII:1.[296] (More on the significance of prima facie nullifications or impairments of benefits will follow in Unit 5.)

i. Subsidies under the Agreement on Subsidies and Countervailing Measures

Almost immediately after the 1954-55 review session, the Contracting Parties adopted a working party report that attempted to create an illustrative list of export subsidies. This working party report eventually formed the foundation of the new WTO rules on subsidies found in the SCM Agreement.[297] The SCM Agreement creates three categories of subsidies, referred to in WTO parlance as 'amber box, 'blue box', and 'green box' subsidies. 'Amber box' subsidies are strictly prohibited (SCM Article 3-4); 'blue box' subsidies may be allowed but are also actionable (SCM Articles 5-6), while 'green box' subsidies are allowed (SMC Article 8). This modification signifies WTO's discipline on subsidies, and is a step forward in identifying what type of subsidies are to be considered 'fair' and 'unfair.' As we will see below, however, this step still falls short of addressing many concerns surroundings the economic effects of subsidies. We will now turn to the SCM Agreement in more detail.

Article 1: Definition of a Subsidy

Article 1 offers the WTO's legal definition of subsidy. As defined above, a subsidy includes almost any kind of financial benefit conferred by a government. This may be in the form of a direct transfer or potential direct transfer (SCM Article 1.1(a)(1)(i)); or government revenue that is foregone, such as the waiver of a tax obligation (sub-

[295] GATT Art. XVI:4
[296] See EC—Oilseeds. [citation template: See Canada—Measures Affecting the Export of Civilian Aircraft (August 20, 1999) WT/DS70/AB/R [149]-[161].]
[297] Jackson, Op. cites, No. 260, p. 774.

paragraph ii); for example, *income* or *price support*, which is as well considered as a subsidy (SCM Article 1).

Article 2: Specific Subsidies

For the first time, the SCM Agreement introduced the concept of 'specific subsidies' into WTO rules. Only specific subsidies fall within the 'core' rules of the SCM Agreement, i.e. Parts II, III, and V.

Considerations for determining whether a subsidy is specific are listed under Article 2. In general, specific subsidies are those that are available only to a given industry or enterprise within a jurisdiction. Furthermore, any subsidy that falls within the scope of Article 3 Prohibited Subsidies is legally deemed specific. Thus, if a subsidy is prohibited for the purpose

SCM Agreement Part II, Articles 3-4: Prohibited Subsidies (i.e. 'Amber box' Subsidies)

Article 3 defines two types of subsidies that are strictly prohibited under the SCM. The first category is subsidies that are contingent upon export performance, whether in law or in fact.[298] A subsidy that is contingent in law is rare, as it would involve a case were a government had explicitly written into its domestic law that the subsidy would only be available if a product was exported. A simple example would be a law that stated: "For every airplane produced and exported, the producer is entitled to a 50% decrease in income tax."

A subsidy that was contingent upon export in fact is the more likely scenario, and it is more difficult to establish. WTO jurisprudence is not well-defined in this area, but the focus is on the 'conditionality' of the subsidy, i.e., does the structure of the subsidy scheme result in a situation where the subsidy is *"tied to actual or anticipated*

[298] SCM Agreement Article 3(a).

exportation or export earnings."[299] This necessitates a factual, case-by-case analysis of the individual subsidy program.[300]

Please read and refer to SCM Agreement footnote 4 now. Notice from this footnote that the mere fact that a good is subsidized *and* exported does not mean that it the subsidy falls within the definition of prohibited subsidy. It is important to note that prohibited subsidies have a level of conditionality to them that gives an incentive to export the good. Specifically, if the producer is responding to a strong foreign market for a subsidized good, but the subsidy is not conditional upon exportation, it is not a prohibited subsidy.

The second group of prohibited subsidy is subsidies that are contingent upon the use of domestic over imported goods.[301] Again, the key consideration here is the conditional nature of the subsidy. An example of this type would be a subsidy for the production of airplanes that is only available if the producer used domestic steel.

If a member establishes that another member is granting a prohibited subsidy, it may demand the removal of the subsidy, and eventually may implement countervailing measures.[302]

SCM Agreement Part III, Articles 5-7: Actionable Subsidies (ie, 'Blue box' subsidies)

SCM Article 5 establishes a category of subsidy that, while not prohibited *per se*, are actionable certain circumstances. Specific subsidies that cause (1) injury to the domestic industry of another member; (b) the nullification or impairment of a benefit accruing to another member; or (3) cause serious prejudice to the interests of another member; are actionable.

More on determining whether a subsidy causes "injury" to the domestic market will be discussed below in Section 4. More on the concept of "nullification or impairment" of a

[299] SCM Agreement, Sc. 4.
[300] For an illustrative list of subsidies falling within the purview of SCM Agreement Article 3.1(a), see Annex 1 to the SCM Agreement.
[301] SCM Agreement Article 3.1(b).
[302] SCM Agreement, Article 4.

benefit accruing to contracting members under the GATT will be discussed in Unit 5 Dispute Settlement below. For now, note that nullification or impairment of a benefit accruing under the GATT refers generally to a guarantee of market access.

Finally, determining whether a subsidy causes serious prejudice to the interests of another member involves a combination of considering SCM Articles 6.1 *and* 6.3. First, serious prejudice necessarily involves one of the instances referred to in Article 6.1, i.e.:

(a) Subsidies where the total *ad valorem* subsidization is more than 5% (Article 6.1(a)), (notice this categorically allows *de minimis* subsidization)
(b) Subsidies that are designed to cover operating losses of a domestic industry *or* a specific enterprise (Articles 6.1(a)&(b); or
(c) Subsidies that are granted for the purpose of debt forgiveness (Article 6.1(c)).

If one of these conditions is met, one must then consider whether the effect of the subsidy falls within Article 6.3; i.e. whether the subsidy (a) displaces or impedes like imports into the subsidizing market, (b) displaces or impedes like exports from the market of a third market, (c) results in a significant price undercutting of a like product of another member in the same market, or (d) has the effect of an increase in world market share of primary product or commodity.[303]

If it can be established that the subsidy is one that falls within one of the categories of Article 6.1, *and* the subsidy results in one of the effects listed in Article 6.3, the injured member may demand that the subsidy be removed, and eventually it may issue countermeasures.[304]

SCM Agreement Part IV: Non-Actionable Subsidies ('Green box' subsidies)

Some subsidies are considered perfectly legitimate. In general, subsidies that are designed to encourage 'positive externalities' are desirable to the world economy as a whole. A 'positive externality' is created when a transaction occurs that has external

[303] The SCM Agreement provides guidance at Article 6.4 and 6.5 for analyzing the effects listed under Article 6.3(b)&(c). For more details on actionable subsidies, please refer to these articles.
[304] See SCM Agreement Article 7.

benefits to parties that are not parties to the transaction. For example, a company might contract with a university to conduct research on the effects of a new type of pharmaceutical product that can be used to fight certain diseases. (For further reading on Countervailing Measures and Subsidies,[iv] refer to Annex 4, at the end of this Textbook.)

ANALYTICAL INDEX ON SCM AGREEMENT

ii. The Agreement on Agriculture

The Uruguay Round also produced important and extremely controversial Agreement on Agriculture (AA). A detailed discussion on the substantive aspects of the AA is beyond the scope of this course. However, it is important to know the basic structure of the AA, and more significantly, the policy debate surrounding it.

1. The Basic Substantive Structure of the Agreement on Agriculture

The first thing to note about the AA is how it interacts with the Agreement on Subsidies and Countervailing Measures. Article 3.1 of the SCM Agreement reads: *"Except as provided in the Agreement on Agriculture…"* Recall that Article 3 of the SCM Agreement prohibits export subsidies. Thus, the Agreement on Agriculture acts as an exception to the WTO's prohibition on export subsidies for agricultural products.

Specifically, the AA allows members to grant export subsidies on agricultural products, subject to bound commitment levels. The AA is designed much like GATT Article II, in that a member must submit a commitment schedule to the WTO in which it binds itself to (1) a maximum subsidized agricultural export volume, and (2) a maximum agricultural export subsidy value.[305] The schedule is then annexed to the AA, and binding on that member.[306] For example, a country might limit itself to a maximum of $50 million in subsidies for exported cotton; and a maximum of 50 million bushels of subsidized, exported cotton.

[305] AA Article 9.
[306] AA Article 8.

Also, the AA restricts circumvention of this requirement. Article 10(1) provides that "[e]xport subsidies not listed in [Article 9] shall not be applied in a manner which results in, or threatens to lead to, circumvention of export subsidy commitments…"
Finally, using a specific base period, the AA required members to reduce the volume of export subsidies by 36%, and the value of export subsidies by 21%, by the year 2000.

The Canada-Milk Case

2. The policy debate surrounding the Agreement on Agriculture

The controversy surrounding the AA is largely a divergence in viewpoints between developed and developing countries concerning the amount of protection afforded to farmers in rich countries. As mentioned above, the attitude that somehow domestic producers have some special claim to the domestic market still persists. This is particularly true for agricultural products. Thus, domestic agriculture lobbies wield considerable influence over policymakers.

In many developed countries, domestic agriculture-friendly policies also enjoy widespread political support for cultural reasons. Many perceive agriculture as a unique industry, and therefore, support its protection. This attitude stems from a nostalgic view of a country's *roots*; i.e. that agriculture is as much a cultural issue as it is an economic issue. Even though most developed economies have generally evolved from agriculture-based, to manufacturing, and finally to high-tech and service based industries, many hold the view that agriculture is part of the national identity. For example, consider such places as the United States and Europe where individualism plays such a central role. If this is the case, then small, independent farmers represent a culturally ideal character. Many believe this ideal should be protected from outside influence.

Finally, it is argued that agriculture is an industry of vital national importance. Just as an individual's independence is important, so is the nation's. Therefore, industries that produce such basic goods as the nation's food should be protect in the event of serious food crises.

The problem with the above arguments is that they largely ignore effects on outside markets, and foreign producers. Specifically, protection through subsidies (and by necessity, other forms of protection, as discussed below) has very serious consequences for developing countries' ability to export agricultural products to rich markets. A less obvious but equally concerning consequence of domestic protection is the effect it has on the *world market* price of agricultural products.

Most developing countries rely very heavily on their agricultural industries. In many developing and least-developed countries, such as Ethiopia, the transition from low-yield, subsistence farming towards high-yield production and exportation sums up the official national economic development policy. Also in many of these countries, again like in Ethiopia, the majority of the population is employed in low-yield, subsistence farming, where any possible household savings comes through small-scale market sales of limited production surplus. As discussed below, the lower the market price of these surpluses, the less a household can save.

Therefore, policies in developing countries that (1) restrict market access for developing countries' agricultural export; and (2) artificially suppress prices in developing countries' domestic markets; interfere with many national development strategies. But understanding this relationship requires basic knowledge of agricultural subsidies and their application in rich countries.

a. Agricultural subsidies under the microscope

Agricultural subsidies in rich countries generally take the form of either (1) 'domestic support', or (2) export subsidies.

<u>Domestic Support</u>

'Domestic support' is a broad term, and its precise definition is unnecessary for the purpose of this discussion. However, before discussing domestic support in more detail, it is important to note two things. First and foremost, while domestic support differs from export subsidies because it is not conditional upon export performance, it is nevertheless

granted to farmers *regardless* of whether the subsidized product is eventually sold for domestic consumption or exported. (Refer again to Footnote 4 of the SCM Agreement—you can see from that footnote that this is a permissible practice.) Second, domestic support is a means by which a government guarantees a certain income level to farmers.[307]

For purposes of this discussion, the means by which a government guarantees such a minimum income to farmers can be divided into two categories:

1) minimum price levels, and
2) direct transfers (also called 'deficiency payments').

Minimum price levels are simply minimum prices set by the government (in coordination with the agricultural industry). This would only be necessary if the actual market price is lower than desirable, and therefore, the minimum price set by the government is always artificially higher than the price which would be dictated by market supply and demand forces. For example, the market supply and demand for *injera* might create a natural market price of 1 birr per *injera*. However, the government has the option of prohibiting sales of *injera* at any price less than 2 birr.

This example of a minimum price level highlights the obvious effect of increases in the domestic price. (Of course, this hurts consumers in the domestic market, but for many rich countries the popular support for farmers outweighs this negative effect.) The other important consequence of such a policy is that it causes artificially high *production*. Consider again the example from above. If the price for *injera* is artificially high, then producers have an incentive to over-produce *injera* beyond the amount demanded in the market.

[307] William Petit, *"The Free Trade Area of the Americas: Is it Setting the Stage for Significant Change in U.S. Agricultural Subsidy Use?"*, 37 Tex. Tech L. Rev. 127, 2004, p. 136.

Thus, a surplus results, where domestic supply exceeds domestic demand, which is inefficient.[308] The problem becomes as to what to do with the surplus? The answer is usually exportation of that surplus (more on this below).

The other problem with such a policy is that it requires the implementation of other protectionist measures. Recall that the purpose of minimum price levels is to protect domestic farmers. But if the price is artificially high, *foreign* farmers will have an incentive to export to the market where the artificially high price exists, which defeats the policy of protecting *domestic* farmers. Thus, in order to give effect to the overall policy, governments must also exclude importation of the same products, which will be accomplished through tariffs, quotas, etc. As discussed above, this has a significant impact on the access farmers in developing countries have to these rich markets. By extension, developing countries' economic development strategies are thereby frustrated.
Direct transfers or *deficiency payments* have similar effects. Instead of setting a minimum price level, a direct transfer involves a payment from the government to the farmer to cover the difference between the market price of a product and a pre-set guarantee of income for the farmer. This is less distorting to the market, because supply and demand forces are still at work in setting the market price, and it does not require the exclusion of foreign exporters. (Of course, taxpayers pay in the end, though.)

However, these payments are usually given to farmers based on what they bring to the market, rather than what they actually sell on the market. Thus, the same incentive to overproduce is created. Again, this leads to domestic surplus, which usually must be exported.

The discussion on domestic support is summarized in the following table:
Notice the farmers' response here. They will be forced to export the surplus, which thereby floods export markets with products, which has the effect of lower prices in those markets. This is allowed by virtue of footnote 4 of the

[308] Id. p. 138.

Table 2: Summary of Domestic Support

Type	Policy Objective	Action	Consequences	Response
Minimum Price Support	Guarantee minimum income level of farmers	Prohibited sales at below a pre-set price	-Surplus through overproduction -Inefficient production -Consumers pay higher prices -Requires other protectionist measures	-Farmers export to limit costs -Governments encourage exportation of surplus through subsidies
Direct Transfers	Guarantee minimum income level of farmers	Pay farmers the difference between pre-set price and market price	-Surplus through overproduction -Inefficient production -Taxpayers pay higher taxes	-Farmers export to limit costs -Encourage exportation of surplus

SCM Agreement. (The effect of lower agricultural prices is discussed below.)

Export Subsidies

Notice also from the table above that under both types of domestic support, the basic domestic policy response to the problem of surplus production is to encourage exportation of the surplus. From a domestic perspective, this makes perfect sense—it would be wasteful for the products *not* to be sold somewhere, and since domestic demand has already been met, the only option is to sell in a foreign market.

The major problem with this response has to do with the fact that the price the farmer expects to receive is artificially high in the domestic market. Indeed, the high domestic price could be the only reason that the farmer produced in the first place. However, the *world market price* is not going to be artificially high, and it can be expected to be lower since the major export markets for these surplus products will be developing countries.

Therefore, the farmer cannot compete at a price on a foreign market that would justify production in the first place, and waste occurs.

Consider the following example: Assume that the cost of production for a bushel of cotton to a farmer in the US is $10/bushel. Assume that the price that the farmer is guaranteed in the domestic market through domestic support is $15/bushel. Of course, in this situation, it makes sense to produce the cotton. But assume that the farmer produces too much (which is likely), and can no longer sell on the domestic market so he or she wants to export the excess cotton. However, the price in the export market is only $2/bushel. In this situation, it would never make sense to produce the surplus in the first place, because now the farmer will be selling below the cost of production. Can you see what a government can do to further protect its farmers from the negative effects of overproduction described in this example? In other words, how could a government guarantee that the farmer earns the expected $15/bushel even though it is exporting the cotton to a foreign market?

This illustration highlights the relationship between domestic support and export subsidies. If a government wants to guarantee a certain income level for its farmers, even after overproduction, it will have to subsidize the exportation of the surplus. Thus, in keeping with the same example above, the US government could offer a subsidy of $13/bushel *contingent upon exportation*. This is an export subsidy which, although prohibited under the SCM Agreement in general, is allowed for agricultural export subsidies by virtue of SCM Agreement Article 3.1. The only requirement is that the export subsidy for the agricultural product falls within the member's schedule of commitments under the AA.

It may not be obvious at first, but this can be highly problematic for developing countries. First, recall that apart from rewarding less-efficient producers, export subsidies have the effect of lowering prices in the export market. It was noted above that this is a short-run benefit to consumers in the export market. However, what if the export market is

overwhelmingly reliant upon agricultural production itself? This leads to lower incomes for farmers in export markets.

Consider again the example of US cotton exports from above. The maximum profit a farmer can make from exporting the cotton and receiving the subsidy is $5/bushel (ie, revenue from market sale + export subsidy - cost of production = $5/bushel). But at what price could the farmer receiving the export subsidy sell one bushel of cotton for on the export market, and still make a profit? The farmer could actually sell a bushel of cotton on the export market for any price $0 and still make a profit! Thus, prices will naturally decrease, and unless a cotton farmer in the export market can produce cotton at a cost close to $0/bushel, it will not be able to compete with the subsidized farmer, and will be pushed out of the market, even if it is a more efficient producer.

This discussion highlights the potentially disastrous consequences that a combination of domestic support and export subsidies for agricultural products can have on developing countries. More on the WTO's current undertakings to remedy this situation is discussed further, below.

In conclusion, consider this situation in context in the following article, excerpted from William Petit, *"The Free Trade Area of the Americas: Is it Setting the Stage for Significant Change in U.S. Agricultural Subsidy Use?"*: [309]

> The corn trade between the United States and Mexico provides a great example of the conflict over what constitutes a de facto export subsidy. The United States claims that it does not use any export subsidies in the corn industry. However, according to a study by Oxfam International, U.S. agricultural policies like the 2002 Farm Bill constitute de facto export subsidies that fund the exportation of corn to Mexico by $105 million to $145 million annually. Oxfam explains that huge government payments that U.S. corn producers receive each year "influenc[e]" domestic production, and therefore determine export volumes and prices.

[309] Petit, Op. cites, No. 130; Ante.

Corn is an extremely important crop in the United States, and not surprisingly the U.S. corn industry *"is the largest single recipient of [U.S.] government payments"*. In fact, in 2000, even before the Farm Bill of 2002, the U.S. government subsidized corn farmers $10.1 billion. The majority of those subsidies were indirectly linked to production. They were linked to land area and past output. Therefore, the more land that farmers had and the amount of corn that farmers previously produced determined the amount of government payments they would receive in the future.

These policies encouraged farmers, usually agribusinesses, to buy more land to farm and to produce more corn hoping that their present production would trigger more subsidies in the future. The 2002 Farm Bill more directly linked subsidies with production through the "counter-cyclical" or deficiency payments. As such, farmers became more inclined to overproduce. In all, these policies allow U.S. corn to represent seventy percent of the world market share of corn production, making the United States *"the largest exporter of corn both globally and to Mexico"*.

With seventy percent of the world market share, the sheer volume of corn exports from the [United States].. influences world prices, and prices in key markets such as Mexico, that are open to imports from the [United States]." In fact, because of government subsidies, the United States can export corn to Mexico at prices twenty percent lower than the cost of producing the corn at home. These prices, together with the volume of exported corn from the United States, necessarily cause the world price of corn to fall dramatically. In Mexico alone, U.S. subsidies have caused corn prices to fall by seventy percent. The consequences that these subsidies have on Mexico and its corn farmers are unconscionable.

As it is already indicated, Oxfam reports that the United States subsidizes its corn export to Mexico by over $100 million annually. That number *"exceeds the total household income of the 250,000 corn farmers in the state of Chiapas"*. Those same farmers are increasingly becoming less able to compete. *"They are*

competing not against [U.S.] farmers, but against [U.S.] taxpayers and the world's most powerful treasury."

As a result, Mexican corn farmers are leaving their fields by the thousands. From the village of Comalapas, Chiapas, in southern Mexico, *"at least 300,000 Mexican workers are forced to immigrate to the [United States] every year"*. The U.S. subsidies force the Mexican farmers and workers who do not leave to provide for their families using the meekest of incomes. Their families' food supply, healthcare, and education suffer. Moreover, farmers are increasingly being forced to sell their corn harvests, a part of which they would normally save for their families' own consumption.

Because of U.S. subsidies, the crisis facing Mexican corn farmers is the same as the crisis that farmers in developing countries face throughout the world. Cotton growers in Africa, for example, cannot compete with cotton growers in the United States who received half of their income last year from the U.S. government under the Farm Bill of 2002. The deficiency payments, in particular, stimulated overproduction and resulted in a record harvest of 9.74 billion pounds of cotton in 2002, much of which was dumped on the world market. That much cotton depressed world prices to an extent "far below the breakeven price of most growers around the world.

Farmers in Africa, for instance, received thirty-five to forty cents per pound for cotton, while U.S. cotton growers, backed by government-deficiency payments that make up for market prices, received seventy to seventy-five cents per pound. African nations, like other developing countries, must be able to export their principal commodities to survive. But, *"[e]ven the World Bank President, James Wolfensohn, acknowledges that 'these [U.S.] subsidies are crippling Africa's chance to export its way out of poverty'."*

The United States is able to subsidize its farmers so extensively because it does so consistently with current international trade regulations at the WTO. *"The problem is that the WTO regulations relating to agriculture are deeply flawed. They fail to acknowledge that transfers to producers include a de facto export subsidy."* Basically, the extent of domestic support that U.S. farmers receive

greatly influences production, results in high-volume exportation, depresses world prices, and causes the economies of developing countries throughout the world to suffer.[310]

5.3.2 Dumping

Introduction to Dumping and Anti-Dumping Duties

The second trade practice that is considered 'unfair' is that of dumping. In general, 'dumping' refers to a situation where goods are exported in an uncompetitive fashion. In most instances, this occurs either (1) when a good is sold at a price in the export market that is below the price for which it is sold in the domestic market; or (2) when a good is sold in the export market at a price below cost of production.[311] If this is the case, the importing country may be entitled to implement anti-dumping duties commensurate with the amount of the injury. Anti-dumping duties are little more than additional tariffs levied against a dumped product. To illustrate, consider the following table:

Notice from the table the effect the anti-dumping duty will have on the price in the export market *after* it is levied. What will the price then become for each product?

Table 3: Examples of Dumping and Appropriate Anti-Dumping Duties for Goods X & Y

	Cost of Production	**Price in Domestic Market**	**Price in Export Market *before* the Anti-Dumping Duty**	**Amount of Anti-Dumping Duty**
Good X	$100	$110	$105	$5/unit imported
Good Y	$70	$75	$60	$10/unit imported

[310] Ibid.
[311] See GATT Article VI:1(a)&(b)(ii).

Economic Effects of Dumping

Arguments against dumping

The overall economic welfare effects of dumping are still debated by economists. However, it is important to note that the WTO categorically considers dumping as having negative effects. This section will discuss the basics arguments in the debate surrounding dumping.

Dumping always results in short-term price decreases in the import market. However, the most common arguments against the practice of dumping revolve around (1) the long and short-term effects on the importing market's producers, and (2) the long-term effects on consumers.

First, dumping hurts producers in the importing market because they may not be able to compete with the price of a good when it is dumped in their domestic market. This may result in 'predatory pricing,' which is a situation where one producer pricing its goods at below-cost with the aim of driving efficient producers out of the market.[312] A producer engaged in predatory pricing would have to produce at a loss, at least for a while. But this might make economic sense if it could gain a monopoly in the long-run.

It is important to note that this scenario requires a considerably un-integrated market, in order to prevent *re*-exportation of a good back into the original market (this is called parallel exportation). Parallel exportation describes a situation where a good is bought at a low price in one market, and then exported back into the market where it was produced at a higher price. This is only possible if the parallel export market is open, rather than protected.

The major negative effect of predatory pricing (sometimes called predatory behavior) is that the producer in the long-run will be less efficient than the producers it was able to drive out of the market. This results in long-run efficiency losses.

[312] Trade Dictionary, p. 287.

Second, if the above situation materializes, the less-efficient will eventually raise prices *above* the natural, market price of the good. The producer will have to do this in order to cover normal costs of production (which are higher than the costs of production of the competitors it has driven out of the market). Furthermore, it may have to raise prices even further to cover the losses it sustained while it was involved in predatory prices. Of course, this results in long-term price increases, and other negative consequences of monopolistic behavior.

To illustrate this effect, consider the following example:

> A company in country A might want to dominate the market for a good in country B. In this case, the company could export and sell the good below cost of production for a short period of time. If others cannot compete with the company selling the good at the below-cost-of-production price, they will eventually have to shift production into another good. If this is the case, then the company will have a monopoly over the product in the country, and therefore, it will be able to raise prices in the long-run which eventually hurts consumers.
>
> Consider this example in the following table:

Table 4: The potential long-run effects of predatory pricing

	Exporter's (inefficient) Cost of Production	**Exporter's (inefficient) Price**	**Domestic Producer's (efficient) Cost of Production**	**Domestic (efficient) Producer's Price**
Short-run	100	50	80	70
Long-run	100	P>100	n/a (out of market)	n/a (out of market)

Argument in favor of dumping

Skeptics of this argument question the practical likelihood of such type of predatory behavior. Such predatory behavior is costly. Imagine selling products at below cost of production for years until your competitors are driven out of the market — that involves quite a loss. Thus, it would only make sense if future profits were guaranteed.

Furthermore, selling at below cost of production can make perfect (and fair) economic sense under certain circumstances. Selling at below cost of production allows producers to minimize marginal costs, whether or not they are earning profit on the sale. Lowering marginal costs is a perfectly fair way of doing business. To illustrate this point, consider the following example:

> Imagine that an automobile manufacturer produces 100 cars. It costs $5000 to produce each car, and the company exports and sells each car for $6000 to earn a $1000 profit. Under this scenario, the total cost of production is $500,000, and the total expected profit is $100,000.
>
> However, assume that the price of oil increases fivefold, which causes the demand for automobiles the decrease significantly. At that point, the company may only be able to sell its cars at a maximum price of $2500, which means that instead of a profit it will be selling at a loss. Should the company be allowed to sell at this price? Or should it be forced to sell at the cost of production?

Table 5: Potential benefits of selling at below cost of production

	Cost of Production	**Price**	**Profit**	**Loss**
Initial state of market	5000	6000	1000/unit sold	n/a
State of market *after* external force—option	5000	5000	0	5000 (assuming no sales)

1				
State of market *after* external force—option 2	5000	2500	0	2500

The above example illustrates the issue of minimizing marginal costs. It should be clear to you that *after* the cars are produced the company should always sell at the best price it can get *regardless* of whether it earns a profit or not. Therefore, even though this example would fall within the definition of dumping, it does not result in predatory behavior.

Dumping Under the GATT

In general, the WTO frowns upon the practice of dumping, for the above reasons. Particularly because of the issue of parallel exportation discussed above.[313] Recall that dumping could benefit the producer in the exporting country, but only if that country was relatively protected. Because producers have a considerable amount of lobbying power, governments might be pressured by these producers to protect their markets.

The first thing to note about the dumping under the GATT is that it is not prohibited behavior. Remember, dumping is a *private* undertaking, and WTO rules control *government* behavior. Thus, the GATT only authorizes importing countries to take remedial measures in the form of anti-dumping duties.

The GATT defines dumping as selling of a product at a price below the "normal value", if it causes or threatens to cause material injury to an industry in another member's

[313] See EC COMMISSION, ELEVENTH ANNUAL REPORT ON THE COMMUNITY'S ANTI-DUMPIGN AND ANTI-SUBSIDY ACTIVITES, 1993, paras. 2.2-2.3.

territory.[314] The "normal value" of a product is either the comparable price if the product was sold in the domestic market (or a third market if a domestic price is unavailable), or below the cost of production.[315]

If the above conditions are met, a country is allowed to levy anti-dumping duties against the country where the company is exporting from. This will be focus of the next section.

5.3.3 The Application of Countervailing Measures and Anti-Dumping Duties

The main focus of applying anti-dumping duties or countervailing measures is whether there has been an 'injury.' This determination is initially conducted by the respective domestic authority. WTO rules for determining injury in the Anti-Dumping Agreement and the Agreement on Subsidies and Countervailing Measures are virtually identical, and therefore they will be dealt with together. Additionally, the injury assessment for the purposes of the AD and SCM are similar, though not identical to, the process of levying a safeguard action under the Agreement on Safeguards.

In general, determining 'injury' for the purposes of applying countervailing measures or anti-dumping duties involves a three-step process:

1) the domestic industry must be defined;
2) material injury to that industry must be assessed; and
3) the cause (or threat of cause) of that material injury must be established.

There is very little WTO jurisprudence interpreting these elements. However, the United States International Trade Commission, and Court of International Trade, have developed a substantial body of jurisprudence regarding domestic industry, and other the other elements of injury and causation, that is useful in guiding arguments in these areas.

[314] GATT Article VI(1).
[315] GATT Article VI(1)(a) & (b).

5.4 Defining the Domestic Industry

Defining the domestic industry is necessary because anti-dumping duties and countervailing measures may only be applied to imported products that injure or threaten to injure that particular industry. If the definition is too broad, anti-dumping duties and countervailing measures could be used as a disguised restriction on trade, with distorting effects. If the definition is too narrow, the negative effects of dumping and improper subsidization abroad would be exacerbated despite the action taken in response.

"Domestic industry" for the purposes of the AD and SCM Agreement refers to *"the producers as a whole of the <u>like products</u>…"* Thus, the focus is on determining likeness. Refer to what you have learned about the relevant considerations in determining like products under Articles I & III. Although analyzing 'like product' is similar to the analysis in these Articles, it is always case-by-case. Consider the following views of the former Commissioner of the United States International Trade Commission:

> "Generally, 'like product analysis' is founded on the following points. First, 'like product' covers more than virtually identical articles and may include substantially similar articles. Next, 'likeness' is determined on the basis of both characteristics and uses. The definitions of 'like product' and 'industry' are factual determinations which involve subjective considerations based on the weight of the evidence…The balance of factors, such as price, similarity of manufacturing processes, interchangeability in use, and customer perceptions as to competition among products is determined on a case-by-case basis."[316]

As with the determination of like product under an Article I or III analysis, product pricing and end-uses play a significant role. Consumers' responses to differences in prices give strong evidence of 'likeness'. For instance, if all else is equal, and two products are priced significantly differently, but both enjoy strong sales on the market,

[316] Quoted from High Capacity Pagers from Japan, U.S. Intl. Trade Comm. (1983), Inv. No. 731-TA-102 (Final)(Pub. No. 1410), 5 ITRD 1721, (Views of Commissioner Sterns).

consumers probably treat them as different. After all, rational consumers would not purchase a higher priced product if it was like or substantially similar to a lower-priced product. Common end-uses also provide strong evidence of customer preferences.

It is also important to note that from the above excerpt that, as with Article I, 'like products' is a category that is broader than *identical* articles. Once 'like products' is established, the focus shifts to the actual producers of those products. Recall that the domestic industry must be carefully defined in order to avoid the use of disguised trade restrictions, and the negative effects of dumping and improper subsidization. Therefore, domestic industry is narrow category that is limited to producers of the 'like products.'

The issues surrounding defining domestic industry has to do with how extensive the "upstream" and "downstream" producers are generally excluded from this category. "Downstream producers" are producers of goods that use inputs, and are more toward their final stages of process (like consumer's goods). "Upstream producers" are producers of goods that are used as inputs in other goods (like primary products or other producers' goods). For example, a wood processing plant is an "upstream producer", while a furniture manufacturer is a "downstream producer".

Question 1: Can you see why these producers are generally excluded from the definition of domestic industry? Are downstream and upstream producers affecting in the same way by 'unfair' trade practices?

Downstream producers typically benefit from 'unfair' trade practices, because their products will be cheaper due to cheaper foreign inputs. Thus, it is clear that they should not benefit from overbroad protection. However, it is less clear that upstream producers should enjoy the same protection, as it is possible that demand for these products would decrease due to cheaper dumped or subsidized imported products that use the upstream product as an input. Ask yourself, what would happen to the price of a domestic upstream product if an anti-dumping duty or countervailing measure was levied against the like imported product?

Anti-dumping duties and countervailing measures are designed to negate the price-distorting effects of subsidized or dumped imports. Thus, for example, if finished furniture products were being dumped into Country A by Country B's industries, the anti-dumping duty would be the difference between the dumped price and the domestic price — i.e. the price after the anti-dumping duty was levied would bring the price back to the natural market price in Country A.

If Country A also levied an anti-dumping duty against wood imports that are used in the production of the furniture (i.e. an upstream product), the price of the domestic wood would increase *above* the natural market price in Country A (due to the effect tariffs have on prices).

This is problematic. Upstream products are usually used in a variety of products. Therefore, if the price of these products were to increase, the price of products other than those being dumped or subsidized would increase. Therefore, instead of serving the objective of cancelling out the negative effects of dumping or improper subsidization (and adjusting prices to the natural market price), the anti-dumping duty or countervailing measure could actually increase prices overall.

5.5 Determining Material Injury

5.5.1 Establishing Causation

Dumping under the Agreement

The GATT does not contain procedural rules that countries must follow in order to make an injury determination or to levy anti-dumping duties. This prompted the creation the Anti-Dumping Agreement (AD) during the Uruguay Round.

Article 3 of the AD dictates the procedure for determining whether dumping "causes or threatens to cause material injury" to a domestic industry. In general, domestic authorities must consider: (1) the volume of the dumped imports, and the effect of the dumped

imports on prices in the domestic market for like products; and (2) the consequent impact of the dumped goods on domestic producers of the like products.[317] These factors *must* be considered, even though they may not be conclusive in and of themselves.[318]

With regard to the first consideration of volume, there must be a *"significant increase dumped imports, either in absolute terms or relative to production or consumption in the importing Member."*[319] 'Significant' in this sense probably means that the increase in imports is enough to have the *potential* to cause or threaten to cause material injury. Next, the country must consider whether a "significant price undercutting" has taken place.[320]

5.2 Third Principle: Implementing Customs Law

5.2. 1 Country of Origin Markings and Non-Preferential Rules of Origin[321]

As noted in the International Trade law books, Article IX of GATT sets forth rules about country of origin marking requirements. Article IX:1 precludes a WTO Member from discriminating against articles of certain countries with respect to country of origin marking requirements. Article IX:2 states that these requirements should be reduced to a minimum to avoid difficulties and inconveniences caused to commerce and industry. Article IX:4 provides that compliance with the requirements should not result in serious damage to, or material reduction in value or unreasonable increase in the cost of, the foreign article.

What purpose should country of origin marking requirements serve? GATT Article IX does not expressly answer this question. Perhaps a clue is provided in Article IX:2, which states that due regard must be given to the "necessity of protecting consumers against

[317] Anti-Dumping Agreement Article 3.1.
[318] See Guatemala—Definitive Anti-Dumping Measure regarding Grey Portland Cement from Mexico (November 17, 2000) WT/DS156/R.
[319] Anti-Dumping Agreement Article 3.2.
[320] Id.
[321] International Trade Law Handbook References: Uruguay Round Agreement on Rules of Origin and 19 U.S.C. $$ 1124-1125 and 1304.

fraudulent or misleading indications." But, how does protection against the risk of fraud relate to a label that says "Made in China"? The label itself could be fraudulent.

Quite possibly, marking requirements are premised on the theory that the ultimate purchaser of imported merchandise has a right to know where the merchandise she might is made.

Except for their outermost containers, the following kinds of articles are among those items which, under the U.S.A. Customs regulation law, are not required to be marked with *country of origin*.

Art, works of
……

Beads, unstrung.
Bearings, ball, 5/8-inch or less in diameter.
----
live or dead animals, fish and birds

Buttons
Cards, playing.

Chemicals, drugs, medicinal, and similar substances, when imported in capsules, pills, tablets, lozenges, or troches.
Cigars and cigarettes.

…….
Nails, spikes, and

…..
Natural products, such as
vegetables,
fruits, nuts and berries, and

Paper, newsprint.

Rope…

Springs, watch

Sugar, maple.

Eggs.
Feathers.

Flowers, cut.
Glass, cut to shape and size for use in clocks, hand, pocket, and purse mirrors, and other glass of similar shapes and size not including lenses or watch crystals.

Leather, except finished.
Livestock
Lumber, except finished.[322]

Trees, christmas

Wire, except barbed.

Unless an article being shipped (e.g., to the United States) is specifically named in the foregoing list, it would be advisable for an exporter to obtain advice from U.S. Customs before concluding that it is exempted from marking.

Other Exceptions

The following classes of articles are also exempted from markings of country of origin; i.e., including on their containers.

- An article imported for use by the importer and not intended for sale in its imported or any other form.
- An article which is to be processed in the United States by the importer or got his account otherwise than for the purpose of concealing the origin of the article and in such manner that any mark of origin would necessarily be obliterated, destroyed, or permanently concealed.

[322] Raj Bhala *et la*, Op cites, No. 13, p. 335.

- An article with respect to which an ultimate purchaser in the United States, by reason of the character of the article, or by reason country of origin even though the article is not marked to indicate its origin. The clearest application of this exemption is when the contract between the ultimate purchaser in the United States and the supplier abroad insures that the order will be filled only with articles grown, manufactured, or produced in a named country.

The following classes of articles are also exempted from being marked with country of origin except on their containers.

- Article that are incapable of being marked.
- Article that cannot be marked prior to shipment to the United States without injury.
- Articles that cannot be marked prior to shipment to the United States, except at an expense economically prohibitive of their importation.
- Articles for which the marking of the containers will reasonably indicate the origin of the articles.
- Crude substances.
- Articles produced more than 20 years prior to their importation into the United Stated.
- Articles entered or withdrawn from warehouse for immediate exportation or for transportation and exportation.

This exemption applies only when the articles will reach the ultimate purchaser in an unopened container. For example, articles which reach the retail purchaser in sealed containers marked clearly to indicate the country of origin come within this exemption. Materials to be used in building or manufacture by the builder or manufacturer who will receive the materials in unopened cases likewise come within the exemption. The following articles, as well as their containers, are exempted from marking to indicate the country of their origin;

- Products of American fisheries those are free of duty.
- Products of possessions of the United States.

- Products of the United States exported and returned.
- Articles valued at not more that $5 that are passed without entry.

Country of origin marking requirements is separate and apart from *special marking or labeling requirement on specific products by other agencies* – like, for example, that of the Food and Drug Administration.

Customs custody, as well as *marking-false impression,* is punishable by law.

***Entry of Articles*[323]**

When an imported good, article reaches any port, the owner, purchaser or licensed customs broker designated by the owner, purchaser or consignee files entry documents for the goods, articles with the port director at the port of entry. As a rule, imported goods are not legally entered:

a) until after the shipment has arrived within the port of entry,
b) delivery of merchandise has been authorized by the concerned (Customs) body, and
c) estimated duties have been paid.[324]

Entry of merchandise, actually, is a two part process, namely,

1) filing the documents necessary to determine whether merchandise may be released fro Customs custody, and
2) filing the documents which contain information for duty assessment and statistical purposes.

Entry Documents

Within five working days of the date of a shipment's arrival at a U.S. port of entry, entry documents must be filed at a location specified by the port director; unless an extension is granted. These documents consist of:

[323] International Trade Law Handbook References: 19 U.S.C. §§ 81a-u, 1555, 1557 and 1562. (As reference, see at United States Customs service, Importing into the United States, November 1998, pp. 8-10, 30-32, 83 [electronically available])
[324] Raj Bhala *et la*, Op cites, No. 13, p. 348.

- Entry Manifest … or Application and Special Permit for Immediate Delivery. . . .
- Evidence of right to make entry.
- Commercial invoice . . .
- Packing lists if appropriate.
- Other documents necessary to determine merchandise admissibility.[325]

If the goods are to be released from Customs custody on entry documents, an entry summary for consumption must be filed and estimated duties deposited at the port of entry within 10 working days of the time the goods are entered.

Surety

Surety refers to accompanying evidence that bond is posted with Customs to cover any potential duties, taxes, and penalties which may accrue. In the case of U.S. regulations, such bonds may be secured through a resident U.S. surety company, but may be posted in the form of United States money or certain United States government obligations. In the even that a customs broker is employed for the purpose of marking entry, the broker may permit the use of his bond to provide the required coverage.

Entry Summary Documentation

Following presentation of the entry, the shipment may be examined, or examination may be waived. The shipment is then released, provided no legal or regulatory violations have occurred. Entry summary documentation is filed and estimated duties are deposited within 10 working days of the entry of the merchandise at a designated customs house. Entry summary documentation consists of;

- The entry package returned to the importer, broker, or his authorized agent after merchandise is permitted released.
- Entry summary . . .
- Other invoices and documents necessary for the assessment of duties, collection of statistics, or the determination that all import requirements have been statistics.

[325] Id, p. 349.

This paper documentation can be reduced or eliminated when utilizing features of the ABI.[326]

-

Immediate delivery[327]

According to U.S. Customs regulations, an alternate procedure provides for immediate release of a shipment. This may be used in some cases by making application for a special permit for immediate delivery prior to the arrival of the merchandise. Carriers participating in the Automated Manifest System can receive conditional release authorizations, after leaving the foreign country, and up to five days before the landing in the United States. If the application is approved, the shipment is released expeditiously following arrival. An entry summary must then be filed in proper form, either on paper of electronically, and estimated duties deposited within 10 working days of release.

Entry for Warehouse[328]

Likewise, if it is desired to postpone the release of the goods, the goods may be placed in a Customs bonded warehouse under a warehouse entry. The goods may remain in the bonded warehouse up to five years from the date of importation. At any time during that period, warehoused goods may be re-exported without the payment of duty, or they may be withdrawn for consumption upon the payment of duty at the rate of duty in effect on the date of withdrawal. If the goods are destroyed under customs supervision, no duty is payable.

Certain, specified types of goods, when not imported for sale, or imported for sale only on approval, may be admitted into the United States under bond, without payment of duty; i.e. for exportation within one year from the date of importation. This is known as *Temporary Importation Under Bond* – or TIB.[329]

[326] Ibid.
[327] Id., p. 349-350.
[328] Id., p. 350.
[329] Id., p. 351.

5.6.2 Foreign Trade Zones

Generally speaking, a country, Foreign Trade Zones (FTZs) can be established within close proximities of a nation's port(s), industrial park or in a terminal warehouse facility. To do so, the country should have provision(s) in its legal system – including appropriate regulations.

According to current regulations in the United States a corporation or a political subdivision, i.e., like one of the 53 States that constitute U.S.A., may apply to the Foreign Trade Zone Board (for the purpose of exhibition, manufacturing and the like activities in order to avoid customs duties) and acquire permission to establish a "general purpose" FTZ or a "subzone", as long as,

a) local domestic industries, or
b) labor groups

are not sensitive to the establishment of such a zone.[330]

There are numerous regulations to the operation and supervision of FTZs. Any item brought or imported from abroad to the FTZ as per set regulations can be exported free of U.S customs duty. But if it is to be imported into the U.S. territory,

> .. Customs Service makes a critical threshold inquiry: is the merchandise 'privileged' or 'non-privileged'? .. In general, only foreign merchandise that has not yet been manipulated or manufactured so as to affect a change in its HTS tariff classification is eligible for privileged status. ..
>
> "The Customs Service appraises and classifies foreign privileged merchandize when the merchandize enters an FTZ. Accordingly, the importer .. pays the previously determined tariff when the merchandise is imported into the customs territory of the United States. …"[331]

[330] Id., pp. 358-359.
[331] Ibid.

If the item in question is "non-privileged", meaning, merchandise that is composed entirely of foreign non-privileged or domestic merchandise, or of a combination of privileged and non-privileged merchandise, the Customs Service appraises and classifies it when it gets transferred out of an FTZ.

> Therefore, the tariff owed on non-privileged merchandise depends on its classification and valuation when it is imported into United States customs territory, not when it enters an FTZ.
>
> ".. The flexibility afforded the importer is significant because it means the importer can pay duty either on components and raw materials, or on a completed article. That is, the FTZ allows the importer to minimize its duty liability – an obvious goal of every importer.
>
> "Suppose the importer .. [has to pay higher customs duty to components or raw materials]. The importer can minimize its tariff liability by (1) bringing higher-duty foreign components into the FTZ, (2) not filing an application for privileged status with the Customs Service, and (3) manufacturing or assembling the higher-duty components in the FTZ into a lower-duty product.[332]

In addition to minimizing tariff liability, FTZs serve the following four purposes.

1. FTZs expedite and encourage foreign commerce.
2. Facilitate marketing.
3. Promote assembly and manufacturing operations within local territory.
4. Minimize, or avoid, transportation costs, delay, .. of manufactured, assembled items for the local market.[333]

(In some countries with few job opportunities, FTZs are used as cites of assemblage, production of items destined for foreign markets.)

[332] Id., pp. 359-360.
[333] Id., pp. 260-261.

5.6.3 Classification[334]

As mentioned earlier, countries are required to have a systematized taxing system if they are to participate in international free trade system, sign trade agreements and become WTO members. One such a requirement relates to "Harmonized Tariff Schedule" – i.e., HTS.

> .. The HTS is based upon the internationally adopted Harmonized Commodity Description and Coding System (known as the Harmonized System or HS) of the Customs Cooperation Council. .. [T]he HS was derived from the earlier Customs Cooperation Council Nomenclature, which in turn was a new version of the older Brussels Tariff Nomenclature. The HS is an up-to-date, detailed nomenclature structure intended to be utilized by contracting parties as the basis for their tariff, statistical and transport documentation programs. …
>
> "Under the HS Convention, the contracting parties are obliged to base their import and export schedules on the HS nomenclature, but the rates of duty are set by each contracting party. …[335]

Countries are shifting away from the previous HS to the widely accepted HTS as they become WTO Member countries. As the following excerpt is indicative, the structure of the document is considerably different from that of the HS.

> The HTS .. sets forth all the international nomenclature through the 6-digit level and, where needed, contains added subdivisions assigned 2 more digits, for a total of 8 at the tariff rate line (legal) level. Two final digits are assigned as statistical reporting numbers … Chapter 98 comprise special classification provisions .., and Chapter 99 .. contains temporary modifications pursuant to legislation or to presidential action [e.g., U.S.A.] ..[336]

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[334] International Trade Law Handbook References: 19 U.S.C. § 1401a., and United States HTS, General Rules of Interpretation and Additional U.S. Rules of Interpretation.
[335] Raj Bhala *et la*, Op cites, No. 13, p. 361.
[336] Id, p. 362. (Students are advised to also read pp. 363-394.)

Since it would be necessary to adapt the latest classification in order to trade with the world, below is given a short note on some features of the HTS form in use.

> As regards the payment of tariffs, there are two essential steps an importer undertakes with respect to imported merchandise: classification and valuation. Classification is the process whereby the article is placed in the correct HTS category. There are approximately 5,000 articles described by headings (identified by four digits) or sub-headings (identified by six digits) in the 96 of the 98 chapters of the HTS. ..
>
> ".. Valuation is the process of appraising the value of the article. In the case of ad valorem duty rates, the tariff is applied to this value. Thus, the process of establishing the duty owed is determined by the following simple arithmetic formula:
>
> Duty Owed=(Tariff applicable to classification of article) X (Value of article)
>
> ".. An important practice tip is that 'if in doubt, ask'. .."[337]

The HTS classifies articles in one of four different ways according to the HTS General Rules of Interpretation – i.e., GRI.

As can be seen, "classification of articles" is common to all; i.e., same articles are given the same identification number wherever in the world. What remains is to set "duty rates". Thus, after a number of attempts, a methodology for *harmonization of valuation standards*, which can be applicable world wide, has been hammered out.

> The Uruguay Round Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade 1994 (Agreement on Customs Valuation) is virtually identical to the 1979 Tokyo Round Code. .. It is important to understand that the Agreement augurs greater uniformity in valuation methodology, but not necessarily uniform values. The aim of the Agreement .. is to ensure that different customs officials in the WTO

[337] Id., p. 369-370.

> Members use the same approach to determine the value of an article for purpose of applying a tariff. The goal is not to ensure that they always reach the same value with respect to a given article.
> "A variety of economic factors may cause the price of a particular article, in dollar terms, to vary from one country to another, and from one week to the next. .."[338]

5.6.4 Drawback[339], PSI[340] and Dispute Settlement

> "The term drawback refers to a refund of 99 percent or taxes collected on imported merchandise because certain legal regulatory requirements have been met. .."[341]

International trade practices necessitate that Pre-Shipment Inspections (i.e., PSI) be undertaken. In compliance to that, such PSI undertakings should provide, among other things, the following important benefits to the exporter:

1. Ensure that confidential exporter information is protected;
2. Minimize unreasonable delays in inspection; and
3. Use uniform price verification.[342]

> "Finally, the PSI Agreement requires user members to ensure that PSI entities establish procedures and designate local personnel to receive, consider, and render prompt decisions on written appeals or grievances lodged by exporters.
> "Article 4 calls for the establishment of a system of binding arbitration for grievances that cannot be resolved through the appeals process described above. …

[338] Id, p. 393.
[339] International Trade Law Handbook References: 19 U.S.C. § 1313.
[340] International Trade Law Handbook References: Uruguay Round Agreement on Pre-Shipment Inspection.
[341] Raj Bhala *et la*, Op cites, No. 13, p. 418.
[342] Id., p. 419.

> "Article 6 provides for ministerial review of the PSI Agreement two years after it goes into effect and every three years thereafter. GATT Article XXII and the WTO Understanding on Dispute Settlement will apply to consultations and dispute settlement under the agreement."[343]

5.6.5 National Treatment[344]: International Taxes, "Like Products" and GATT Article III:1-2[345]

As mentioned earlier, GATT does not forbid states to levy tariff (Sur-Tax included) on imports. It focuses on taxing of import, export goods; i.e., leaves internal taxes, to states. The arguments discussed below relate to the question: Which kind of taxes are *international* and which ones are *internal/ national*? As practical experiences have demonstrated, this matter is of great significance in abiding to terms and conditions of trade agreements; i.e., avoiding trade war/conflict/.

> A tariff duty is a tax. But the General Agreement makes a fundamental distinction between tariff duties and other taxes, usually called internal taxes. This distinction gives rise to two kinds of problems. First, where a country elects to impose a tax at the point of importation but does not call the tax tariff is the tax to be considered a tariff duty or an internal tax? Second, in view of the fact that tariff duties and internal taxes may have the same effect on imports, what are the rights and duties under the General Agreement? These questions may arise in either of two contexts. First, an increase in an internal tax affecting a bound item may be said to give rise to 'nullification or impairment' of the tariff binding under Article XXIII. In that event the problem is not .. one of non-tariff barriers, but rather one of the scope of rights and obligations of arising from a tariff concession. Second, the residual rights and duties concerning internal taxes, above and beyond those rights and duties arising from tariff concessions, may come into question whether or not the item in question is bound. ..

[343] Id., pp. 420-421.
[344] International Trade Law Handbook References: GATT Article III and NAFTA Article 301.
[345] Kenneth W. Dam, The GATT, 1970, pp. 115-117.

> "In view of the similarity between tariffs and internal taxes, ..[GATT] indicates the priority position accorded the problem of internal taxes. The crucial internal tax provisions of Article III are paragraphs 1 and 2. .. Paragraph 1 sets forth a general principle applicable not only to internal taxes but also to internal legislation and regulations in general. Paragraph 2 deals with internal taxes in particular and is divided into two sentences, only the second of which refers to paragraph 1.[346]

The ambiguities inherent in Article III become evident as we discuss Japan's case, the second largest market of American distilled spirits, on Alcoholic Beverages. In light of the fact that this precedent case throws light to the final outcome of proceedings of similar cases, vital points raised and the conclusion reached are included as follows.

> ".. Under Japan's Liquor Tax Law, certain imported beverages – such as brandy, cognac, genever, gin, liqueurs, rum, vodka whiskey and other spirits – were subject to an internal tax. However, domestically produced shochu .. was subject to a much-reduced tax.
>
> "Naturally, the complainants ... claimed the Japanese tax scheme violated Article III:2. [Claiming:-] contrary to the first sentence, the Japanese applied different tax rates to like products. [Also claiming:-] Contrary to the second sentence, it distorted the relative prices of imports and shochu, and consequently distorted consumer choice between these categories of alcoholic beverages."[347]

The agreement's specific part relating to the case under consideration reads as follows:

Article III – National Treatment on International Taxation and Regulation

1. The contracting parties 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

[346] Raj Bhala *et la*, Op cites, No. 13, pp. 423-424.
[347] Id., p. 424.

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 contracting party imported into the territory of any other contracting party shall not be subject, directly or indirectly, to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products. Moreover, no contracting party shall otherwise apply internal taxes or other internal charges to imported or domestic products in a manner contrary to the principles set forth in paragraph 1.

Article III – Paragraph 2

A tax confirming 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.

Since Japan contested the claim on the grounds that:

a) *shochu* is different than the other imported *spirits*, i.e., is not a "like product" as to the others, and
b) brandy, genver, gin, liqueurs, rum, and whiskey were not "directly competitive or substitutable products" to *shochu*, a WTO panel was assigned to look at the matter.

The panel held that *shochu* is a "like" product vis-à-vis *vodka*, and, therefore, Japan violated the first sentence of Article III:2. The panel also concluded that *shochu* and the other imported *spirits* are "directly competitive or substitutable product"; therefore, Japan has also violated the second sentence of Article III:2.

After a second hearing, the final note reads as follows:

> The Appellate Body recommends that the Dispute Settlement Body request Japan to bring the Liquor Tax Law into conformity with its obligations under the General Agreement on Tariffs and Trade 1994.[348]

5.6.6 GATT Article III:4 and Article III:5

Any laws and regulations issued or requirements set should not be in contradiction to Article III:4 of the General Agreement. So, WTO Member countries should see to it that their respective laws, regulations and requirements are in line with Articles of the General Agreement; i.e., whatever the intent of an Act, none should infringe free trade as envisioned under GATT.

Thus, for example, *The Foreign Investment Review Act*,[349] adopted by the Canadian Parliament in 1973, was countered by U.S.A in fear that it would oblige foreign investor(s),

a) to purchase goods of Canadian origin in preference to imported goods or in specified amounts or proportions, or to purchase goods from Canadian sources, and
b) to manufacture in Canada goods which would be imported otherwise are inconsistent with Article III:4 of the General Agreement.

On the other hand, Canada requested the panel to find that the purchase undertakings (i.e., paragraph 3.1(a)), given by foreign investors are not inconsistent with the provisions of Article III:4 of the General Agreement. As to the manufacturing undertakings (i.e., paragraph 3.1(b)), it asked the panel to find that these do not fall under the Panel's terms of reference.

[348] Id., p. 443.
[349] Id., pp. 443-450. (Read also Report of the GATT Panel, Canada- Administration of the Foreign Investment Review Act, B.I.S.D., 30th Supp., (Adopted 7 February 1984), at pp. 140, 142-147, 157-162, 165-168.)

The case was resolved with the Panel's suggestion that Canada ensure that any future purchase undertakings will not provide more favorable treatment to Canadian products than that of others as soon as possible.

Another, similar case of interest would be the Domestic Marketing Assessment[350] (or DMA) of the United States enacted in 1993 as part of the Budget Act.[351]

The Panel found that the DMA, i.e., Section1106 (a) of the 1993 Budget Act, is in violation with Article III:5 of the General Agreement in sourcing its national market to its domestic cigarette manufacturers.

5.7 The Fourth Principle: Non-Tariff Barriers

The new array of protectionist approaches that began to proliferate after the 1930s are "Non-Tariff Barriers" – or NTBs. These consist of erection of a host of restrictive measures like *domestic content legislation*. According to the most recent definition of NTB, the restrictive measures include:

1) Lack of transparency in a trade regime,
2) Measures implemented under the rubric of "technical standards" (mostly by developed countries, as will be discussed), and
3) Measures ostensibly designed to protect an array of interests, including human, animal or plant life/health, labor rights;

Meaning, the goal of non-tariff barriers is actually to expand exports and support/protect specific, local industrial sectors; i.e., expanded governmental discretionary powers influencing trade patterns and the global location of economic activities through policies promoting export subsidy, credit guarantee and tax incentives.[352]

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[350] Report of the GATT Panel, United States – Measures Affecting the Importation, Internal Sale and Use of Tobacco, (adopted 4 October), B.I.S.D. (41st Supp. Vol. 1), 1997, at pp. 131-134, 159, 160-162, 176-177.
[351] Omnibus Budget Reconciliation Act of 1993, Pub. L. No. 103-66, 107 Stat. 318, August 10, 1993.
[352] Raj Bhala *et la*, Op cites, No. 13, p. 499.

Lack of openness surrounding customs inspection activities, performance requirements and/or government regulations – i.e., governmental use of voluntary export restraints and orderly market arrangements (also known as VERs or "organized free trade") included – make it difficult to distinguish these new protectionist approaches as NTBs. VERs are controlled sectors generally characterized by global overcapacity, usually unionized, and major sources of blue-collar, labor intensive employment. The "newly Industrialized Countries (NICs) like South Korea made use of foreign investments, joint ventures, etc .., and managed to become exporters of automobiles, accessories of high technologies and even services to the developed countries within a comparatively short period of time, as the comparative economic advantage dramatically shifted to their favor. [353]

As the trend toward this sectoral protectionism has become a major feature of the evolving trade regime, it has become clear that it is altering the structure of world trade; i.e., is determining who is trading, who is left out and what is to be traded. Another major aspect of NTB has been its effect on market structure, trade, the international trade and the location of world industry. Their effects comprise,

1. promoting oligopolies by means of "cartelization";
2. forcing target countries to [climb] up the technological ladder within a product line to higher value-added exports (e.g., from unprocessed to highly processed);
3. dispersion or re-allocation of the industries through direct investments made by multinational corporations.[354]

Another effect of the new NTBs has been to alter trade negotiations away from MFN principles as opposed to GATT Article XIX, i.e., towards increased trade discrimination, benefitting few privileged foreign exporters and certain protected domestic industries, intensifying the politics of international trade and the issue of who benefits and who shouldn't. Because of these effects (effects that are contrary to MFN principles), the following crucial questions should necessarily be asked.

[353] Id., p. 500.
[354] Id., pp. 500-501.

1) *Which firms and countries will be included in the trading regimes and the cartelized world markets?*
2) *Who will share the economic rents and who will be left out?*
3) *On what political or other basis will these determinations be made?*
4) *Will the powerful countries seek to reward their friends and punish their enemies in the determination of voluntary export restraints and orderly marketing agreements?*
5) *How can tradeoffs be determined and international agreements be negotiated successfully, given the inherent difficulty of measuring the extent and welfare costs of non-tariff barriers and the benefits of eliminating them?*
6) *Does the New Protectionism inevitably mean a collapse of the world economy similar to the 1930 or merely its transformation into an economically more stable and politically more sustainable set of global economic relations?"*[355]

The initial philosophy of GATT being one that dictates the immediate abolishment of NTBs, it – however – has no general provision, but rather treats each type separately; since NTBs can assume widely varying forms, and since there can be honest disagreement not only on whether a given measure should be termed a non-tariff barrier or what might be resultant effect of such a prohibitory action be, say, on imports. These concerns seem to have partly contributed to the inclusion of NTBs in the Kennedy, Tokyo as well as Uruguay Round of talks.[356]

In such cases where prohibitory approach is deemed feasible, e.g., quantitative restrictions, contracting parties are prohibited from introducing new measures and required to eliminate forthwith existing measures according to Article XI. On the other hand,

> ".. such a prohibitory approach is not feasible for all types of trade measures that may inhibit imports. Various financial measures, to take only one set of examples, are considered consistent with free trade, despite

[355] Id., pp. 501-502.
[356] Ibid.

the fact that they inhibit imports to a great or lesser extent. A 'trade barrier' effect is thought to arise from these financial measures only if the charge is inordinately high or if there is some kind of discrimination in its imposition or administration. Thus, the relevant provisions of the General Agreement must be regulatory and not prohibitory in character.

"The regulation of permissible financial measures takes several forms. Internal taxes are not to be imposed at a higher rate on imported goods than on domestically produced goods (Article III). Antidumping and countervailing duties are permitted only in certain prescribed cases and even then are limited to amounts deemed sufficient in the circumstances to accomplish a few approved objectives (Article IV). And fees charged by customs officials are limited to the approximate cost of customs services (Article VIII).

"Non-tariff barriers that are other than financial in character raise a variety of problems. With respect to some measures, such as domestic legislation and regulations concerning sales, purchases, transportation, and distribution, a 'trade barrier' effect arises only if there is discrimination against imported goods, and it is considered sufficient to prohibit such discrimination (Article III). But with respect to other measures, such as requirements concerning marks of origin, the source of any 'trade barrier' effect is hard to pin down, and quite general language is necessary (Article IX). In some instances the General Agreement even regulates non-tariff barriers by setting out affirmative rules, such as the rule requiring the prompt publication of laws, judicial decisions, and regulations concerning imports (Article X).

"… In the case of production subsidies that tend to reduce imports, the General Agreement does not go beyond a general requirement of notification and consultation designed to reduce subsidization (Article XVI). …

"Quantitative restrictions ... are subjects of very complex provisions. [T]he General Agreement undercuts its general prohibition of quantitative

> restrictions with three major exceptions. .. [Q]uantitative restrictions may be maintained [: a)] for balance-of-payments purposes (Article XII-XV) .. [b)] in support of certain domestic agricultural programs, particularly.. [for] raising domestic prices above the world market price, tend to create an incentive for importation (provided that domestic production or marketing is similarly limited) (Article XI) .. [c)] by less-developed countries [as these] are permitted under certain circumstances to impose quantitative restrictions in furtherance of their economic development programs or in response to foreign exchange problems attributable to their peculiar status (Article XVIII).
>
> "The General Agreement ... [dealing on] the free flow international commerce that operates on the export, rather than the import, side of the transaction ... is generally operative Article (XI). But the export equivalent of the tariff – that is, the export subsidy – .. of primary products are subject to special rules designed to prevent one country from obtaining an undue proportion of world trade, and other forms of export subsidies are subject to more stringent limitations (Article XVI)."[357]

5.7.1 Transparency and GATT Article X[358]

As noted earlier, transparency and openness in trade is one of the prerequisites under GATT, WTO. Non-transparency of rules is a barrier to free and fair competition in two respects.

1) Those who are not made aware of the rules are disadvantaged;
2) Potential entrants are disadvantaged relatively to those who are aware of the rules.

[357] Id., pp. 502-503.
[358] International Trade Law Handbook References: GATT Article X and NAFTA, Chapter 18.

Transparency is all about providing the opportunity to learn the rules to all existing and potential competitors on a non-discriminatory basis, by ensuring that international trade laws are sufficiently transparent and avoid NTB.

Here, a number of questions might arise, like for example:

- When, how early, should a law, regulation, .. be made public?
- Is a government required to publish all its trade related laws, regulations in all of the official United Nations languages (Arabic, Chinese, English, French, Russian and Spanish)?
- Is a government required to publish all its trade related laws, regulations to each and every trading partner?

  "GATT Article X:1 provides some guidance, requiring prompt publication in such a manner as to allow governments and traders to become acquainted with the law. Article X:2 calls for enforcement of laws only after they have been officially published*."*[359]

It has been established that Article X:1 does not require publication of administrative rulings to all other than to those specific trading entities. Likewise, the government of a WTO Member country is not expected to share information on impending changes in law with all, except those few it needs to consult with.

A Panel assembly report over a trade dispute between Brazil and the European Communities (ECC) came to the following conclusion as to what constitutes transparent and appropriate practice of trade as relates to Article X.

"… VI. Article X of the GATT 1994

"109. Article X of the GATT 1994 states, in relevant part:

"1. Laws, regulations, judicial decisions and administrative rulings of general application, made effective by any Member .. shall be published

[359] Raj Bhala *et la*, Op cite, No. 13, p. 504.

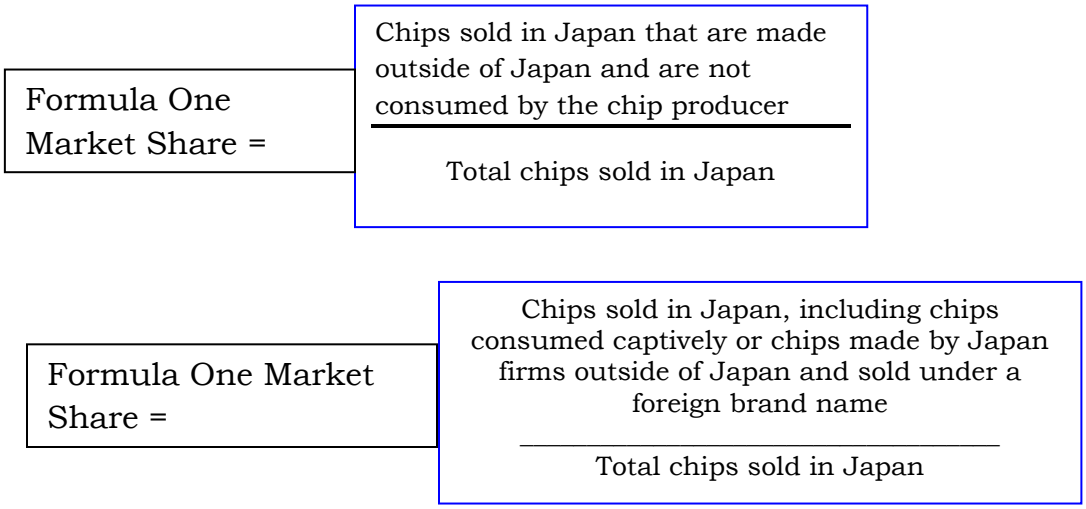
> promptly in such a manner as to enable governments and traders to become acquainted with them …
>
> "3. (a) Each Member shall administer in a uniform, impartial and reasonable manner all its laws, decisions and rulings of the kind described in paragraph 1 of this Article.
>
> "110. With respect to Article X, the Panel found:
>
> ".. that Article X is applicable only to laws, regulations, judicial decisions and administrative rulings 'of general application' .. licenses issued to a specific company or applied to a specific shipment cannot be considered to be a measure 'of general application'. .." [360]

Similar kind disputes arise over "quota restriction"; i.e. another type of NTB. The economic effects of quotas have been well described by economists; e.g. U.S. Steel Industry.[361] Article XI of the General Agreement is concerned with quantitative restrictions in trade.[362] Unlike the trade disputes that arose in the automobile, photographic film paper, steel and telecommunications sectors, that on semiconductors created considerable friction in trade between U.S. America and Japan throughout the Reagan, Bush and Clinton times of presidency. At issue was: Was Japan dumping its semiconductor products in the United States and its markets?

Here, to make it clear to students,

> ".. dumping is the sale of a good in an importing country at less than fair value, i.e., at a price less than the price at which the same or a like product is sold in the home country. If dumping causes or threatens injury to an industry in the importing country, then it is actionable [through a]ntidumping law ..."[363]

[360] Report on the Appellate Body, European Communities – Measures Affecting the Importation of Certain Poultry Products, WT/DS69/AB/R, (Issued 13 July 1998, Adopted 23 July 1998).
[361] Raj Bhala *et la*, Op cites, No. 13, pp. 512-527.
[362] International Trdae Law Handbook References [ITLHR], Op. cites, No. 358, Article 309.
[363] Raj Bhala *et la*, Op cites, No. 13, p. 528.



After some consultations and wrangling on the wordings, the parties agreed on the following two set of conceptual formulas [conceivably, as a means of conceptual framework in determining dumping on trade regimes].[364]

Through such a conceptual formula, and efforts at achieving sectoral reciprocity ".. a market sharing, cartel-type arrangement, as the U.S –Japan semi-conductor arrangement has become in some respects, strengthening the very government-business collusion the United States normally seeks to eliminate…"[365]

5.7.2 Exceptions to the Rule against Quantitative Restrictions[366]

Though Article XI:1 of GATT purports to promote free trade by taking a hard line against quantitative restrictions on imports, the prospective Article XI:2(b) condones certain technical barriers to trade permitting quantitative restrictions "necessary to the application of standards or regulations for the classification, grading or marketing of

[364] Id., pp. 530-531.
[365] Ibid. (Students are advised to read:- Report of the GATT Panel, Japan – Trade in Semiconductors, B.I.S.D. (35th Supp.) 1989, Adopted 4 May 1988), pp. 116, 118-122, 151-158.)
[366] [ITLHR], Op. cites, No. 358; GATT Articles XII–X IV and XVIII and NAFTA Annex 301.3 and Article 2104.

commodities".[367] In a similar fashion, NAFTA Annex 301:3 contains exceptions to Article 309:1 (i.e., the one that mentions Article X:1) in addition to those in GATT Article XI:2.

Member countries typically impose "foreign exchange controls" as they face "hard-currency" shortfalls; i.e., serious current account deficit of widely accepted currencies for import/export payments such as U.S. Dollars ($), Euro (€), Japanese Yen, … necessitates countries to limit BOP – Bill of Payment. As Panama's practical experience has shown that abandoning ones currency and replacing it with a hard currency of another would amount to sacrificing a substantial degree of sovereignty over monetary affairs.[368]

In order to preserve precious "hard currency" reserves, exporters in Member countries are usually required to deposit a portion of their hard-currency earnings with the central bank (e.g. Ethiopian National Bank). The export earnings are normally withdrawn by the exporter only in local currency, i.e. "soft-currency", at an official exchange rate. Typically, the Member country determines what may be imported with such a precious reserve currency; i.e., essential raw materials, intermediate goods and vital finished products, rather than luxury items.

In crisis conditions, i.e., if the country's hard-currency reserve is below that of 1/3 of its import requirements for twelve consecutive weeks, a Member country (having difficulty of BOP – Bill of Payment) may elect to enact quantitative barriers to imports that would otherwise run afoul of Article XI:1. Some of these measures may include a [special] license from the government in order to import goods and imposition of import quotas on certain products, while certain products, such as toys, can be completely banned.

[367] Raj Bhala *et la*, Op cites, No. 13, p. 550.
[368] Folmson, Ralph *et la*, International Business Transactions, (2nd Ed. West Group, St. Paul, MN), 2001, p. 1003.

As the restrictions are to be drafted in terms of the quantity (i.e., value) of the importable goods, parameters are set within which the scheme must operate.[369] These are, in short, enumerated as follows:

> (1) Restrictions shall be progressively relaxed as conditions permit;
>
> (2) Measures should avoid uneconomic employment of productive resources;
>
> (3) As far as possible, measures should be adopted that expand rather than contract international trade;
>
> (4) (Measures should) (a)void unnecessary damage to commercial or economic interests of any other contracting parties;
>
> (5) (Measures should) (a)llow minimum commercial quantities of each description of goods so as to avoid impairing regular channels of trade;
>
> (6) (Measures should) (a)llow imports of commercial samples;
>
> (7) (Measures should) (a)void restrictions that prevent compliance with **'**patent, trademark, copyright, or similar procedures';
>
> (8) But imports of certain products deemed more essential may be preferred over other imports."[370]

A special exception to Article XI:1 is provided in GATT Article XVIII:B that establishes a BOP exception to the rule against quantitative restrictions for LDCs (i.e., for Least Developed Countries).

> As Article XVIII:4(a) makes clear, the exception applies specifically to WTO Members with an **'**economy .. (that) can only support low standards of living and is in the early stages of development.**'** The BOP exceptions in GATT Articles XII and XVIII are not mutually exclusive, and some distinctions exist between the two Articles. For example, Article XVIII does not speak of an 'imminent' reserves crisis and, therefore, seems to contemplate that LDCs may face a chronic problem and need to implement quantitative restrictions for long periods. Moreover, Article XVIII:9 indicates that quantitative restrictions may be used **'**to ensure a

[369] Raj Bhala *et la*, Op cites, No. 13, pp. 549-551.
[370] John H. Jackson, Op. cites, No. 260, p. 685.

> level of reserves adequate for the implementation of its (i.e., the LDC's) program of economic development …' Thus, evaluating an LDC's right to invoke Article XVIII: - requires an examination of its development plans. Finally, a Member imposing a quantitative restriction for BOP reasons under Article XII must enter into annual consultations with the rest of the Membership. If the basis of the restrictions is Article XVIII:B, then such consultations must be biennial. Significantly, pursuant to Article XIV, an Article XVIII BOP exception may be applied in a discriminatory fashion.[371]

Aside from the special attentions given to certain circumstances and economic conditions of LDCs, it would be interesting to note, here, that the terms of the General Agreement (GATT) is insurmountable; i.e., Members can hardly attain legal rights permitting them to impose restrictions on import goods. Say, for example, if significant number of consumers and their associations, etc .. wish to block or restrict import of certain goods; e.g., through "self-imposed limitations to foreign imports"[372] and the like, they may not; because the country's foreign trade (foreign relations) would be in jeopardy.

5.7.3 Technical Barriers to Trade[v]

"Technical barriers" are conditions that limit the utilitarian significance of a commodity within a given country. For simplicity, a conscious/enlightened consumer living in Ethiopia would prefer to buy an electrical device of 220 Volts power-supply than another of 120 Volt, as the former would function without a step-up transformer.

Here, it should be clear to the student that International Trade Law is not interested in the technicality of standards or manufacturing requirements but rather in "technical barriers to trade (i.e., TBT)". International Trade Law concern over TBT lies only in so far as

[371] Raj Bhala *et la*, Op cites, No. 13, pp. 552-553.
[372] [ITLHR], Op. cites, No. 358; Uruguay Round Agreement on Safe guards Articles 11:1(b), 11:2. See as well:- Consumers Union of U.S., INC. v. Kissinger, 506 F.2D 136, 137-139, 141, 143-144, 146, 149-152 (D.C. CIR. 1974), cert. denied, 421 U.S. 1004, (1975).

such barriers become tools or means of "disguised protectionist measures"; i.e., indirect NTBs.

> "To be sure, in some markets, traders and trading nations realize a shared interest in avoiding market chaos by harmonizing product standards quickly. The work of .. the International Telecommunications Union, as regards radio frequency is a case in point. ..
> "The different standards for electricity, .., cars, .., computer operating systems, .. , reflect both market forces and government intervention. ..
> "A key factor in the ultimate success or failure of a standard in terms of its adoption is the availability of the standard. ..."[373]

So, from the perspective of international trade, as long as the formidable, appropriate standard is available, the question seems to be resolved; i.e., every Member country should follow suite, adapt and work according to the testing methodology of the newly set standard. Otherwise, the TBT could be considered as unjustified, disguised, protectionist measure that amounts to a measure in violation of GATT Article XI:1 (which, by the way, focuses on border measures).[374]

The only condition that may win some consideration, it seems, is when that particular methodology and technical standard can truly not be met by a Member country.[375] For clarity, supposing a developing country:

- lacks the required level of sophistication – can truly not meet the required level of standard beginning from the earliest to the last stages of production/processing; or
- truly lacks the necessary capital, human, etc.., resources to meet those standards.

As long as these difficulties can be overcome, it surely would be presumable that it would be to the benefit of the developing countries themselves to adapt and work according to agreed-upon, set standards.[376]

[373] Raj Bhala *et la*, Op cites, No. 13, pp. 565-566.
[374] Id., p. 566.
[375] Ibid.
[376] Also read from Raj Bhala *et la*, Op cites, No. 13, pp. 567-578.

Recapitulation

The Principle of Non-Discrimination in the GATT 1994

Non-Discrimination: Definition[377]

The principle of non-discrimination, or, in other words, the requirement not to treat less favorably all "like" products, irrespective of their origin or whether they are imported or domestic, is the cornerstone of the WTO multilateral trading system. The non-discrimination obligation contributes to ensuring fair and predictable international trade relations.

The principle of non-discrimination in international trade is two-faceted: it consists of the most-favoured-nation treatment obligation and the national treatment obligation.

Most-Favoured-Nation Treatment Obligation: Article I:1[378]

The most-favoured-nation treatment obligation, widely known as the MFN treatment obligation, requires WTO Members not to discriminate *between* products originating in or destined for different countries. In simple terms, Country A should, for example, treat equally, or not discriminate *between* a product originating in Country B and a "like" product originating in Country More particularly, Article I:1 of the GATT 1994 provides:

Article I

General Most-Favoured-Nation Treatment[379]

> 1. With respect to customs duties and charges of any kind imposed on or in connection with importation or exportation or imposed on the international transfer of payments for imports or exports, and with respect to the method of levying such duties and charges, and with respect to all rules and formalities in connection with importation and exportation, and with respect to all matters

[377] Mrs. Stephanie Cartier, Op cites, No. 192, p. 13.
[378] Id., pp. 13-17.
[379] Id., p. 14.

> 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].

The objective of the MFN treatment obligation is to ensure equality of opportunity to import from or to export to all WTO Members.

When is there a Violation of the Most-Favoured-Nation Treatment Obligation?

Article I:1 of the GATT 1994 sets out a three-tier test. In order to determine whether or not there is a violation of the MFN treatment obligation of ArticleI:1, three questions need to be answered. First, does the measure at issue confer an "advantage" upon the products originating in or destined for the territories of all other Members? Second, are the products concerned "like"?

Third, was the advantage at issue granted "immediately and unconditionally" to all like products concerned?

Has an "advantage" been conferred upon imported or exported products?

The MFN treatment obligation concerns any advantage granted by any Member to any product originating in or destined for any other country through a variety of measures. The obligation to provide MFN treatment is not confined to tariffs. Article I:1 of the GATT 1994 enumerates measures by which an "advantage" can be conferred upon the products of a country. They include:

- tariffs and charges of any kind imposed in connection with importation and exportation;
- the method of levying tariffs and such charges;
- rules and formalities in connection with importation and exportation;
- internal taxes and charges on imported goods;
- internal laws, regulations and requirements affecting sales.

It is important to emphasize that the MFN treatment obligation not only takes into consideration advantages conferred upon products originating in or destined for WTO Members, but also advantages granted to "any other country". Therefore, if a WTO Member grants an advantage to products originating in or destined for a non-Member, the Member is compelled to grant the same advantage to all other WTO Members.

A broad definition is usually given to the term "advantage", and Article I:1 of the GATT 1994 covers a wide variety of measures.[380] In particular, it includes the rules and formalities applicable to countervailing duties, and those applicable to the revocation of countervailing duty orders as they constitute "rules and formalities imposed in connection with importation", within the meaning of Article I:1.[381] Merchandise processing fees are considered to be "charges imposed on or in connection with importation", within the meaning of Article I:1.[382] Regulations making the suspension of an import levy conditional on the production of a certificate of authenticity also fall under Article I:1.[383]

In *EC – Bananas I1I* , the European Communities maintained the so-called "activity function rules" which imposed requirements on importers of bananas from certain countries to qualify for tariff quotas that differed from those imposed on importers of bananas from other countries. The Panel found that the procedural and administrative requirements of the "activity function rules" for importing third-country and non-traditional ACP bananas differed from and went significantly beyond those required for importing traditional ACP bananas.[384] The Appellate Body, relying on the Panel's factual analysis, concluded that the European Communities had acted inconsistently with Article I:1 of the GATT 1994 through its "activity function rules" because they conferred an

[380] Ibid. (See Panel Report, United States – Denial of Most-Favoured-Nation Treatment as to Non-Rubber Footwear from Brazil ("US – Non Rubber Footwear"), adopted 19 June 1992, BISD 39S/128, para. 6.9; Appellate Body Report, EC – Bananas III, para. 206.)
[381] Ibid. (See Panel Report, US – Non Rubber Footwear, para. 6.8.)
[382]Ibid. (Panel Report, United States – Customs User Fee ("US – Customs User Fee"), adopted 2 February 1988, BISD 35S/245, para. 122.)
[383] Ibid. (See Panel Report, European Economic Communities – Imports of Beef from Canada ("EEC – Beef from Canada"), adopted 10 March 1981, BISD 28S/92, paras. 4.2 and 4.3.)
[384] Appellate Body Report, EC – Bananas III, para. 206.

advantage upon bananas imported from a group of States (ACP States), and not upon bananas imported from other WTO Members, within the meaning of Article I:1.[385]

In *Canada – Autos*, Canada maintained an import duty exemption on imports of motor vehicles granted to manufacturers of motor vehicles which met certain requirements related to their production of motor vehicles in Canada. The Appellate Body emphasized that: "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. Are the products "like"?

Article I:1 of the GATT 1994 provides that an advantage granted to a product originating in or destined for any other country shall be accorded to other "like products" originating in or destined for the territories of all other WTO 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.[386]

The MFN treatment obligation only applies to "like products". Discrimination between imported products is prohibited only if the products at issue are "like".

Accordingly, products that are not "like" may be treated differently.

The concept of "like products" is also found in numerous other articles of the GATT 1994, namely, Articles II:2(a), III:2, III:4, VI:1(a), IX:1, XI:2(c), XIII:1, XVI:4 and XIX:1. However, the concept of "like products" is not defined anywhere in the GATT 1994. The meaning of this concept has been examined in a number of GATT and WTO reports. It is generally accepted though that the concept of "like products" has different meanings depending on the context in which it is found. In *Japan – Alcoholic Beverages*

[385] Appellate Body Report, EC – Bananas III, para. 206.
[386] Appellate Body Report, Canada – Certain Measures Affecting the Automotive Industry ("Canada – Autos "), WT/DS139/AB/R, WT/DS142/AB/R, adopted 19 June 2000, para. 79.

II, the Appellate Body compared the concept of "likeness" to an accordion and is stated as:

> 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."[387]

In *Spain – Unroasted Coffee*, the issue before the Panel was whether different types of unroasted coffee were "like" within the meaning of Article I:1 of the GATT 1994. The Panel considered the characteristics of the products, their end-use and tariff regimes of other Members.[388]

> "The Panel examined all arguments that had been advanced during the proceedings for the justification of a different tariff treatment for various groups and types of unroasted coffee. It noted that these arguments mainly related to organoleptic differences resulting from geographical factors, cultivation methods, the processing of the bean, and the genetic factor. The Panel did not consider that such differences were sufficient reason to allow for a different tariff treatment. It pointed out that it was not unusual in the case of agricultural products that the taste and aroma of the end-product would differ because of one or several of the above-mentioned factors.
>
> The Panel furthermore found relevant to its examination of the matter that unroasted coffee was mainly, if not exclusively, sold in the form of blends, combining various types of coffee, and that coffee in its end-use, was universally regarded as a well-defined and single product intended for drinking.

[387] Appellate Body Report, Japan – Alcoholic Beverages II, p. 21.
[388] Panel Report, Spain – Tariff Treatment of Unroasted Coffee ("Spain – Unroasted Coffee"), adopted 11 June 1981, BISD 28S/102, para. 4.11.

> The Panel noted that no other contracting party applied its tariff regime in respect of unroasted, non-decaffeinated coffee in such a way that different types of coffee were subject to different tariff rates. In the light of the foregoing, the Panel concluded that unroasted, non decaffeinated coffee beans listed in the Spanish Customs Tariff … should be considered as 'like products' within the meaning of Article I:1."[389]

Finally, Article I:1 applies also to products that are not subject to a tariff binding.[390]

Was the advantage accorded "immediately and unconditionally"?

Article I:1 of the GATT 1994 requires that any advantage granted by a WTO Member to any country must be accorded "immediately and unconditionally" to all other WTO Members. This means that once a WTO Member has granted an advantage to a country, it cannot impose conditions on other WTO Members for them to benefit from that same advantage. The WTO Member must extend the benefit of the advantage to all WTO Members unconditionally.

In *US – Non-Rubber Footwear*, the Panel explained:

> "The Panel … considered that Article I:1 does nor permit balancing more favourable treatment under some procedure against less favourable treatment under others. If such a balancing were accepted, it would entitle a contracting party to derogate from the most-favoured-nation obligation in one case, in respect of one contracting party, on the ground that it accords more favourable treatment in some other case in respect of another contracting party. In the view of the Panel, such an interpretation of the most-favoured-nation obligation of Article I:1 would defeat the very purpose underlying the unconditionality of that obligation."[391]

[389] Panel Report, Spain – Unroasted Coffee, paras. 4.11 ff.
[390] Panel Report, Spain – Unroasted Coffee, para. 4.3.
[391] Panel Report, US – Non-Rubber Footwear, para. 6.11.

In *Indonesia – Autos*, the Panel found that under the Indonesia car programmes, customs duty and tax benefits were conditional on achieving certain local content value for the finished car. The Panel concluded that these conditions were inconsistent with the provisions of Article I:1 which provides that tax and customs duty advantages accorded to products of one Member (in that case, on products from the Republic of Korea) be accorded to imported like products from other Members "immediately and unconditionally".[392]

In *Canada – Autos*, the Appellate Body 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.[393]

In *US – Certain EC Products*, the United States increased the bonding requirements on certain products imported from the European Communities in order to secure the payment of additional import duties to be imposed in retaliation for the EC banana import regime. The Panel found that the additional bonding requirements violated the most-favoured-nation treatment obligation of Article I:1 of GATT 1994, as it was applicable only to imports from the European Communities, although identical products from other

[392] Panel Report, Indonesia – Certain Measures Affecting the Automobile Industry ("Indonesia – Autos"), WT/DS54/R, WT/DS55/R, WT/DS59/R, WT/DS64/R and Corr.1, 2, 3, and 4, adopted 23 July 1998, DSR 1998:VI, 2201, paras. 14.145-14.146.
[393] Appellate Body Report, Canada – Autos, para. 85.

WTO Members were not the subject of such an additional bonding requirements. The Panel explained further, that the regulatory distinction (whether an additional bonding requirement is needed) was not based on any characteristic of the product but depended exclusively on the origin of the product and targeted exclusively some imports from the European Communities.[394]

National Treatment Obligation: Article III

The national treatment obligation, commonly referred to as the NT obligation, requires WTO Members not to discriminate *against* imported products once the imported products have entered the domestic market. In other words, Country A should not treat products imported from Country B or C less favourably than its own "like" domestic products. Article III of the GATT 1994 provides, in relevant part:

National Treatment on Internal Taxation and Regulation

> 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.*
>
> …
>
> 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

[394] Panel Report, United States – Certain EC Products ("US – Certain EC Products"), WT/DS165/R, adopted 17 July 2000, as modified by the Appellate Body Report, WT/DS165/AB/R, para. 6.54. 3.5 GATT 1994 19)

> and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use. The provisions of this paragraph shall not prevent the application of differential internal transportation charges which are based exclusively on the economic operation of the means of transport and not on the nationality of the product.

Article III of the GATT 1994 prohibits discrimination between domestic and like imported products through the use of various internal measures enumerated in Article III:1, namely, 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, …

The purpose of Article III:1 is to ensure that such internal measures should "not be applied to imported or domestic products so as to afford protection to domestic production".[395]

In *Japan – Alcoholic Beverages II*, the Appellate Body emphasized that the broad and fundamental purpose of Article III is to avoid protectionism and that toward this end, ... *Article III obliges Members of the WTO to provide* equality of competitive conditions *for imported products in relation to domestic products.*[396]

Moreover, in *Korea – Alcoholic Beverages*, the Appellate Body went on to explain further, that Article III aims at: *"...avoiding protectionism, requiring equality of competitive conditions and protecting"* expectations of equal competitive relationships.[397]

The Appellate Body also made clear that Article III of the GATT 1994, like Article I, is not limited to products that are the subject of tariff concessions under Article II of the

[395] GATT, Article III:1.
[396] Article III:1 of the GATT 1994 and Panel Report, US – Section 337, para. 5.10.
[397] Appellate Body Report, Japan – Alcoholic Beverages II, p. 16.

GATT 1994.[398] However, Article III of the GATT 1994 is only concerned with internal measures and not border measures.

Article III only concerns internal measures while other GATT provisions deal specifically with border measures, such as Article II on tariff concessions and Article XI on quantitative restrictions. When the measure is applied at the time or point of entry into the importing country, it may be difficult to distinguish border measures from internal measures. *Ad* Article III Note specifies:

> "Any internal tax or other internal charge, or any law, regulation or requirement of the kind referred to in paragraph 1 which applies to an imported product and to the like domestic product and is collected or enforced in the case of the imported product at the time or point of importation, is nevertheless to be regarded as an internal tax or other internal charge, or a law, regulation or requirement of the kind referred to in paragraph 1, and is accordingly subject to the provisions of Article III."

For example, a ban on a product at the border for failure to meet public health standards would fall under Article III, and not Article XI, in spite of the fact that Article XI concerns specifically quantitative restrictions including total import bans. However, there can also be violations of both Articles III and XI in one single set of facts.[399]

The general principle on non-discrimination in Article III:1 informs the rest of Article III. The following paragraphs of Article III set out specific nondiscrimination obligations. Article III:2 of the GATT 1994 specifically concerns internal taxation, while Article III:4 deals with internal regulations. A further distinction needs be drawn. In Article III:2, the non-discrimination obligation regarding internal taxation applies not only to "like products" (first sentence), but also to "directly competitive or substitutable products" (second sentence).

[398] Appellate Body Report, Korea – Alcoholic Beverages, para. 120.
[399] Panel Report, India – Measures Affecting the Automotive Sector ("India – Autos"), WT/DS146/R, WT/DS175/R and Corr.1, adopted 5 April 2002, para. 8.1.

In contrast, the non-discrimination obligation regarding internal regulations in Article III:4 applies only to "like products". The relationship between Articles III:1, III:2 and III:4 of the GATT 1994 has been examined by the Appellate Body. Article III:1 provides the general principle that internal measures should not be applied so as to afford protection to domestic production. In *Japan – Alcoholic Beverages II*, the Appellate Body clarified that the function of this "general principle" is to "inform" the rest of Article III". The Appellate Body went on to state:

> The purpose of Article III:1 is to establish this general principle as a guide to understanding and interpreting the specific obligations contained in Article III:2 and in the other paragraphs of Article III, while respecting, and not diminishing in any way, the meaning of the words actually used in the texts of those other paragraphs.[400]

The Sections below examine more closely the obligations contained in Articles III:2, first sentence, Article III:2, second sentence and, Article III:4 of the GATT 1994.

When is there a Violation of the National Treatment Obligation, under Article III:2, first sentence?

Article III:2, first sentence, reads:

> 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.

As stated earlier, Article III:2 concerns only "internal tax or other internal charge of any kind". Once the measure at issue is an "internal tax or other internal charge of any kind", Article III:2, first sentence, sets out a two-tier test, which means that two questions need to be answered to determine whether there is a violation of Article III:2, first sentence:

(1) Whether imported and domestic products are "like products"; and

[400] Appellate Body Report, Japan – Alcoholic Beverages II, p.18.

(2) Whether the imported products are taxed in excess of the domestic products.[401]

The Appellate Body found that it is not necessary to establish a protective application of the internal taxation measure, pursuant to Article III:1, separately from the specific elements or requirements of Article III:2, first sentence.[402] As the Appellate Body explained, this does not mean that the general principle against protectionism in Article III:1 does not apply to Article III:2, first sentence, but that Article III:2 is, in effect, an application of the general principle against protectionism.[403] The Panel clarified in *Argentina – Hides and Leather* that whenever imported products from one Member's territory are subject to taxes in excess of those applied to the like domestic products in the territory of another Member, this is deemed to "afford protection to domestic production" within the meaning of Article III:1.[404]

Have internal taxes been applied?

Article III:2, first sentence, concerns only "internal taxes and other charges of any kind" which are applied "directly or indirectly" on products. Internal taxes on products such as value added taxes (VAT), sales taxes and excise duties are covered by Article III:2, first sentence. However, income taxes or import duties are not covered by Article III:2, first sentence, since they do not constitute internal taxes on products. Whether internal taxes are "applied directly or indirectly" on products should be understood to mean whether these taxes were applied "on or in connection with" products. The term "charges" denotes a "pecuniary burden" or a "liability to pay money laid on a person".[405]

Penalty provisions coupled with a domestic content requirement may be qualified as "internal taxes or other charges of any kind" within the meaning of Article III:2, first

[401] As reflected in the Panel and the Appellate Body reports in Canada – Periodicals, p. 20.
[402] See Appellate Body Report, Japan – Alcoholic Beverages II, pp. 18-19.
[403] See Appellate Body Report, Japan – Alcoholic Beverages II, pp. 18-19.
[404] Panel Report, Argentina – Measures Affecting the Export of Bovine Hides and Import of Finished Leather ("Argentina – Hides and Leather"), WT/DS155/R and Corr.1, adopted 16 February 2001, para. 11.137.
[405] The New Shorter Oxford English Dictionary, Vol. I, Oxford (1993), p. 374 3.5 GATT 1994 23.

sentence.[406] Security deposits are not fiscal measures if they are enforced for a purchase requirement.[407] Border tax adjustments are fiscal measures by which the exporting country waives or reimburses taxes and the importing country imposes taxes in accordance with the destination principle. They enable exported products to be relieved of some or all of the tax charged in the exporting country in respect of similar domestic products sold to consumers on the home market. They also enable imported products sold to consumers to be charged with some or all of the tax charged in the importing country in respect of similar domestic products. Such border tax adjustments fall within the scope of application of Article III:2.[408]

The aim pursued by the government imposing the tax measure is not relevant in determining whether the measure constitutes an internal tax within the meaning of Article III:2. In *Japan – Alcoholic Beverages II*, the Appellate Body stated that Members may pursue any given policy objective through their tax measures, provided that they do so in compliance with Article III:2.

In *Argentina – Hides and Leather*, Argentina required the pre-payment of certain taxes on the importation of goods. The Panel found that such "prepayment" constituted a mechanism for the collection of the taxes which also provided for the imposition of charges.[409] The Panel concluded that the tax measure was not designed to achieve efficient tax administration and collection, but rather took the form of an "internal charge" applied to products and therefore, fell within the scope of Article III:2, first sentence. Therefore, "tax administration" measures are not systematically excluded from Article III:2. They must be examined closely.[410]

Are the imported and domestic products "like"?

[406] Panel Report, United States – Measures Affecting the Importation, Internal Sale and Use of tobacco, ("US – Tobacco"), adopted 4 October 1994, DS44/R, para. 82.
[407] Panel Report, EEC Measures on Animal Feed Proteins ("EEC – Animal Feed Proteins"), adopted 14 March 1978, BISD 25S/49, para. 4.4.
[408] See Report of the Working Party, Border Tax Adjustment, adopted 2 December 1970, BISD 18S/97.
[409] Panel Report, Argentina – Hides and Leather , para. 11.143.
[410] Panel Report, Argentina – Hides and Leather , para. 11.144.

The national treatment obligation under Article III:2, first sentence, only applies to "like products". The concept of "like products" is not defined anywhere in the GATT 1994, and it does not contain any guidance as to the characteristics that must be considered in determining "likeness". However, numerous GATT and WTO dispute settlement reports have examined and applied the concept of "like products" in Article III:2, first sentence.

In *Japan – Alcoholic Beverages II*, the Appellate Body examined in detail the scope of the concept of "like products" within the meaning of Article III:2, first sentence. The issue was whether shochu and vodka could be considered to be "like products". The Appellate Body opted for a narrow interpretation of the concept of "like products" in the first sentence of Article III:2:

> 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.[411]

The Appellate Body also confirmed the basic approach for determining "likeness" set out in the 1970 Report of the Working Party on *Border Tax Adjustments*.

> .. 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

[411] Appellate Body Report, Japan – Alcoholic Beverages II, pp. 19-20.

> and habits, which change from country to country; the product's properties, nature and quality'.[412]

Although acknowledging the helpfulness of this approach in *Japan – Alcoholic Beverages II*, the Appellate Body emphasized that the range of "like products" in Article III:2, first sentence, is meant to be narrower than the range of products contemplated in some other provisions of the GATT 1994 and other Multilateral Trade Agreements of the WTO Agreement.*[413]* The Appellate Body also stated that determining whether products are "like" always involves "an unavoidable element of individual, discretionary judgments".[414] The Appellate Body said further that "[n]o one approach to exercising judgment will be appropriate for all cases. The criteria in Border Tax Adjustments should be examined, but there can be no one precise and absolute definition of what is "like"."[415] Two Panel Reports attempted to introduce the aim and effect test in assessing the likeness of products by ruling that in determining whether two products subject to different treatment are like products, it is necessary to consider whether the product differentiation at issue was being made "so as to afford protection to domestic production".[416] This approach was explicitly rejected in 1996 by the Panel in *Japan – Alcoholic Beverages II*,[417] and the Appellate Body also implicitly confirmed the Panel's rejection of the aim and effect test.[418]

In *Japan – Alcoholic Beverages,* the Panel concluded that shochu and vodka were "like" on the basis of the following reasoning:

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[412] Report of the Working Party, Border Tax Adjustments, para. 18 and Appellate Body Report, Japan – Alcoholic Beverages II, pp. 19-20.
[413] Appellate Body Report, Japan – Alcoholic Beverages II, pp. 19-20.
[414] Appellate Body Report, Japan – Alcoholic Beverages II, pp. 19-20.
[415]Appellate Body Report, Japan – Alcoholic Beverages II, pp. 19-20.
[416] See Panel Report, United States – Measures Affecting Alcoholic and Malt Beverages ("US – Malt Beverages"), adopted 19 June 1992, BISD 39S/206, paras.5.25 and 5.26 and the unadopted Panel Report, United States – Taxes on Automobiles, ("US – Automobile Taxes), circulated 11 October 1994, DS31/R, paras. 5.8 ff.
[417] See Panel Report, Japan – Taxes on Alcoholic Beverages ("Japan – Alcoholic Beverages II "), WT/DS8/R, T/DS10/R, WT/DS11/R, adopted 1 November 1996, as modified by the Appellate Body Report, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, DSR 1996:I, 125.
[418] Appellate Body Report, Japan – Alcoholic Beverages II, p. 16.

… The Panel noted that vodka and shochu shared most physical characteristics. In the Panel's view, except for filtration, there is virtual identity in the definition of the two products. The Panel noted that a difference in the physical characteristic of alcoholic strength of two products did not preclude a finding of likeness especially since alcoholic beverages are often drunk in diluted form. The Panel then noted that essentially the same conclusion had been reached in the 1987 Panel Report, which '... agreed with the arguments submitted to it by the European Communities, Finland and the United States that Japanese shochu (Group A) and vodka could be considered as 'like' products in terms of Article III:2 because they were both white/clean spirits, made of similar raw materials, and the end uses were virtually identical'.

Following its independent consideration of the factors mentioned in the 1987 Panel Report, the Panel agreed with this statement. … [The Panel] noted that (i) vodka and shochu were currently classified in the same heading in the Japanese tariffs, (although under the new Harmonized System (HS) Classification that entered into force on 1 January 1996 and that Japan plans to implement, shochu appears under tariff heading 2208.90 and vodka under tariff heading 2208.60); and (ii) vodka and shochu were covered by the same Japanese tariff binding at the time of its negotiation. Of the products at issue in this case, only shochu and vodka have the same tariff applied to them in the Japanese tariff schedule (see Annex 1). The Panel noted that, with respect to vodka, Japan offered no further convincing evidence that the conclusion reached by the 1987 Panel Report was wrong, not even that there had been a change in consumers' preferences in this respect. … Consequently, in light of the conclusion of the 1987 Panel Report and of its independent consideration of the issue, the Panel concluded that vodka and shochu are like products. In the Panel's view, only vodka could be considered as like product to shochu

> since, apart from commonality of end-uses, it shared with shochu most physical characteristics. Definitionally, the only difference is in the media used for filtration. Substantial noticeable differences in physical characteristics exist between the rest of the alcoholic beverages at dispute and shochu that would disqualify them from being regarded as like products. More specifically, the use of additives would disqualify liqueurs, gin and genever; the use of ingredients would disqualify rum; lastly, appearance (arising from manufacturing processes) would disqualify whisky and brandy…[419]

On the use of tariff classification to determine "likeness", the Appellate Body in the appeal in *Japan – Alcoholic Beverages II* explained that a uniform tariff classification of products can be relevant in determining what are "like products", if sufficiently detailed. Uniform classification in tariff nomenclatures based on the Harmonized System (the "HS") was recognized in GATT 1947 practice as providing a useful basis for confirming "likeness" in products.

However, as regards tariff bindings, the Appellate Body cautioned:

> [T]here is a major difference between tariff classification nomenclature and tariff bindings or concessions made by Members of the WTO under Article II of the GATT 1994. There are risks in using tariff bindings that are too broad as a measure of product "likeness". Many of the least-developed country Members of the WTO submitted schedules of concessions and commitments as annexes to the GATT 1994 for the first time as required by Article XI of the WTO Agreement. Many of these least-developed countries, as well as other developing countries, have bindings in their schedules which include broad ranges of products that cut across several different HS tariff headings. For example, many of these countries have very broad uniform bindings on nonagricultural products. This does not necessarily indicate similarity of the products

[419] Panel Report, Japan – Alcoholic Beverages II, para. 6.23. 26 Dispute Settlement

> covered by a binding. Rather, it represents the results of trade concessions negotiated among Members of the WTO. It is true that there are numerous tariff bindings which are in fact extremely precise with regard to product description and which, therefore, can provide significant guidance as to the identification of "like products". Clearly enough, these determinations need to be made on a case-by-case basis. However, tariff bindings that include a wide range of products are not a reliable criterion for determining or confirming product "likeness" under Article III:2.[420]

Are the imported products taxed "in excess of" the domestic products?

Article III:2, first sentence, provides that 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 ruled that "(e)ven the smallest amount in excess is too much".[421] The Appellate Body added that Article III:2, first sentence, does not require to apply a "trade effects test", nor does it stipulate a *de minimis* standard.[422] With regard to the absence of a "trade effects test", the Appellate Body stated:

> … 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. 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.[423]

[420] Appellate Body Report, Japan – Alcoholic Beverages II, pp. 21-22.
[421] Appellate Body Report, Japan – Alcoholic Beverages II, p. 23.
[422] Appellate Body Report, Japan – Alcoholic Beverages II, p. 23.
[423] Panel Report, United States – Taxes on Petroleum and Certain Imported Products, ("US – Superfund"), adopted 17 June 1987, BISD 34S/136, para. 5.1.1.

On the absence of a *de minims* standard, the Panel found in *US – Superfund* :

In *Argentina –Hides and Leather*, the Panel rejected the argument that the tax burden differential between imported and domestic products would only exist for a 30-day period and therefore was *de minimis*.[424] In that case, the dispute concerned the Argentine tax collection system which required the prepayment of taxes with respect to all import transactions but only with respect to internal sales made by certain taxable persons, the so-called "*agentes de percepción"*. The Panel ruled that the identity and circumstances of the persons involved in sales transactions could not serve as a justification for tax burden differentials.[425] The Panel also maintained that Article III:2, first sentence, requires a comparison of actual tax burdens. Recalling the purpose of Article III:2, first sentence, which is to ensure equality of competitive conditions between imported and like domestic products, the Panel explained that this Article is concerned with the economic impact on the competitive opportunities of imported and like domestic products, and not with taxes or charges as such or the policy purposes pursued with them.[426] Therefore, in the view of the Panel, tax burdens imposed on the taxed products should be the object of comparison.[427] The Panel stated:

> …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.[428]

It should be noted that the Panel in *EEC – Animal Feed Proteins* ruled that an internal regulation which merely exposes imported products to a risk of discrimination constitutes, by itself, a form of discrimination within the meaning of Article III.[429]

[424] Panel Report, Argentina – Hides and Leather , para. 11.245.
[425] Panel Report, Argentina – Hides and Leather , para. 11.220.
[426] Panel Report, Argentina – Hides and Leather , para. 11.182.
[427] Panel Report, Argentina – Hides and Leather , para. 11.182.
[428] Panel Report, Argentina – Hides and Leather , para. 11.183.
[429] Panel Report, EEC – Animal Feed Proteins, paras. 5.57, 5.60 and 5.76.

In *Argentina – Hides and Leather*, the Panel also ruled that Article III:2, first sentence, does not permit Members to balance more favorable tax treatment of imported products in some instances against less favorable tax treatments of imported products in other instances.[430]

Finally, in *Indonesia – Autos*, the Panel found that differences in taxes which are based only upon the nationality of producers or the origin of the party and components contained in the products are inconsistent with the national treatment obligation in Article III:2, first sentence.

When is There a Violation of the National Treatment Obligation, under Article III:2, second sentence?

Article III:2, second sentence, reads:

> *"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 earlier, Article III:1 sets out the general principle that internal taxes and other internal charges: …should not be applied to imported or domestic products so as to afford protection to domestic production.

Moreover, the *Ad* Article III Note provides that:

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

Article III:2, second sentence, can only be resorted to if the measure at issue is not inconsistent with Article III:2, first sentence. Therefore, one must always apply first the

[430] Panel Report, Argentina – Hides and Leather , para. 11.260.

test under Article III:2, first sentence. If the answer to one question is negative, then there is a need to examine further whether the measure is consistent with Article III:2, second sentence.[431] The Appellate Body stated on two occasions that Article III:2, second sentence, contemplates a "broader category of products" than Article III:2, first sentence.[432]

As stated earlier, Article III:2 concerns only "internal tax or other internal charge of any kind". Once the measure at issue is an "internal tax or other internal charge of any kind", and after it has been determined that it is not inconsistent with the first sentence of Article III, the second sentence of Article III sets out a different test. It is a three-tier test, which means that three questions need to be answered to determine whether there is a violation of Article III:2, second sentence. In *Japan – Alcoholic Beverages*, 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) the 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 aren't similarly taxed'; and

[431] Appellate Body Report, Canada – Certain Measures Concerning Periodicals ("Canada –Periodicals"), WT/DS31/AB/R, adopted 30 July 1997, , pp. 22-23.
[432] Appellate Body Report, Japan – Alcoholic beverages II, p. 25; Appellate Body Report, Canada – Periodicals, p. 19.

> (3) the dissimilar taxation of the directly competitive or substitutable imported 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."[433]

Have internal taxes been applied?

Article III:2, first sentence, concerns only "internal taxes and other charges of any kind" which are applied "directly or indirectly" on products. Internal taxes on products such as value added taxes (VAT), sales taxes and excise duties are covered by Article III:2, first sentence. However, income taxes or import duties are not covered by Article III:2, first sentence, since they do not constitute internal taxes on products. Whether internal taxes are "applied directly or indirectly" on products should be understood to mean whether these taxes were applied "on or in connection with" products. The term "charges" denotes a "pecuniary burden" or a "liability to pay money laid on a person".36

Articles III:2, first and second sentence, concern "internal taxes or other internal charges". This phrase has been interpreted consistently notwithstanding its position in the first or second sentence of Article III. The section 2.5.1 above includes discussion of this phrase.

Are the imported and domestic products "directly competitive or substitutable"?

The national treatment obligation in Article III:2, second sentence, applies to "directly competitive or substitutable products", which is a broader category than "like products" in Article III:2, first sentence.

[433] Appellate Body Report, Japan – Alcoholic Beverages II, p.24. See also Appellate Body Report, Canada – Periodicals, pp. 24-25, and Appellate Body Report, Chile – Alcoholic Beverages, para. 47.

In *Canada – Periodicals*, the Appellate Body ruled that products do not have to be perfectly substitutable in order to be "directly competitive or substitutable", because a case of "perfect substitutability" would fall under Article III:2, first sentence.[434]

On 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:

> "Like" products are subsets 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.[435]

In *Korea – Alcoholic Beverages*, the Appellate Body stated that it considers products to be "directly competitive or substitutable" when they are interchangeable or if they offer alternative ways of satisfying a particular need or taste.[436] The Appellate Body also said 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".[437] Furthermore, the Appellate Body reminded that past panels had acknowledged that consumer behavior could be influenced by protectionist internal taxation, and concluded that it may be highly relevant to examine latent demand.[438]

As for the factors to be taken into account in establishing whether products are "directly competitive or substitutable", they include, in addition to their physical characteristics,

[434] Appellate Body Report, Canada – Periodicals, p. 28.
[435] Appellate Body Report, Korea – Alcoholic Beverages, para. 118.
[436]Appellate Body Report, Korea – Alcoholic Beverages, para. 114-116.
[437] Appellate Body Report, Korea – Alcoholic Beverages, para. 120.
[438] Appellate Body Report, Korea – Alcoholic Beverages, para. 120.

common end-use and tariff classifications, the nature of the compared products and the competitive conditions in the relevant market.[439]

In *Korea – Alcoholic Beverages*, the Appellate Body considered an examination of the competitive conditions in the market, and the cross-price elasticity of demand in that market, as a means for establishing whether products are "directly competitive or substitutable".[440] Cross-price elasticity 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.[441] However, the Appellate Body carefully clarified that cross-price elasticity of demand for products is not the decisive criterion in determining whether these products are "directly competitive or substitutable".[442] The Appellate Body supported the Panel's emphasis on the "quality" or "nature" of competition rather than the "quantitative overlap of competition".[443] The Appellate Body also shared the Panel's reluctance to rely on quantitative analyses of competitive relationship.

In its view, an approach that focuses solely on the quantitative overlap of competition would, in essence, result in making the cross-price elasticity the decisive criterion in deciding whether products are "directly competitive or substitutable".[444]

The Appellate Body considered, in *Korea – Alcoholic Beverages*, that the market situation in other Members may be taken into consideration in determining whether products are "directly competitive or substitutable". The market situation in other Members is particularly relevant when demand on that market has been influenced by regulatory barriers to trade or to competition, on the condition that the other market display characteristics similar to the market at issue. As the Appellate Body stated, the

[439] See Appellate Body Report in Japan – Alcoholic Beverages II, p. 24.
[440] Appellate Body Report, Korea – Alcoholic Beverages, para. 121.
[441] See Appellate Body Report, Korea – Alcoholic Beverages, para. 121.
[442] Appellate Body Report, Korea – Alcoholic Beverages, para. 134.
[443] Appellate Body Report, Korea – Alcoholic Beverages, para. 134.
[444] Appellate Body Report, Korea – Alcoholic Beverages, para. 137.

determination of whether products are "directly competitive or substitutable" can only be determined on a case-by-case basis, taking account of all relevant facts.[445]

In examining whether products are "directly competitive or substitutable", it is not always necessary to examine products on an item-by-item basis. Products can be grouped together for the purpose of this examination. However, as the Appellate Body said, whether and to what extent products can be grouped is a matter to be decided on a case-by-case basis.[446]

Are the imported and domestic products "not similarly taxed"?

In order to determine whether there is a violation of Article III:2, second sentence, it must also be found that the products at issue are "not similarly taxed". As opposed to Article III:2, first sentence, which provides that even the slightest tax difference suffices for a finding of WTO-inconsistency, Article III:2, second sentence, provides that the tax differential has to be more than *de minimis* in order to support a conclusion that the internal tax imposed on imported products is WTO-inconsistent.

As the Appellate Body said in *Japan – Alcoholic Beverages II* :

> 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. In other words, there may be an amount of excess taxation that may well be more of a burden on imported products than on domestic 'directly competitive or substitutable products' but may nevertheless not be enough to justify a conclusion that such products are

[445] Appellate Body Report, Korea – Alcoholic Beverages, paras. 143-144.
[446] Appellate Body Report, Japan – Alcoholic Beverages II, pp. 29-30.

> 'not similarly taxed' for the purposes of Article III:2, second sentence. We agree with the Panel that this amount of differential taxation must be more than de minimis to be deemed 'not similarly taxed' in any given case. And, like the Panel, we believe that whether any particular differential amount of taxation is de minimis or is not de minimis must, here too, be determined on a case-by-case basis. Thus, to be 'not similarly taxed', the tax burden on imported products must be heavier than on 'directly competitive or substitutable' domestic products, and that burden must be more than de minimis in any given case.[447]

In the event that only some imported products are similarly taxed as compared with the domestic products, while other imported products are taxed similarly, the Appellate Body found that such dissimilar taxation of even some imported products as compared to directly competitive and substitutable domestic products is inconsistent with Article III:2, second sentence.[448]

Is the internal tax measure applied "so as to afford protection to domestic production"?

The last requirement of the test under Article III:2, second sentence, is whether the internal taxes are applied "so as to afford protection to domestic production". The Appellate Body specified that this requirement is separate from the requirement of "not similarly taxed", and that accordingly, it must be examined separately. Therefore, if imported and domestic products are "not similarly taxed", then a further inquiry must be made in order to determine whether the tax measure has been taken "so as to afford protection to domestic production".[449]

As the Appellate Body said, the examination of whether the tax measure was applied "so as to afford protection to domestic production" does not require to examine the actual

[447] Appellate Body Report , Japan – Alcoholic Beverages II, pp. 26-27.
[448] Appellate Body Report, Canada – Periodicals, pp. 25-29.
[449] Appellate Body Report, Japan Alcoholic Beverages II, p. 27.

intent of the legislator or regulator to engage in some form of protectionism.[450] It is the result of the application of a measure that matters under Article III:2, second sentence.[451] In particular, the element *"so as to afford protection to domestic production"*, requires a comprehensive and objective analysis of the structure and application of the measure at issue on domestic as compared to imported products.[452] The underlying criteria used in a particular tax measure, its structure, and its overall application may ascertain whether it is applied in a way that affords protection to domestic production.[453] Even if the aim of the same measure as such may not be easily found, the protective application of a tax measure may often be discerned *"from the design, the architecture and the revealing structure of a measure"*.

This means that if the lower brackets of a tax measure cover almost exclusively domestic products, while the higher brackets cover almost exclusively imported products, the tax measure may be deemed to be applied so as to afford protection to domestic production. Such an analysis does not require the examination of the subjective intent of the legislator or regulator, but rather the criteria, the structure and the overall application of the tax measure.

When is There a Violation of the National Treatment Obligation, under Article III:4?

The national treatment obligation of Article III concerns internal laws and regulations as well as internal taxation. Article III:4 deals specifically with internal laws and regulations. Article III:4 reads:

> *4. The products of the territory of any [Member] imported into the territory of any other [Member] shall be accorded treatment no less favorable than that accorded to like products of national origin in respect of all laws, regulations and requirements affecting their*

[450] Appellate Body Report, Japan Alcoholic Beverages II, p. 29.
[451] See Appellate Body Report, Japan – Alcoholic Beverages II, pp. 29-30. It should be noted however, that the Appellate Body seemed to give some importance to statements made by the representatives of the Canadian Government about the policy objectives of the tax measure at issue. See Appellate Body Report, Japan – Alcoholic Beverages II, footnote 20.
[452] Panel Report, Argentina – Hides and Leather , para. 11.183.
[453] Appellate Body Report, Japan Alcoholic Beverages II, p. 29. See also Appellate Body Report, Chile – Alcoholic Beverages.

> *internal sale, offering for sale, purchase, transportation, distribution or use. The provisions of this paragraph shall not prevent the application of differential internal transportation charges which are based exclusively on the economic operation of the means of transport and not on the nationality of the product.*

In order to determine whether there is a violation of Article III:4, three questions need to be answered:

> (1) whether the measure at issue is a "law, regulation or requirement affecting their internal sale, offering for sale, purchase, transportation, distribution or use";
> (2) whether the imported and domestic products at issue are "like products";
> (3) whether the imported products are accorded "less favourable" treatment than that accorded to like domestic products.[454]

It should be noted that Article III:4 does not make any specific reference to the element of "so as to afford protection to domestic production" in Article III:1. Therefore, Article III:4, like Article III:2, first sentence, does not require a separate examination of whether the measure at issue is applied "so as to afford protection to domestic production".[455]

However, Article III:1 and the element of "so as to afford protection to domestic production" provide "particular contextual significance in interpreting Article III:4, as it sets forth the 'general principle' pursued by that provision".[456]

Have laws, regulations or requirements affecting the sale and use of products been applied?

Article III:4 applies to "all laws, regulations and requirements affecting [the] internal sale, offering for sale, purchase, transportation, distribution or use[of products]". In

[454] See Appellate Body Report, Korea – Measures Affecting Imports of Fresh, Chilled and Frozen Beef ("Korea – Beef"), WT/DS161/AB/R, WT/DS169/AB/R, adopted 10 January 2001, para. 133.
[455] See Appellate Body Report, EC – Bananas III, para. 216.
[456] Appellate Body Report, EC – Asbestos, para. 93.

general terms, the national treatment obligation of Article III:4 concerns regulation affecting the sale and use of products.

The scope of application of Article III:4 has been interpreted broadly. The use of the term "affecting" has been interpreted to mean that Article III:4 should cover not only laws and regulations which directly govern the conditions of sale or purchase but also any laws and regulations which might adversely modify the conditions of competition between the domestic and imported products on the internal markets.[457]

Moreover, it has been found that Article III:4 covers *procedural* laws, regulations and requirements as well as *substantive* laws, regulations and requirements. The Panel in *US – Section 337* explained that enforcement procedures cannot be separated from the substantive provisions they serve to enforce.[458] The Panel also said that if procedural provisions of internal law were not covered by Article III:4, WTO Members could escape the national treatment obligation by enforcing consistent substantive law through inconsistent procedures less favorable to imported products than to like national products.[459]

GATT case law has further refined the scope of application of Article III:4. For example, it specified that Article III:4 applies to minimum price requirements applicable to domestic and imported beer,[460] to limitations on points of sale for imported alcoholic beverages,[461] to the practice to limit listing of imported beer to six-pack size,[462] to the requirement that imported beer and wine be sold only through in-state wholesalers or other middlemen,[463] to a ban on all cigarette advertising,[464] to additional marking

[457] Panel Report, Italian Discrimination Against Imported AgriculturalMachinery ("Italian Agricultural Machinery"), adopted 23 October 1958, BISD 7S/60, para.12.
[458] Panel Report, United States – Section 337 of the Tariff Act of 1930 ("US – Section 337"), adopted 7 November 1989, BISD 36S/345, para. 5.10.
[459] Panel Report, US – Section 337, para. 5.10.
[460] Panel Report, Canada – Import Distribution and Sale of Certain Alcoholic Drinks by Provincial Marketing Agencies ("Canada – Provincial Marketing Agencies (1992)"), adopted 18 February 1992, BISD 39S/27, para.5.30.
[461] Panel Report, Canada – Provincial Marketing Agencies (1992), para. 4.26.
[462] Panel Report, Canada – Provincial Marketing Agencies (1992), para. 5.4.
[463] Panel Report, US – Malt Beverages, para. 5.32.

requirements such as an obligation to add the name of the producer or the place of origin or the formula of the product[465] and, to practices concerning internal transportation of beer.[466]

WTO reports also defined the scope of application of Article III:4. For instance, the Appellate Body agreed with the Panel that Article III:4 was applicable to the European Communities' import licensing requirements at issue in *EC – Bananas III*. The Appellate Body ruled:

> At issue in this appeal is not whether any import licensing requirement, as such, is within the scope of Article III:4, but whether the EC procedures and requirements for the distribution of import licenses for imported bananas among eligible operators within the European Communities are within the scope of this provision. … These rules go far beyond the mere import license requirements needed to administer the tariff quota for third-country and nontraditional ACP bananas or Lomé Convention requirements for the importation of bananas. These rules are intended, among other things, to cross-subsidize distributors of EC (and ACP) bananas and to ensure that EC banana ripeners obtain a share of the quota rents. As such, these rules affect 'the internal sale, offering for sale, purchase, ...' within the meaning of Article III:4, and therefore fall within the scope of this provision.[467]

In *Canada – Autos*, the Panel used a broad interpretation of the term "affecting" by referring to measures which have an effect on imported goods. The Panel ruled that a measure can be considered to be a measure affecting the internal sale or use of imported

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[464] Panel Report, Thailand – Restrictions on Importation of and Internal Taxes on Cigarettes ("Thailand – Cigarettes"), adopted 7 November 1990, BISD 37S/200, para. 77.
[465] Working Party Report, Certificates of Origin, Marks of Origin, Consular Formalities, adopted 17 November 1956, BISD 5S/102, para. 13.
[466] Panel Report, Canada – Provincial Marketing Agencies (1992), para. 5.12; and Panel Report, US – Malt beverages, para. 5.50.
[467] Appellate Body Report, EC – Bananas III, para. 220.

products even if it is not shown that under current circumstances the measure has an impact on the decisions of private parties to buy imported products.[468]

Article III:4 also covers "requirements" which may apply to isolated cases. Although most cases dealing with Article III:4 concern laws and regulations, Article III:4 covers "requirements" which may apply to isolated cases only.

However, it should be noted that both measures that apply across-the-board and measures that apply to isolated cases only are covered by Article III:4.[469] Furthermore, a "requirement" within the meaning of Article III:4 does not necessarily need to be imposed by government. Action by a private party can constitute a "requirement" under the purview of Article III:4, insofar as there is a nexus between that action and the action of a government such that the government must be held responsible for that action.[470] For instance, in *Canada– Autos*, the Panel had to decide whether commitments undertaken by Canadian motor vehicle manufacturers in letters addressed to the Canadian Government to increase Canadian value added in the production of motor vehicles, qualified as "requirements*"* under Article III:4. The Panel said:

> We do not believe that such a nexus can exist only if a government makes undertakings of private parties legally enforceable, as in the situation considered by the Panel on Canada – FIRA, or if a government conditions the grant of an advantage on undertakings made by private parties, as in the situation considered by the Panel on EEC – Parts and Components. We note in this respect that the word 'requirement' has been defined to mean '1. The action of requiring something; a request. 2. A thing required or needed, a want, a need. Also the action or an instance of needing or wanting something.
>
> 3. Something called for or demanded; a condition which must be complied with.' The word 'requirements' in its ordinary meaning and in

[468] See Panel Report, Canada – Autos, paras. 10.80 and 10.84.
[469] See Panel Report, Canada – Administration of the Foreign Investment Review Act ("Canada – FIRA"), adopted 7 February 1984, BISD 30S/140, para. 5.5.
[470] See Panel Report, Canada – Autos, paras. 10.80 and 10.84.

> light of its context in Article III:4 clearly implies government action involving a demand, request or the imposition of a condition but in our view this term does not carry a particular connotation with respect to the legal form in which such government action is taken. In this respect, we consider that, in applying the concept of "requirements" in Article III:4 to situations involving actions by private parties, it is necessary to take into account that there is a broad variety of forms of government action that can be effective in influencing the conduct of private parties.[471]

Are the imported and domestic products "like"?

The non-discrimination obligation in Article III:4 applies only to "like products", as in Articles I:1 and III:2, first sentence, both discussed above. The Appellate Body examined thoroughly the meaning of the concept of "like products" in Article III:4 in *EC – Asbestos*. The Appellate Body reminded that the concept of "like products" in Article III:2, first sentence, is to be construed "narrowly".[472] However, the Appellate Body was of the opinion that the concept of "like products" in Article III:4 does not suggest a similarly narrow reading of "like" essentially because Article III:2 distinguishes "like products" from "competitive and substitutable products", while Article III:4 is only concerned with "like products". Thus, the Appellate Body concluded that given the textual difference between Articles III:2 and III:4, the "accordion" of "likeness" stretches in a different manner in Article III:4.[473]

As regards the effect of the "general principle" against protectionism in Article III:1 on the interpretation of Article III:4, the Appellate Body said that:

> …[I]n endeavoring to ensure "equality of competitive conditions", the "general principle" in Article III seeks to prevent Members from applying internal taxes and regulations in a manner which affects the competitive relationship, in the marketplace, between the domestic and

[471] Panel Report, Canada – Autos, paras. 10.106-10.107.
[472] See Appellate Body Report, EC – Asbestos, para. 95. See Appellate Body Report, Japan Alcoholic Beverages II, pp. . 19-20 and Appellate Body Report, Canada – Periodicals, pp. 20-23.
[473] Appellate Body Report, EC – Asbestos, paras. 94-96.

> imported products involved, "so as to afford protection to domestic production.[474]

The Appellate Body went on to state:

> "As products that are in a competitive relationship in the marketplace could be affected through treatment of imports "less favorable" than the treatment accorded to domestic products, it follows that the word "like" in Article III:4 is to be interpreted to apply to products that are in such a competitive relationship. Thus, 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.
>
> … [W]e [] 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.
>
> We recognize that, by interpreting the term "like products" in Article III:4 in this way, we give that provision a relatively broad product scope – although no broader than the product scope of Article III:2."[475]

The Appellate Body in *EC – Asbestos* also enumerated criteria to be taken into account to determine whether products are "like" within the meaning of Article III:4. The Appellate Body said:

> "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 judgment" 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

[474] Appellate Body Report, EC – Asbestos, para. 98.
[475] Appellate Body Report, EC – Asbestos, paras. 97-100.

> 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 behavior – 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."[476]

However, it should be noted that this list is by no means exhaustive. These criteria are meant to be "simply tools to assist in the task of sorting and examining the relevant evidence".[477] This means that all pertinent evidence should always be examined, and not only evidence related to any of these criteria. In *EC – Asbestos*, the Appellate Body disagreed with the Panel's refusal to consider the health risks posed by asbestos in its determination of "likeness". The Appellate Body said:

> …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 fibers need be examined under a separate criterion, because we believe that this evidence can be

[476] Appellate Body Report, EC – Asbestos, para. 101.
[477] Appellate Body Report, EC – Asbestos, para. 102.

> evaluated under the existing criteria of physical properties, and of consumers' tastes and habits, …."[478]

Therefore, the Appellate Body concluded that the physical properties of chrysotile asbestos fibers include their carcinogenicity or toxicity, and this aspect must be considered in determining "likeness" under Article III:4. The Appellate Body also said that "evidence relating to health risks may be relevant in assessing the *competitive relationship in the market place* between allegedly 'like' products".[479]

As for the end-uses and consumer's habits, the Appellate Body stated 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 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

[478] Appellate Body Report, EC – Asbestos, para. 113.
[479] Appellate Body Report, EC – Asbestos, para. 115. It should be noted that one Appellate Body Member wrote a "concurring opinion" on this issue in which he disagreed with the two other Members of the Division that the competitive relationship is decisive in the determination of "likeness" of products under Article III:4.

> together, demonstrates that the products are "like" under Article III:4 of the GATT 1994.[480]

As regards the element of consumers' tastes and habits, the Appellate Body said that they are highly relevant with respect to asbestos fibers or substitutes, even where commercial parties, such as manufacturers, are involved, since the health risks associated with asbestos fibers may well influence their decision to use them or not.[481]

Although the concept of "like products" in *EC – Asbestos* was interpreted broadly, it is not so broad to include chrysotile asbestos fibers and substitutes as "like products".

In *US – Gasoline*, the Panel found that chemically-identical imported and domestic gasoline were "like products" because "chemically-imported and domestic gasoline by definition have exactly the same physical characteristics, end-uses, tariff classification and are perfectly substitutable".[482] The Panel did not examine the aim and effect of the regulatory distinction in determining "likeness".

Finally, the Panel in the un adopted report on *US – Tuna* found that differences in process and production methods of products are not relevant in determining "likeness":

> 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 favorable 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.[483]

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[480] Appellate Body Report, EC – Asbestos, paras. 117-118.
[481] Appellate Body Report, EC – Asbestos, para. 122.
[482] Panel Report, United States – Standards for Reformulated and Conventional Gasoline ("US –Gasoline "), WT/DS2/R, adopted 20 May 1996, as modified by the Appellate Body Report, WT/DS2/AB/R, DSR 1996:I, 29, para. 6.17.
[483] Unadopted Panel Report, United States – Restrictions on Imports of Tuna ("US – Tuna/Dolphin"), circulated 3 September 1991, BISD 39S/155, para. 5.15.

This approach has attracted some criticism from scholars and environmental-ists.[484]

Was the treatment less favorable?

In order to determine whether the measure at issue is inconsistent with Article III:4, not only must it distinguish between "like products", it has also to accord "less favourable treatment" to the like imported product than it accords to the group of like domestic products. In *US–Section 337*, the Panel interpreted "treatment on less favorable" to require "effective equality of competitive opportunities". Panels and the Appellate Body have consistently used this approach in later GATT and WTO reports.[485]

In *US - Gasoline*, the Panel found that the measure at issue accorded to imported gasoline less favourable treatment than to domestic gasoline on the basis that sellers of domestic gasoline were authorized to use an individual baseline, while sellers of imported gasoline had to use the more onerous statutory baseline.[486]

In *Korea – Beef,* the dispute concerned 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 Appellate Body found that such a measure was inconsistent with the Republic of Korea's obligations under Article III:4 of the GATT 1994. The Appellate Body emphasized that a formal difference in treatment between domestic and imported products is neither necessary nor sufficient for

[484] For a discussion of the product-process distinction, please refer to Robert E. Hudec, "Chapter 12: The Product-Process Doctrine in the GATT/WTO Jurisprudence" in Marco Bronckers and Reinhard Quick, New Directions in International Economic Law: Essays in Honour of John H. Jackson, Kluwer Law International, 2000, pp.187-218; and Robert Howse and Donald Regan, "The Product/Process Distinction – An Illusory Basis for Disciplining 'Unilateralism' in Trade Policy", European Journal of International Law, Vol. 11, No. 2, 2000, pp. 249-289.)

[485] See, inter alia, Panel Report, Canada – Import, Distribution and Sale of Certain Alcoholic Drinks by Provincial Marketing Agencies ("Canada – Provincial Liquor Boards (US) "), adopted 18 February 1992, BISD 39S/27, paras. 5.12-5.14 and 5.30-5.31; Panel Report, US - Malt Beverages, para. 5.30; Panel Report, US - Gasoline, para. 6.10; Panel Report, Canada – Periodicals, p. 75; Panel Report, European Communities – Regime for the Importation, Sale and Distribution of Bananas – Complaint by the United States ("EC – Bananas III (US) "), WT/DS27/R/USA, adopted 25 September 1997, as modified by the Appellate Body Report, WT/DS27/AB/R, DSR 1997:II, 943, paras. 7.179-7.180; and Panel Report, Japan – Measures Affecting Consumer Photographic Film and Paper ("Japan – Film "), WT/DS44/R, adopted 22 April 1998, DSR 1998:IV, 1179, para. 10.379.

[486] See Panel Report, US – Gasoline, para. 6.10.

a violation of Article III:4. Different treatment of imported products in a formal manner does not necessarily constitute less favourable treatment.

Conversely, absence of formal difference in treatment does not necessarily mean that there is no less favourable treatment. As the Appellate Body stated in that case:

> 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. …
>
> 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.[487]

In *US – Gasoline*, the Panel explained that "[the] wording [of Article III:4] does not allow less favourable treatment dependent on the characteristics of the producer and the nature of the data held by it".[488] The Panel also rejected the argument made by the United States that the regulation at issue treated imported products "equally overall" and was therefore consistent with Article III:2. The Panel noted that this argument amounted to claiming that less favourable treatment of particular imported products in some instances could be offset or balanced by more favourable treatment of particular products in others.[489] However, under Articles I:1, III:2 and III:4, such "balancing" is not admissible.[490]

[487] Appellate Body Report, Korea –Beef, paras. 135-137.
[488] Panel Report, US – Gasoline, para. 6.11.
[489] Panel Report, US – Gasoline, para. 6.14.
[490] See Panel Report, US – Section 337, para. 6.14.

In GATT and WTO case law, a wide variety of measures have been found inconsistent with the national treatment obligation of Article III:2, apart from the measures at issue in *US – Section 337*, *Korea – Beef* and *US - Gasoline*.

They include minimum price requirements,[491] regulations concerning internal transportation,[492] the allocation system for tariff quota for bananas,[493] and the Canadian Value Added requirements in the automobile industry.[494]

Questions of Concern:

1. What are the two elements of the non-discrimination principle in International Trade Law? What is the difference between the most favoured-nation treatment obligation and the national treatment obligation?

2. What is the objective of the most-favoured-nation treatment obligation? When is there a violation of the most-favoured-nation treatment obligation? Is the concept of "advantage" limited to internal taxes, laws, regulations and requirements? Is the concept of "like products" interpreted consistently in the different provisions of the GATT 1994? What are the criteria to determine whether two products are "like" within the meaning of Article I:1of the GATT 1994? Once a WTO Member has granted an advantage to a country, can it impose conditions on other WTO Members for them to benefit from that same advantage?

3. What is the objective of the national treatment obligation? Is the national treatment obligation limited to products subject to tariff concessions under Article II of the GATT 1994? Does Article II apply to internal measures only?

[491] See Panel Report, Canada – Provincial Marketing Agencies.
[492] See Panel Report, US – Malt Beverages.
[493] See Appellate Body Report, EC – Bananas III.
[494] *See Appellate Body Report,* Canada – *Autos.*

4. When is there a violation of Article III, first sentence? Can tax administration measures qualify as "internal taxes or charges" within the meaning of this Article? How does one assess whether products are "like" within the meaning of Article III:2, first sentence? What is the minimum amount of the internal tax or charge for which the imported products are considered to be taxed "in excess of" the domestic products? Does Article III:2, first sentence, require a separate examination of whether the measure at issue is applied "so as to afford protection to domestic production"?

5. When can an interpreter consider Article III:2, second sentence? When is there a violation of Article III:2, second sentence? How does the concept of "directly competitive or substitutable" differ from the concept of "like products"? What is the minimum amount of the internal tax or charge for which the imported and domestic products are considered to be "not similarly taxed"? Does Article III:2, second sentence, require a separate examination of whether the measure at issue is applied "so as to afford protection to domestic production"?

6. When is there a violation of Article III:4? What types of measures does Article III:4 apply to? How different is the concept of "like products" interpreted in Article III:4 as compared with other GATT provisions? What criteria need be taken into consideration in determining whether products are "like" under Article III:4? Does Article III:4 require a separate examination of whether the measure at issue is applied "so as to afford protection to domestic production"?

Questions to ponder

1. In GATT, it is stated that *".. any advantage granted by a GATT contracting party to any other country must be granted to all contracting parties"*. Does this rule grant a private self-proprietor, a P.L. Co. or Share Co., an oligopoly, access to the advantages given by any GATT member country? To whom/which entity does the term *"contracting party"* refer to? Explain in reference to what has been discussed.

2. What would have been the outcome if the suggestion made in 1947, at the Geneva meeting had not been rejected and the GATT rule had been accordingly reformulated (i.e., *".. that GATT benefits should apply only to GATT members"*)? Explain. Which one would have been better for international trade in your opinion? (Here – among other things – consider such factors as avoiding economic fraud or unfair competitions, .. as well as enhancing "freer trade", "free and fair trade".)
3. Read the following argument and then suggest how the law and the regulation thereof should discern, discriminate between "salt extract" and "iodized salt".

> *"Having a comprehensive identification methodology of goods produced, manufactured, imported and exported is crucial for any country, as only then can it devise a law and issue coherent regulations. This requires that the country should workout a formidable identification methodology of discerning between and among goods; i.e., a methodology that clearly specifies and acknowledges the value(s) each produced good inherits. It also means that such a methodology is based on a systematic, scientific approach that unequivocally discerns the value added to each product during each and every successive stage of processing."*

4. a) Does GATT permit setting specific regulations to internal trade, market?

b) Would it be "discriminatory and contrary to GATT" if a regulation gets issued restricting sale of "un-iodized salt" to consumers?

c) How about beverages? Would it be contrary to "free trade" and GATT rules if export license gets issued only to those factories which pack according to specified, nutritional standards? For example, factories/local firms which supply none-standardized beverages such as *'Ttela', 'Ttej'* are denied "export license"? Explain in view of what has been discussed. (When trying to give answers to these questions, think of the fact that equal treatment to imported goods is a must.)

5. In view of the fact that we are living in post-Cold-World-War era, there are no Imperialist–Communist blocks. But there is "terrorist threat". Would it be plausible to issue an amendment forbidding MFN treatment to parties directly linked with terrorism?

Chapter Six

Challenges to Multilateralism: Custom Unions and Free-Trade Areas

It has become common practice that governments form "Custom Union" – resort to form a "Trade Block". Diagram 4 (a & b below) illustrates the welfare effects of eliminating trade barriers; tries to illustrate the economic gains attained thereby.

Supposing that all supply curves are perfectly flat, the following two effects would be the economic result of the union.

1) Forming the trade block is costly because too much trade is diverted from lower-cost to higher-cost suppliers.
2) Forming the trade block is beneficial because it creates more low cost trade.[495]

A welfare gain from trade creation is the net volume of new trade created by forming the trade block. It causes the national gain shown as area *B* in

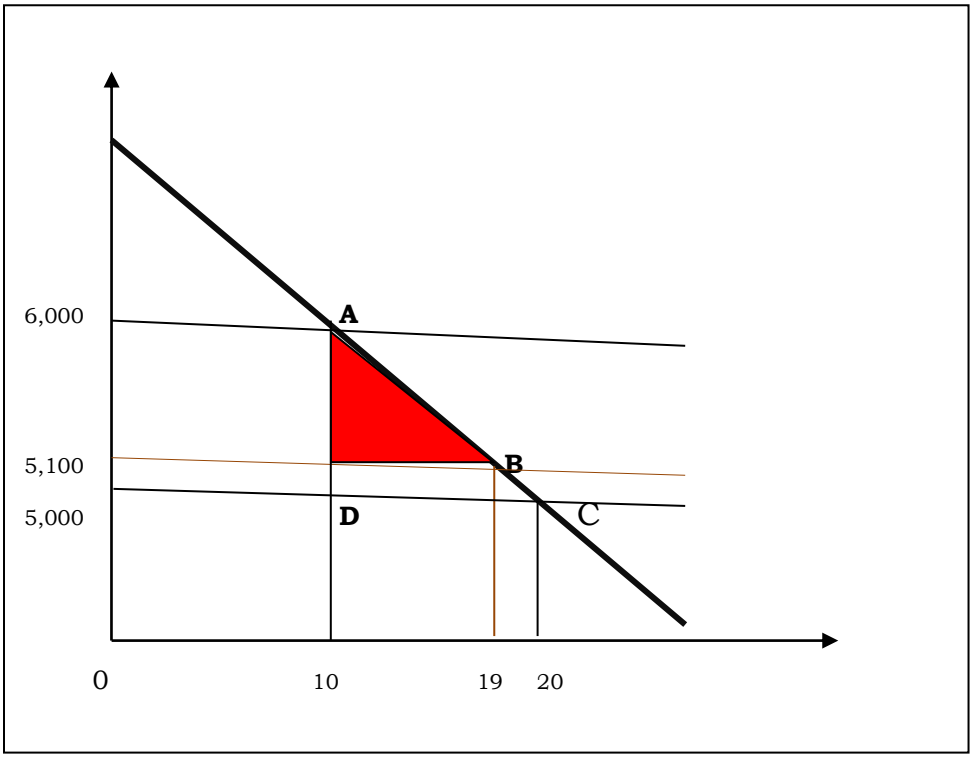


Diagram 4a: Trade Creation Dominates, Bringing a Net Gain

[495] Thomas A. Pugel and Paul H. Lindert, International Economics, (11th Ed.,), pp. 217-218.

Diagram 4, above. Area *B* represents two kind of gain in the economy under consideration: gains extra consumption of the product, i.e., extra amount of consumption nonexistent prior to the formation of the block, and gains on replacement of higher-cost production by lower-cost partner production.

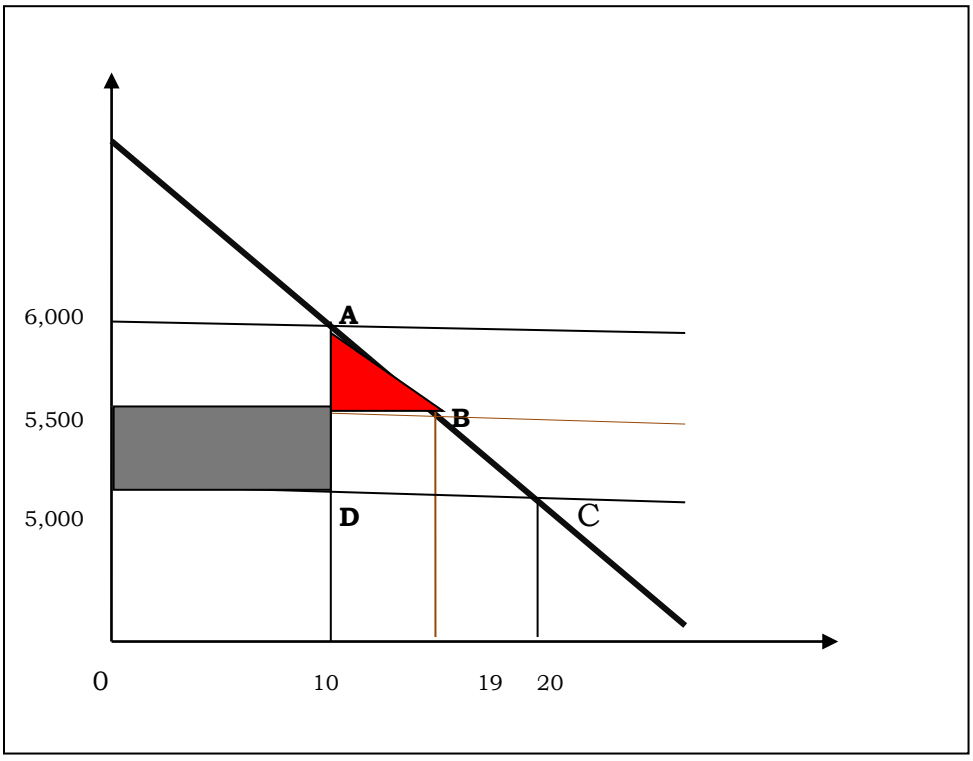


Diagram 4b: Trade Diversion Dominates, Bringing a Net Loss

A welfare loss trade from trade diversion is the volume of trade diverted from low-cost outside exporters to higher-cost block-partner exporters. It causes the national loss shown as area *C*.

This is the general result: The gains from a customs union are tied to trade creation, and the losses are tied to trade diversion. The net welfare effect, the trade-creation gain minus the trade-diversion loss, could be positive or negative.

Taking the good side resulting from such a customs union, the three tendencies that contribute for greater gains are:

a) The greater the differences between the home-country and partner country costs (supply curves), the greater the gains;
b) The smaller the differences between the partner-country and outside-world costs (supply curves), the greater the gains;
c) The more elastic the import demand, the greater the gains.[496]

Conversely, the worst trade-diverting case is one with inelastic import demands and high costs throughout the new customs union.

Countries of the various Continents are increasingly forming trade blocks through customs unions and special provisions, arrangements. Looking at some customs unions, i.e., trade blocks of the European Union (EU), North American Countries) and that of the LDCs, namely Eastern African Countries would be of some help.

Studies made in the 1960s and 1970s (though on static welfare effects) predicted that the economic gains of customs union to the EU would exceed that of EEC by 90%.

> "By concentrating on trade in manufactured goods, the literature generally overlooked the significant social losses from the EU's Common Agricultural policy. … For now, the empirical judgment is threefold:
>
> (1) on manufactured goods, the EU has brought enough trade creation to suggest small positive net welfare gains.
>
> (2) The static gains on manufacturers have probably been smaller than the losses on the Common Agricultural Policy.
>
> (3) But the net judgment still depends on what we believe about the unmeasured dynamic gains from economies of scale and productivity stimuli.
>
> "The formation of a truly common market in 1992 .. involved removing all sorts of nontariff trade barriers:

[496] Id., p. 218.

- No longer are truckers irked by thousands of trade barriers within the EU, such as frontier checkpoint delays, paperwork, and freight-hauling restrictions.
- The change brought an end to product 'quality' codes that were thinly disguised for protecting higher-cost domestic producers. .. Some standards were harmonized, but in most cases countries mutually recognized the validity of each other's standards.
- Capital is now free to flow anywhere in the EU countries.
- Workers from any of the EU countries can now practice their trades and professions anywhere."[497]

Considering the North American Free-Trade Block, i.e., Canada, U.S.A. and Mexico, we seem to get a mixed picture as the countries are at differing levels of development; so to say, Canada and U.S.A. being comparatively at much higher level of development than Mexico. Most studies in the late [1980ies] of the Canada-U.S. free-trade area, focused on Canada's stake in it. Some concluded that Canada would gain 1 to 25 percent of GDP, while few concluded that it would gain as much as 8 to 10 percent – a far larger gain than any EU country,[498] according to some estimates.

Because the Mexican government's resolve to join the North American Free-Trade Block, it stripped-down its own for establishing a freer trading environment. The Mexican government also privatized most of the economic sectors – as is the rule in the other trading countries. Thus,

> "[a] series of reforms deregulated business and knocked down barriers to imports of goods and services from other countries. The culmination of this economic liberalization drive was the 1993 signing of an agreement with the United States and Canada to form the **North American Free Trade Area (NAFTA)** [which] eliminates tariffs and some nontariff barriers on trade within the area, with some liberalizations phased in over 5- to 15-year period. It removes barriers to cross-

[497] Id., p. 219-220.
[498] Id., p. 222.

> border business investments within the area, and Mexico must phase out performance requirements, including local content requirements and export requirements, that the Mexican government had imposed on foreign businesses operating in Mexico. NAFTA requires open trade and investment in most service industries (including banking and other financial services). .."[499]

A seemingly analogous development was set in motion in the 1960s and 1970s in several less developed economic settings. Like in the East African context and elsewhere, the argument for "protecting infant industries" could hardly hold ground and stay firm. Many argued that

> ".. forming a customs union or free-trade area among developing countries would give the union a market large enough to support a large-scale producer in each modern manufacturing sector without letting in manufacturers from the highly industrialized countries. The new firms could eventually cut their costs through economies of scale and learning by doing until they could compete internationally, …
>
> "For all the appeal of the idea, its practice 'has been littered with failures', .. and the life expectancy of this type of trade bloc was short. ..
>
> "The key change in the trade policies since the 1970s .., has been a shift in development philosophy, toward an outward, pro-trade (or at least pro-export) orientation. …"[500]

After we have discussed the economic effects of free-trade areas, let us now focus on the legal aspect.

6.1 The Weak Discipline of GATT Article on RTAs[501]

Seen in light of International Law, free-trade areas are treated as "Regionalism in the Multilateral Trading System"; in other words, a preferential way of treatment of within

[499] Ibid.
[500] Id., 225-226.
[501] International Trade Law Handbook References: GATT Article XXIV.

and from among "most-favored-nations (MFN); i.e., even if some/all are WTO Member countries. This – presumably – is because: "Regional integration agreements receive a considerable amount of attention from trade specialists in good measure because their provisions.. [are] designed to permit the achievement of greater economic integration.."[502]

Although the principle of GATT stipulates (Article I) that commitments made in the course of trade negotiating rounds gets applied by each country to all its trading partners, in

> ".. terms of domestic political considerations, the requirement to treat all signatories equally is a restraint on the temptation to discriminate against imports from particular sources, especially small or politically weak countries. More generally, by limiting the extent to which a country can play favourites, and thus depoliticizing trade, .. helps trading nations realize their desire to be treated equally in their economic relations with their more powerful trading partners. …
>
> "With the case for non-discrimination so strong, the question naturally arises as to why the founders of GATT included provisions permitting customs unions and free trade areas. … Dismantling restrictions on all (or most) trade represents an important step in the direction of carrying out economic activity with one .. provinces of the same country. The founders of GATT recognized .. that economic integration between several countries has or can have an economic rationale analogous to the process of integration within a single sovereign state, which in turn means that regional integration agreements do not pose an <u>inherent</u> threat to efforts to promote continued integration on a world-wide basis.
>
> "GATT rules on customs unions and free-trade areas reflect the drafters' desire to provide for such agreements, .."[503]

But in doing so, these rules insist:

[502] Raj Bhala *et la*, Op cites, No. 13, p. 617.
[503] Id., p. 617-618.

- that the trading interests of third countries are respected even where "free-trading blocks" are instituted;
- that free-trade area agreements are compatible with a rules-based and progressively more open world trading system.

"For this reason, the provisions on customs unions and free trade areas establish a number of conditions which the agreements must satisfy, as well as transparency requirements in order to monitor whether those conditions are being met.

"The principal GATT rules on regional integration agreements .. are contained in Article XXIV .. In addition, Article XXV (waivers) has provided the GATT basis for several past agreements. .."[504]

Under the provisions of Article XXIV, paragraph 4 sets out the parameters of trade liberalization both internally and externally: "the purpose of a customs union or of a free trade area should be to facilitate trade between the constituent territories and not to raise barriers to the trade of other contracting parties with such territories."[505]

As stated, forming free-trade area between constituent territories is commendable only as long as the agreement on customs union does not restrict trade activities of other parties.

"Paragraph 8 of Article XXIV defines the characteristics of customs unions and free trade areas. Summarizing and simplifying slightly, it states that parties to customs unions and free trade areas must eliminate duties and restrictive regulations of commerce .. [though] members may still 'where necessary' exercise their rights to maintain duties or restrictions under GATT Articles XI.., XII.., XIII, .., XIV.., XV.., XX. A further criterion which applies only to customs unions is that its members must apply substantially the same duties and other regulations of commerce to trade with non-members (in other words, have a common external tariff and more generally a common trade policy).

[504] Ibid.
[505] Id., p. 619.

> "An important rationale for the substantially-all-trade requirement is that it helps governments resist the inevitable political pressures to avoid or minimize tariff reductions in inefficient import-competing sectors. …
> "Paragraph 5 of Article XXIV spells out the conditions to be met by customs unions and free trade areas so as to avoid adverse effects on the trade of third countries. …
> "Paragraph 7 contains requirements to ensure transparency of proposed agreements. Agreements are to be promptly notified to GATT for examination by the contracting parties .., article XXIV provides explicitly for interim agreements. .."[506]

Summary

Seen in light of international free trade practices, forming "custom unions" and "free trade zones" is a new trend that is quite not in line with the primary goals and principles of GATT.

As can be understood, forming "custom unions" between and among specially, neighbouring countries, is becoming an ever more increasing trend. Initiated by the earlier European Countries (i.e. EEC) and followed by North American Economic Block, the trend seems to have gained momentum as South Asian Countries, Countries of the Caukas Sub-Region (i.e. neighbouring countries of the Kazahstan, Azerbaidjan,..) as well as that of ECOWAS, SADEC, etc .. have followed suite.

With the ever more increasingly looming South–North economic divide, "custom unions" and "trade zones" seem to mushroom even more. But the question is whether these would really deliver economic gains and prosperity, especially in such Continents like Africa, where territorial contentions have still not been fully resolved. This – coupled with poor kind of governance and custom regula-tions, practices – could most probably make it difficult for governments to cherish the economic fruits such blocks without having fear

[506] Id., p. 620.

of loosing control, endangering national security or the sovereignty of their respective States.

As long as governments manage to effectuate formidable mechanisms that enable them curb any adverse effects that might ensue thereof, it goes without saying that the economic gains could lead to mutual prosperity.

All the same, one essential issue requires due attention. The intent of the ITO had the purpose of forming a world-wide organization that would set and regulate international trade. With the progress of time, the advancement of globalization, .. the need of having a functional organization as the ITO might become a necessity.

All the same, whether that would be the case or not, GATT requires that formally trading partners should be entitled to equal treatments – i.e. MFN treatment; which, by the way, is the backbone of General Agreement. In view of this fact, the longevity of "Custom Unions" and "Trading Blocks" would eventually loose weight; or better to say, "Custom Unions" and/or "Trading Blocks" are transitional practices till the time comes that trade practices would be governed at the global level through an organization.

Any way, since such a time comes, if at all it does, the economic gains that can be attained could compel governments to form "Trade Blocks"; naturally, as long as they manage to regulate/control all the afore mentioned effects. In doing so, governments forming "Trading Blocks" would be required to give appropriate, similar treatments to other formally trading partners. As we would see in the forth coming few chapters, providing such kind of treatment to all is not necessarily required from LDCs.

Chapter Seven
WTO's Dispute Settlement Mechanism[vi]

Introduction

The World Trade Organization's dispute settlement system is considered one of its crowning achievements—not many other multilateral dispute settlement systems have enjoys the same level of success.[507] However, this was not always the case, and the rules on dispute settlement have changed over the years. In general, dispute settlement under the GATT/WTO system has transformed over the years from one that emphasizes negotiation and mediation, to one that favors adjudication.[508]

Initially, disputes were decided at regular GATT member meeting, by countries that based their decision on what would be in their best interests. Sometimes, difficult disputes would be arbitrated by 'working groups'—groups consisting of individuals sent by contracting parties acting in their national representative capacity. In the 1950's, a 'panel' system became the norm. Under this system, a GATT Panel would be established consisting of three panelists acting in their individual capacities. A Panel would submit to a report on their decision to the contracting GATT Council, which would usually be adopted by consensus. (The Panel system has been incorporated into the WTO, with some important modifications, and the addition of the Appellate Body.)

However, in the years leading up the creation of the WTO, this system proved unworkable due to delays in implementation of decision, and various blocking tactics used by losing parties. The failures of the dispute settlement system seriously threatened the credibility and existence of the GATT system itself in those years. This leads to the

[507] John H. Jackson, Op cites, No. 315, p. 257. (As of 1993, the 'success rate' of the WTO dispute settlement system was at 90%.)
[508] For a discussion on the respective merits of adjudicatory systems versus negotiation-based systems in the international trading system, see William J. Davey "Dispute Settlement in GATT" (1987) 11 Fordham Intl. J.L., 51.

overhaul of the 'dispute settlement system'; i.e. the overhaul of the implementation of the Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU). The DSU was implemented during the Tokyo Round in 1980, with some important modifications during the Uruguay Round. The DSU is incorporated into the WTO Charter in Annex 2. It is implemented by the Dispute Settlement Body (DSB) of the WTO.

The DSU establishes the principles of the WTO dispute settlement main body and its procedures, which form the basis for the Sections 1 and 2. Article XXIII of the GATT is still the principal substantive dispute settlement provision, and is discussed in Section 3.

7.1 Principles of the Dispute Settlement System

The Dispute Settlement Understanding sets out the WTO's philosophy on dispute settlement in its General Principles Article 3. Article 3.2 establishes the central principles of the WTO dispute settlement system. The system is the "central element in providing security and predictability to the multilateral trading system"; it serves to "preserve the rights and obligations of Members"; it cannot "add to or diminish the rights" of members provided under other agreements; and it must clarify existing provisions of the GATT/WTO agreements according to *"customary rules of interpretation of public international law"*.

Article 3.3 establishes that the "prompt settlement of disputes" is the central aim of the dispute settlement system, as this is necessary to preserving the balance of rights and obligations of contracting parties. In light of this aim, Article 3.7 provides that the "positive solutions" should be sought. The hierarchy of those positive solutions is as follows: (1) a mutually agreed upon solution; a (2) the withdrawal of the measures concerned (if they are inconsistent with the provisions of any of the covered agreements; and finally (3) retaliation against those measures as a last resort.

7.1.1 Procedural Aspects of Dispute Settlement

The dispute settlement procedure under the DSU is divided into four stages: (1) Consultation; (2) the Panel Process; (3) the Appellate Process; and (4) Implementation of a Decision.

a. Consultation

First, parties must attempt to resolve their disputes through consultation before entering into the official dispute settlement system. Actually the improvement of the consultation system is one of the objectives that members affirm under DSU Article 4.1. If after 60 days of consultation, the parties do not reach an agreement, the complaining party may request the formation of a Panel.

b. The Panel Process

The right to have a Panel established to resolve a dispute is granted under DSU Article 6.1. Unless establishment of a Panel is rejected by consensus, the DSB has the obligation of establishing the Panel at the DSB meeting following the date that the request was made (DSU 6.1).

i. Composition of the Panel

Panels consist of three individuals, who are selected by the DSB Secretariat. Parties have the right to reject the Secretariat's proposed panelists for compelling reasons (i.e. DSU 8.6). If no panel is set up within 20 after establishment of the panel, either party may request the Director General to appoint the panelists.

Examples of panelists are well-qualified governmental officials, former Secretariats, or trade academics or lawyers (i.e. DSU 8.1). The panelists cannot be individuals from any of the parties to the dispute or third parties (i.e. DSU 8.3). Panelists serve in their individual capacities, rather than as governmental or organizational representatives (i.e. DSU 8.9). Finally, it is important to note that in disputes involving developing countries,

the developing country has the right to demand at least one panelist from another developing country (i.e. DSU 8.10).

ii. Responsibilities of the Panel

Under DSU Article 7, the Panel's standard terms of reference are as follows:

> "To examine, in the light of the relevant provisions in (name of the covered agreeemtn(s) cited by the parties to the dispute), the matter referred to the DSB by (name of party) in document…and to make such findings as will assist the DSB in making the recommendations or in giving the rulings provided for in that/those agreement(s)."[509]

Article 11 defines more generally the responsibilities of the Panel. It provides that the primary responsibility of the Panel is to assist the DSB in discharging its responsibilities under the DSU. In line with this responsibility, a Panel must 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…"[510] 'Objective assessment' means that both parties are treated with fundamental fairness, and are granted due process.[511]

7.1.2 Adoption of Panel Reports

One of the fundamental weaknesses of the dispute settlement system prior to the implementation of the DSU was its procedure for the adoption of Panel Reports. Under the previous rules, Panel Reports had to be adopted by consensus of the GATT Council. That meant that even the losing party to a dispute could vote to refuse to adopt a Panel Report. This was a major weakness in what many believed to be an otherwise successful dispute settlement system. One major consequence of this weakness was that it caused economically powerful countries (namely the United States) to lose faith in the system.

[509] DSU 7.1
[510] DSU 11.
[511] See EC Measures Concerning Meat and Meat Products, (February 13, 1998) WT/DS26 & 48/AB/R.

This in turn caused these countries to take unilateral action, which undermined the rules-based system as a whole.

With the DSU came a fundamental change in the procedure to adopt Panel Reports. Under DSU Article 16, Panel Reports are presumed adopted unless the DSB decided by consensus *not* to adopted the report. This is known as 'reverse-consensus.' Furthermore, DSU 23.2(a) requires contracting members to use the dispute settlement system when resolving disputes. These were significant changes, and have had the effect of a much more stable and authoritative dispute settlement system, and have limited countries' ability to act unilaterally.

The Appellate Process

The other significant change in the dispute settlement system of the GATT/WTO was the establishment of an appellate process, provided for under DSU 17. The Appellate Body consists of seven members, three of which are selected randomly to sit for each appeal. The DSU grants parties the right to lodge an appeal under DSU 17.4.

The Appellate Body is *"limited to issues of law covered in the panel report and legal interpretations developed by the panel."* (DSU 17.6). The Appellate Body has the power to uphold, modify, or reverse the legal findings and conclusions of the panel (i.e. DSU 17.13).

Implementation of a Decision

If it is determined that a complaint is justified, the Panel or Appellate Body will recommend the offending party to withdraw the measure. If this recommendation is not implemented within a reasonable amount of time, the injured party may seek compensation or withdraw concession previously made to the offending party; this is known as 'retaliation' (i.e. DSU 22.1).

7.1.3 GATT Article XXIII: The Substantive Aspects of Dispute Settlement

While the DSU provides the procedural rules of dispute settlement under the WTO, GATT XIII is the principal substantive dispute settlement provision.[512] Even though it is a GATT article, other agreements either expressly incorporate it, or use a provision quite similar to it.

GATT XXIII reads:

> Nullification of Impairment
>
> 1. If any contracting party should consider that any benefit accruing to it directly or indirectly under the Agreement is being nullified or impaired or that the attainment of any objective of the agreement is being impeded as the result of
>
> (a) the failure of another contracting party to carry out its obligations under this Agreement, or
>
> (b) the application by another contracting party of any measure, whether or not it conflicts with the provisions of this Agreement, or
>
> (c) the existence of any other situation,
>
> the contracting party may…make written representations or proposals to the other contracting party… which it considers to be concerned.

In other words, if a member considers that XXIII:1(a),(b) or (c) have been fulfilled, it may initiate dispute settlement proceedings.

Look closely at XXIII:1(a) and (b). Dispute settlement under the GATT can generally be divided into two categories: 'violation' cases (XXIII:1(a)) and 'non-violation' cases (XXIII:1(b)).[513] 'Violation' cases are disputes where one contracting member alleges that another is violation its obligations under the GATT (or other relevant agreement). Interestingly in 'non-violation' cases, a contracting member essentially claims that

[512] The DSU expressly incorporates GATT Article XXIII, at Article 3.1.

[513] No Panel has ever considered a question of GATT XXIII:1(c), and it is unclear whether an Article XXIII:1(c) case will ever arise. However, DSU Article 26.2 excludes the possibility that there is any overlap between GATT Article XXIII:1(c) and GATT Articles XXIII:1(a) or (b).

another is required to change its behavior, even though it is *not* violating an obligation of the GATT. Non-violation cases will be discussed in more detail in Section 3(b) below.

7.2 Violation Cases

As mentioned above, a contracting member that believes another contracting is acting in a manner that *violates* the GATT, or any other agreement, may bring a claim under Article XXIII:1(a). Almost all cases coming before GATT/WTO Panels have been violation cases.

In general, in order to establish a violation case, the complaining member must establish that:

(1) A *benefit* is being nullified or impaired;
(2) Another member is *breaching* an obligation; and
(3) This breach of obligation is *causing* the nullification or impairment of a benefit.

As we will see, however, the focus is put on whether there has been a breach of an obligation. In 1962, the Panel established the principle that a breach of an obligation was a *prima facie* cause of a nullification or impairment of a benefit:

> In cases where there is a clear infringement of the provisions of the General Agreement, or in other words, where measures are applied in conflict with the provisions of GATT and are not permitted under the terms of the relevant protocol under which the GATT is applied by the contracting party, the action would , *prima facie*, constitute a case of nullification or impairment and would *ipso facto* require consideration of whether the circumstances are serious enough to justify the authorization of suspension of concessions.[514]

[514] Uruguayan Recourse to Article XXIII (Panel Report adopted November 16, 1962) 11th Supp. BISD 95, 100.

Thus, while the legal elements are distinct, in most, if not all cases, a complaining party that establishes a breach (or 'violation') of a GATT obligation, has *prima facie* established the other two elements. This presumption is sometimes called the 'Uruguay Presumption,' and it has been incorporated into the DSU at Article 3.8. The Panel report cited above leaves the possibility open of rebutting this presumption. However, no respondent party has ever successfully rebutted the 'Uruguay Presumption.'

Read the case below, *United States—Taxes on Petroleum and Certain Imported Substances.* Think carefully about exactly what the United States is arguing in this case.

7.3 Non-Violation Cases

Article XXIII:1(a) violation cases form the basis for an overwhelming majority of WTO/GATT jurisprudence. However, in some instances, complaining parties have argued that a nullification or impairment of a benefit has been caused by a measure that does *not* breach an obligation under the General Agreement. These are called Article XXIII:1(b) 'non-violation' cases. Such cases are extremely rare, and there have been only three successful complaints that use a non-violation theory.[515] In the past, most non-violation cases have challenged the use of certain subsidies. After the SCM Agreement was implemented which clarified what subsidies may be used, it can be expected that non-violation cases will appear more and more infrequently.

However, it is important to understand the rationale for such claims. After all, it is an obscure provision, which is rare in the law—essentially a party attempts to change another's domestic economic policy, even though they have not violated any obligation. Consider the following excerpts which explain the policy behind non-violation cases (Excerpt 1, *EEC—Oilseeds*):

[515] See EEC—Payments and Subsidies Paid to Processors and Producers of Oilseeds and Related Animal-Feed Proteins (January 25, 1990) 37th Supp. BISD 86; Australian Subsidy on Ammonium Sulphate (April 3, 1950) II BISD 188; and Treatment by Germany of Imports of Sardines (October 31, 1952) 1st Supp. BISD 53.

> The idea underlying [the provisions of Article XXIII:1(b)] is that the improved competitive opportunities that can legitimately be expected from a tariff concession can be frustrated not only by measures proscribed by the General Agreement but also by measures consistent with that Agreement. In order to encourage contracting parties to make tariff concessions they must therefore be given a right of redress when a reciprocal concession is impaired by another contracting party as a result of the application of any measure, whether or not it conflicts with the General Agreement.
>
> "The Panel considered that the main value of a tariff concession is that it provides an assurance of better market access through improved price competition. Contracting parties negotiate tariff concessions primarily to obtain that advantage. They must therefore be assumed to base their tariff negotiations on the expectation that the price effect of the tariff concessions will not be systematically offset. If no right of redress were given to them in such a case they would be reluctant to make tariff concessions and the General Agreement would no longer be useful as a legal framework for incorporating the results of trade negotiations."[516]

(Excerpted 2, Japan—Photographic Film and Paper)

> "Although the non-violation remedy is an important and accepted tool of WTO/GATT dispute settlement and has been "on the books" for almost 50 years, we note that there have only been eight cases in which panels or working parties have substantively considered Article XXIII:1(b) claims. This suggests that both the GATT contracting parties and WTO Members have approached this remedy with caution and, indeed, have treated it as an exceptional instrument of dispute settlement. We note in this regard that both the European Communities and the United States in the EEC—Oilseeds case, and the two parties in this case, have confirmed that the non-violation nullification or impairment remedy should be approached with caution and treated as an exceptional concept. The reason for this caution is straightforward. Members negotiate the rules that they agree to

[516] EEC—Oilseeds (January 25, 1990) BISD 37S/86, pp. 128-129, para. 144,148.

follow and only exceptionally would expect to be challenged for actions not in contravention of those rules.

"In GATT jurisprudence, most of the cases of non-violation nullification or impairment have dealt with situations where a GATT-consistent domestic subsidy for the producer of a product has been introduced or modified following the grant of a tariff concession on that product. The instant case presents a different sort of non-violation claim. At the outset, however, we wish to make clear that we do not a priori consider inappropriate to apply the Article XXIII:1(b) remedy to other governmental actions, such as those designed to strengthen the competitiveness of certain distribution or industrial sectors through non-financial, direct or indirect, does not determine whether its effect may offset the expected result of tariff negotiations. Thus, a Member's industrial policy, pursuing the goal of increasing efficiency in a sector, could in some circumstances upset the competitive relationship in the market place between domestic and imported products in a way that could give rise to a cause of action under Article XXIII:1(b). In the contest of a Member's distribution system, for example, it is conceivable that measures that do not infringe GATT rules could be implemented in a manner that effectively results in a disproportionate impact on market conditions for imported products. In this regard, however, we must also bear in mind that tariff concessions have never been viewed as creating a guarantee of trade volumes, but rather…as creating expectations as to competitive relationships."[517]

7.3.1 Standard of Review

One of the interesting questions with dispute settlement is the standard of review that is to be applied by WTO Panels. Scattered throughout WTO rules are situations where a national authority is called upon to make an official determination of the existence of a certain condition, before it takes some responding action. How much deference should be given to a national authority in making these determinations? How much weight should

[517] Japan—Measures Affecting Consumer Photographic Film and Paper (April 22, 1998) WT/DS44/R, 10.36 and 10.38.

be given to factual findings? The application of safeguard measures, anti-dumping duties, countervailing measures, general exceptions under Article XX, and more recently, the determination that a …

7.3.2 Additional Notes

As trade relations often involve conflicting interests, *"[a]n important aspect of the WTO's work is dispute settlement".*[518] That is why a harmonious way to settle these differences is through some neutral procedure based on an agreed legal foundation. This is actually the purpose behind the dispute settlement process written in the WTO agreements. The Provisions relating to dispute settlement, i.e., Article XXII and XXIII of the GATT, 1994, would be elaborated herein below, as follows.

> "The GATT as an institution, consciously or by force of circumstances, has established customary ways of handling those disputes arising out of the agreement. The agreement contains no provisions for references, of either actual disputes or questions of interpretation, to any court of law or to the International Courte of Justice. In fact the contracting parties, by acting jointly under Article XXV:I or under more specific provisions of the General Agreement, exercised the function of a tribunal.
>
> "The system of sanctions built into the General Agreement conditions not only (?) the manner of resolving the disputes but also changes the attitudes towards violations are so drafted in conventional terms, including a rather liberal use of prohibitory language, but the remedy provisions are not drawn in terms of sanctions. Rather, the organising principle is that GATT as a whole, is a system of reciprocal rights and obligations to be maintained in balance. If a contracting party fails to live upto substantive obligations or violate a substantive prohibition; pursuant to Article XXIII the contracting parties may authorize the suspension of application to the offending contracting party 'of such concessions or other obligations .. as they determine to be appropriate in the circumstances'. In other

[518] M.B. Rao Manula Guru, WTO and International Trade, (2nd Ed., Vikas Publ. House Inc., 5 Ansri Road, New-Delhi, India – 110 002), 2003, p. 263.

> words the role of the contracting parties as tribunal is to be maintenance of a balance of concessions and other obligations among the contacting parties."[519]

Although Article XXIII:2 establishes procedures of the last resort in the event of "nullification and impairment" of GATT obligations, retaliatory provisions are to be found in Article XII(4) (c), related to the same procedure. On the other hand, Article XXII provides for consultations, which may be invoked by any contrac-ting party in an event that ".. any matter affecting the operation of the of the [GATT] Agreement" and the *prior to consultation procedures* retaliation of Article XXIII(I); e.g., Article XXVIII on modification of schedules.[520] Another example could be the waiver procedure – Article XXV:(5). A waiver, if not in law, it *in fact* settles the rights of the complaining party. Waivers were introduced as it became clear that full compliance with all provisions of the GATT by all contracting parties would not be possible to comply with.

Though it appears that treaty enforcement was not originally regarded as a very important function of the GATT, account of all provisions, of the checks and balances provided, Article XXII still remains the key provision.[521]

Article XXII

To begin with, Article XXII gives the affected party a sole remedy – that of withdrawal of such concessions or other obligations as determined appropriate in the circumstances. Though a withdrawal does not accord the injured contracting party a comparable benefit,

> *"*Article XXII grants three kinds of jurisdiction. First, a complaint by an injured party [assumes] that the benefits [accorded] to it are being impaired or nullified. .. [P]aragraph 1(a) assumes a violation of the Agreement. It refers to complaints concerning the failure of another contracting party to carry out its obligations under the Agreement[;] i.e., a violation complaint.

[519] Id., pp. 263-264.
[520] Id., p. 264.
[521] Kenneth W. Dam, The GATT – Law and International Economic Organization, (University Chicago Press), 1970, pp. 352-353.

> "Paragraph 1(b) on the other hand, covers complaints concerning the application of another contracting party of any measure, .. i.e., a non-violation complaint.
>
> "Paragraph 1(c) is even more wide ranging: it refers to complaints concerning the existence of any other situation[;] (i.e.) 'a situation complaint'."[522]
>
> "Since the 1950s, GATT practice had been to refer legal disputes to an ad hoc [qualified/knowledgeable] arbitration panel of three (or occasionally five) neutral individuals agreed to by the parties. The panel report is then referred to the GATT Council and in due course, the Council adopts the report , thereby making it an official ruling of the GATT
>
> "A similar dispute settlement system is provided .., adopted 1979, .. limited to the [30] code signatories. …"[523]
>
> "The core problem is [that] the GATT dispute settlement procedures are run by consensus. No decision is adopted unless everyone, including the defendant country, agrees; including consent to adoption of the ruling by GATT. In essence, the defendant has the power to block the dispute settlement process at any point."[524]

The rules and procedures are thoroughly detailed. Rigorous procedures with specified time limits are set in order to make the exercise of the blocking powers more difficult. Furthermore, the midterm agreement reaffirms the consensus principle.[525]

In the long run, a binding dispute settlement procedure has evolved and been adopted.

> "The situation is such that panels would be created automatically on request, and panel rulings would become binding automatically on request, either directly upon being issued, or if the loosing party wishes to appeal, upon review and affirmance by an appellate tribunal of legal experts.
>
> "Article 1 specifies the coverage and application of the understanding. It states that the rules and procedures (,) shall apply to disputes in all Agreements (called

[522] M.B. Rao Manula Guru, Op. cites, No. 526, p. 265.
[523] Ibid.
[524] Robert E. Hudec, Editor Jeffrey J. Schott, *"Dispute Settlement in Completing the Uruguay Round"*, (Institute for International Economics), 1990, pp.180-181.
[525] Raj Bhala *et la*, Op cite, No. 13, p. 267.

> covered Agreements) listed in the Appendix I to the understanding. The Appendix contains the agreement establishing WTO, and Annex 1A, 1B, 1C, Annex 2 and Annex 4 thereof."[526]

Article 2 provides for the establishment of DSB, i.e., Dispute Settlement Body, under the Chairman of DSB, within 20 days of the establishment of the panel. As need be, the DSB shall establish panels, whose undertakings it should supervise and harmonize.[527]

> "Article 3 contains general provisions. The dispute settlement system is intended to preserve the rights and obligations of the members as stated in the WTO code, and to clarify the provisions in accordance with the rules of interpretation under customary public international law. The recommendations and rulings arising from the settlement of disputes cannot add or diminish the rights and obligations agreed by the members under the code. The provisions of the understanding are to be applied to new requests, prospectively[;] i.e. after the establishment of WTO.
>
> "Under para 8, the burden of proof is on the defendant in cases where the infringement of the obligation is assumed under a covered agreement. It should be noted that a member has a distinct right from the dispute settlement procedures – to obtain an authoritative interpretation of the WTO agreements from W.T.O. (para 9). Para 10 provides that all members will act in good faith and use of settlement procedures should not be intended or considered as a contentious act. It further provides that complaints and counter complaints in regard to distinct matters should not be linked.
>
> "Article 3.12 contains the first of the special and differential treatment in favor of developing countries. Its interalia provides that if a developing country member brings a complaint against a developed country, it can invoke an old 1966 Decision on procedures under Article XXIII of the GATT. This is considered to be 'an alternative' to certain DSU provisions contained in Articles 4,5,6, and 12

[526] Id., p. 268.
[527] Id., pp. 268-269.

> of the DSU. If there is conflict in the latter articles of the DSU and the 1966 Decision, the latter takes precedence.[528]
>
> "Article 4 provides for consultations amongst members. … If, however, the consultation does not result in any fruitful result, then the aggrieved party may ask for the establishment of a panel so that the matter may be adjudicated upon (para 7)."[529]
>
> "Article 5 states that good offices, conciliation and mediation be undertaken voluntarily if the parties so agree. They may commence any time and be terminated at any time."[530]
>
> "Article 6 deals with establishment of panels. When consultations fail .., a complaining party has a right to request for the establishment of a panel. .. Article 8 deals with the composition of the panels. .. Article 9 deals with procedures for multiple complaints .. [that] panel process in such disputes shall be harmonized .. [while] Article 10 deals with third parties[;] i..e. a third state that has substantial trade interest affected, may join the consultation process."[531]

The functions of the panels is to assist the DSB, by making an objective assessment of the facts to the case as stipulated in Article 11, while Article 12 provides for panel procedures. Article 12.10 of the DSU speaks of "a complaint against a developing country", while Article 12.11 provides that:

> .. if one or more of the parties is a developing country member, the panels report shall explicitly indicate the form in which an account has been taken of relevant provisions on differential and more favourable treatment for developing country member .."[532]
>
> "Under Article 13, the panels are given specific authority to seek information and expert opinion from any individual or body within the jurisdiction of a member

[528] Mary E. Footer, Journal of World Trade: *"Developing Country Practice and WTO Dispute Settlement"*, Vol 35 (1), 55-98, 2001, p. 61.
[529] M.B. Rao Manula Guru, Op cites, No. 526, pp. 269-270.
[530] Id., p. 271.
[531] Id., pp. 272-273.
[532] Id., p. 274.

state (para. 2). However before seeking such information or advise, it shall inform the member state of its intention to seek information (para. 1).

"Article 14 interalia provides that panel deliberations are to be confidential; and opinions expressed by individual panelists are to be anonymous (para. 3).

"Article 15 enjoins on the panel to issue an interim report for the consideration of the parties before a final report is finalized. The final report shall include a discussion of the arguments the parties may make at the interim review stage.

"Article 16 deals with adoption of panel reports. Members are to be provided with the report and be given twenty days time to consider the report. Members may raise their objections in writing. They have the right to participate fully in the consideration of the panel report by the DSB. The final report is to be adopted within sixty days of its issuance to the members at the DSB meeting (para 4). However the final report will not be adopted, if one of the parties to the dispute formally notifies the DSB of its intention to appeal [as per Article 17] or the DSB decides by consens*us not to adopt the report."*[533]

Article 18 requires that all communications addressed to the panel or appellate body be treated as confidential, but should be communicated to the other side for the sake of keeping transparency in the proceedings.[534]

Article 19 deals with panel and appellate body recommendations; recommendations that may include bringing in conformity to the agreement any inconsistent undertakings of a member state with suggestions of implementation.[535]

Article 20 stipulates that the time frame for decision shall not exceed nine months as a general rule.[536]

Article 21 is important and it deals with surveillance of implementation of recommendations and rulings of the DSB; para. 1 interalia states that prompt

[533] Id., pp. 275-276.
[534] Id., p. 277.
[535] Ibid.
[536] Ibid.

> compliance with recommendations or rulings of the DSB is essential in order to ensure effective resolution of the disputes among members. Para 2 requires that attention be paid to matters affecting the interests of a developing country members with respect to measures which have been subject to dispute settlement. ..”[537]
>
> “Article 22 deals with compensation and suspension of concessions. If the recommendations or rulings are not implemented, a member may receive compensation and/or suspended concessions or other obligations [which] is in relation to the other member. …”[538]
>
> “Article 23 aims at strengthening of the multilateral system. It provides that members shall have recourse to and abide by the rules and procedures of the understanding when they seek redressal of violation of obligations or other nullification or impairment of benefits under the covered agreements. ..”[539]
>
> “Article 24 interalia provides that particular considerations shall be given to the special situation of least developed country members. ..”[540]

Article 25 provides arbitration, stressing that it should only proceed if there is mutual consent of the parties to the case. Article 26 deals with non-violation; i.e., non-violation complaint initiated under clause (b) of Article XXIIII: of GATT even if the members' rights are not directly violated. Article 26.1 deals with complaints under Article XXIII:1 (b) of the GATT, while Article 26.2 deals with complaints under Article XXIII:1 (c) of the GATT – situation complaints. (Refer to Article 5.)

Finally Article 27 deals with the responsibilities of the Secretariat. It shall assist the panels and provide secretarial assistance. It may also provide legal advice and assistance to developing country member in respect of dispute settlement. It may provide legal experts as part of technical assistance at the request of a developing country member. It

[537] Ibid.
[538] Id., p. 280.
[539] Id. p. 281.
[540] Id., p. 282.

shall also conduct special training courses of interested members concerning the dispute settlement procedures.[541]

Mentioning a case between U.S.A. and India from among a number of various cases would be of paramount interest to developing, and most specifically, to the Least Developed Countries (LDCs). The case relates to the complaint filed by U.S. about violation of TRIPS agreement in regard to patent protection for pharmaceutical and agricultural chemical products: (WT/D.S350).[542] In the case, the request concerns the alleged absence of patent protection for the specified products in India. The most important point to be noted in this lengthy deliberation is that, ".. developing countries are free to adopt their own laws and policies with respect to all intellectual property issues that were not expressly harmonized in TRIPS standards themselves."[543]

Though such and other, special kinds of treatments are afforded in GATT/WTO agreements, special care and sensitivity is required during negotiations.[544] That is because failure to abide to the spirit of an agreement would have devastating effect as the other party retains the right to take retaliatory, economic actions.

It is noted that developed countries are advised not to do so, i.e., retaliate, in relation to developing or LDCs. But, for any eventualities, it would be recommendable to take great care during the drafting of any trade agreement; and once agreed – to abide to the spirit thereon. As the cases between India and U.S.A. (e.g., WT/DS90/1, WT/DS175/1), and that of India and E.C. (e.g. (WT/DS146/1, WT/DS140/1) show, judgments are made according to the spirit of the governing laws of the General Agreement. In most cases, India tried to bring to the attention of the panels that the other party (vis-à-vis E.C. or E.U. member country) infringes one or the other sector, or, being a developing country, it did not give it the right to use its special treatment right.

[541] Id., pp. 282-283.
[542] Id., p. 283-284.
[543] Id., p. 285.
[544] Id., pp. 285-297. (Students are strongly advised to read all of the "Decided Cases" – i.e., pp. 282 up to 297).

Recapitulations

Forum for Trade Negotiations

A second function of the WTO is to provide a permanent forum for negotiations amongst its Members. These negotiations may concern matters already dealt with in the WTO agreements but may also concern trade matters currently not yet addressed in WTO law. With regard to negotiations on matters already dealt with, the WTO is "the" forum for negotiations while for other negotiations, it is "a" forum among others. To date, WTO Members have negotiated and concluded in the framework of the WTO a few trade agreements providing for further market access in particular regarding services.

At the Doha Session of the Ministerial Conference in November 2001, the WTO decided to start a new round of trade negotiations, commonly referred to as the Doha Development Round. In the Ministerial Declaration, Ministers stressed their *"commitment to the WTO as the unique forum for global trade rule-making and liberalization"*.[545] The Ministerial Declaration provides for an ambitious agenda for negotiations. These negotiations include matters on which WTO Members had already agreed in 1994 in the *WTO Agreement* to continue negotiations, such as trade in agricultural products and trade in services (the "built-in" agenda).[546] In fact, negotiations on these matters had already started in early 2000. Furthermore, the Doha Development Round negotiations also include negotiations on matters such as market access for non-agricultural products, dispute settlement, rules on anti-dumping duties, subsidies and regional trade agreements and certain issues relating to trade and the environment. The WTO Members also decided that after the Fifth Session of the Ministerial Conference in 2003, they would start negotiations on the relationship between trade and investment, the relationship between trade and competition law, transparency in government procurement, trade facilitation and issues relating to trade and the environment other than those already the subject of negotiations. At the 2003 Session of the Ministerial Conference, the modalities of these negotiations will be decided upon by "explicit

[545] Ministerial Declaration, adopted 14 November 2001, WT/MIN(01)/DEC/1, 20 November 2001, para. 4.
[546] Article 20 of the Agreement on Agriculture and Article XIX of the GATS.

consensus". In the meantime, the relevant WTO bodies will "prepare" these negotiations by discussing and attempting to clarify the matters that will be addressed in the negotiations.

With regard to the organization of the negotiations, the Doha Ministerial Declaration states that the negotiations to be pursued under the terms of this declaration shall be concluded not later than 1 January 2005. With the exception of the improvements and clarifications of the Dispute Settlement Understanding, the conduct, conclusion and entry into force of the outcome of the negotiations shall be treated as parts of a single undertaking.

The Doha Ministerial Declaration explicitly states:"The negotiations shall be conducted in a transparent manner among participants, in order to facilitate the effective participation of all. They shall be conducted with a view to ensuring benefits to all participants and to achieving an overall balance in the outcome of the negotiations.[547]

Settlement of Disputes[548]

A third and very important function of the WTO is the administration of the WTO dispute settlement system which is detailed below.

Monitoring of Trade Policies

A fourth function of the WTO is the administration of the trade policy review mechanism (the "TPRM").[549] The TPRM provides for the regular *collective* appreciation and evaluation of the full range of *individual* Members' trade policies and practices and their impact on the functioning of the multilateral trading system. The purpose of the "TPRM" is to contribute to improved adherence by all Members to the WTO agreements by achieving greater *transparency* in, and *understanding* of, the trade policies and practices of Members.

[547] Ministerial Declaration, adopted 14 November 2001, WT/MIN(01)/DEC/1, 20 November 2001, paras. 45, 47 and 49.
[548] Mr. Peter Van den Bosche, Op cites, No. 207, pp. 8-12.
[549] WTO Agreement, Annex 3, Trade Policy Review Mechanism.

Under the TPRM, the trade policies and practices of all Members are subject to *periodic review*. The four largest trading entities, i.e., the European Communities, the United States, Japan and Canada are subject to review every two years. The next 16 largest trading nations are reviewed every four years.

Other Members, including most developing country Members, are reviewed every six years, except that a longer period may be fixed for least-developed country Members. The trade policy reviews are carried out by the Trade Policy Review Body on the basis of two reports: a report supplied by the Member under review, in which the Member describes the trade policies and practices it pursues and a report drawn up by the WTO Secretariat.[550] These reports, together with the minutes of the meeting of the Trade Policy Review Body are published after the review and are a valuable source of information on a WTO Member's trade policy and practices.

It is important to note that the TPRM is not intended to serve as a basis for the enforcement of specific obligations under the WTO agreements or for dispute settlement procedures, or to impose new policy commitments on Members. However, by *publicly* denouncing the inconsistency with WTO law of a Member's trade policy or practices, the TPRM intends to "shame" Members into compliance *and* to bolster domestic opposition against trade policy and practices inconsistent with WTO law. Likewise, by *publicly* praising free tradepolicies, the TPRM bolsters, both internationally and domestically, support for such policies.

In his concluding remarks at the meeting in January 2002 at which the TPRB concluded the trade policy review of Pakistan, the Chairperson of the TPRB observed:

> "Purely as an aside, and as much a comment on the review process as on this Review, I was struck by [Pakistan's] Secretary Beg's remarks that questions had

[550] Ministerial Declaration, adopted 14 November 2001, WT/MIN(01)/DEC/1, 20 November 2001, paras. 45, 47 and 49. (See WTO Agreement, Annex 3, Trade Policy Review Mechanism. The two reports cover all aspects of the Member's trade policies, including its domestic laws and regulations, the institutional framework, bilateral, regional and other preferential agreements, the wider economic needs and the external environment.)

given his delegation food for considerable thought and that sources of information had been found of which he was unaware. This goes to the heart of our work: not only do we learn a lot about the Member, but also often the Member learns a lot about itself. Moreover, this is put into a multilateral setting, thus serving to strengthen our system. Increasingly our work highlights the value of the Trade Policy Review Body."[551]

Questions of Concern

1) What is the main rationale behind allowing non-violation claims?

2) From the excerpt from *Japan—Photographic Film and Paper*, what is a "benefit" the context of non-violation claims? Is there a difference between "benefit" for the purpose of violation and non-violation claims?

3) From a legal standpoint, what is the difference between establishing a violation case and a non-violation case? (Consider the presumption at work in a violation claim).

4) For discussion on the specific elements of non-violation claims (ie, the application of a measure that causes a nullification or impairment of a benefit), see *Japan—Measures Affecting Consumer Photographic Film and Paper* paragraphs 10.41—10.206.

5) *US—Taxes on Petroleum* is largely a case dealing with the definition of the term "benefit" under the GATT. What is the US arguing is the proper definition of "benefit" under the General Agreement? The Panel disagrees with this characterization. Can you see how? [Re-read paragraph 5.1.9].

[551] PRESS/TPRB/187, dated 25 January 2002.

6) The United States argues that the tax differential is so small that it could never have cause a nullification or impairment of a benefit. This is a '*de minimis'* argument. Can you see what is fundamentally weak about this argument, even if it true?

7) Does the case shed any light on the rebuttable nature of the Uruguay Presumption?

8) The Panel determines that the United State's argument with respect to the difference between the Article III inconsistent tax and what it proposes is "illogical." Do you see why?

Part III
Specific Areas of Concern

Chapter Eight
Trade in Services

8.1 The General Agreement on the Trade in Services (GATS)

Up to this point, you have been studying the rules and exceptions related to the trade in goods. Now you will focus on the trade in a different, but increasingly important, area: the trade in services. For some large economies, the trade in services represents a substantial amount of total exports. In developing economies, the trade in services represents possible areas where comparative advantage can be obtained and exploited. In this Unit you will focus on why liberalizing the trade in services is important, followed by an exploration of the WTO General Agreement on the Trade in Services. Finally, you will study the special concerns that developing countries have with regard to the services trade.

The trade in services involves trading intangible goods. As with trading goods, the trade in services involves producers of the service, and consumers of the service. The international trade in services involves some international element, although this is not as clear-cut as with the international trade of goods. The trade in services is divided into four *modes of supply*.

A rudimentary understanding of services can be obtained by reference to some common examples of services that are traded on the international market: telecommunications; finance and banking; insurance; transportation of passengers and freight; tourism; and professional services such as medical, legal, and education services.

When goods are traded, economic gains are obtained through the principle of comparative advantage and specialization. Likewise, when services are traded, the same gains through specialization should apply. In other words, the economic rationale for liberalizing the trade in services is identical to that for liberalizing the trade in goods.[552] For instance, if mobile telephone services are traded, more efficient suppliers provide the service, which results in increased product quality and decreased prices. This increases per capita income and avoids opportunity costs in the domestic market.

Two of the more common arguments advanced against liberalization of services are rooted in the essential nature of services, and the infant industry argument. First, it is often argued that, since services are essential to the functioning of a country, they should be controlled by domestic suppliers.[553] However, as with goods, the need for regulation of services does not imply a need to keep the service sector domestic. For example, doctors provide a valuable service to countries, and are highly regulated by rules of ethics, qualification standards, etc. Those regulations may apply regardless of whether a doctor is foreign or domestic.

The other common argument is the infant industry argument, which posits that, since the service sector of many countries is underdeveloped, domestic suppliers will not be able to compete with foreign service suppliers and therefore should be protected. However, like all infant industry arguments, its applicability is limited. Some protection might be justified in the short term in order to allow for infant industries to 'catch-up'. However, unless domestic service industries can accurately be identified as ones that will compete in the long-run, short-term protection will result in foregone gains from liberalization. Also, if domestic service industries themselves have certain guarantees that they will be capable of competing in the long-run, they will have no incentive to invest in areas to improve competitiveness.[554]

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[552] *"The Developmental Impact of Trade Liberalization under GATS"*, Informal Note by the Secretariat (July 7, 1999), Job No. 2748/Rev.1, page 1. (To electronically download, also available at WTO Web-Page.)
[553] Geza Feketekuty, *"Trade in Professional Services: An Overview"* (1986) 1 U. Chi. Leg. Forum 1, p. 4.
[554] Ibid.

8.1.1 Historical Background

As mentioned above, the importance of the trade in services to the world market has grown rapidly since the inception of the WTO/GATT system. Despite this increase, multilateral disciplines on the trade in services have been slow to develop. One explanation is that barriers to the international services trade are unlike those restricting the trade in goods—such a tariffs and quotas — which were the primary focus of the WTO/GATT system in its early years.[555] Rather, barriers to the trade in services usually take the form of domestic regulations, investment limitations, and immigration policies.[556] These types of restrictions have lagged behind the more common barriers applicable to goods.

Furthermore, the need and desirability of liberalization have often been questioned. Many sectors, such as tourism, have traditionally been considered purely domestic areas, with no real international element. Some infrastructural sectors, such as transportation and telecommunications, have often been considered of such vital importance, that opening them to foreign meddling could prove disastrous. Also, some sectors, such as medical and educational services, have often been considered as essentially domestic social matters, and therefore fall within the responsibilities of domestic government.[557]

Nevertheless, impetus for a multilateral framework to liberalize the services trade grew, largely as a result of the increasing prominence services have obtained in the international marketplace:

> Services have recently become the most dynamic segment of international trade. Since 1980, world services trade has grown faster, albeit from a relatively modest basis, than merchandise flows. Defying wide-spread misconceptions, developing countries have strongly participated in that

[555] Jackson, Op cites, No. 115, p. 854.
[556] Ibid.
[557] See *"The General Agreement on the Trade in Services: An Introduction"*, p. 2. (It can be accessed at the World Trade Organization website)

growth. Whereas in 1980 their share of world services exports amounted to 20%, in 2004 it was 24% on a Balance of Payment (BOP) basis.[558]

This type of dynamic growth eventually led countries to consider a comprehensive services agreement during the Uruguay Round negotiations of 1986-1994. The result was the General Agreement on the Trade in Services, or GATS.

8.1.2 The Framework of GATS

The GATS was the first comprehensive, multilateral agreement on the services trade. *"GATS' contribution to world services trade rests on two main pillars: (a) ensuring increased transparency and predictability of relevant rules and regulations, and (b) promoting progressive liberalization through successive rounds of negotiations."*[559] GATS contains two types of obligations: (1) a collection of *general* concepts, principles and rules that apply to *all* measures affecting trade in services; and (2) *specific* negotiated obligations that make up a collection of commitments that apply to service sectors that are listed in a member country's 'schedule'.[560]

a. General Provisions

i. The Preamble

GATT recognizes that the trade in services has been, and is, a sector of growing importance to the world economy as a whole.[561] It also aspires to develop a system of international services trade "under conditions of transparency and progressive liberalization and as a means of promoting the economic growth of all trading partners and the development of developing countries."[562] 'Progressive liberalization' is to be attained through successive multilateral negotiations.

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[558] Ibid.
[559] Id., p. 3.
[560] Bernard Hoekman, *"The General Agreement on Trade in Services"*, (1994, Paper prepared for presentation at an OECD Workshop on The New World Trading System, Paris), April 25-26, 1994.
[561] Id., GATS Preamble.
[562] Ibid.

Interestingly, 'progressive liberalization' does *not* entail a specific obligation to deregulate services markets. GATS specifically recognize the rights of member states to regulate and to introduce new regulations to meet national policy objectives.[563] Thus, GATS is similar to the GATT in that it does not *require* liberalization, it only *promotes* liberalization through successive multilateral negotiations (which lead to binding commitments, which are discussed below). Indeed, GATS and the GATT are based on many parallel concepts. However, it would be shortsighted to ignore important differences which arise due to differences between the trade in services and in goods. Important differences between these two agreements are discussed below.

ii. **Part I: Scope and Definitions**

GATS applies to "measures by Members" that affect the "trade in services".[564] "Services" are defined as "any service in any sector except services supplied in the exercise of governmental authority."[565] WTO members generally classify services into 12 core categories:

- Business services (including professional services and computer services)
- Communication services
- Construction and related engineering services
- Distribution services
- Educational services
- Environmental services
- Financial services (including insurance and banking)
- Health-related and social services
- Tourism and travel-related services
- Recreational, cultural and sporting services
- Transport services
- Other services not included elsewhere[566]

[563] Ibid.
[564] GATS Article I.
[565] GATS Article I(3)(b).
[566] "The General Agreement on the Trade in Services: An Introduction", Op cites, No. 370, p. 4.

"Measures by Members" includes all measures taken by central, regional or local governments and authorities, and nongovernmental bodies, if they exercising delegated authority.[567] The definition of a "measure" is significantly broader than one might expect. It covers any measure "whether in the form of a law, regulation, rule, procedure, decision, administrative action, or any other form, ... in respect of:

- the purchase, payment or use of a service;
- the access to and use of, in connection with the supply of a service, services which are required by those Members to be offered to the public generally;
- the presence, including commercial presence, of persons of a Member for the supply of a service in the territory of another Member.[568]

A close examination of GATS' treatment of the "trade in services" highlights some of the unique aspects of the services trade in general, and some of the important differences between the trade in services and the trade in goods. Understanding the structure of the "trade in services" is also necessary to understanding the *specific* commitments member countries undertake.

GATS divides the trade in services into four categories, or "modes of supply" as follows:[569]

- **The 'cross-border supply' of a service**, i.e. "from the territory of one Member into the territory of any other Member." [GATS Article I(2)(a)]. The cross-border supply of services does not require the physical movement of the supplier or consumer.

  For example, a Doctor situated in India examines radiographic pictures (e.g. X-rays) of an Ethiopian patient sent electronically, and sends back his diagnosis to the pertinent body. This can be a good example where neither the service provider (i.e. the Doctor), nor the consumer of the service (i.e. the patient) need to

[567] GATS Article I (3)(a)(i) & (ii).
[568] B. Hoekman, Op cites 171, No. 370.
[569] Id.

cross any international border physically. Nonetheless, the transaction takes place through the system made available to both, i.e. the Doctor in India and the patient in Ethiopia; a system devised and regulated by the pertinent governmental bodies of the two Countries, i.e. the Ministries of Telecommunication, Health, .. of India and Ethiopia, as well as the money transferring Banks (e.g. NBE and that of India). In such instances, services are provided across international borders without the need of persons having to travel from one country to the other.

- **The provision of services implying movement of the consumer to the location of the supplier,** i.e. "in the territory of one Member to the service consumer of any other Member.*"*[570] Here, physical movement of the *consumer* to the territory of another member is required.

  For example, a patient gets permission to get medical care in a specialized hospital, say somewhere in Europe. In order to get the medical service, the patient has to cross international borders and physically appear at the specific place, i.e. the hospital, in order for the transaction to take place..

- **Services sold in the territory of a Member by (legal) entities that have established a presence there but originate in the territory of another Member,** i.e. "by a service supplier of one Member, through commercial presence in the territory of any other Member."[571] Here, physical movement of the *supplier* to the territory of another member is required.

  For example, an Egyptian mobile telecommunications company opens a telecommunication center in Algeria and sells mobile services to the Algerian public. Here, the supplier (Egyptian company) establishes itself inside the territory of another member country to transact with the consumer (the Algerian public).

  This example highlights an important distinction that must be made between the international trade in services and foreign direct investment — both of which are present in the example. The service is the actual sale of mobile telecommunications capabilities. However, it requires an initial investment in the

[570] GATS Article I(2)(b).
[571] GATS Article I (2)(c).

infrastructure that allows the service to reach the consumer. Thus, while the service (the provision of mobile telecommunications capabilities) would be subject to the WTO's services rules, the investment in infrastructure would be subject to the WTO's rules on investment; i.e. the Agreement of Trade Related Investment Measures (called "TRIMs")[572]

- **The provision of services requiring the *temporary* movement of *natural* persons;** i.e. "by a service supplier of one Member, through presence of natural persons of a Member in the territory of any other Member."[573] Here, a national of one member physically travels into the territory of another member in order to provide the service. For example, a Cuban doctor travels to Mexico to practice medicine.

iii. Part II: General Obligations and Disciplines

The general obligations of GATS apply to all measures affecting the trade in services. Some of the general obligations have clear counterparts in the GATT. These differences, and a selection of the more important obligations, are discussed below.

1. Most-Favored National Treatment

Article II requires members to afford unconditional most-favored nation treatment to service suppliers from all other members:

> With respect to any measure covered by this Agreement, each member shall accord immediately and unconditionally to services and service suppliers of any other Member treatment no less favourable than that it accords to like services and service suppliers of any other country."[574]

This obligation is, of course, analogous to the MFN clause of GATT Article III. As with any unconditional most-favored nation provision, it is subject to some level of abuse

[572] The TRIM's Agreement has been excluded from the International Trade Law Course Material because it is thoroughly covered in the Investment Law Course Material. Instructors wishing to cover the TRIMs Agreement should refer to those materials.
[573] GATS Article I (2)(d).
[574] GATS Article II(1).

through 'free-riding'. This occurs when one country does not lower its own restrictions, but takes advantage of other countries that have lowered their restriction.

For example, two countries A and B, both having large markets, might negotiate to lower all restrictions on the services trade by 50%. Another country C, representing a smaller market, might refuse to lower *any* of its restrictions. The smaller market would still be afforded most-favored nation treatment in the markets of countries A and B (because it is an *unconditional* requirement).

Thus, country C clearly benefits without the *quid pro quo* of lowering restrictions of its own. As with the trade in goods, liberalization theory suggests that both countries A and B still benefit *regardless* of the refusal by country C to allow greater market access. (Actually, countries should gain even through *unilateral* liberalization.) Furthermore, the entire international trade in services system benefits as well. Thus, if countries A and B were allowed to treat country C less favorably than they treated each other, the value of the entire system would be reduced.

The G-7 countries with large markets were quite concerned with free-riding on the unconditional most-favored obligation, despite its benefit to the entire services trade system. During the Uruguay Round negotiations, they were successful in lobbying for a less restrictive most-favored nation obligation. GATS Article II(2), which allows for just such an exemption. It reads: *"A Member may maintain a measure inconsistent with paragraph 1 provided that such a measure is listed in, and meets the conditions of, the Annex on Article II Exemptions."*

The Annex on Article II Exemptions attempts to reduce the potential negative long-tem effects of the MFN exemption. It specifies that exemptions to Article II(1) are time-bound in principle, and should not last longer than 10 years or sooner.[575] Countries seeking exemptions to the GATT's MFN obligation are subject to the approval process detailed in Article IX(3) of the WTO Agreement; i.e. they must receive three-fourths of

[575] GATS Annex on Article II Exemptions, para. 6.

the support of members at a subsequent Ministerial Conference.[576] The exemptions are also subject to review by the Council for Trade in Services, within 5 years of their implementation.[577] The Council's review is used to examine whether the conditions justifying the exemption still prevail.[578] All exemptions are also subject to negotiation in the future.[579] Finally, all exemptions must be listed as annexes to the WTO Agreement.[580]

8.1.3 Economic Integration

GATS Article V allows countries to enter into agreements to deepen integration through liberalization measures in the service sector. It reads: "This Agreement shall not prevent any of its Members from being a party to or entering into an agreement liberalizing trade in services between or among the parties to such an agreement…"

This Article is analogous to the GATT Article XXIV exception. Its structure is similar, and it acts as an exception to the MFN obligation. As with free trade areas and customs unions, there is a concern that trade diversion could result from this type of agreement; i.e. if barriers to the trade in services that are *external* to the integration agreement are raised. Thus, Article V contains conditions that are designed to minimize that potential adverse effects of trade diversion; like those contained in GATT Article XXIV:V and VIII.

Article V imposes three conditions on economic integration agreements. First, such an agreement must have "substantial sectoral coverage."[581] The interpretative note states that "substantial sectoral coverage" should be understood in terms of (1) the number of sectors; (2) the volume of the trade affected; and (3) that no mode of supply should be excluded on an *a priori* basis.[582] This requirement is analogous to, but not the same as, GATT Article XXIV which requires the elimination of restrictions on "substantially all

[576] Id., para. 2.
[577] Id., para. 3.
[578] Id., para. 4 (a).
[579] Id., para. 5.
[580] Id. at paragraph entitled "Lists of Article II Exemptions".
[581] GATS Article V(1)(a).
[582] Ibid.

trade".[583] The difference may suggest an intention by the drafters that this requirement be less restrictive than its counterpart in the GATT.[584]

The second requirement is that parties to integration agreements must eliminate "substantially all discrimination…between or among parties…in the sectors covered under subparagraph (a)".[585] (The discriminatory measures that must be 'substantially eliminated' are discussed earlier while dealing on Article XVII.) This requirement may be fulfilled either through the elimination of existing discriminatory measures, or through the prohibition of new or more discriminatory measures.[586] Thus, this requirement may be fulfilled simply through a standstill agreement, which further suggests an intention that GATS Article V should be read to be less restrictive than GATT Article XXIV.[587]

The finally requirement is that parties to the integration agreement must not "raise the overall level of barriers to trade in services" with respect to members that are not parties to the agreement, within the respective sectors.[588] This requirement is designed to ensure trade facilitation, and to avoid trade diversion. However, unlike the GATT, no distinction is made between free trade areas and customs unions. Furthermore, the requirement is less stringent than the GATT in that it only requires that parties to the agreement do not raise the *overall* level barriers. Thus, it allows some parties to raise *some* of the barriers to non-parties, as long as the *overall* barriers are not raised.[589]

Will the GATS Article V exception lead to greater integration?

After evaluating the Article V exception, the relevant question is whether it will lead to great integration of services markets. Consider the following excerpt:

> The conditions imposed by Article V are relatively weak. The requirements regarding the extent of internal liberalization that must occur under Article I

[583] GATT Article XXIV(8)(a)(i) (applying to Customs Unions) and GATT Article XXIV(8)(ii) (applying to Free Trade Areas).
[584] B. Hoekman, Op cites, No. 171, p. 370.
[585] GATS Article V(1)(b).
[586] GATS Articles V(1)(b)(i) & (ii).
[587] B. Hoekman, Op cites, No. 171, p. 370.
[588] GATS Article V(4).
[589] B. Hoekman, Op cites, No. 171, p. 370.

> imply only a limited constraint on "strategic" violations of the MFN obligation and the specific commitments on market access and national treatment made under the GATS. The absence of any requirement in Article V that integration agreements be "open" in principle (i.e., contain an accession clause) is an important shortcoming. Article B appears to have been worded primarily with a view to ensuring that existing regional agreements would be consistent with the GATS. Weak multilateral disciplines, in conjunction with the rather convoluted structure of the GATS and the resulting lack of transparency and significant scope for governments to determine the conditions of competition for foreign service suppliers, suggests that the net effect of the GATS may well be to increase the marginal incentive for Members to pursue regional options.

Other Exceptions

Another analogy between GATS and the GATT can be drawn in terms of other exceptions allowed in order to pursue public policies. Members are allowed to restrict trade in services in the event of serious balance-of-payments difficulties [Article XII], for health or other public policy concerns,[590] or to pursue essential security interests.[591] The scope of these exceptions is uncertain at present, and there is room for interpretation. Although rudimentary at present, these exceptions are designed to allow governments to pursue legitimate policy objectives, while limiting unnecessary trade effects.[592]

8.1.4 Specific Provisions

In addition to the general obligations that apply to all restrictions of the trade in services, members are also required to undertake specific commitments with regard to market access and national treatment.

[590] GATS, Article XIV.
[591] Id., Article XIV *bis.*
[592] Rudolf Adlung, "*The GATS Turns Ten: A Preliminary Stocktaking"* (2004) p. 11; WTO Staff Working Paper ERSD-2004-05, (Electronically accessible at WTO Web-Page; WTO.ORG.)

Market Access and National Treatment

Like GATT Article II, the main obligation members undertake with respect to limitations on the trade in services comes in the form of commitments listed in a member's schedule. Article XVI(1) provides:

> With respect to market access through the modes of supply identified in Article I, each Member shall accord services and service suppliers of any other Member treatment no less favourable than that provided for under the terms, limitations and conditions agreed and specific in its Schedule."

Before exploring the structure of schedules, it is worth discussing two other main obligations members undertake through GATS Part III: national treatment and market access.

Within the framework of schedules, GATS Article XVI(2) outlines six market-affecting measures which are, in principle, prohibited. This article consists of limitations on:

- The number of service suppliers allowed;
- The value of transactions or assets;
- The total quantity of service output;
- The number of natural persons that may be employed;
- The type of legal entity through which a service supplier is permitted to supply a service (for example, a measure requiring a bank to operate through a subsidiary rather than a branch); and
- Participation of foreign capital in terms of a maximum percentage limit of foreign shareholding or the absolute value of foreign investment.

Again, these measures are only prohibited *in principle*. As discussed below, members may use these measures as long as they are properly scheduled.

The national treatment obligation differs from the national treatment obligation of the GATT. Article XVII reads:

> "In the sectors inscribed in its Schedule, and subject to any conditions and qualifications set out therein, each Member shall accord to services and service suppliers of any other Member, in respect of all measures affecting the supply services, treatment no less favorable than that it accords to its own like services and service suppliers."

It is important to note that, unlike the GATT's national treatment obligation which applies across to measures across the board, GATS' national treatment obligation is confined to scheduled services, and it is subject to possible limitations. At first glance it might not be apparent why GATS' national treatment obligation is much more limited than that found in the GATT. The reason stems from the nature of services. Unlike goods, most services cannot be restricted by border measures such as tariffs or quotas. The national treatment obligation under the GATT is designed to ensure that countries do not erode the market access afforded through tariff bindings. Thus, it applies to the treatment of goods *after* they enter the domestic market.

However, the main means that countries use to restrict the trade in services are applied after the service has 'entered the market.' Thus, if countries were obliged to grant all imported services treatment no less favorable than that afforded to domestic services, a situation would result that would be tantamount to a guarantee of free market access. In other words, countries could not employ *any* restrictions on the imported services.

8.1.5 Members' Schedules

As mentioned above, members' specific obligations with respect to levels of protection over services are largely found in Schedules annexed to the GATS; like members' tariff obligations and the GATT. Schedules are organized on a sector-by-sector basis, with reference to each mode of supply, and with reference to limitations and conditions on market access, national treatment, and additional commitments. Refer to Table 1 below for the schedule format.

Notice that members schedule their commitments by sector; e.g. telecommunications or sub-sector e.g. mobile telephone providers vs. landline telephone providers. This structure implies that negotiations on services liberalization will be (and have been) sectoral, which further implies that they will be driven primarily by the interests of the major players in these sectors.

Table 1: Format for Country Schedules of Specific Commitments[593]

Sector or sub-sector	Mode of supply	Conditions and limitations on market access[594]	Conditions and qualifications on national treatment[595]	Additional commitments
	Cross-border [ie, Article I(2)(a)			
	Movement of Consumer [ie, Article I(2)(b)			
	Commercial presence [ie, Article I(2)(c)			
	Movement of personnel [ie, Article I(2)(d)			

Also notice that the two main specific obligations undertaken may be limited by each member, according to its schedule. This is referred to as a 'hybrid' approach to liberalization, because members first list what commitments are made, then list what limitations to those commitments are available. GATS's hybrid structure, combined with its other provisions, may have three negative consequences:

Finally, countries are allowed to negotiate commitments with respect to services that are not subject to scheduling under Articles XVI or XVII; i.e. commitments with respect to

[593] Corresponds to GATS Article XVIII.
[594] Corresponds to GATS Article XVI.
[595] Corresponds to GATS Article XVII.

market access and national treatment.[596] These may include commitments regarding qualifications, standards or licensing matters.

Modification of Scheduled Commitments

Members wishing to modify commitments must do so in accordance with principles of compensatory adjustments through mutually advantageous commitments, and subject to notification requirements. Specifically, GATS Article XXI allows members to modify their commitments, subject to negotiation with and compensation for affected parties. [GATS Article XXI(2)(a)]. If these negotiations do not resolve the issue of modification between parties, the affected party may refer the matter to arbitration.[597] If the member adjusting its commitments does not comply with the findings of the arbitration, the affected members may retaliate by withdrawing substantially equivalent benefits in conformity with the findings of the arbitration.[598]

8.2 Developing Countries and Trade in Services

While the potential benefits to developing countries of multilateral liberalization of the trade in services are vast, that potential is still left untapped. As with the trade in goods, liberalization of the services trade will generally benefit developing countries in two ways: (1) through increased exports due to improved foreign market access, and (2) through efficiency gains reaped in the internal market due to domestic de-regulation. While the latter probably represents more potential benefit to developing countries (at least in the short run), both are of vital importance.[599] Additionally, both come with their own set of challenges.

[596] GATS Article XVIII.
[597] GATS Article XXI(3)(a).
[598] GATS Article XXI(4)(b).
[599] Bernard Hoekman, Constantine Michalopoulos, and L Alan Winters, "More Favorable and Differential Treatment of Developing Countries: Towards a New Approach in the WTO (August 2003) World Bank Policy Research Working Paper 3107.

Challenges Facing Developing Countries with Respect to Increasing Exports of Services

In order for developing countries to maximize the benefits of multilateral services liberalization, developed countries must afford greater market access to service sectors that are of vital importance to developing countries, and developing countries must be able to supply those markets effectively.[600]

In exporting services, the fourth mode of supply (i.e. movement of personnel) represents a major potential comparative advantage for developing countries. Poorer countries almost invariably have a large supply of cheap labor. However, most developed countries maintain strict regulations on the movement of this labor into developed country markets. Thus, in order to take advantage of their labor, developing countries are forced to rely upon attracting foreign firms through foreign direct investment. If developed countries undertook firm commitments to de-regulating international labor flows, developing countries could expect to benefit substantially from exportation of services under the fourth mode of supply.[601]

In spite of this, the major improvements in information and telecommunication technology has had a great benefit on the developing countries' exportation of mode one services (i.e. cross-border supply). Trade through information and telecommunications networks remains largely unregulated, which has proved to be a great benefit to developing countries.[602]

In addition to maintaining conditions in developed countries that are favorable to *improving* developing countries' market access, developing countries themselves have found it difficult to *supply* the markets that are already available to them. Namely, developing countries suffer from supply constraints and poor capacity building in open sectors.[603]

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[600] United Nations Conference on Trade and Development, "Trade in Services and Development Implications: Note by the UNCTAD Secretariat (December 20, 2002) TD/B/COM.1/55, at 13.
[601] Ibid.
[602] Ibid.
[603] See "Trade in Services and Development Implications", Op. cites, No. 601, p. 13.

Challenges Facing Developing Countries with Respect to Domestic De-regulation

Aside from the obvious benefits of increasing service exports, developing countries have the potential for reaping substantial efficiency gains, and lower prices, through internal deregulation of service sectors. However, the structure of the GATT itself may not create conditions that are favorable for developing countries to push through liberalization.

As with all multilateral obligations, GATS offers a platform for which to push through liberalization reforms. Specifically, it may (1) increase the credibility of the reform itself, and (2) help countries to resist domestic protectionist pressure against liberalization (as does the WTO/GATT institution in general); and (3) help countries to resist domestic protectionist pressure to depart from pre-existing obligations (by imposing costs for "backsliding")[604].

1. What are the challenges facing DC's to reap benefits of GATS?
    a. Challenges of reaping benefits of efficiency gains/lower prices—do to structure of the GATS itself

(Article IV: Increasing Participation of Developing Countries. Article V(3) Jackson page 890, and 892 See Cases from Jackson)

[604] B. Hoekman *et la*, Op. cites, No. 598.

Chapter Nine

The Concept of Intellectual Property and Its Theoretical Discourses

9.1 The Nature of Intellectual Property

This chapter is devoted to defining and clarifying or interpreting the term 'intellectual property' as enshrined in TRIPS. It will further deal with typical modules or classes of intellectual property, defining and explaining them briefly, as well. Then, an analysis of the concept of intellectual property, along with its justifications and rebuttals, will be offered. The chapter is wound up by appraising the vantage point of theories and perspectives of International Relations.

Primarily, the importance of providing for the protection of IP, at the multilateral level, was recognised in the Paris Convention for the Protection of Industrial Property in 1883 and the Berne Convention for the Protection of Literary and Artistic Works in 1886 which were brought under WIPO.[605] Accordingly, Article 2 of the Convention Establishing the World Intellectual Property Organisation (1967) defines intellectual property rights as including "the rights relating to literary, artistic and scientific works; performances of performing artists, phonograms and broadcasts; inventions in all fields of human endeavour; scientific discoveries; industrial designs; trademarks; service marks, and commercial norms and designations; and protection against unfair competition, and all other rights resulting from intellectual activity in the industrial, scientific, literary or artistic fields."

The WTO identifies IP as, "…rights given to people over the creation of their minds and creators can be given the right to prevent others from using their inventions, designs or other creations".[606]

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[605] WIPO, Understanding Copyright and Related Rights, (Pub. No. 909, Geneva), 2004, p. 5.
[606] Satardien Mogammad Z., *"A Critical Analysis of the Trade Related Aspects of Intellectual Property Rights Agreement and has South Africa complied with this Agreement with Special References to Patented Pharmaceuticals."* (M.A. Theses, University of the Western Cape), 2006, p. 7.

Broadly, IP refers to creation of the human mind. IPRs provide protection, accorded through property rights, so as to keep the interests of creators over their creations.[607] IP relates to the information or knowledge that could be manifested in tangible products which could be reproduced. The property, however, is not in these reproduced items, rather in the information or knowledge contained in them.[608]

IP law is the legal rights associated with creative effort or commercial reputation and good will. It prohibits others from copying or taking unfair advantage.[609] In the legal sense, IP is property that could be owned and dealt with. IP are *'chosen in action'* – rights that are enforced only by legal action as opposed to other property rights.[610]

Most significantly, IP protection is granted to the owner or creator with regards to the expressed idea and not to the idea itself. If an idea exists without being expressed, then no protection could be conferred to it.[611] IP is best explained through examining its individual components, some of which are discussed below, and through its theoretical justifications.

9.1.1 The Modules of Intellectual Property

As mentioned above, IP is a broad concept and touches upon so many subjects and is compromise of a number of species whose genus is IP, permit to be figurative. Consequently, and again taking this analogy one step forward, the species may be grouped into two sub-species, namely Industrial Property and Copyright. Industrial property includes patents, trademarks and industrial designs. There are other forms of IP, but deliberating upon them here will be outside the scope and research of this paper. To mention some of the others under the auspices of TRIPS, they are geographical indications; integrated circuit topographies, 'undisclosed information' (trade secrets), etc.

[607] WIPO, Op. Cites, No. 606, p. 5.
[608] Id., p. 6.
[609] Bainbridge, David, Intellectual Property, (4th Ed. London, Pitman Publishing), 1999, p. 3.
[610] Id., p. 10.
[611] Satardien, Op. Cites, No. 607, p. 8.

Only the aforementioned categories of IP will be dealt with in brief in the following manner.

9.1.2 Copyright

Generally, copyright is concerned with 'literary and artistic works', accordingly "Article 2 of the Berne Convention for the Protection of Literary and Artistic Works states that: '[t]he expression 'literary and artistic works' shall include every production in the literary, scientific and artistic domain, whatever may be the mode or form of its expression' ".[612]

There are various categories of items protected under copyright law. They include:

> "literary works (books, magazines, poems etc); dramatic works (plays, shows etc); musical works (songs, musical pieces etc); artistic works (paintings, drawings, maps, architecture etc); sound recordings (cassettes, CDs); broadcasts (television programmes, radio shows etc.); typographical arrangement of published editions (published works); and cinematograph films (movies, DVDs or music videos)".[613]

The ownership of copyright is alienable and it could be transferred to another or licence may be granted by the owner to another (Bainbridge, 1999:6). It explicitly prohibits reproduction without express permission of the owner. In addition, the copyright owner is entitled to a share of any return acquired through the utilisation or reproduction of the copyrighted material (May, 2002:9). These creations, like artistic works, for instance, which are not capable of reproduction, whose means of exploitation and the corresponding mode of protection, are not yet articulated.[614]

[612] WIPO, Op. Cites, No. 606, p. 7.
[613] Satardien, Op. Cites, No. 607, p. 10.
[614] Seleshi Zeyohannes, The Ethiopian Law of Literary and Artistic Ownership, (Unpublished, Addis Ababa University, Law Faculty), 1982.

Not every work of authorship is entitled to copyright protection. In order for a work to acquire copyright protection, it must be both fixed and original. According to copyright law, a work is fixed if it is only recorded in a permanent form, like writing it down or storing it in storage devices like CDs, removable disks, etc or recording it on videotape, or sculpting it in marble. For instance, if a poet recites his new poem to an audience without putting it on paper or without recording it permanently in some other way, then copyright cannot protect the poem because it is not fixed.[615] Secondly, for a work to be original, it must not be copied from previously existing material and must show at least a reasonable amount of creativity. *"*For example, if an author writes the words 'the sky is blue' on a piece of paper, copyright does not protect the words because they lack sufficient creativity. Consequently, short phrases and titles are usually not protected by copyright, but in some circumstances they may be protected by trademark law."[616]

Copyright doesn't essentially protect ideas, but only the expression of an idea, i.e. its tangible form. Copyright only protects the words, notes, or images that the author has used and not the ideas or concepts made known by the work. A fitting example of this concept would be to consider if an article published by a scientist offers details on a new process of purifying water, the copyright accorded to it would only prevent others from copying the words of the article. It would not, however, prevent anyone else from using the process described to purify water. In order to protect the process the scientist must obtain a patent.[617] "Similarly, if a novelist writes a book about a man obsessed about killing a whale, other people may write their own books on the same subject, as long as they do not use the exact words or a closely."[618] That is why the notion that others have the right to create similar works or even identical ones as long as they do so independently and by their own efforts has, therefore, been upheld by copyright law.[619]

Although the difference between expression and idea is often blurred, there are clear cases on both sides of it, as for instance, if an author of romantic novels copies a portion

[615] Encarta Encyclopaedia, 2007.
[616] Ibid.
[617] Ibid.
[618] Ibid.
[619] Bainbridge, Op. Cites, No. 610, p. 6.

of a novel written by another romantic novelist then he may be held as an infringer. But, inspired by the romantic novelist, if he decides to write a novel about a similar romantic story, then it may not be possible to hold him as an infringer. If a theoretician reprints Marx's article on "Dictatorship of the Proletariat" without authorisation, he would most likely be held as an infringer; but if he explains the concept in his own words, then it is less likely to hold him as an infringer.[620] The whole issue revolves around the interpretation that would be given to what amounts to infringement or creation.

Copyright gives two major forms of rights:

i) the right to control copying –holders who can halt further reproduction or use of their copyright,[621] and

ii) moral rights, which are attributed to the very person of the author or creator who may no longer be the owner of the copyright, but left with any control over how his work should be exploited in the future.

In this respect, the latter point i.e. moral rights are independent of the former one, i.e. economic rights.[622] The latter is purported to the attainment of material interest due to him. The moral rights are, thus, prone to human rights, whereas economic rights belong to the other corresponding collective rights.

9.1.3 Patents

Patent right is granted to an invention capable of industrial application or of other economic activities and gives a monopoly right that can last for up to 20 years. Patent law gives its owner a monopoly, and as such "it's a form of IP par excellence".[623] Patent enables an inventor to exclude others from making, using, selling, offering to sell, or importing an invention for a specified number of years. The perceived goal of any patent system is to encourage the advancement of technology by granting inventors special

[620] Landes, William M. and Richard A. Posner, *"An Economic Analysis of Copyright Law"*, (Journal of Legal Studies, 18), 1989, p. 33.
[621] May, Christopher, A Global Political Economy of Intellectual Property Rights, (London and New York, Routledge), 2002, p. 9.
[622] Bainbridge, Op. Cites, No. 610, p. 6.
[623] Id., p. 7.

rights that enables them to benefit from their inventions. Patents are also available for significant improvements on previously invented items.[624]

An idea or knowledge to be patentable must first fulfil these criteria. Firstly, the idea should be new and not subject under a previous patent nor should it be already in the public realm –it must be "novel". If the invention has already been explained in previous patents or already written about in publications, then it is an "anticipated" invention and had existed in perception of the public and so will be denied a patent protection.[625] Secondly, it mustn't be obvious, i.e. it shouldn't be a common sense solution or a self evident one where a problem is solved using available skills and technology. This means that the invention must be a noteworthy improvement to existing technology. Simple changes made to previously known devices do not fall within the ambit of a patentable invention.[626] Thirdly, the idea should consist of a stated function with practical use and could be manufactured so as to fulfil this function.[627] Legally this, for instance, may be interpreted as granting no right for inventions that can only be used for an illegal or immoral purpose.[628]

There are some kinds of discoveries that are not patentable. It is impossible for someone to confer patent on a law of nature or a scientific principle, even if that person is the first to make the discovery. For instance, Isaac Newton could not have obtained a patent on the laws of gravity, and Albert Einstein could not have patented his formula for relativity, $E=mc^2$. It is acceptable, however, to obtain a patent on an altered or purified form of a natural substance. "Under this rule, if a mineral only occurs in nature with impurities, a person who invents a completely impurity-free version of the mineral can get a patent both on the pure mineral and on the method of purifying it."[629]

[624] Encarta, Op. cites, No. 616.
[625] Encarta, Op. Cites, No. 616.
[626] Ibid.
[627] May, Op. Cites, No. 622, p. 8.
[628] Encarta, Op. Cites, No. 616.
[629] Ibid.

Patent protection has great economic importance to a number of industries that quite often heavily rely on technological innovation to remain competitive, such as the chemical, pharmaceutical, and computer industries. This rule also allows firms in the biotechnology business to attain patents on purified deoxyribonucleic acid (DNA) gene sequences. DNA is the basic unit of heredity that carries the information that manages the synthesis and replication of proteins. Through closely observing and studying certain sequences of nucleic acids in DNA strands, they have been able to gather they could have specific medical benefits or applications. Thus, scientists are now capable of manufacturing purified DNA gene sequences through a process known as recombinant DNA technology. However, though this might be a new discovery, the patenting of DNA has become a controversial issue because these gene sequences are often the raw materials for developing a wide range of future medical inventions. Thus, if granted, patent on a DNA strand can encompass extremely broad rights. Consequently, some members of the scientific community and those outside have argued that the assessment for patenting DNA should be quite strict so as not to hinder future scientific progress.[630]

Moreover, holder of a patent or the proprietor can't keep the patented knowledge completely to him/herself, rather the proprietor receives reward every time the patented idea is put in use.[631] In some cases, compulsory licensing would be appropriate if the patent wasn't being worked or if the holder was limiting supply of a patented product in order to maintain unfair prices.[632]

9.1.3 Trademarks

A trademark could be made up of one or more distinctive words, letters, numbers, drawings or pictures, emblems or other graphic representation that labels the manufacturer of a product or service and can be legally protected. Trademark law is perceived "to facilitate and enhance consumer decisions" and "to create incentives for firms to produce products of desirable qualities even when these are not observable

[630] Ibid.
[631] May, Op. Cites, No. 622, p. 8.
[632] Bainbridge, Op. Cites, No. 610, p. 8.

before purchase".[633] Trademark law helps in getting rid of the risk of free riding of manufactured products by encouraging manufacturers to invest in the development of brand names and distinctive packaging. Labels are sometimes distinguished from the broader notion of trademarks.[634]

In other words, a trademark is a guarantor that the particular product has been fabricated by a specific manufacturer and in so doing preserves its previous quality. Thus, another competitor cannot associate its products with that trademark in the effort to delude the public into believing that this product is the same with the authentic one. In this way, trademark law distinctively curves out unfair trade practice of this kind by conferring legal protection to the designated mark and by qualifying it as distinct from all other resembling marks that might confuse the public into thinking that those products have originated from the legally designated source.[635] Because consumers often continue to buy products they trust, well-known trademarks can be extremely valuable. For example, experts in trademark law estimate that the value of the Coca-Cola trademark is more than $40 billion.[636]

Trademarks are closely associated with business image, goodwill and reputation that have been created in the hearts and minds of the general consumer public. A trademark does not only indicate a proposition that appears in the course of trade, but also is used as a certification mark signifying origin or quality of the goods.[637] For instance, "Adidas" is a well recognised trade name and so most of its consumers can recognise its products or garments by means of the trade name and colours used. Due to this fact, they know that the quality of the product is reliable. Due to "Adidas" being a protected trade name, others cannot sell its product under this name or any other similar name (for instance "Addidas" or "Adibas"), since it would probably mislead the public in believing that the products with these slightly altered names and the original products have a common source. If, under the use of such names, products are sold to the public as originating

[633] Menell, Peter S., Op. Cites, No. 633, p. 149. (Economides and McClure cited in Menell.)
[634] Ibid.
[635] Satardien, Op. Cites, No. 607, p. 14.
[636] Encarta, Op. Cites, No. 616.
[637] Bainbridge, Op. Cites, No. 610, p. 9.

from "Adidas", then the goodwill and reputation of "Adidas" is at stake. Therefore, trademark law prevents this predicament by granting the trademark owner monopoly on the use and designation of the mark given to a particular product.[638]

Furthermore, the trademark owner himself cannot through use of the trademark or similar mark attempt to mislead the public as to the quality of the product. It was held in Kentucky Fried Chicken Corp. v Diversified Packaging Corp. that where a trademark owner permits a licensee to negatively alter the quality standards of the product associated with the trademark, the public is given the wrong impression about the product and the trademark will in turn cease to have utility as an "informational device". Since the mark no longer reflects quality it ceases to be functional in which case protection of the mark will be merely gratuitous of nature.[639]

As a trademark is the first thing that differentiates products of one company from another, it must be registered and there should be no prior use or registration of it. As mentioned, if a trademark is too similar to or liable to cause confusion with an already registered trademark, then it's unlikely that it will successfully be registered.[640] Through re-registration, unlike other IP, a trademark could remain right in property within the bounds set by domestic and/or international law.

9.1.5 Industrial Designs

The decorations and ornamental details that appear on a product are generally termed as industrial designs.[641] Industrial design is usually the art and science involved in the creation of machine-made products. The success of a design is measured by the profit it yields its manufacturer and the service and pleasure it gives its owner. The term industrial design was originated in 1919 by the American industrial designer Joseph Sinel. Initially, industrial designers dealt exclusively with machine-made consumer products, now,

[638] Satardien, Op. Cites, No. 607, p. 15.
[639] Ibid.
[640] May, Op. Cites, No. 622, p. 9.
[641] Id., p. 10.

however, the scope of the profession enlarged to include the design of capital goods, such as farm machinery, industrial tools, and transportation equipment, and the planning of exhibitions, commercial buildings and packaging.[642]

Today industrial design has been applied to practically all consumer products, notably to home appliances, such as air conditioners, irons, and washing machines; office equipment, such as typewriters, Dictaphones, and duplicating machines; electronic communication equipments such as radios, television sets, phonographs, and tape recorders; bathroom and lighting fixtures; furniture; hardware and tableware; automobiles; and, photographic equipment. Industrial design is applied also to products involved in distribution, such as trucks and automatic vending machines, and to industrial materials and equipment.[643]

The industrial designer must be concerned not only with product design but with the conditions under which products are sold. In planning retail stores and display areas, for example, the industrial designer works with the architect to increase the value (producing interior space and to create arrangements and atmosphere conducive to sales). Industrial designers also work to facilitate the profitable operation of railroad stations, airports, hotels, shopping centres, exhibitions, restaurants, public auditoriums, television stations, and offices.[644]

The fundamental problem of design in packaging is to provide all the essential information, such as the instructions for use of the product and the legally required identification of its contents, while fulfilling the broader purpose of selling the product. “Because of the current trend toward self-service in merchandising, the importance of packaging increases constantly”.[645]

[642] Encarta, Op. Cites, No. 616.
[643] Ibid.
[644] Ibid.
[645] Ibid.

English legal experts have classified industrial designs into *'class A'* and *'class B'* designs. The former is concerned with the aesthetic appearance of the product which highly affects consumer choice. Such products include furniture, textiles, clothes, china-cutlery and household appliances. The latter is related to functional efficacy where the product performs a certain function and that the product's appearance does not necessarily affect the choice of the consumer. These products include engineering tools, machinery and computer terminals.[646]

The underlying principle of protecting industrial designs is to provide an enticement to produce useful articles that incorporate new and original designs. Hence, industrial design law provides protection for the authors of such designs to prohibit the illicit use of their designs by other companies or manufacturers.[647]

9.1.6 Theoretical Discourses

Before delving into the theoretical discussions, an explanation on how IPRs translate to political proportions must be explained. After all, laws of all kinds are nothing but forms of political expressions. Whether to maintain power or maximise it, political interests are expressed and maintained through and enforced by laws. Behind or at the end (enforcement stage) of law, politics comes into play. The term 'behind' is used because jurisprudence may assign a different rationale for law, yet for the law to have the desired outcome, it should necessarily be supplied by the coercive instruments of the state, which more often than not resides in the executive, wherein politics is actualised.[648]

One of the main reasons for the rise of IP as an area of political interest has been the growingly multiplication of an information society, both at the national and global levels. In a time that might be characterised as the *'Age of Information'*, IP law is no longer

[646] Satardien, Op. Cites, No. 607, p. 16.
[647] Ibid.
[648] May, Op. Cites, No. 622, p. 94.

confined to the interests of a few specialists, rather IP has now become a global issue, hence also political.[649]

Susan Strange, a renowned author and scholar in the field of international political economy, offers that knowledge as a source of power in the international political economy is not given the attention it deserves. Strange characterises power as disseminated through four important interrelated structures: security, production, finance and knowledge. The critical point that Susan Strange makes revolves around the interaction of the knowledge structure with the other three. According to Strange, it is the control of knowledge and information that facilitates structural power that ultimately sets the agenda in the realms of security, production and finance. Consequently, knowledge becomes a determinant factor to the attainment and furtherance of structural power which is characterised by the transfer of risk from the powerful to the powerless and preservation of benefits of certain groups or even classes, at the expense of others.[650]

From this line of argument, one might deduce that the knowledge structure has a primary position when compared to the others and perhaps would retain a foundational position. Nonetheless, Susan Strange contends that it is possible to understand the relation of the four structures without giving one a prior position to the others. Even if this is conceded, the important thing to comprehend, according to her, is that knowledge highly influences social practices.[651] As eloquently argued by Bourdieu, this quote, from his work, summarises the above discussion: "'the theory of knowledge is a dimension of political theory because the specifically symbolic power to impose the principles of the construction of reality –in particular, social reality- is a major dimension of political power'".[652]

The theoretical discourses commence with modest explanations of justificatory theories of IP. Then, refutations of these theories will be provided where political economic

[649] Ibid.
[650] Id., pp. 30-31.
[651]To further understand Strange's complex arguments see Strange, Susan, States and Markets, (London: Pinter Publishings), 1988.
[652] May, Op. cites, No. 622, p. 32. (Bourdieu, (1977 on p. 165); as quoted in May.)

explanations become evident. Following these rebuttals, what certain standpoints of international relations theories have to say about the knowledge structure will be presented.

9.1.6.1 Justificatory Theories

Initially, IPRs emerged in the early mercantilist period where nation states used them as a means of strengthening and maximising their power and wealth –the integral concept of mercantilism- through the development of manufacturers and establishment of foreign trading monopolies. Hence, the philosophy of IP developed as a response to the use of monopoly power to stimulate innovation.[653]

In this section, the different 'justificatory schemata'[654] of IP will be presented. Various arguments have been forwarded for justifying and legitimising the notion of IP. Accordingly, numerous theories have been formulated to fulfil this purpose. However, for this research, only four major theories: utilitarianism, labour theory, personality theory, social planning theory[655]; and an economic justification will be our foci.

As Christopher May states, "the operation of forms of power over the generation of knowledge is crucial to understanding how certain justificatory schemata are utilised to support particular institutional settlements in the political economy of intellectual property, and why these settlements emerge".[656]

A. The Utilitarian Justification

Utilitarian theories of IP developed and evolved along with the evolution of the modern state – the transition from mercantilist nation-states to modern capitalist economy.[657]

[653] Menell, Op. Cites, No. 634, p. 131.
[654] [Remark:- The presenter of this part of this text developed the term from May, Christopher A Global Political Economy of Intellectual Property Rights, 2002, as referred to at p. 22.]
[655] [Note:- These theories are enumerated as they were named and developed by William Fisher in his "Theories of Intellectual Property"].
[656] May, Op. Cites, No. 622, p. 29.
[657] Menell, Op. Cites, No. 633, 131.

Different scholars of utilitarianism provided different arguments to justify IP protection. Adam Smith, though he renounced monopoly as harmful to the operation of what he termed the "invisible hand" (the market), however, he saw it legitimate the need for some monopolies "to promote innovation and commerce requiring substantial up front investments and risk".[658] In line with this approach, Jeremy Bentham, the father of utilitarianism, who to date is regarded as, justified IPRs in this manner,

> "[T]hat which one man has invented, all the world can imitate. Without the assistance of the laws, the inventor would almost always be driven out of the market by his rival, who finding himself, without any expense, in possession of a discovery which has cost the inventor much time and expense, would be able to deprive him of all his deserved advantages, by selling at a lower price"[659]

Concurring this same doctrinaire proposition, John Stuart Mill justified patent monopolies by contending that patent protection issued temporarily were better than general governmental awards, because it ensures that the reward to the inventor are proportional to the 'usefulness' of the invention to its consumers.[660]

By late 1960's economists turned their attention towards how IPRs should best be designed to promote innovation as its growing importance in economy and culture became intense and clear. In the utilitarian parameter, the main concern is formulating IPRs in a way that maximises net social utility. To do so, the ability of these rights to encourage and stimulate creation must not inhibit the enjoyment of these creations by the general public.[661]

Landes and Posner,[662] arguing to this effect, presented their case by stating that, since intellectual products could be easily duplicated, enjoyment of them by one person does

[658] Ibid.
[659] Bentham, 1839: 71 quoted in Menell, 1999: 131.
[660] Menell, Op. Cites, No. 634, p. 133.
[661] Fisher, Op. Cites, No. p. 1.
[662] Arguments of Landes and Posner are taken from Landes, William and Richard Posner, "An Economic Analysis of Copyright Law," Journal of Legal Studies, 18 (1989): 325, at 325-53. These arguments are derived in substantial part from Jeremy Bentham, A Manual of Political Economy (New York: Putnam,

not necessarily prevent the enjoyment of them by other persons. However, they further pointed out that this same feature of IP presents a danger to creators, that they couldn't recover their "costs of expression" – the time, effort and the like spent on the creation– because they will be undermined by copyists, whose costs of production are quite low and hence could provide these copied items in a much lower price than the original makings. So that this danger does not discourage creators from making socially valuable intellectual products, exclusive rights of making copies of these creations, for a limited time, must be conferred on their innovators. Landes and Posner argue that all other ways of regaining "costs of expression" are for the most part, wasteful of social resources. Therefore, it is this utilitarian raison d'être, they propose, must be and must have been used to justify and form various sets of guidelines within the realms of IPRs.

Landes and Posner also formulate a related argument by considering the case of trademarks. They contend that trademarks

i) reduce consumers' "search costs" since it would be easier for consumers to pick a particular brand of products that they have had previous experience with and hence they know what to expect; and

ii) spurs firms to consistently produce high quality goods and services, for they know that their competitors cannot benefit from making similar products by imitating their distinctive marks due to the original firm's consistency in quality.[663]

B. The Labour Theory Justification

This theory was drawn from Locke's theory of property as laid down in his Two Treatises on Government. Property for Locke was "the reward for the conversion or 'improvement' of nature, taking place in a society of men into which the individual's born".[664] In this sense, property is a social phenomenon where ownership of property is held against other claimants. Only the employment of labour establishes ownership.

1839); John Stuart Mill, Principles of Political Economy, 5th ed. (New York: Appleton, 1862); and A. C. Pigou, The Economics of Welfare, 2nd ed. (London: Macmillan and Co., 1924).

[663] Fisher, 2001: 4.

[664] May, 2002:24.

Locke based his theory on Natural Law which allowed the recognition of things that are not owned –'God's property'- but, the mixture of an individual's labour with these naturally existing resources gives it a certain value, a 'value added' character to property. It's not just the mere combination of labour and nature that turns an entity to property.[665] This theory is pertinent to IP in that, actual raw materials (ideas and facts) seem to exist naturally and if labour is put into these raw materials, then this contribution becomes an integral part of the value of added to this finished product.[666] Generally, property rights benefit those who have worked on the 'improvement' of any entity, even if that entity has been transferred to another along with its attached rights.[667]

Moreover, Robert Nozick[668] in his Anarchy, State and Utopia deliberating upon Locke's argument by one ambiguous proposition put as a 'proviso' –a person may acquire property rights by mixing labour with resources held in common so long as after the property rights are acquired, there is enough left of that good for others to enjoy communally– Nozick interprets this in such a way that acquisition of property rights through labour is justified provided that other persons do not suffer – experience "net harm". In this case, according to Nozick, "net harm" includes damages like being left poorer than they would have in a system that didn't allow the exploitation of the resources held in common in this manner. Therefore, Nozick argues that patent protection is in conformity with Locke's 'proviso' since, even if accessibility to the invention is quite limited due to the issuance of the patent, it wouldn't have been available without the labours of the inventor in the first place. Hence, the consumers are helped rather than harmed. Nevertheless, Nozick asserts that Locke's theory puts forth two limitations when according these rights to the inventor. The first limitation is persons who subsequently have invented the same device must be accorded the rights to make and sell the invention. If not, the patent granted to the previous inventor would leave this next inventor worse off. The second limitation proposed was that, for this same reason, patents should not last

[665] May, 2002:25.
[666] William Fisher, "Theories of Intellectual Property", p. 2.
[667] May, Op. Cites, No. 622, p. 26.
[668] R. Nozick is seen by many as anarchist, and by few as Utopian, in anyway he is a protagonist of the supremacy of collective good. The researcher's only intent in here is to demonstrate how property, labour and invention are seen

longer than, on average, the time it would take for the same device to be invented by someone else, had it not been invented already.[669]

On the whole, these two important assumptions that underlie this line of justification must be duly noted. The first is that the individual has ownership of his\her efforts and that as individuals they are free in owning their own labour. The second assumption is the value added by any particular effort can be recognised. Rewarding productive activities promotes human endeavour and efforts of individuals, without which little form of economic development or advancement can take place. Therefore, this is the reason why labour theorists claim that no individual would work if there was no reward that was linked to property, including IP.[670]

C. The Personality Theory

This theory originated from the works of Hegel and Kant where they developed it through the notion of 'personhood'. Here,

> "the legitimacy of property is intimately tied with the existence of the free individual and the recognition of that individual by others ... an individual has the will to control and master nature which is expressed through ownership of fruits of such control, reflecting the individual's personality".[671]

The premise of personhood is, so as to achieve proper development or to be a person, an individual needs a control over resources in the external environment. The personhood justification of property emphasises the extent to which property is personal where it would be strongest when an object or idea is closely intertwined with an individual's personal identity or will.[672]

Will is the central theme of 'personhood'. Hence, IPR prevents requisition or even confiscation, nationalisation or in any way, dispossession without due compensation,

[669] Fisher, Op. Cites, No. 666, p. 3.
[670] May, Op. Cites, No. 622, p. 92.
[671] Id., p. 26.
[672] Menell, Op. Cites, No. 633, p. 30.

alteration of artefacts through which artists and authors have expressed their will. IPR creates conducive social and economic conditions to "creative intellectual activity" which in turn contributes to the thriving of human being.[673] So as to fully develop this argument, Justin Hughes, by referring to Hegel's Philosophy of Right, offers the following thoughts as a guiding principle to the properly shaping of an IP system. Firstly, more legal protection must be accorded to those intellectual products that are highly expressive of the *'self'*, such as, literary works, than those which are less expressive, like invention of articles. Secondly, since *'persona' – "public image, including physical features, mannerisms and history"* – is vital to the essence of personality which by itself makes it eligible for legal protection, even if no labour has been spent on it. Thirdly, authors and inventors should be able to earn respect, honour, admiration and money from the public through selling or giving away copies of their work, but they should be entitled to prevent others from impairing, distorting or marring their works in any way.[674]

This line of justification centres upon the construction and definition of the self. In this case, property is not rewarded for the efforts or labours put in the creation, rather it establishes the freedom of individual through its protection of the individual form from interference.[675] Property rights, here, is held against the state and the rest of the society and they are the integral element of an individual's free existence. Ownership of property is how the individual in a society is able to protect and maintain the freedom on which selfhood depends. Thus, only by having the right to property can the individual become free.[676]

Even Karl Marx, who had stated that under capitalism, it was exactly the inability of the individual's who was under wage labour to own his creation that brought about the alienation of the worker from his fruits of labour and the productive processes altogether,[677] seems to uphold the proposition that IP is an expression of the self. But, he reached at a completely different proposition as an inevitable mode of resolving the

[673] Fisher, Op. Cites, No. 666, p. 4.
[674] Fisher, Op. Cites, No. 666, p. 4.
[675] May, Op. Cites, No. 633, p. 92.
[676] Ibid.
[677] Ibid.

political, social and economic problems that private property brought about, i.e. the socialisation of property, including wage labour.

D. The Social Planning Theory

This theory is less well developed and less recognised than the other theories. According to this theory, property rights in general and IPRs in particular could be devised to cultivate a just and attractive culture. It's similar with utilitarianism in its teleological argument but dissimilar in that it envisages a society bound by so much more than the idea of 'social welfare' as developed by utilitarian theorists. The proponents of this theory derive their thoughts from many theorists including Jefferson, Legal Realists and Classical Republicans.[678]

An alluring example of this approach is presented in Neil Netanel's[679] essay "Copyright and a Democratic Civil Society" commences his discourse by painting a picture of a very active and strong pluralist civil society comprising of different types of churches, unions, political and social movements, associations, etc. In this society which he has conjured all people benefit, on the one hand, from some degree of financial independence and, on the other, have a significant responsibility in moulding their local social and economic environments. A civil society of this kind, Netanel claims, is imperative to sustain democratic political institutions. Nonetheless, it should be nurtured by the government as well, and one way of doing this would be formulating copyright laws that work towards this end. These laws help maintain the said civil society in that (i) copyright allows the proliferation of creative expressions that touch upon various issues including political and social ones. This in turn improves and builds upon a democratic culture and strengthens the foundations of the various civic associations; and (ii) copyrights aid in sustaining creativity and related activities without being biased by the state, elite sponsorship or by cultural heritages. Netanel believes that copyright laws should be legislated in such manner that the public realm will be able to appropriately manipulate intellectual

[678] Fisher, Op. Cites, No. 666, p. 6.
[679] For further elaborations of his arguments see Netanel, Neil "Copyright and Democratic Civil Society," American Intellectual Property Law Association Quarterly Journal, 21 (1993): 305, at 308-10.

creations and that a balance between the interests of artists and their 'consumers' may even be maintained.[680]

E. The Economic Justification

This line of justification is based on the efficient allocation of resources. By allowing transferability of property within a market structure, particular items will pass to those who value the property most highly because they are able to utilise it more efficiently to produce further economic goods and they can maximise the return on an investment. Thus, the transfer of property supports such economic growth and expansion of social welfare by maximising productivity and efficiency.[681]

This line of justification assures us that monopoly rights accorded to IP would not cause problems that monopolies do in other markets, rather the competition for property resources will have the overall effect of enhancing the efficiency of resource use and so guarantees the expansion of total socio-economic utility.[682]

R. Lamb[683] justifies the protection of intellectual property from a more modern and economic perspective. He provides more realistic reasons for the need to protect intellectual property. He argues that the true profit potential of creators is not realized due to the piracy of intellectual products. Owing to piracy, a company never gains the profits it deserves, "it 'steals' profits from those products that possess the greatest investment potential".[684] Thus, the person to whom IPRs are accorded to receives an "asymmetric pattern of investment returns" with low potential growth rates, thus intensifying the economic drawbacks. If the company is a weaker company, then threats of this kind brought about by piracy would constantly endanger the survival of this weak company.[685]

[680] Fisher, Op. Cites, No. 666, p. 8.
[681] Menell, Op. Cites, No. 633, p. 36.
[682] Ibid.
[683] For further understanding see Lamb, R. (1999) "Economic and Financial Issues in Intellectual Property." In Simensky Intellectual Property in the Global Market Place 2 ed. Vol. 1 Ch 5
[684] Satardien, Op. Cites, No. 607, p. 20.
[685] Id., p. 21.

9.1.6.2 Arguments Against Intellectual Property

Just as there are those who defend the necessity of IP, there are others who argue against it and deem it as superfluous. In addition to the fact that it retards innovation and exploits the less developed nations, most agree that the biggest owners of IP have sought to expand it both in scope and depth, well beyond any sensible rationale.

According to Cox and whose critique of IP centres on its conceptualisation (philosophical and legal aspects) and the actual use (technology and economy). For him the political economy of IP makes it highly susceptible to political conflict in that IP brings about substantial economic effects and hence puts it in a position where power resources require mobilisation. The root of the conflict, thus springs from the "metaphorical treatment of 'knowledge objects' as material objects" since this connection is less of use for political platform, but its ability to make possible the aggregation of partial and specific interests of certain groups is important. IP is treated as a scarce resource and this 'myth', to Cox, is perpetuated by the powerful justifications derived from the history of material property. It is nothing but the outcome of mobilising structural power over knowledge.[686]

IP is a method of "commodification" of knowledge that enables the expansion of capitalism into areas which up till now were regarded as a dominion outside direct exchange relations. Co-modification, so to say, became an important means of expansion of capitalism at the second half of the previous century. Cox offers that there is an argument that the emergence of the 'new' global information society and its use differentiates it from previous systems of capitalism. If the claim of disjuncture between the previous systems of capitalism (industrial society) and the information society is based on the resources they utilise, that information is a different sort of input from material resources, then this claim is gravely misguided by the tendency of capitalism to treat both of these resources as the same, which is as property. Despite this fact,

[686] May, Op. Cites, No. 622, p. 93.

however, actual economic and social organisations are conceived to maintain and expand a wide spread recognition of legitimacy of IP.[687]

Morris-Suzuki deemed it important to note the difference between "the commodity production of innovation and the commodity production of physical objects … is [that] in the production of knowledge, the main raw material is knowledge itself".[688] But, the knowledge that comes out of this commodity production process is the private property of the corporation which is monopolised and highly rewarded with market values. As per Morris-Suzuki this knowledge, which is utilised as a raw material is often a social knowledge that is owned and produced communally by the society as a whole. Therefore, information capitalism not only exploits the labour of those directly employed by corporations, for their creations are not theirs, but also indirectly exploits the labour of those involved in the maintenance, transmission and expansion of social knowledge (Morris-Suzuki, 1988: 80-81). In the end, everybody is affected since IPRs are granted and all rewards given to "the most recent manifestations of the development of an idea, disregarding the precursors and the social element of the knowledge object".[689]

Nozick identifies that the labours spent and the rewards received on knowledge products are totally not proportional. He agrees that a creator's rights must be protected for some time, but a long term protection will surely harm and would not serve the needs of other stakeholders (prior contributors).[690]

So as to achieve social utility, new ideas and innovations must be explored and refined and then returned, at some point in time, to its originators, the public. Labour theory justification underscores that the expansion of new knowledge in turn expands social utility. If, then, IP fails to achieve this goal, or if it prioritises some other type of social

[687] May, Op. Cites, No. 622, p. 93.
[688] T., Morris-Suzuki, Beyond Computia: Information, Automation and Democracy in Japan. London: Kegan Paul International, 1988, p. 79.
[689] May, Op. Cites, No. 622, p. 95.
[690] Menell, Op. Cites, No. 633, p. 140.

benefit, then this line of justification would be exposed as a means of furthering interests than net social utility.[691]

According to May, the moral rights of copy right owners have been compromised in the TRIPS agreement. Since one of its main features is its total inalienability, i.e. IP is tradable which means moral rights can be fully detached from the creator. According to the theory of personhood, while creators must be entitled to preserve rents for the enjoyment of their products, they should not however give up the right of setting conditions to its transferability. Since they are forced to give these rights up in the TRIPS agreement, this would then be contradictory in terms with that of personhood justification.[692]

Furthermore, classical critiques forwarded by Marxist political economists focused on the issue of wage labour and alienation, which play a big role in addressing this theory's efficacy. They assert that if creators of knowledge or knowledge workers do not retain the rights of entitlement to their fruits of labour, then this will directly affect the freedom and selfhood and will ultimately result in the loss of control which amounts to the invasion of the self.[693]

To some states, the essential problem of economic justification is that new inventions would be subjected to monopoly control, which, actually, restricts their use and thereby reduces their social benefits.[694] The longer the period of protection conferred, the more serious the objection becomes. Monopoly rights may encourage rent-seeking behaviour by their owners and hinder further innovations.[695]

Edwin C. Hettinger, though he believes that IPRs encourage creation of ideas through financial incentives is the soundest argument for IPR, he still has his doubts for his

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[691] May, Op. Cites, No. 622, p. 96.
[692] Id., p. 97.
[693] Ibid.
[694] A.A., Quaedvlieg, Information Law Towards the 21st Century: *"The Economic Analysis of Intellectual Property Law",* (W.F. Korthales *et al.*, Eds., Deventer: Kluwer), 1992, p. 384.
[695] Ibid..

argument is built on contradiction – in order to promote the development of ideas it will become necessary to reduce people's freedom to use them. If industries shared information without restrictions then innovations would have been speeded up and costs immensely reduced. However, patents which put information in the market and raise its costs, actually slow down the innovative process.[696]

To further understand the claim that IPR promotes development of new ideas, it's important to examine the concept of "the market place of ideas". Its premise is that ideas compete for acceptance in the market and if competition is fair i.e. if all ideas and contributors are allowed in the market, then the good ideas will ultimately win over the bad ones. But, what if the market is inhibited, for instance by some groups being excluded then certain ideas cannot be put to the test. Groups that are marginalised or are weak hardly have their viewpoints presented. Besides, not all successful ideas are necessarily the best ideas. Those with more power and money could transmit their ideas with little or no opposition at all. If ideas are 'unwelcome' to sections of the society, like governments and corporations, these ideas have no chance of resurfacing.[697]

After considering all of these theories, one may ask how do we reconcile the two extreme points or what may be the proposed solution? From the facts this researcher has gathered, it is in her belief that one should be entitled to the fruits of his/her labour. However, the attainment of this objective should not be at the expense of the society at large. Through formulating IP laws geared towards maintaining overall social utility, the writer of this paper believes that it is possible to strike a balance between the rights of creators and innovators on the one hand and the needs of the general public on the other. Of course, this proposition might seem like begging the question since all of the hitches in this field are centred on how it would be possible to strike this balance and keep everyone happy at the same time. Nevertheless, it is possible to put into place not a panacea, but a fair mechanism that will again do justice to the two contending interests –that of the inventor

[696] Martin, Brian, Information Liberation, (London: Freedom Press), 1998, p. 31.
[697] Id., p. 33.

and the general public, that is to say for all.[698] What we call justifiable matters are issues of this kind whose balance of equilibrium are set by the police, sanctioned by the law and articulated by judges on case by case basis.

Others have proposed their own remedies. Scholars like Christopher May suggest that the TRIPS and other legal formulations of IP are not technical solutions to problems that have emerged from the socio-economic structure, but are mere manifestations of structural power with the global political economy. Similarly, Boldrin[699] suggest that "intellectual monopoly" should altogether be abolished, but must be approached by smaller steps since its immediate elimination may bring about damages of "intolerable magnitude". In this respect, how step by step the law maker should design a mechanism to maintain a balance is well articulated by this writer in the following words:

> "Other things being equal, a society whose members are happy is better than one whose members are, by their own lights, less happy. Applied to the field of intellectual property, this guideline urges us to select a combination of rules that will maximize consumer welfare by optimally balancing incentives for creativity with incentives for dissemination and use. That goal must, however, be tempered by other aspirations. Pursuit of that end in the context of intellectual property, it is generally thought, requires lawmakers to strike an optimal balance between, on the one hand, the power of exclusive rights to create stimulation of inventions and works of art and, on the other hand, the partially offsetting tendency of such rights to curtail widespread public enjoyment of those creations"[700]

[698] An alternative theory towards change is proposed by Christopher May. [For further reading see May, Christopher A Global Political Economy of Intellectual Property Rights (2002) at pp 32-42]
[699] For his detailed arguments see Boldrin, M. and K. Levine (2002) The Case against Intellectual Property at www.dklevine.com/papers/ip.ch2.pdf.
[700] Fisher, Op. Cites, No. 666, p. 39.

Intellectual Property from the Perspectives of International Relations Theory [701]

The author of this Note attempts to merge the legalistic and policy-based perspective through a policy-oriented application of international relations (IR) theory to the TRIPS regime. This Note proceeds from the perspective of a developed country, such as the United States, which seeks to increase global compliance through the protection of IP norms. In particular, this Note examines and applies the three most dominant strands of IR theory: realism, institutionalism, and liberalism. Though the author does not provide any policy prescriptions, the author attempts to broaden the current understanding of the TRIPS by looking at it through an IR perspective.

i. Realism

According to this theory, States are the primary actors in the international arena and are in constant power struggle. Prior to all other points, it is important to enumerate the basic assumptions of realism. For realists, the international system is anarchic; and, there is no single central entity to which States have delegated their power. Second, States intrinsically possess the power to attack and possibly destroy one another. Third, States are sceptical and doubtful of one another and are also uncertain of the policy one State has towards the other. Fourth, the central motive of States is survival at any cost through rational and even through tactful means.[702]

In the context of legal schemes like TRIPS, structural realism theory relates to the impact of the allocation of State power to these legal apparatuses which themselves are a product of premeditated State(s) interests. When forming international structures like TRIPS, according to structural realism, States usually promote their self interests through such forms of cooperation; and these interests may not necessarily be considered as normal or acceptable by community of states. A State can, at any time, withdraw from such agreements or even violate them if it perceives that would best serve it in upholding its

[701] All of the perspectives and issues related to them under this section are derived from an Article published by the authoritative Harvard Law Review, 116: 4 [an Article made by a person(s) un-mentioned by name]:- *"Tackling Global Software Piracy under TRIPS: Insights from International Relations Theory"*, 2003, pp. 1139-1160

[702] Morgenthau, Hans, Politics Among States, (5th Ed.), 1978, pp. 1-15.

national interests; likewise, if it also comes to view that the agreements have become more beneficial to other states than to its own.

Therefore, according to this theory, the effect of TRIPS in the international system becomes evident when states use these structures to further their own national interests. To a realist, though TRIPS possess enforceable and obligatory nature, it's possible for a State to manipulate, distort or even abandon such agreements if it sees it fit to its particular and immediate interests.

Since all States possess divergent interests, it would be impossible to come-up with a coherent and all-satisfying agreement when viewed from a realist perspective. Due to this divergence in interests, TRIPS jurists are forced to take into account local issues while examining disputes between States. This very fact could very well serve the interests of many States, particularly the developing ones that do not have institutional capacity or even the underlying desire to implement stronger IP protection. In contrast, for countries like USA, whose economies are highly dependent upon high technological companies, an ambiguous and infrequently enforced IP rules will naturally be of little use; and as such, will be counter productive to their interests. Due to this fact, though Developed States can press on amendments of such provisions under the TRIPS, they rather prefer taking unilateral actions to fulfil their own national needs, whenever they think the particular situation may require the taking of such action no matter how incongruent it might be to the prevailing status quo.

In light of the realist view, it seems that TRIPS has become inconsistent; i.e. with regard to the various issues raised and particularly as refers to the provisions of TRIPS. So concerns are raised as to whether or not powerful States would and could finally decide to either withdraw from any such agreement or even the WTO altogether as they please. If this is possible, the realists' point, i.e. such international institutions are merely formed and maintained only to promote the interests of states, seems to have been proven right. The writer of this paper believes that powerful States have a lot of political and diplomatic means at their disposal; i.e. which they surely can utilise to slowly, but

certainly, induce adherence to such agreements, rather than opt to disengage themselves or others from an all-rounded, all-encompassing international trade order and agreement.

ii. Institutionalism

The key assumptions of institutionalism are (i) States are primary actors of the international system; (ii) States take part in international institutions in pursuits of power, through their respective interests, which may not necessarily be divergent; (iii) Unlike realist perspectives, these theorists believe that international institutions bring about viable cooperation between states and as a result permit them to attain their mutual interests; (iv) The output of international institutions is as much a determining factor to the international cooperation as is allocation of power between and among states.[703]

According to the author, these assumptions are clearly visible in the regime of TRIPS: states are the primary actors in the international arena where they opt to promote their interests mutually –the global acceptance of IP protection as augmenter of collective social utility – protecting their power through cooperation. According to this theory the author states, the effectiveness of TRIPS will rely on its inclusion of safeguards against defection or shortcomings of any kind so as to allow all members to experience the overall gains fully and efficiently. The institutional characteristics of TRIPS becomes all the more comprehensible if seen and conceived as being itself an international regime; here, note that "regime" is defined as *"implicit or explicit principles, norms, rules and decision making procedures around which actors' expectations converge in a given area of IR"*.[704] And accordingly regimes are formed when State interests become mutual in certain standards and when these States recognise that there is a need for cooperation to attain certain goals related to these mutual interests.[705]

[703] See Keohane, Robert, (Ed.), "Neo-liberal Institutionalism: A Perspective on World Politics." In his International Institutions and State Power, 1989, pp. 7-8

[704] This definition is provided in Krasner, Stephen D., "Structural Causes and Regime Consequences: Regimes as Intervening Variables." In his International Regimes, 1983, p. 2.

[705] See Abbott, Kenneth W. *"Modern International Relations Theory: A Prospectus for International Lawyers"*, (Yale Journal of International Law 14), 1989, pp. 335-354

To further develop the argument of this theory, the author of the note sees it appropriate to discuss the two subgenres of institutionalism, at this juncture. The two sub divisions of institutionalism are Rationalist Institutionalism and Constructivist Institutionalism, which will be the subject of our discussion.

a. Rationalist Institutionalism

These theorists state that the power of international rules and institutions emanates from the collective sate interests that countries seek to sustain. The basic variables of rationalist theorists, the author of this Note claims, encompass "problem" structures that surround 'coordination games' and 'collaboration games'. In the former, actors are able to take advantage from the existence of mutually shared norms that lead to cooperation from the fact that these states seldom seek to break or bend the established (institutional) rules. In the latter, however, actors do not cooperate on the basis of shared norms, rather they have assorted purposes (other than promoting mutual interests) to cooperate. Unlike actors in coordination games, in the context of international trade and IP, the contentious issues are usually collaboration games, where distinct benefits are obtained by certain parties.[706]

The structure of a regime carries quite important institutions, i.e. the rules, standards and institutions a treaty creates. These components of the regime are significant because they could be manoeuvred through laws and policies. For instance, one of the principles that the TRIPS is based on, is reciprocity. It is an essential element that ensures equal treatment among the contracting parties. When dealing with the issue of trade, the author submits that it is expected to have a reciprocal affect among contracting parties. Thus, these reciprocated trade sanctions possibly could sustain cooperation and force parties to abide by commitments overtime, even in collaboration game situations where non-compliance and divergent motives subsist.

[706] Unknown, 2003: 1150.

b. Constructivist Institutionalism

Theorists under this domain state that power of international rules and institutions originate from norms that are not shared but rather defined independently from state interests. This differs from rationalist theories because the focus is on the power of norms and ideas that influence individual state behaviour. In the context of TRIPS, a constructivist institutionalist contends that the norms instilled in the agreement shape domestic state interests and thus their domestic laws. In rationalist institutionalism, it is the mutual state interests that accord power to international rules and institutions. But here, state interests adjust to the international rules.[707]

Another theory the author claims, that relates to the above is the theory of managerialism[708] and contends that enforcement mechanisms supported by rationalists are often "misplaced, inapplicable and sometimes counterproductive".[709] They argue that non-compliance is often involuntary and is usually caused due to lack of administrative or financial capacity, ambiguous terms in the treaty, or due to the ineffectiveness of the enforcement mechanisms. They suggest that the non-obedient state should instead be assisted by putting cushions, that is to say the provision of relevant information, financial and technical assistance, and performing open dialogue so as to resolve disputes resulting from misinterpretations of the provisions. This method of inducing compliance must be non-confrontational, prospective and broadly cooperative, so that collective improvement can be attained rather than solely identifying wrongful behaviour.[710]

Since the agreement of TRIPS is susceptible to excessive litigation brought about by its enforcement rules, institutionalism argues that developed states should enhance reforms that lower the transaction costs so as to avoid excessive litigation and nurture a viable cooperation. One such reform the institutionalists support is that TPRM should centre on

[707] Harvard Law Review, Op. Cites, No. 701, p. 1152.
[708] See Chayes, Abram et al. "Managing Compliance: A Comparative Perspective." In Weiss, Edith Brown & Harold K. Jacobson (ed.) (I998) Engaging Countries Strengthening Compliance with International Environmental Accords, pp. 39-49.
[709] Harvard Law Review, Op. Cites, No. 701, p. 1153.
[710] Ibid.

reviewing national laws, monitoring TRIPS' implementation and deliberating upon unresolved issues within the TRIPS framework.[711]

For the theory of rational institutionalism, a much greater emphasis is put on this review mechanism since it aids in clarifying the terms of compliance and forms a linkage between the actors' behaviour towards the nature of the problem and the arrangement of chosen solutions.[712]

i. Liberalism

According to Professor Andrew Moravcsit[713] the three core assumptions of liberalism in international politics are, firstly, individuals and private groups are primary actors in international politics and not states. Secondly, the state is a formal representative of some sect of the domestic society. Thirdly, state behaviour is determined by the structure of domestic politics. Therefore, according to the author, the centre of attention in this theory is on *"domestic and transnational actors, the institutions that reflect the interests of such actors, and the effects that these institutions have in shaping cumulative state interests."*

This theory contends that cooperation and compliance with rules depends on whether these rules will benefit or cost domestic and transnational actors. Thus, states that do not participate in international trade of any kind to maximise their power or political stability rather sates comply with international trade regimes due to the "shifting interests of domestic constituencies" and these, according to the author, are lawyers, judges, law makers and other bureaucrats who have spent their time and effort to the implementation of s particular regime. This theory places importance in the rise of these domestic compliance constituencies since state actions are guided by these domestic constituencies which therefore have a powerful effect upon the interpretation of TRIPS.

[711] Id., p. 1153.
[712] Ibid
[713] Moravcsik, Andrew, Taking Preferences Seriously: A Liberal Theory of International Politics, 1997, pp. 513-514.

For instance, different forms of civil societies like NGOs are often opposed to the advancement of IP protection of any kind due to the threats it presents upon different domains like environment, labour issues, consumer welfare, etc. As the author states, since liberalism contends that individuals and private groups should be primary subjects of IL then it is plausible to argue that under liberalist perspective, the participation of these civil societies in the TRIPS regime is more important, for these are which profoundly affect state actions.

As per the author, NGOs' involvement in TRIPS regime would most likely promote interests of developing countries. Hence, due to the arguable liberal approach that domestic and transnational actors like NGOs are an integral part and as well the real centre of power and influence within global IP regime. Then developed states like US should pursue policies that promote the interests of these NGOs, even when they are acting independently from the state.[714]

To this effect, liberals have forwarded certain propositions that have in mind a more active role of NGOs, in global IP regimes. One such proposition the author provides is, "bargaining" in TRIPS agreement by involving state and other private actors so as to achieve the optimal benefit for all that are concerned. In this dialogue, states will take part as "economic actors and not as political actors" –which traditionally act reactionary to pressures of, for example, formulating official IP policies.[715] Moreover, governments must make sure that these governments are propelled towards protecting public interests as opposed to forsaking them.

The second proposition the author offers is developed states like the USA should give NGOs important positions in TRIPS regime so as to enhance their participation in the implementation stages of the agreement, so as to increase compliance.[716] NGOs could aid states especially developing ones in drafting legislative IP laws and educating the public about the benefits of IP protection. All these entities like NGOs, can influence and

[714] Harvard Law Review, p. 1157.
[715] Id., p. 1158.
[716] Id., p. 1159.

pressurise governments to adopt and enforce western style IP laws. However, there is an eminent risk the western NGOs may eventually end up protecting the interests of their respective constituents. In this respect, it is likely that they would face difficulty of advancing their constituents' interests while, at the same time, sustaining "the image of helping-hand" organisations.[717]

To conclude, the author of the Note offers that the alternatives provided by these IR theories are in_no way mutually exclusive. He proposes by mixing elements from each area of analysis, we might be able to reach an all-satisfying reform package for the TRIPS regime. He further points that the wide spread perception of IP as a legal matter overshadows its implications in the global governance of IP.

As mentioned in the above discussion, the contentious issue now is whether reform should go underway regarding TRIPS or should another legal structure be constructed altogether anew. In this respect, the author states that his/her Note is:

> "… a word of caution for states and private entities seeking alternative measures to the traditional multilateralist approach embodied in the WTO. …Like most international agreements, compliance with TRIPS is linked to individual state willingness to comply. Ultimately (and admittedly from a constructivist view), the willingness of developing countries [IP] under a rule-based regime corresponds to the extent that they perceive TRIPS as an equitable agreement that permits the meaningful implementation of their countries' development objectives."

However, the writer of this paper tends to disagree with this statement as subsequent chapters will show how these developing countries were forced to consent with this agreement. The researcher does not believe they joined WTO because it was an answer to all of their problems; rather it was an answer for all of the problems of the Western world on which developing countries depended upon for their sustained existence. They conceded because they had no other choice.

[717] Ibid.

The point that reconciles the author and that of the researcher is the fact that this proposition does not attempt to deride the reliance of the realists or rationalist institutionalists on rules backed by the threat of sanctions instead, the author's intention was to display that such policy measures alone may prove insufficient. Therefore, the author offers, the measures proposed by the institutionalist constructivists, complemented by the activities of non state actors as supported by liberalist theory, in the author's belief, may offer greater compliance with the TRIPS regime than what a purely power-based approach does.[718]

9.2 Agreement on Trade Related Aspects of Intellectual Property Rights

Prior to the TRIPS agreement, there existed other international conventions administering IPRs. However, these treaties were inadequate since they did not do much to control piracy and counterfeiting of goods and furthermore they lacked enforceability. Consequently, developed countries, through a persistent political pressure, called for the strengthening of IP on the global scale.

The negotiation in TRIPS was one of the most difficult ones in the Uruguay Round, both politically and technically since it involved a North-South confrontation. The forerunners of this initiation were US MNCs that formed the Intellectual Property Committee (IPC), which not only aimed to influence the US government to broach the subject on the negotiating table, but they also had in mind to provide considerable legal support to the negotiating team. These corporations were able to mobilise significant political resources to further their particular interests.[719] "They essentially drafted the TRIPS agreement while the actual negotiations fine-tuned the text and made some concessions to the developing states".[720] This very fact made the agreement had to be waited against world citizens in general and the poorest nations in particular. As part of the Final Act that was

[718] Id., 1160.
[719] Shiva, Vandana, Protect or Plunder? : Understanding Intellectual Property Rights, (London and New York, Zed Books Ltd.), 2001, p. 97.
[720] May, Op. Cites, No. 622, p. 82.

signed by the negotiating countries of the Uruguay Round, for the very first time, an agreement was included with rules that regulate and protect IP at the multilateral level.[721] The TRIPS agreement is an integral part of the WTO since joining the organisation would automatically entail accession to this particular agreement. It is a complex agreement with seven major parts and 73 Articles. It essentially covers these five broad issues: the application of the basic principles and other international intellectual property agreements, providing adequate protection to IPRs, how countries should enforce these rights sufficiently in their own territories, the settlement of disputes on IP between member states and issues of "special transitional arrangements" during the period when the new system is being introduced.[722]

9.2.1 The Analysis of the Objectives of TRIPS

Generally, the central aim of TRIPS is *"to bring all the member sates' legislation into harmony and thus to bring the same level of protection to IP that was previously only available in developed states to all states in the global trading system"*.[723] The objectives underlying the TRIPS are stated in the Preamble of the agreement and according to Gervais' analysis, the Preamble attempts to achieve a point of equilibrium between intellectual property protection and free trade, and also between private rights and the public interest.

In the first paragraph of the Preamble it deals with the relation between the protection of IP and the promotion of international trade. It opts to reduce distortions in international trade and enhance the protection of intellectual property rights in the realisation that inadequate protection of intellectual property rights could bring about dysfunction in international trade and at the same time an excessive protection could become barrier to trade, which in turn disturbs the procession of international trade.[724]

[721] WTO, Op. Cites, No. 172, p. 39.
[722] Ibid.
[723] May, Op. Cites, No. 622, p. 68.
[724] Gervais, 2003: 77.

The second and third paragraphs of the Preamble state that the members of WTO have the intention of introducing and implementing new rules based on the applicability of basic principles of GATT and other intellectual property conventions. By doing so, the agreement aims to provide effective mechanisms that promptly permit the enforcement of intellectual property rights. Moreover, TRIPS make possible the settlement of disputes between governments through "effective and expeditious" procedures. Lastly, transitional arrangements are formulated so as to maintain full participation of all members in the negotiations.[725]

The fifth and sixth paragraphs of the Preamble express a developmental objective and the need for flexibility where special provisions are set forth to address the special needs of LDCs. The last two paragraphs reflect the goal of maintaining cooperative relations between the WTO and WIPO and encourage conflict resolution through multilateral measures.[726]

Lastly, Article 7 of TRIPS states further objectives of IPR protection "…to the promotion of technological innovation and to the transfer and dissemination of technology, to the mutual advantage of producers and users of technological knowledge and in a manner conducive to social and economic welfare, and to a balance of rights and obligations." This article grants members the right to introduce national laws that protect public health and nutrition, and also promote public interest in areas related to socio-economic and technological development. However, the formulation of these laws should be in line with the rest of the provisions of the agreement.

9.2.2 The Contentious Issues under TRIPS

Several problems with the TRIPS agreement have been identified and pondered over. However, for the purposes of this research, the consequences of a membership will be analysed with respect to patent protection. This is not to say that other forms of IPRs are

[725] Gervais, 2003: 78.
[726] Id., p. 80.

not fraught with difficulties, but the ones evident in patent protection are more pronounced and far more sensitive to developing countries and to LDCs like Ethiopia. Among these problems surrounding patents, this research will further narrow its scope to the effects the Agreement has on biodiversity and public health.

The Scope of Patents in TRIPS: "The Sore Spot"

Being the most controversial agreement in the WTO, the TRIPS agreement has raised concerns from different corners, the gravest of which revolve around patents and the extent to which it is granted. Thus, this research focuses on the issues related to patents; and to comprehend the scope of patents under TRIPS, one must first examine the provision that sets the scope of coverage.

Pursuant to Article 27.1, patents are available for any invention, whether it is a product or process, in all fields of technology, provided that the invention is new, involves an inventive step and is industrially applicable. It further states that patents should be made available and enjoyable without any discrimination as to the place of invention, the field of technology or whether the product is imported or locally produced.

Nonetheless, under some circumstances member states can, as an exception, exclude inventions from patentability. Firstly, under Article 27.2 these exceptions are conferred in case of the need for protecting the order public or morality. In these circumstances, members can prevent the commercial exploitation of the particular invention within their territory. Though this exception is granted, it does not, however, define the terms 'ordre public' and 'morality', nor does it enumerate the type of inventions that could be considered as contrary to ordre public or against morality. It only describes that the exception can be granted in order to protect human, animal or plant life or health or to avoid serious prejudice to the environment, provided that such exclusion is not made merely on the ground that the exploitation of the invention is prohibited by the national laws of member countries. Except for these situations, therefore, it is up to the members to further define what constitutes a violation of the ordre public or morality. Yet, this is not meant to leave the exception open-ended; instead the understanding that should be

had is that matters are left for future development and till then, to rational differentia, as are found palatable by member states.

Secondly, as Article 27.3 states, members may also exclude from patentability diagnostic, therapeutic and surgical methods, and not the devices, for the treatment of humans or animals.

Thirdly, Article 27.3(b) excludes plants and animals other than micro-organisms from patentability. However, those plants and animals produced non-biologically and micro-biologically, i.e. artificially, do not fit in this category. In such cases, members can provide for the protection of plant varieties either by patents or by an effective sui generis system or by any combination thereof.

This particular provision is the cause for most of the controversies that surround the issue of patents. It formally allows the patentability of life forms which raises ethical concerns, interpreting living things as 'inventions', for some, is debatable and labelling the proprietors of these as 'inventions' or 'creators' of these living organisms, most importantly, this patent right has direct implications on food sovereignty and food security since the right to save, exchange and sell seeds will certainly be compromise the interests of corporations that own the patent for these seeds.[727]

However preposterous this may seem to developing countries, where small farmers dominate food production using traditional agricultural practices so as to meet the food requirements of around 66% of the world's population,[728] patenting of plant varieties in the developed world is a common practice. Due to this factor, a huge North-South division has occurred and its detailed discussions will be presented in subsequent paragraphs.

[727] Oxfam, 2002: 220.
[728] ActionAid, *"Trade Related Intellectual Property rights: Food Rights",* (ActionAid Alliance), 2004, p. 1.

As stated above, plants and animals and the biological processes that produce them are indeed excluded from patentability. Yet, in spite of this exclusion, plant varieties must be protected by an effective sui generis system or by the combination of both patents and a sui generis system, though, what makes a sui generis system an effective one is not clearly stipulated. Nonetheless, it has now become very clear that when the Article prescribes for an effective sui generis system, it is implicitly referring to that system described in the International Convention for the Protection of New Varieties of Plants (its French acronym, UPOV.[729] Countries like the US and EU consider the UPOV as TRIPS compliant and are pressuring developing countries to adopt this Convention in their trade and investment agreements.

The existing agreement that covers Plant Breeders' Rights (PBRs) is the UPOV Convention. The Convention is designed to suit the socio-economic context of the industrialized countries where farmers do not constitute a large part of the population and do not have any control over plant breeding or seed supply.[730] This situation is very different from ours where the majority of the population continues to be engaged in farming and farmers' seed production and supply system is still the main source of seeds. It is so rigid and sets high degree of standardisation. This standardisation goes against the reality of biological diversity and socio economic diversity of different countries. It is, therefore, inappropriate as a sui generis system evolved to protect plants, people and creativity in diverse realities.[731]

In stark contrast, the Convention on Biological Diversity (CBD) has the objectives of conservation, sustainable utilisation and equitable benefit sharing supplemented by appropriate access to genetic resources and by appropriate transfer of relevant technologies. Moreover, the CBD recognises the sovereign rights of states over their biological and genetic resources and the rights of shaping regimes of property rights to suit their biodiversity. CBD also requires signatories to protect and promote the rights of communities, farmers and indigenous people with regards to their use of biological

[729] Merso *et la*, Op. Cites, No. 186, p. 149.
[730] Shiva, Op. Cites, No. 219, p. 97.
[731] Id., p. 100.

resources and traditional knowledge systems.[732] Yet, it is undermined by TRIPS because it excludes life forms from patentability. Therefore, it would not be a suitable sui generis system according to the developed world which prioritises the patenting of life forms.[733]

TRIPS and Public Health

In 1981, in the World Health Summit, Prime Minister Indira Gandhi, while addressing the assembly, stated:

> *Affluent societies are spending vast sums of money understandably on the search for new products and processes to alleviate suffering and to prolong life. In the process, drug manufacturers have become a powerful industry. My idea of a better-ordered world is one in which medical discoveries would be free of patents and there would be no profiteering from life or death.*[734]

One of the most contentious issues under the TRIPS is that of its implication on public health. In developing countries and LDCs, HIV/AIDS, malaria and tuberculosis are the main afflictions that often claim the lives of millions and leave millions more in debilitating physical situation. Leaving aside what poverty itself does to the people, these figures keep on rising due to the recent lack of access to essential drugs in these impoverished countries. However, many argue that this lack is caused by poverty and that it has no relations to TRIPS and the strengthening of patent protection. A lot of great debate has taken place over the patenting of pharmaceuticals and the role TRIPS plays in making accessible essential drugs in developing as well as LDCs.

Patents and their Relations to Public Health

The parts in the TRIPS agreement that may have an effect on access to essential drugs are those from Article 27 to 34. These Articles impose obligations upon Members to provide minimum standards of protection for inventions (for a period of twenty years from the date of application) (Article 33). Most importantly, the provisions require Members to grant patent protection for inventions in all fields of technology whether the invention is a

[732] Id., p. 103.
[733] Id., p. 102.
[734] [Shiva quoted in Keayla, 2001, p. 87.]

product or process (Article 27.1). Article 28 grants patent holders certain exclusive rights, including the right to prevent third parties from exploiting the invention without the authorisation of the patent holder. A third party is consequently prevented from using, making, offering for sale, selling or importing the invention in absence of authority to do so (Article 28).

Bruce Lehman[735] states that access to medicines in these countries is related to other factors like adequate health care facilities, international pricing mechanisms, financing and tariffs. He concludes that TRIPS is not an obstacle to the distribution of HIV/AIDS pharmaceuticals since most of the Sub-Saharan African countries, where the epidemic is rampant, are not attributable to TRIPS; and even if they were, Lehman argues that the Agreement provides sufficient flexibility for these countries to avoid the negative effects. Similarly, Lehman further argues that patent should not be an issue concerning access to drugs because most of the drug companies in Africa have not obtained patents. The real problem is that of providing adequate financing for the overall health system and for the development of health care institutions.[736]

To the contrary, others have a different point of view. Sirothiya[737] argues that the TRIPS agreement is causing the price of patented drugs to skyrocket. Before its establishment, countries were allowed to exclude drugs from patent protection, but now this is impossible since the agreement obligates its contracting parties to do the exact opposite.

Oxfam, a renowned NGO, describes the pharmaceutical industry as not only the 'greatest beneficiary' of the TRIPS agreement, but also as its main architect. It further adds that the greatest losers would be the poor people in developing countries, for whom it will mean higher health care costs and greater vulnerability.[738] Moreover, Oxfam states:

[735] Former President Clinton's Commissioner of Patents and Trademarks who is one of the key proponents of TRIPS and has put forth this argument in his "Patents and Health" Discussion Paper (2002) available at www.iipi.org/speeches/Beijing_Health_052202.pdf.
[736] Satardien, Op. Cites, No. 607, pp. 53-55.
[737] See Sirothiya, S. "Intellectual Property Rights and the Challenges Faced by the Pharmaceutical Industry" at www.indlaw.com
[738] Oxfam, 2002: 213.

> [Developing countries] don't have the technology or size of market to manufacture affordable generic versions of new medicines for themselves but TRIPS restricts any other country from supplying them. The bottom line is that they have to either pay the high price of the patented product – which they can ill-afford – or go without. Rich countries can bargain effectively over prices but a developing country is at the mercy of Goliath-sized companies often bigger than its national economy.[739]

In light of these arguments, the researcher tends to agree with the latter argument that holds TRIPS responsible and has contributed to the rising costs of essential medicines. Nevertheless, the former argument as forwarded by Lehman should not be totally undermined, for in countries like Ethiopia, where severe aspects of poverty affects public health, it has a degree of truth. By the same token, the fact that essential drugs are becoming unaffordable in developing countries and LDCs due to the imposition of TRIPS and strengthening of patent protection should not be overlooked, either.

As Satardien intelligibly argued, the fact that the accessibility to drugs in developing countries and LDCs depends on infrastructures and finances in these countries is quite indisputable. Yet, Lehman failed to note that this issue should not be investigated solely from the perspective of a certain country's abilities only. Subsequently, Satardien argued that one can present the case of India and Brazil where both developing countries have the capability of manufacturing pharmaceuticals. If TRIPS had not prohibited them from doing so, they could have exported them in cheaper prices to poorer countries like Ethiopia, which could have enabled the country buy medicines for its people for more affordable prices.[740]

Moreover, the fact that Lehman puts forward that patents are not the causes of inaccessibility to essential drugs in Sub-Saharan African countries for the reason that the drug companies did not attain patents, is only partly correct. Satardien provides that

[739] Satardien quoted in Oxfam, 2005: 56.
[740] Satardien, Op. Cites, No. 607, p. 57.

patent protection in these countries would be redundant since they lack the capability of producing these drugs. However, in developing countries that can produce these drugs, the Agreement confers patent protection to pharmaceuticals and thus, poorer countries are unable to import cheaper versions from these countries. This along with their inability of manufacturing pharmaceuticals, some how portrays how the TRIPS agreement negatively affects the accessibility of essential drugs.[741]

The Exceptions and Flexibilities regarding Patents

In order to limit the rights of patent holders and offset the negative impacts of patent monopoly, the TRIPS agreements proffers the exceptions found in Articles 5, 28, and 31 in relation to public health. The general exceptions are provided in Article 30 where exceptions cannot conflict with the normal exploitation of patents and should not affect the 'genuine' interests of patent holders and of third parties too.

Article 31 entitles members to grant compulsory licence. Compulsory licences allow third parties to utilise a patented invention without the proprietor's consent. Generally, they are issued under certain circumstances where the holder of the patent acts undesirably (anti competitive, non-working or blocking behaviour), in situations of public need (like government infringement or national emergency), or for non-commercial use like in the context of dire needs in food and medicines.[742]

Article 31 of the TRIPS, among others, permits WTO members to issue compulsory licences for use by their respective governments or by a third party acknowledged by these governments. It demands for the use of these patented inventions predominantly for the supply of the domestic market of the member authorising such use. After this authorisation has been terminated, the article states that the patent holder must be remunerated taking into account the economic value of the authorisation.

[741] Id., p. 58.
[742] Id., p. 61.

Another exception to the exclusive rights of patent holders is the parallel importation clauses of Article 28 and 5. Parallel importation essentially allows countries to import goods through a third party at a cheaper rate than charged in the importing country.

The most contentious of these exceptions is the one provided in Article 31(f) where even if a country succeeds in attaining compulsory licence it could only manufacture the products for local use and could not export them. As Abbott submits:

The limitation imposed by Article 31(f) creates two inter-linked problems:

1. By restricting the availability of export drugs made under compulsory license, it limits countries that are not in a position to support manufacturing under compulsory license (or where patent protection is not in force) in the availability of supply of generic import drugs, and;
2. By requiring compulsory licensees to supply a predominant part of their production to the domestic market, it limits the flexibility of countries to authorize the export of compulsory-licensed drugs and thereby to exploit economies of scale.[743]

This renders, therefore, the article useless for countries like Ethiopia with no capability of manufacturing pharmaceuticals. Therefore, an attempt to provide a solution for this problem was made in 1998 at the Doha Ministerial Conference.

The Doha Declaration on TRIPS and Public Health

Although the declaration is mainly of a political nature, it has achieved two important goals. First, the Health Declaration gives more space for flexible interpretations of the TRIPS Agreement in relation to health issues. Paragraph 5 of the Declaration accorded to members the right to grant compulsory licences and the freedom of determining what situation constitutes a national emergency, or other circumstances of an extreme urgency.[744] This space for interpretation can help developing countries resist bilateral pressures by developed countries on behalf of their business corporations, and thus

[743] Abbott, Op. Cites, No. 705, p. 320.
[744] Merso, Op. Cites, No. 186, pp. 203-204.

reduces the risk of potential disputes that might arise in respect of TRIPS Agreement vis-a-vis the implementation of national health policies.[745]

Second, according to paragraph 7 of this declaration, "least-developed country Members will not be obliged, with respect to pharmaceutical products, to implement or apply Sections 5 and 7 of Part II of the TRIPS Agreement or to enforce rights provided for under these Sections until 1 January 2016". This decision therefore allows developing and LDCs to take the necessary steps for improving health conditions in their respective territories and to implement policies designed to create a national pharmaceutical sector that can respond to their health needs.[746]

Most importantly, the TRIPS Council after spending an entire year after the Doha Conference, agreed upon Paragraph 6 of the Declaration in 2002 that gave an exception to Article 31(f) of the TRIPS agreement so as to allow members with insufficient or no manufacturing capacity to import generic copies of patented drugs to combat their health care crisis,[747] but to this Paragraph, several cumbersome and costly conditions to compulsory licensing have been attached to it. The establishment of many procedural, legal and other hurdles to generic exports has made it harder for a country to import these generic drugs. Even if a country issued a compulsory licence, the obstacles and high costs involved could discourage imports of these drugs and could lead to no supplier taking up the offer to export.[748] Therefore, these flexibilities are much more difficult to implement than they appear at first glance. Moreover, for countries like Ethiopia that face dire financial problems, these may exacerbate the situation, for it may mean more costs to when putting into place these remedies.

[745] Eugui, David V., "What agenda for the review of TRIPS?: A Sustainable Development Perspective." A Paper prepared by the Centre for International Environmental Law (CIEL), (n.d), p. 2.
[746] Ibid.
[747] Merso *et la*, Op. cites, No. 186, p. 204.
[748] Jawara *et la*, Op. cites, No. 147, p. 252.

9.3 The General Implications of TRIPS

For developing countries and LDCs, TRIPS tend to have a negative effect towards these countries. Only general implications are discussed in this section and the specific effects of TRIPS, particularly those of patents, will be dealt with in the next chapter.

The TRIPS agreement is not only limited to the scope of legal concern, rather its effects are felt in other aspects of everyday life, giving it political, social and economic implications. One of the main implications of the agreement is an expansion of corporate control of important knowledge resources which is ultimately at the cost of public or social availability of such knowledge. The outcome of the agreement is actually the critical reduce of public knowledge, especially in those areas where new technologies and innovations are crucial to socio-economic transformation. This means that what might once have been publicly or commonly owned is rendered, through TRIPS, as trade related and hence private.[749]

Therefore, as Dhar and Rao suggest, accession to the agreement by developing states will have the effect of making the technology gap more severe. Through limiting and controlling the free flow of new technology, the technological gap will further widen and strengthen.[750]

The agreement also gives rise to economic costs and benefits. Through monopoly, IPR holders can extract a considerable sum of consumer surplus. On the other hand, net importers of technologies and knowledge intensive goods and services may experience a loss in terms of trade since providers of these goods and services (industrialised countries) are able to obtain rents from domestic consumers of poor countries.[751]

Some empirical examinations have shown that the net transfers from South to North are positive, i.e. the North gains positively from the South. One investigation in particular

[749] May, Op. Cites, No. 622, pp. 77-78.
[750] Id., p. 79.
[751] Hoekman and Kostecki, Op. Cites, No. 132, pp. 293-294.

showed that the lion share of this transfer is amassed by the US where the country adds about $5 billion to its total revenue, while developing countries like Brazil, India and Mexico incur great losses.[752]

Nonetheless, most empirical investigations regarding IPRs and economic development are non conclusive. In the absence of conclusive evidences, studying historical backgrounds of policy making in different countries could prove to be useful. For instance, due to strong patent protection laws put in place during their industrial revolutions, Britain and USA were able to reap substantial benefits from these IPR systems. In contrast, industrialised countries like Netherlands and Switzerland were able to attain economic development even though they had no patent system set in place.[753] Similarly, Asian countries like Japan and India had weak systems of IP protection which had enabled the transfer and adoption of foreign technology and in case of India the patent system was designed in a way that suited the needs and priorities of the country. According to some authors, it is these factors that led to their astounding level of growth and development.[754]

Even though there are no conclusive empirical evidence with respect to the relations between economic development and IPR, through examining the history of IP policies of individual countries one can deduce that as long as they are formulated in a manner which caters to the interests of the individual country, there is no reason, therefore, why IPRs shouldn't be used as an instrument of development.

The TRIPS agreement also presents other policy implications. It allows governments to formulate policies that encourage IPR holders to abuse their market power.[755] In the end, it is hard to generalise the effect of TRIPS agreement on individual WTO members, but what is for sure is that it will definitely play a vital role, both in the domestic and international arena.

[752] Id., p. 294.
[753] Merso *et la*, Op. cites, No. 186, p. 143.
[754] Id., p. 144
[755]Hoekman and Kostecki, Op. Cites, No. 132, p. 295.

At the end of the day, for TRIPS to prove successful in the future, the Agreement, the researcher believes, should be interpreted in the view of Article 7 where all the provisions of the TRIPS Agreement must be beneficial to both producers and consumers of intellectual property. The agreement should be interpreted and implemented in such a way that its provisions will serve the purpose of spreading technology, and that enforcements of these rights doesn't encroach upon social and economic welfare, and carried out in such a way that it balances rights and obligations. If this is made practicable, then both producers and consumers of intellectual property can mutually benefit.

9.3 Ethiopia's Accession to WTO and TRIPS

9.4.1 The Accession Process

Presently, the WTO has 151 members out of which 128 were contracting parties of the GATT and about two thirds of these members are developing countries.[756] The 27 states of the European Union are represented as the European Communities and the African countries are referred to as the Africa Group. Membership to WTO is open to any state or separate customs territory possessing full autonomy regarding its commercial activities where the terms of membership are agreed between the applicant and WTO members.[757] Thus, Hong Kong became a GATT contracting party, and Chinese Taipei (Republic of China) acceded to the WTO in 2002.[758]

Moreover, non-members of about 31 countries have been granted observer status out of which Ethiopia has been an observer since 1997.[759] With the exception of the Holy See (Vatican), observers must start accession negotiations within five years of becoming observers.[760] Some international intergovernmental organizations are also granted

[756] WTO, Op cites, No. 172. (Also available at the Web-Page Web-Page, http// www.wto.org.)
[757] Hoekman and Kostecki, Op. cites, No. 132, p. 65
[758] Encarta Encyclopaedia, 2007.
[759] WTO, Op. cites, No. 172, p. 112; and Merso *et la*, Op. Cites, No. 186, p. 26.
[760] Ibid.

observer status to WTO bodies. 14 states and 2 territories so far have no official interaction with the WTO.[761]

In order to be a full member, a country or a customs territory must first go through a number of stages of negotiations before reaching the final substantive phase. After it had requested for an observer status, the government that wants to join the organisation writes a letter of application to the Director General. The General Council then establishes a Working Party consisting of interested countries to examine the application.[762] To this effect, Ethiopia has officially applied for membership in January 2003 and a Working Party under the chairmanship of N. MacMillan, who is from the U.K, has been established on 10 February, 2003.

After the establishment of the Working Party, a stage of fact finding or information gathering ensues. In this phase, the government seeking accession must submit a detailed memorandum describing its trade regime. Based on this memorandum, the Working Party clarifies the functioning of the trade regime with the applicant mainly through a series of questions centred on its consistency with multilateral rules.[763] If inconsistency is observed, then these rules must be removed or negotiated and fitted in the form of special provisions.

When the Working Party has made sufficient progress, the negotiation phase carries on. This part of the accession process is a key aspect since it entails the bilateral component of the multilateral proceeding, where negotiations will be held between the acceding government and all other members interested in enhancing market access in the country of the new member to be. The new comer negotiates on schedules of tariff concessions and may be enter into specific commitments on trade in services with interested WTO members.[764]

[761] Ibid.
[762] Hoekman and Kostecki, Op. Cites, No. 171, p. 65.
[763] Ibid.
[764] Ibid.

Once these negotiations end, a report by the Working Party consisting of schedules of concessions and commitments on goods and of specific commitments in services, is completed. Along with this report, a draft on Decision and Protocol of Accession will also be concluded. In this draft, three documents enumerating the concessions and commitments on goods and services and the terms of accession as agreed between the applicant and other WTO members, is annexed.[765]

Finally, the report and the Protocol are submitted to the General Council as part of the last phase, i.e. membership. The applicant must sign the Protocol, secure two third majority votes of the existing WTO members and lastly, 30 days after it has notified the WTO Secretariat that it has completed ratification process, the aspiring government will then become a full fledged member of the multilateral trade organisation.[766]

9.4.2 Timeframe of the Accession Process

There is no specific timeframe set by Article XII of the WTO which is a provision that deals with elements of accession. This is so because the process is dependent upon various conditions. Usually, the accession process is long and complex requiring of both multilateral as well as bilateral negotiations at the different stages of accession.

Some of these complexities arise from the fact that acceding terms under the WTO are much more stringent than those of its predecessor, GATT. Negotiations of accession under the aegis of GATT were more flexible and pragmatic. Now, under the WTO, for instance, applicants are required to bind their whole tariff schedules at or close to the applied rates, which on average, are not higher than 10 percent. If these rates go any higher, they would not be acceptable.[767]

Furthermore, an accession process could be delayed if the great powers or the Quad (from quadrilaterals) as they are referred to consisting of Canada, USA, Japan and the

[765] Hoekman and Kostecki, Op. Cites, No. 132, p. 65.
[766] Merso, Op. Cites, No. 186, p. 28.
[767] Hoekman and Kostecki, Op. cites, No. 132, p. 67.

EC, in WTO do not support the aspirant member for political or economic reasons. Just as in the IMF and World Bank, these powers use WTO not only as an instrument of trade liberalisation and its adjoining policies, but they also use it as leverage to force on others their policy prescriptions[768] like the structural adjustment programs that have crippled many of the economies in which they have been implemented.

The best example that emulates this situation is that of the lengthy and excruciating negotiation of nearly two decades underwent by China to acquire a WTO membership. The main reason why China was unable to become a member was due to US opposition. As soon as it successfully concluded its bilateral negotiations with the US, it was able to become a member. This can relate to how an accession process drags on because of the burdensome requirements set by the WTO on applicants.[769]

Ethiopia's accession is supported both by the US and EC and as long as this support is maintained, the above factor will not affect the country's accession. However, due to the technicality and complexity of the process, it will require a great deal of capacity, experience and resources, all of which our country is in severe lacking. Only two out of the six observing LDCs, Nepal and Cambodia, were able to complete the negotiations.[770] The Doha Development Agenda (DDA) has provided easy means to facilitate accession through providing some flexibility in implementation of the different WTO agreements. The General Council has also adopted a directive to simplify the inclusion of the poorest nations in the international economic order by reforming some of the procedures of accession. Ethiopia as an LDC could benefit from these facilities if only they had not stopped short from being theoretical. For example, for Cambodia the level of binding commitments in the areas of agriculture and TRIPS went far beyond what is appropriate for the level of development of an LDC like Cambodia. Therefore, there is no priori reason for Ethiopia to be treated differently or to expect more favourable terms than those

[768] Merso, Op. Cites, No. 186, p. 28.
[769] Hoekman and Kostecki, Op. cites, No. 132, p. 68.
[770] Merso, Op. Cites, No. 186, p. 30.

of Cambodia.[771] For this reason, Ethiopia must proceed with great caution and vigilance so as not to slip into a political and economic blunder.

9.4.3 The Costs of Accession

The accession process for Ethiopia will surely face a number of challenges. In a country where the industrial and agricultural sector is truly underdeveloped with no comparative advantage and with lack of economies of scale, technology, marketing competence, and efficient production and distribution set up, the country, beyond doubt, cannot compete within the present system of the global economy where zero-sum game happens to be its fundamental feature.[772]

The legislative and institutional revisions that have to be made in compliance of the WTO agreements will definitely require skilled and knowledgeable man power as well as ample financial resources, both of which are limited in Ethiopia. Bureaucratic procedures along with lack of relevant data at the relevant time will only add to the problem. Moreover, inefficient production techniques and deficiencies in infrastructural elements may hinder the country from benefiting from the economic opportunities presented by the world economic system.

Recapitulation

Recognition of the Interests and Needs of Developing Countries

In the Preamble of the *WTO Agreement*, WTO Members explicitly recognize the need for positive efforts designed to ensure that developing countries, and especially the least developed countries, are integrated into the multilateral trading system and secure a share in the growth in international trade commensurate with the needs of their economic development.[773] As noted above, a large majority of the WTO Members are developing countries and 30 of them are least-developed countries. In the Doha Ministerial

[771] Id., p. 31.
[772] Id., pp. 38-39.
[773] WTO Agreement, Preamble, second paragraph.

Declaration adopted at the close of the Fourth Session of the Ministerial Conference in Doha in November 2001, the WTO Members noted:

> International trade can play a major role in the promotion of economic development and the alleviation of poverty. We recognize the need for all our peoples to benefit from the increased opportunities and welfare gains that the multilateral trading system generates. The majority of WTO members are developing countries. We seek to place their needs and interests at the heart of the Work Programme adopted in this Declaration. Recalling the Preamble to the Marrakesh Agreement, we shall continue to make positive efforts designed to ensure that developing countries, and especially the least developed among them, secure a share in the growth of world trade commensurate with the needs of their economic development. In this context, enhanced market access, balanced rules, and well targeted, sustainable financed technical assistance and capacity-building programmes have important roles to play.
>
> We recognize the particular vulnerability of the least-developed countries and the special structural difficulties they face in the global economy. We are committed to addressing the marginalization of least-developed countries in international trade and to improving their effective participation in the multilateral trading system. We recall the commitments made by ministers at our meetings in Marrakesh, Singapore and Geneva, and by the international community at the Third UN Conference on Least-Developed Countries in Brussels, to help least-developed countries secure beneficial and meaningful integration into the multilateral trading system and the global economy. We are determined that the WTO will play its part in building effectively on these commitments under the Work Programme we are establishing.[774]

The interests and needs of developing countries, and, in particular, least developed countries are, since the 2001 Doha Session of the Ministerial Conference, more than ever before at the heart of the WTO's activities and concerns. At the Doha Session itself, the WTO Members adopted a *Decision on Implementation Related Issues and Concerns*,

[774] Doha Ministerial Declaration, 14 November 2001, WT/MIN(01)/DEC/1, paras. 2 and 3.

addressing problems developing country Members have experienced with the implementation of the WTO agreements resulting from the Uruguay Round.[775] WTO Members also adopted in Doha a *Declaration on the TRIPS Agreement and Public Health,* in which they affirmed, against the background of the gravity of the public health problems afflicting many developing and least-developed countries, that the *TRIPS Agreement* can and should be interpreted and implemented in a manner supportive of WTO Members' right to promote access to medicines for all.[776] In the Doha Development Round, and the broader Work Programme for the WTO, agreed to in Doha, the interests and needs of developing countries are central. The integration of developing countries, and especially least developed countries, in the multilateral trading system and efforts to secure them a bigger share in international trade are high on the WTO's agenda.

Special and Differential Treatment for Developing Country Members

To ensure that developing countries, and especially the least developed countries, are integrated into the multilateral trading system and increase their share in international trade, WTO law already provides for many special provisions in favour of developing and least-developed countries, taking into account their particular needs and interests. In general, these provisions provide, in many areas, for fewer or less demanding obligations, longer periods for implementation and technical assistance. This section describes the special and differential treatment provided for *all* developing country Members. The following section focuses on the *additional* special and differential treatment provided for the least-developed countries.

In the Doha Decision on Implementation Issues of 14 November 2001, Members agreed as follows:

The Committee on Trade and Development is instructed:

> *(*i) to identify those special and differential treatment provisions that are already mandatory in nature and those that are non-binding in character, to consider the

[775] Decision of the Ministerial Conference on Implementation-related Issues and Concerns, 14 November 2001, WT/MIN(01)/DEC/17.

[776] Declaration of the Ministerial Conference on the TRIPS Agreement and Public Health, 14 November 2001, WT/MIN(01)/DEC/2.

> legal and practical implications for developed and developing Members of converting special and differential treatment measures into mandatory provisions, to identify those that Members consider should be made mandatory, and to report to the General Council
> with clear recommendations for a decision by July 2002;
> (ii) to examine additional ways in which special and differential treatment provisions can be made more effective, to consider ways, including improved information flows, in which developing countries, in particular the least-developed countries, may be assisted to make best use of special and differential treatment provisions, and to report to the General Council with clear recommendations for a decision by July 2002; and
> (iii) to consider, in the context of the work programme adopted at the Fourth Session of the Ministerial Conference, how special and differential treatment may be incorporated into the architecture of WTO rules.[777]

In this section, we distinguish between provisions aimed at increasing trade opportunities; provisions allowing flexibility for developing countries in the use of measures in support of their economic development; provisions allowing longer periods for implementation; provisions limiting the possibility to take action against products originating in developing country Members; and provisions concerning technical assistance.

Increasing Trade Opportunities

Pursuant to Article XXXVII:1 of Part IV of the GATT 1994, entitled *Trade and Development*,65 WTO Members must "to the fullest extent possible" give high priority to the reduction and elimination of barriers to trade in products currently or potentially of particular export interest to developing country Members and refrain from imposing higher tariff or non-tariff barriers to trade with developing country Members. Furthermore, Article XXXVI:8 of Part IV of the GATT 1994 incorporates into WTO law the principle of non-reciprocity in trade negotiations between developed and developing country Members.

[777] Part IV was not part of the original GATT 1947 but was added in 1965.

This provision states: "The developed country Members do not expect reciprocity for commitments made by them in trade negotiations to reduce or remove tariffs and other barriers to the trade of developing country Members."

The 1979 *Decision on Differential and More Favourable Treatment*, commonly referred to as the Enabling Clause, further elaborates the provisions of Part IV of the GATT 1994.[778] The Enabling Clause allows developed country Members to depart from the MFN treatment obligation in their trade relations with developing countries and to grant these countries "differential and more favourable treatment. The Enabling Clause states in relevant part:

> 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.[779]

Developed country Members are thus allowed to grant preferential tariff treatment to developing country Members. Most developed country Members have done so under the Generalized System of Preferences (the "GSP"), first adopted as a policy by UNCTAD in 1968. A high percentage of the exports of developing countries is covered by GSP schemes and thus benefits from preferential tariff treatment. The Enabling Clause also provides for differential and more favourable treatment with respect to non-tariff measures and allows developing country Members to enter into regional or global arrangements amongst themselves for the mutual reduction or elimination of tariffs and, under certain conditions, non-tariff barriers to trade.

Article IV of the GATS, which is entitled "Increasing Participation of Developing Countries", calls for the negotiation of specific commitments to facilitate the increasing participation of developing country Members in world trade in services. Article IV refers *inter alia* to specific commitments relating to access to technology on a commercial basis; access to distribution channels and information networks; and, more generally, the

[778] BISD 26S/203.
[779] 64 Para. 12.1 of the Decision, WT/MIN(01)/EC/17.

liberalization of market access for services of export interest to developing country Members. Under Article IV:2, developed country Members must establish contact points to facilitate the access of service suppliers of developing country Members to information relating to the supply of services in their respective markets.

Measures in Support of Economic Development

Article XVIII of the GATT 1994, entitled "Government Assistance to Economic Development", recognizes that it may be necessary for developing country Members "to take protective or other measures affecting imports" in order to implement their programmes and policies of economic development. More specifically, Sections A, C and D of Article XVIII, the "infant industry" sections, allow, under certain conditions, developing country Members to modify or withdraw tariff concessions or to take other GATT inconsistent measures in order to promote the establishment of a particular industry. Furthermore, Section B of Article XVIII, the "balance of payments" section, allows, again under certain conditions, developing country Members to impose quantitative restrictions on imports in order to safeguard their external financial position and to ensure a level of reserves adequate for the implementation of their programmes and policies of economic development.[780]

The *SCM Agreement* recognizes that subsidies may play an important role in economic development programmes of developing country Members. This agreement thus provides that the general prohibition on export subsidies does not apply to developing country Members that have a *per capita* income below $ 1000 per annum.[781]

The *Safeguards Agreement* allows developing country Members to extend the period of application of a safeguard measure for a period of up to two years beyond the normal maximum period of eight years. Developing country Members may also apply a

[780] See also the Uruguay Round Understanding on the Balance-of-Payments Provisions of GATT 1994.
[781] Article 27.2 and Annex VII of the SCM Agreement.

safeguard measure *again* to the import of a product that has been subject to such a measure, earlier than developed country Members are allowed.[782]

The *Agreement on Agriculture* imposes on developing country Members less demanding requirements regarding the reduction of, for example, agricultural export subsidies and tariffs on agricultural imports. Developing country Members are required to reduce the budgetary outlays for export subsidies and the quantities benefiting from such subsidies by 24 and 14 per cent respectively. Developed countries must reduce by 36 and 21 per cent respectively. The required average reduction of tariffs of developing country Members was 24 per cent, while developed country Members had to reduce their tariff by 36 per cent.

Article XII:1 of the GATS recognizes that particular pressures on the balance of payments of a Member in the process of economic development "may necessitate the use of restrictions to ensure, *inter alia*, the maintenance of a level of financial reserves adequate for the implementation of its programme of economic development". As under Article XVIII of the GATT 1994, the use of restrictions for balance of payments purposes is, therefore, allowed subject to specific conditions.

Article XIX:2 of the GATS provides that the process of liberalization of trade in services must take place with due respect for national policy objectives and the level of development of individual Members. For developing country Members there must be "appropriate flexibility" for opening *fewer* sectors, liberalizing *fewer* types of transactions, *progressively* extending market access in line with their development situation, and attaching to such market access *conditions* aimed at achieving the objectives of increasing their participation in world trade in services.

Longer Periods for Implementation

Many WTO agreements provide that developing country Members have longer periods to implement the obligations under those agreements. The *TRIPS Agreement*, for example,

[782] Article 9.2 of the Safeguards Agreement.

granted developing country Members a delay of application of the TRIPS provisions until 1 January 2000; developed country Members had to apply the TRIPS provisions as of 1 January 1996. Under the *Agreement on Agriculture*, developing country Members have ten years, instead of the "normal" six years, to implement their reduction commitments.[783]

The Decision of 14 November 2001 of the Ministerial Conference at the Doha Session on Implementation Issues includes a number of provisions to make "additional time" provisions in the WTO agreements more specific.

Limitations on action Against Products Originating in Developing Country Members
Several WTO agreements that allow action against fair and unfair trade of Members, such as the *Anti-Dumping Agreement*, the *SCM Agreement* and the *Safeguards Agreement*, limit the possibility to take action against developing country Members. *The Anti-Dumping Agreement* requires developed country Members considering the application of anti-dumping measures to give "special regard" to "the special situation of developing countries".[784] Before applying anti-dumping duties affecting the essential interests of developing country Members, developed country Members must first explore the possibilities of constructive remedies provided for by the *Anti-Dumping Agreement.*[785] Under the *Safeguards Agreement* safeguard measures shall normally not be applied against a product originating in a developing country Member as long as that Member's share of imports of the product concerned in the importing Member does not exceed three per cent.[786] The *SCM Agreement* requires developed country Members to terminate any countervailing duty investigation of a product originating in a developing country as soon as it has been determined that the overall level of subsidies granted upon the product concerned does not exceed two per cent of its value; or the volume of the subsidized

[783] Article 15.2 of the Agreement on Agriculture.
[784] Article 15, first sentence, of the Anti-Dumping Agreement. See also paras. 7.1 to 7.4 of the Doha Decision on Implementation Issues, WT/MIN(01)/DEC/17.
[785] Article 15, second sentence, of the Anti-Dumping Agreement.
[786] Article 9.1 of the Safeguards Agreement. However, if the imports of all developing country Members with less than three per cent import share collectively account for more than nine per cent of the total imports of the product concerned, safeguard measures may be applied.

imports represents less than four per cent of the total imports of the like product in the importing Member.[787]

Technical Assistance

Many WTO agreements, including the *SPS Agreement*, the *TBT Agreement*, the *TRIPS Agreement*, the *Customs Valuation Agreement* and the *DSU*, specifically provide for technical assistance to developing country Members.

This technical assistance may be given, on a bilateral basis, by developed country Members, or may be given by the WTO Secretariat.

At the Doha Session of the Ministerial Conference in November 2001, developing country Members made their participation in a new round of trade liberalisation negotiations "conditional" upon a significant increase in technical assistance and capacity building efforts in order to enable them to participate effectively in the new Round and to allow them to benefit fully from the results.

The WTO has therefore embarked on a programme of greatly enhanced support for developing countries. Thus far, this has resulted in a notable increase in the WTO's budget and generous donations from developed country Members to the Doha Development Agenda Global Trust Fund. Since 1998, available funds for technical assistance have risen by 340 per cent to a projected CHF 30 million in 2002. (2002 figure projected. See WTO Secretariat, Factsheet on Technical Cooperation, 28 March 2002, at www.wto.org.)

The WTO has also significantly improved coordination with other international organizations (World Bank, IMF, UNCTAD, etc.) in the so-called Integrated Framework, with regional banks and regional organizations and with bilateral governmental donors.

[787] Article 27.10 of the SCM Agreement. However, if imports from developing country Members whose individual share of total imports represents less than four per cent collectively account for more than nine per cent of the total imports of the like product in the importing Member than the countervailing duty investigation must not be terminated.

The WTO considers that "[a]ssisting officials from developing countries in their efforts to better understand WTO rules and procedures — and how these rules and procedures can benefit developing countries — is among the most important aspects of the organization's work."[788]

The WTO Secretariat, and, in particular, the Technical Cooperation Division, organizes, mostly in response to a specific request from one or more developing country Members, *general seminars* on the multilateral trading system and the work of the WTO; *technical seminars and workshops* focusing on a particular area of trade law or policy; and *technical missions* to assist developing country Members on specific tasks related to the implementation of obligations under the WTO agreements (such as the adoption of trade legislation or notifications). In 2002 the WTO Secretariat organized 514 technical cooperation activities as compared with 349 in 2001.[789]

Furthermore, the WTO Secretariat, and in particular, the WTO Training Institute, which was established in 2001, also organizes training courses. These training courses, held at WTO headquarters in Geneva, run for as long as 12 weeks and cover the full range of WTO issues. In 2002, 300 government officials of developing country Members will receive in this way an intensive training in WTO law and policy.[790] The WTO also organizes a programme known as Geneva Week, which is a special week-long event bringing together representatives of WTO member countries who do not have permanent missions in Geneva. Geneva Week covers all WTO activities and includes presentations by other international organizations based in Geneva. In 2002 Geneva Week will be organized twice.

[788] Ibid.
[789] Ibid.
[790] In 2001 the number of government officials participating in these training seminars was only 116.

Dispute Settlement

Since 1997, the WTO Secretariat has also been installing Reference Centres in developing countries.[791] These Reference Centres allow government officials to access essential documents instantly via the WTO website. As of March 2002, 109 reference centres had been established in 88 countries including 54 in Africa, 16 in the Caribbean, 17 in Asia, 10 in the Middle East, 10 in the Pacific, three in Latin America, and two in Eastern Europe.[792]

Special and Differential Treatment for Least-Developed Country Members

For least-developed country Members, WTO law provides *additional* special and differential treatment.

Increased Trade Opportunities

With regard to trade in goods, the Enabling Clause provides that developed country Members must exercise the utmost restraint in seeking any concessions or contributions in trade negotiations from the least-developed country Members. At the First Session of the Ministerial Conference in 1996 in Singapore, developed country Members agreed to examine how they could improve access to their markets for products originating in least-developed country Members, including the possibility of removing tariffs completely.

With regard to trade in services, the GATS provide that developed country Members must take account of the serious difficulty of the least-developed countries in accepting specific commitments. (Shaded Areas Are Those Serviced By WTO Reference Centers.)

Measures in Support of Economic Development

The prohibition on export subsidies under the *SCM Agreement* does not apply to least-developed country Members.[793] Moreover, the *Agreement on Agriculture* exempts the

[791] The WTO Secretariat provides governments with computer and other hardware, software and the training required for the operation of these Reference Centers.
[792] See WTO Secretariat, Factsheet on Technical Cooperation, 28 March 2002, at ww.wto.org.
[793] Article 27.2 of the SCM Agreement.

least-developed country Members from the obligation to reduce tariffs on agricultural imports and agricultural domestic and export subsidies.[794]

Longer Periods for Implementation

In view of the special needs and requirements of least-developed country Members, their economic, financial and administrative constraints, and their need for flexibility to create a viable technological base, least-developed country Members may delay the application of most obligations under the *TRIPS Agreement* for a period of 11 years, i.e. until 1 January 2006.[795] Pursuant to the *SCM Agreement,* the prohibition on subsidies contingent on the use of domestic over imported goods shall not apply to least-developed countries for a period of eight years, i.e., until 1 January 2003.[796]

Questions of Concern:

1. Does WTO law and policy recognize the particular interests and needs of developing country Members? If so, has there been a positive or negative evolution in the extent of this recognition?

2. What special and differential treatment for developing country Members does WTO law provide with respect to access to the markets of developed country Members?

3. Does WTO law give developing country Members significantly more leeway than developed country Members to apply trade-restrictive or trade-distorting measures adopted in support of domestic economic development?

4. Which of the provisions of WTO law providing developing country Members with extra time to implement their obligations are still relevant in 2003?

[794] Article 15.2 of the Agreement on Agriculture.
[795] Article 66.1 of the TRIPS Agreement. However, the MFN treatment obligation and the national treatment obligation do apply.
[796] Article 27.3 of the SCM Agreement.

5. Are developed country Members restrained from applying anti dumping, countervailing or safeguard measures against imports of products originating from developing country Members? If so, to what extent?

6. In which respect do least-developed countries receive additional special and differential treatment under WTO law?

7. After going through Copy Right and Neighbouring Rights Proclamation No. 410/2004, Proclamation Concerning Inventions, Minor Inventions and Industrial Designs No. 123/1995 as well as Ethiopian Intellectual Properties Establishment Proclamation No. 320/2003, explain how much these cover the rights discussed in this text? Are there any minimum concerns to be covered by the law of Ethiopia to satisfy requirements of WTO in these respects?

Chapter Ten
International Trade Investment – Ethiopia

10.1 General Framework

At the beginning of this Course, we mentioned the three fundamental economic problems any society faces. These are: "What commodities are to be produced and in what quantities? How shall goods be produced? For whom shall goods be produced?" As these are matters primarily deliberated on by policy-makers, the technocrats are supposed to assist in the implementation of set objectives, goals. Meaning, once the course of action has been set by the competent body, professionals are expected to provide the most economic, appropriate ways(s) of implementing the solutions and devising formidable mechanisms.

The success, or failure, of any designed economic venture at the national level is evaluated vis-à-vis the net economic benefit/welfare gained thereof. As noted, some economic gains might be difficult to quantify – i.e., measure. Never the less, some of the following economic indicators can be useful bars for comparing and contrasting any advancements made in the economic sphere.

- Minimization of costs on inputs in view of maximizing the overall production rate, the GNP and GDP.
- Optimizing opportunity cost.
- Technology transfer coupled with scaled-up skill and knowhow of the indigenous work force.
- Re-adjusting and over-whole of the economy; e.g., as noted earlier, studies have shown that economies of sub-Saharan Africa used to create joblessness and traded commodities which had least or no comparative advantage during the Cold-War era. Re-adjusting such malice would surely contribute to the healthy growth and enhancement of the national economy.

- Creating an economy of scale; by means of, for example, upgrading manufacturing/production "capital goods", construction of fundamental infrastructures that especially would add-up to the comparative advantage of the economy.
- Scaling-up economic returns; e.g., by setting tariffs so as locally produced import-substitutes have better share in the local market share.
- "Factor Accumulation"; i.e., investment, higher national and domestic savings, increased marginal profit gains from exports, increased foreign direct investment (FDI), facilitation of fair import/export competition, liquidation of inappropriate trade barriers on productivity, exposure to newer and appropriate technologies, growth of human capital and, to some extent, openness.

All these, measured and quantified separately, and – thereafter – taken in tandem, would give a clearer picture of a nation's economic gains in real terms. This, in turn, would tell a lot about the successfulness of an economic venture, as it would also tell of its short comings.

Successful students of International Trade Law, when becoming architects, facilitators and/or negotiators of the country's trade regime, would naturally be expected to safeguard Ethiopia's economic interests. In an ever increasingly hefty trading environment, accomplishing such a cumbersome duty might not always be an easy job; but, all the same, that would scarcely be accepted as excuse.

Pointing this simple fact just as a reminder, let us now proceed and look at some of Ethiopia's Investment Laws and Regulations.

10.1.1 Decisions on Measures in Favour of LDCs

Part IV of the GATT that bears the heading "Trade and Development", contains:

- Article XXXVI enumerates "principles and objectives";

- Article XXXVII – "trends in international trade";
- Article XXXVIII – calls for "joint action".

These three Articles take into account the different levels of economic development and the need to facilitate the development of Developing and L.D. countries. A report on "trends in international trade" also known as Habler Report (named after the chairman of the panel (1958), can be said to be the turning point in GATT's relations to the LDCs. In response to the Habler Report, GATT entrusted a Committee (committee III) with the responsibility to track trade measures that restrict LDC from getting access to export. According to a learned commentators, the reason and intent of GATT response was to win the trust of most of the countries, specially of the Developing and LDCs, for the establishment of a U.N. body.

> "There is not much doubt that the less developed countries obtained a great deal of verbage and few precise commitments .. recognizing the need for adequate legal and institutional frame work to discharge their responsibilities towards LDCs, was a reaction to the preparations in progress for the 1964 UNCTAD conference .. to the growth of the UNCTAD from an isolated United Nations conference to a permanent body commanding the allegiance of the entire less developed world"[797]

With this background, Committee III took up its work and began asking '*increasingly embarrassing questions'* and making steadily more specific recommendations. On the other hand, *"*the developed countries undertook no precise commitments and were too accustomed to viewing the GATT as a passive organization in which barriers to trade were reduced only by quid pro quo negotiations, to be willing to take extensive unilateral steps towards the reduction of barriers to less developed countries exports."[798]

[797] M.B. Rao Manjula Guru, WTO and International Trade,(2nd Ed., Vikas Publishing House Pvt. Ltd., 2003, p. 334. [Referring to: DAM-GATT and the International Organization, (Chicago University Press, 1970), at p. 231]
[798] Id., p. 332.

Coming back to part IV of the GATT, Article XXXVI states that one of the principal objectives of the GATT Agreement is the progressive development of the economies of all the contracting parties, particularly that of the Developing and Less Developed countries (LDCs), urgently; since their export earnings can play a vital part to their economic development and bridge the wide economic gap as well as the gap in living standards. It also recommends that encouraging measures be set, including not to expect reciprocity (paragraph 8), to the limited number of their primary products; i.e. which includes 'agricultural products' (paragraph 4). To achieve that, conditions in the world market should be designed that the primary and other products be so designed that they get stable, equitable and remunerative prices, so as to provide them with expanding resources for their economic development. Agreement was also reached that there is need for increased access to markets under favorable conditions to export of processed and manufactured products of interest to LDCs, among other things.[799]

Article XXXVII sets out provisions that contracting parties of the developed countries reduce trade barriers to products of export interest of less developed countries; i.e. including customs duties and other restrictions. It also has provisions that Developed Countries refrain from imposing new barriers.[800]

Less developed countries on their part agree to take appropriate measures for the benefit of trade of other less developed countries.[801]

Article XXXVIII calls for joint action to further the objectives set forth in Article XXXVI; i.e. provide improved remunerative prices for Developing and LD Countries, to collaborate with UN and its organs like UNCTAD and others in matters of trade and development, including promotion of export potential and access to the export markets.[802]

[799] Id., pp. 332-333.
[800] Id., p. 333-334.
[801] Id., p. 334.
[802] Ibid.

This same Article (XXXVIII) calls for "[j]oint action of the contracting parties through International arrangements".[803]

A Ministerial meeting reaffirmed the decision on measures in favor of LDCs, passed November 28, 1979, which calls a) that differential and more favorable treatment be provided to LDCs, b) that Developed Countries should not demand reciprocity during trade negotiations and agreements from these countries, and c) that developing countries afford fuller participation.[804]

> *"*The Ministerial Decision having regard to the commitment setout in section B(vii) of part I of the Punta del este declaration that as long as LDCs remain in that category, they will be only required to undertake commitments and concessions to the extent consistent with their individual development, financial and trade needs or their administrative capabilities, … The ministers also agreed on expeditious implementation of all measures taken in favour of LDCs which shall be ensured through regular reviews, .. to implement the MFN concessions on tariff and non-tariff measures in favour of LDCs and to further improve GSP and other schemes for export products of LDCs. Sympathetic consideration be also given to specific and motivated concerns .."[805]

On the basis of these arrangements, a developing country, for instance, may impose quantitative restrictions on imports for balance of payments purposes, to deal with the demand for imports generated by the program for economic development.

> "Though some of these measures are criticized as 'escape clauses' and are not in keeping with the GATT motto of free trade, they are nevertheless very necessary in the interests of all developing countries. ..
>
> "The dispute settlement procedures also contain provisions showing sufficient latitude to the developing countries – particularly LDCs. ..

[803] Id., p. 335.
[804] Id., p. 335-336.
[805] Id., p. 336.

> "But the larger question is how far have these measures .. really helped the LDCs in any good measure. This may come out of the reviews ..."[806]

A review of a five year period that came out as the "Implementation-Related Issues and Concerns" on the Doha Round of Talks reveals that little has actually been accomplished. So,

> "..in their Declaration on TRIPs Agreement and Public Health adopted on 14th November 2001, have decided on the several issues facing the developing countries in general and the LDCs in particular. There under longer transition periods, improved technical assistance and other forms of 'capacity building' to help with the implementation of Uruguay Round agreements are envisaged."[807]

On the report of the Committee on Agriculture regarding the implementation of the Declaration on Measures, it approved the recommendation on 1) Food aid, 2) technical and financial assistance in the context of aid programs, 3) review of follow up.[808]

These, coupled with the Decision on TRIPS and public health, i.e. producing patented drugs to combat AIDS/HIV, helped pass decisions that relieve some of the grave concerns of Developing and Least Developed countries. All said, the most vital issue at hand is and remains to be the "implementation aspect".[809]

10.1.2 Expropriation under International Law

To begin with, "expropriation", i.e. "governmental taking or modification of an individual property",[810] is a grave impediment to investment. "Expropriation" in the context of International Law, e.g. Foreign Direct Investment, could result in economic blockade, if the party whose property has been expropriated manages to show to the pertinent bodies that the measure taken by the other was inappropriate. In such cases

[806] Id., p. 337.
[807] Ibid.
[808] Id., pp. 337-338.
[809] Id., p. 338.
[810] Black's Law Dictionary,

others would naturally decide to withdraw their stakes, while potential investors would decide to invest somewhere else. Moreover, the foreign relation of such a country would be in jeopardy.

A country which can be cited as a good example could be Ethiopia. Though, compensated afterwards through special arrangements, the Dergue Regime began its adventurous journey by expropriating properties of foreign companies. The burnt of that deed to Ethiopia was that it got completely shunned by the whole Western World for about a decade and a half. Ethiopia was also effectively secluded from foreign capital – let alone FDI; except aid. A more recent, but somehow similar or analogous example could be that of Zimbabwe.

Having said this much on the effects of "expropriation", let us now come back to the essential subject matter.

Students should note that any country can legally expropriate or requisite any property, i.e. that of its nationals or of foreigners. But, in order that the expropriation can be considered rightful, the need for expropriation should be

- in the national interest,
- is on the basis of public utility,

all of which would be overriding purely individual or private interests; i.e. both domestic and foreign. Besides, the expropriating government should pay compensation for everything and everyone it has expropriated.

In the majority of countries, most land is privately owned. So, these countries seek to establish a legal system that will protect private property rights to the maximum extent possible. They would be set in place land registration systems and other zoning ordinances (regulations) to clearly define private, institutional properties coupled with various legal protections.

From the historical point of view, international rules regarding expropriation are a rather recent development. All the same, even in such countries such as U.S.A. and Britain, where capitalism and private land ownership have long been an absolute right of private property ownership, that condition would not prevent their governments from expropriating land for building, say railroads, etc..; i.e. as long as it gives payment, and all the above mentioned conditions are met.

By the 20th Century, the United States had become a champion of the *just* compensation principle (14th Amendment), which serves to both provide restitution to individuals who got divested of their property and to place limitations on the powers of federal and state governments of the U.S.[811]

With the beginning of socialism in the former U.S.S.R. began nationalization, i.e. expropriation without compensation, as the ideology deemed it necessary. In the wake of Mexico's nationalization in the 1930ies, significant amount of American-owned property which was in that country was also expropriated. This latter instance created a debate between the American and Mexican Ministers of Foreign Affairs over expropriation, i.e. the American- and Latin American-view points.

American-view point, as articulated by the then Secretary of State, Cordell Hull, and restated in the Third (Section 712), entitled "Economic Injury to Nationals of Other State", reads as follows.[812]

> "A state is responsible under international law for injury resulting from:
>
> i. (1) a taking by the state of the property of a national of another state that
>
> 1. (a) is not for a public purpose, or
> 2. (b) is discriminatory, or
> 3. (c) is not accompanied by provision for just compensation."
>
> ii. "What is 'just compensation' under the American viewpoint? Just compensation is 'an amount equivalent to the value of the property taken'

[811] Swan, Alan and John Murphy, Cases and Materials on the Regulation of International Business and Economic Relations, (2nd Ed., Lexis Nexis, New York), 1999, pp. 1053-1054.
[812] *?*

and should be paid ‘at the time of the taking, or within reasonable time thereafter with interest ..’. Finally, compensation should be ‘in a form economically usable by the foreign national’.

iii. The standard formulation of the American point of view is known as the Hull formula, ..

iv. Hull continued with the following comments: ‘If it were permissible for a government to take the private property of the citizens of other countries and pay for it as and when, in the judgment of the government, its economic circumstances and its local legislation may permit, the safeguards which the constitutions of most countries and established international law have sought to provide would be illusory. Governments would be free to take property far beyond their ability or willingness to pay, and the owners thereof would be without recourse. .. But we can not admit that a foreign government may take the property of American nationals in disregard of the rule of compensation under international law.’

v. Under the American viewpoint, an expropriation of a foreign national’s property clearly falls under the jurisdiction of international law. While countries may treat their own nationals as they please .. “

In the 1960s and 1970s, a large number of new States became free – i.e. were decolonized. They started to challenge the American viewpoint. These treat the same issue under Customary International Law. During this time, the General Assembly of the U.N. passed several resolutions that adopted the so-called Latin American-view; i.e. adopted the “Permanent Sovereignty over Natural Resources”, which also insists that the above mentioned conditions should be met and compensation provided “.. in accordance with the rules in force in the State taking such measures in the exercise of its sovereignty and in accordance with in international law. The resolution further provides for dispute settlement in the host country in the first instance with the possibility of later appeal to an

international tribunal*"*.[813] In respect of this issue, the following points should be brought to the attention of instructor and students.

Developments of the mid-20th Century in International Human Rights and International Law have brought to the attention of the general public that investor(s) can sue the State. For this purpose, an International Center for Settlement of Investment Disputes (ICSID) got established by the World Bank, at the outskirts of Washington DC. One of the two essential provisions of ICSID Convention, Article 26, states:[814]

> "Consent of the parties to arbitration under this Convention shall, unless otherwise stated, be deemed consent to such arbitration to the exclusion of any other remedy. A contracting State may require the exhaustion of local administrative or judicial remedies as a condition of its consent to arbitration under this Convention."

Article 27 of the same Convention, states:

> "No Contracting State shall give diplomatic protection, or bring an international claim, in respect of a dispute which one of its nationals and another Contracting State shall have consented to submit or shall have submitted to arbitration under this Convention, unless such other Contracting State shall have failed to abide by and comply with the award rendered in such dispute."

As mentioned earlier on, the International Trade Organization (ITO) signed at the Havana Convention was left aside and efforts were directed in establishing the WTO. Though the 1948 charter of the ITO incorporates some provisions with regard to foreign investment, it does not incorporate detailed provisions. Bilateral Treaties (BTs) of investment, judicial decisions passed by the International Court of Justice (ICJ) as well as widespread Custom Laws are serving as sources of International Law and expressions of *opinion juries*, respectively. These are currently in use by international tribunals as general rules of International Law on foreign investment.

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[813] G.A. Res. 1803, (1962) and G.A. Res. 3171, (1973).. See also Article 38 of the Statute of the International Court of justice.
[814] UNCTAD, *International Investment Agreements: Key Issues,* (Vol. 1), 2004, pp. 318-323.

Accordingly, full payment of compensation where foreign property is nationalized or expropriated is based on the general principle of law on unjust enrichment. Likewise, notions of equity are applicable as a general principle.[815] The principle of sanctity of contracts, is another accepted principle that requires that State(s) cannot change unilaterally a foreign investment contract they agreed to, as long as public interest does not necessitate, justify such an action.[816]

In light of some of the decisions passed, some accuse international arbitration tribunals of resorting to judgments that mostly favour the protection of investment interests; i.e. judgments that give little or no consideration to the interest of the host nation. But, in theory, international tribunals are supposed to deliver judgments solely on the basis of those general principles that have won acceptance in International Law.

Multilateral Instruments on Foreign Investment

In the early 1970s, developing countries brought to the attention of the international body their concerns over the conducts of Multinational Corporations (MCs) – also known as oligopolies. Their efforts were associated with the move to bring about a New International Economic Order (NIEO). In 1972, the Economic and Social Council of the United Nations asked a group of eminent persons to study the problem. It's report (in 1974) included that "..certain practices and effects of transnational corporations had given rise to widespread concern and anxiety in many quarters and a strong feeling has emerged that the present modus vivendi should be reviewed at the international level."[817] Though disregarded by the others, it induced developing countries to draft a "code of conduct" to the multinational corporations. Countries of the Socialist Bloc drafted their own codes.

After some fifteen years since the initiation of drafting of codes of conduct, the Developed States got interested in having such a code as they themselves became

[815] Id., p. 76.
[816] Id., pp. 78-79.
[817] M. Sornarajah, The international Law on Foreign Investment, (Grotius publications, Cambridge University Press), 1996, p. 191.

recipients of foreign trade. Thus, in anticipation of controlling the activities of multinational corporations, the United States, for example, required reference to the relevant principles of Customary International Law in the field. The Developed States gave preference to a "balanced Code" that would incorporate the rights and duties of both parties, in view of maximizing the contributions of oligopolies to economic development and growth and minimizing their negative effects.[818] The "balanced Code" incorporates articles that ensure the sovereignty of host states over their natural resources as well as their right to renegotiate contracts where the contractual equilibrium has been altered by a fundamental change of circumstances.[819] Among other things, the code also restricts oligopolies in interfering in domestic political activities of the host State or to influence their parent State to intervene on their behalf in a manner inconsistent to the Declaration of Friendly Relations between States enshrined in the charter of the United Nations.[820] The parts included in the Code are:[821]

a) recognition of international legal rules and principles relevant to the treatment of transnational corporations;
b) requirement of compensation for nationalization;
c) provision on jurisdiction; and
d) dispute settlement.

As the "balanced Code" gave less emphasis to the treatment of oligopolies by the host State, attention was reverted to the non-binding guidelines of the Development Committee of the World Bank, that *".. reflect emerging, rather than settled standards under contemporary international law".*[822]

In the second half of the 1990s, a serious effort was made by the OECD to negotiate a comprehensive treaty on investment, known as the Multilateral Agreement on Investment (MAI), which was destined to eventually be transferred to the WTO. The MAI

[818] Tesfaye Abate, *"Investment Law"*, (Text for Students of Law Faculty, Saint Mary Univ. College, Addis Ababa), 2008, p. 247.
[819]Id., p. 248.
[820] Id., pp. 248-249.
[821] Id., p. 250.
[822] Ibid..

negotiations had the intent to remove barriers to investment, provide protection against expropriation, and institute a dispute settlement system. The negotiations failed and were abandoned in late 1998 over concerns that a) oligopolies can exert too much influence or dominate economic sectors unless they were subjected to some control, b) liberalization of investment would lead to economic crisis, and c) oligopolies will use FDI for exploiting workers in low-wage countries with inadequate labour standards.[823] Thus, Trade Related Investment Measures (TRIMs) and the requirements thereof (discussed earlier on) are applicable in WTO member countries.

BITs Concluded by Ethiopia

As none universally accepted, multilateral investment treaties exist, countries have tended to tailor out their own treaties. For long, *".. developing countries have been striving to bring about a New International Economic Order (NIEO), one facet of which is national control over investment …"*[824]

Like any of the other countries, Ethiopia also has concluded a number of Bilateral Investment Treaties (BITs). Some of these are:

- Agreement signed on the Encouragement and Reciprocal Protection of Investment with the Great Socialist People's Libyan Arab Jamahiriya – Proclamation No. 406/2004; signed in Addis Ababa and ratified on June 15, 2004;
- Agreement between the governments of FDRE and the Peoples Republic of China concerning the Encouragement and Reciprocal Protection of Investments.

These and similar BITs have the aim of:[825]

- creating favourable conditions for investments,

[823] Mitsuo Matsuchita, Thomas J. Schoolman and Peters C. Marvroidis, The World Trade Organization: Law, Pracice, and Policy, (Oxford University Press), 2003, p. 523.
[824] Tesfaye Abate, Op cites, No. 821, p. 253.
[825] Mehamed I.K. Khalil, *"Surveys of Existing Instruments: Treatment of Foreign Investment in Bilateral Investment Treaties",* (ICSID Review Foreign Investment Law Journal, Vol. 7, Number 2, Fall), 1992, p. 350-351.

- provide that admission of investments be made according to the laws, regulations and/or administrative practices of the contracting States.
- oblige the contracting States to admit investments, facilitate the transfer of proceeds of their investments.
- impose a duty to agree to a reasonable mode of settlement of dispute arising out of them.

Such agreements also could envisage that each contracting party should encourage investors of the other contracting State and the investor(s) of the respective countries should get fair and equitable treatment and protection; i.e. treatment not less favourable than that accorded to any other [investor of] third State.[826] In contradistinction to the MFN treatment, *"..,* one party cannot claim a preferential treatment accorded by the other party on the basis of customs union, free trade zones, economic union, etc (Art. 3(3))".[827] The BIT concluded between FDRE and the Peoples Republic of China also gives right to the investors of the respective countries to transfer their investments and returns held in the territory of the one contracting party,[828] compensate the investor for the loss he/she sustains due to war, a state of emergency, insurrection, riot or other similar events in case that the host State takes measures, or makes certain treatments lower than that accorded to investor(s) of another State.[829] Besides, the Agreement has a provision on standards of compensation.[830] According to that, expropriation may be made

- for the interest of the public;
- in accordance with the legal procedures of the host State;
- without discrimination;
- by effecting to the investor an easily/freely transferable compensation in hard currency without delay.

[826] Tesfaye Abate, Op cites, No. 821, p. 257; Referring to Agreement between the Government of the FDRE and the Government of the Peoples Republic of China concerning the Encouragement and Reciprocal Protection of Investments, Articles 2 and 3.
[827] Id., p. 258.
[828] Ibid; Article 6.
[829] Ibid; Article 5.
[830] Ibid; Article 4.

As concerns disputes arising from investment transactions, it was agreed that these should be resolved as agreed upon by the contracting parties.[831]

Ethiopia's Investment Regulation

Regulating investment is a normative standard of control. The reason and purpose of regulation is to ensure stability within the market and safeguard a competitive economic environment as well as protect fraud and mismanage-ment.[832] Unless effective mechanisms are set in place, business and/or investment can easily resort to illegal or un-lawful practices that could lead to dangerous or futile exercises. Thus, *'.. developing a legal system based on the rule of law as well as an institutional environment in which enterprises have incentives to invest in productive activities ..'* is an essential element to ensuring sustainable development and maintaining good governance.[833]

Generally speaking, there are three types of Investment regulations, namely:[834]

- market regulation; presumed to cause uncertainty and instability to producers, employees and consumers alike;
- industrial regulation; could eliminate, reduce tensions between business organizations and the labour force, but causing higher cost and lower quality of production.
- governmental regulation aims at fairness, non-discrimination, consumer protection and quality control; i.e. leads to higher cost and inflated bureaucracy.

In "[r]egulating investment, it is imperative to think how to constructively harness the innovative power and motivating incentive of the business enterprises so that they could meet the needs of society without weakening the unique characteristics of a free society".[835]

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[831] Ibid; Article 8.
[832] George A. Steiner and John F. Steiner, Business, Government and Society: A Managerial Perspective, Text and Cases, 2006, p. 287.
[833] Tesfaye Abate, Op cites, No. 821, p. 262.
[834]Ibid.
[835] K.G. Friedmann, Legal Aspects of Foreign Investment, 1959, p. 750.

In line with that, a country having a free market economy should take the following five steps in order that its economy performs well.[836]

1) Simplify and deregulate the market in a way that investors/firms become the responsible figures in business matters. Furthermore, deregulation of the market should be based on and for the enhancement of the principle of "fair competition". (As concerns "fair competition", see pp. 39–52 in this text.)
2) Enhancement the right to property; i.e. the law should perpetually, conscientiously ascertain and give legal protection to the property of individuals, associations, etc …
3) Ensure use of better technologies and know-how.
4) Reduce involvement of Courts in settling business disputes as much as possible.
5) Make appropriate business reforms successively.

Having said this much about the general principle on regulation of investment, let us now look at the investment laws and regulations of Ethiopia.

To begin with, every government tries to set a formidable economic policy –

".. general principles by which the government is guided in its management of public affairs".[837] Economic policy has three main objectives: [838]

- economic objectives; i.e. desired results of the economy;
- economic instruments; i.e. methods by which policy objectives are implemented; and
- economic models; i.e. includes how the economy is transacted (the structure, opportunities and challenges), how the instruments are interconnected with the policy objectives and other similar matters. It can be used as an indicative, empirical evidence of the theoretical outline. Mostly, economic models are left aside in devising economic policies.
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[836] George A. Steiner and John F. Steiner, Op cites, No. 835, p. 287.
[837] Ne-Thi, Somashekar, Development and Environmental Economics, 2003, p. 634.
[838] Alemayehu Seyoum Tafesse, *"Economic Administration and the Ethiopian Development: some Perceptions"*, (Ethiopian Economic Professionals Workshop Paper, in Amharic) 1996 (EC), pp. 222-224.

10.1.3 Investment Incentives in Ethiopian Law

The authority to issue Regulations about investment incentives is that of Council of Ministers as per Article 9 of the Investment Proclamation No.280/2002. Regulation No. 84/2003, after stating that certain "[a]reas of investment listed in the schedule attached to these Regulations are exclusively reserved for domestic investors"[839], grants two principal incentives to both foreign and domestic investors.

1. Income tax exemptions to investors engaged in *"manufacturing or agro-industrial activities or the production of agricultural products to be determined by the Board".*[840]

   On the basis of the Sub-Articles 4(1(a)) and (1(b), investors who either export 50% of their products or supply 75% of it *"to an exporter as a production input"* are eligible for tax exemption for five years, which may be extended to an additional two years upon approval. Investors exporting less than 50% of their products are eligible to tax exemption for a period of two to five years. Sub-Article 4(7) permits those investing in *"relatively under developed Regions"* to acquire an additional one year tax exemption. Besides, Article 5 stipulates that, "[a]n investor engaged in activities mentioned under Sub Article (1) of Article 4 who exports at least 50% (fifty percent) of his products and increases, in value, his production by 25% shall be eligible for income tax exemption for 2 years."

   The Investment Board may issue a directive barring investors from obtaining tax exemption, when they seize to export their products abroad. Article 7 stipulates that *"*an investor who has incurred loss within the period of income tax exemption shall be allowed to carry forward his loss for half of the income tax exemption period, after the expiry of such period."

2. Part three of the same Regulation stipulates the terms and conditions under which investors are exempted from payment of Customs Duty.

[839] Council of Ministers Regulations on Investment Incentives and Investment Areas Reserved for Domestic Investors No.84/2003, Federal Negarit Gazeta, 9th Year, No. 34, February 7, 2003, Article 3.
[840] Id., Art. 4(1).

> "1) An investor shall be allowed to import duty-free capital goods and construction materials necessary for the establishment of a new enterprise or for the expansion or upgrading of an existing enterprise.
> "2) In addition, an investor granted with a customs duty exemption privilege shall be allowed to import duty free capital goods necessary for his enterprise.
> "3) Notwithstanding the provisions of Sub Articles, (1) and (2) of this Article the Board may, by its directive~, bar the duty-free importation of capital goods and construction materials where it finds that they are locally produced with competitive price, quality and quantity.
> "4) An investor eligible for duty-free importation of capital goods pursuant to these Regulations shall be given the same privilege for spare parts whose value is not greater than 15% (fifteen percent) of the total value of the capital goods to be imported.

Aside from that, Article 9 stipulates that "[t]he Board shall determine, by its directives, conditions for importing vehicles duty-free depending on the type and nature of the project. However, any investor may import duty-free:

> (a) ambulances. for employees that are needed for
> emergency cases;
> (b) buses for tour operation services."

Questions to ponder

1. See Investment Proclamation No. 280/2002 and amendments Regulations issued there under. What are the essential and persistent malice, drawbacks, etc .., that should be addressed by the law?

2. Explicitly explain your view concerning the benefits and short comings of giving extensive tax-holidays to investments? Aside from helping win-over potential investments, discuss how it ensures the sustainability of such a transaction in

respect of guaranteeing acquisition of considerable, valuable amount of revenue to the host nation s well as building a reliable economic system thereof?

3. In view of the fact that LDCs strive to make maximum use of “capital goods” they import in “hard currency”, they train their own professionals for making maintains of such equipments accessible. Currently, income tax of such services stands at 35%. Do you think this would undermine the “triple effect” of technology presumed to be acquired through international trade?

4. Do you think this and similar issues fall within the domain of International Trade Law? Which faculty of law and/or body of government should address such issues?

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[i] **ANNEX I**

THE GENERAL AGREEMENT ON TARIFFS AND TRADE

(4248)

The Governments of the Commonwealth of Australia, the Kingdom of Belgium, the United States of Brazil, Burma, Canada, Ceylon, the Republic of Chile, the Republic of China, the Republic of Cuba, the Czechoslovak Republic, the French Republic, India, Lebanon, the Grand-Duchy of Luxemburg, the Kingdom of the Netherlands, New Zealand, the Kingdom of Norway, Pakistan, Southern Rhodesia, Syria, the Union of South Africa, the United Kingdom of Great Britain and Northern Ireland, and the United States of America:

Recognizing that their relations in the field of trade and economic endeavour should be conducted with a view to raising standards of living, ensuring full employment and a large and steadily growing volume of real income and effective demand, developing the full use of the resources of the world and expanding the production and exchange of goods,

Being desirous of contributing to these objectives by entering into reciprocal and mutually advantageous arrangements directed to the substantial reduction of tariffs and other barriers to trade and to the elimination of discriminatory treatment in international commerce,

Have through their Representatives agreed as follows:

PART I

Article I

General Most-Favoured-Nation Treatment

1. With respect to customs duties and charges of any kind imposed on or in connection with importation or exportation or imposed on the

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

2. The provisions of paragraph 1 of this Article shall not require the elimination of any preferences in respect of import duties or charges which do not exceed the levels provided for in paragraph 4 of this Article and which fall within the following descriptions:

(*a*) Preferences in force exclusively between two or more of the territories listed in Annex A, subject to the conditions set forth therein;

(*b*) Preferences in force exclusively between two or more territories which on July 1, 1939, were connected by common sovereignty or relations of protection or suzerainty and which are listed in Annexes B, C and D, subject to the conditions set forth therein;

(*c*) Preferences in force exclusively between the United States of America and the Republic of Cuba;

(*d*) Preferences in force exclusively between neighbouring countries listed in Annexes E and F.

3. The provisions of paragraph 1 shall not apply to preferences between the countries formerly a part of the Ottoman Empire and detached from it on July 24, 1923, provided such preferences are approved under paragraph 5[i], of Article XXV which shall be applied in this respect in the light of paragraph 1 of Article XXIX.

4. The margin of preference* on any product in respect of which a preference is permitted under paragraph 2 of this Article but is not

specifically set forth as a maximum margin of preference in the appropriate Schedule annexed to this Agreement shall not exceed:

(*a*) in respect of duties or charges on any product described in such Schedule, the difference between the most-favoured-nation and preferential rates provided for therein; if no preferential rate is provided for, the preferential rate shall for the purposes of this paragraph be taken to be that in force on April 10, 1947, and, if no most-favoured-nation rate is provided for, the margin shall not exceed the difference between the most-favoured-nation and preferential rates existing on April 10, 1947;

(*b*) in respect of duties or charges on any product not described in the appropriate Schedule, the difference between the most-favoured-nation and preferential rates existing on April 10, 1947.

In the case of the contracting parties named in Annex G, the date of April 10, 1947, referred to in subparagraph (*a*) and (*b*) of this paragraph shall be replaced by the respective dates set forth in that Annex.

Article II

Schedules of Concessions

1. (*a*) Each contracting party shall accord to the commerce of the other contracting parties treatment no less favourable than that provided for in the appropriate Part of the appropriate Schedule annexed to this Agreement.

(*b*) The products described in Part I of the Schedule relating to any contracting party, which are the products of territories of other contracting parties, 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. Such products shall also be exempt from all other duties or charges of any kind imposed on or in connection with the importation in excess of those

imposed on the date of this Agreement or those directly and mandatorily required to be imposed thereafter by legislation in force in the importing territory on that date.

(*c*) The products described in Part II of the Schedule relating to any contracting party which are the products of territories entitled under Article I to receive preferential treatment upon importation into the territory to which the Schedule relates shall, on their importation into such territory, 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 for in Part II of that Schedule. Such products shall also be exempt from all other duties or charges of any kind imposed on or in connection with importation in excess of those imposed on the date of this Agreement or those directly or mandatorily required to be imposed thereafter by legislation in force in the importing territory on that date. Nothing in this Article shall prevent any contracting party from maintaining its requirements existing on the date of this Agreement as to the eligibility of goods for entry at preferential rates of duty.

2. Nothing in this Article shall prevent any contracting party from imposing at any time on the importation of any product:

(*a*) a charge equivalent to an internal tax imposed consistently with the provisions of paragraph 2 of Article III* in respect of the like domestic product or in respect of an article from which the imported product has been manufactured or produced in whole or in part;

(*b*) any anti-dumping or countervailing duty applied consistently with the provisions of Article VI;*

(*c*) fees or other charges commensurate with the cost of services rendered.

3. No contracting party shall alter its method of determining dutiable value or of converting currencies so as to impair the value of any of the

concessions provided for in the appropriate Schedule annexed to this Agreement.

4. If any contracting party establishes, maintains or authorizes, formally or in effect, a monopoly of the importation of any product described in the appropriate Schedule annexed to this Agreement, such monopoly shall not, except as provided for in that Schedule or as otherwise agreed between the parties which initially negotiated the concession, operate so as to afford protection on the average in excess of the amount of protection provided for in that Schedule. The provisions of this paragraph shall not limit the use by contracting parties of any form of assistance to domestic producers permitted by other provisions of this Agreement.*

5. If any contracting party considers that a product is not receiving from another contracting party the treatment which the first contracting party believes to have been contemplated by a concession provided for in the appropriate Schedule annexed to this Agreement, it shall bring the matter directly to the attention of the other contracting party. If the latter agrees that the treatment contemplated was that claimed by the first contracting party, but declares that such treatment cannot be accorded because a court or other proper authority has ruled to the effect that the product involved cannot be classified under the tariff laws of such contracting party so as to permit the treatment contemplated in this Agreement, the two contracting parties, together with any other contracting parties substantially interested, shall enter promptly into further negotiations with a view to a compensatory adjustment of the matter.

6. (*a*) The specific duties and charges included in the Schedules relating to contracting parties members of the International Monetary Fund, and margins of preference in specific duties and charges maintained by such contracting parties, are expressed in the appropriate

currency at the par value accepted or provisionally recognized by the Fund at the date of this Agreement. Accordingly, in case this par value is reduced consistently with the Articles of Agreement of the International Monetary Fund by more than twenty per centum, such specific duties and charges and margins of preference may be adjusted to take account of such reduction; *provided* that the CONTRACTING PARTIES (*i.e.*, the contracting parties acting jointly as provided for in Article XXV) concur that such adjustments will not impair the value of the concessions provided for in the appropriate Schedule or elsewhere in this Agreement, due account being taken of all factors which may influence the need for, or urgency of, such adjustments.

(*b*) Similar provisions shall apply to any contracting party not a member of the Fund, as from the date on which such contracting party becomes a member of the Fund or enters into a special exchange agreement in pursuance of Article XV.

7. The Schedules annexed to this Agreement are hereby made an integral part of Part I of this Agreement.

PART II

Article III*

National Treatment on Internal Taxation and Regulation

1. The contracting parties 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 contracting party imported into the territory of any other contracting party shall not be subject, directly

or indirectly, to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products. Moreover, no contracting party shall otherwise apply internal taxes or other internal charges to imported or domestic products in a manner contrary to the principles set forth in paragraph 1.*

3. With respect to any existing internal tax which is inconsistent with the provisions of paragraph 2, but which is specifically authorized under a trade agreement, in force on April 10, 1947, in which the import duty on the taxed product is bound against increase, the contracting party imposing the tax shall be free to postpone the application of the provisions of paragraph 2 to such tax until such time as it can obtain release from the obligations of such trade agreement in order to permit the increase of such duty to the extent necessary to compensate for the elimination of the protective element of the tax.

4. The products of the territory of any contracting party imported into the territory of any other contracting party 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. The provisions of this paragraph shall not prevent the application of differential internal transportation charges which are based exclusively on the economic operation of the means of transport and not on the nationality of the product.

5. No contracting party shall establish or maintain any internal quantitative regulation relating to the mixture, processing or use of products in specified amounts or proportions which requires, directly or indirectly, that any specified amount or proportion of any product which is the subject of the regulation must be supplied from domestic sources. Moreover, no contracting party shall otherwise apply internal

quantitative regulations in a manner contrary to the principles set forth in paragraph 1.*

6. The provisions of paragraph 5 shall not apply to any internal quantitative regulation in force in the territory of any contracting party on July 1, 1939, April 10, 1947, or March 24, 1948, at the option of that contracting party; *Provided* that any such regulation which is contrary to the provisions of paragraph 5 shall not be modified to the detriment of imports and shall be treated as a customs duty for the purpose of negotiation.

7. No internal quantitative regulation relating to the mixture, processing or use of products in specified amounts or proportions shall be applied in such a manner as to allocate any such amount or proportion among external sources of supply.

8. (*a*) The provisions of this Article shall not apply to laws, regulations or requirements governing the procurement by governmental agencies of products purchased for governmental purposes and not with a view to commercial resale or with a view to use in the production of goods for commercial sale.

(*b*) The provisions of this Article shall not prevent the payment of subsidies exclusively to domestic producers, including payments to domestic producers derived from the proceeds of internal taxes or charges applied consistently with the provisions of this Article and subsidies effected through governmental purchases of domestic products.

9. The contracting parties recognize that internal maximum price control measures, even though conforming to the other provisions of this Article, can have effects prejudicial to the interests of contracting parties supplying imported products. Accordingly, contracting parties applying such measures shall take account of the interests of exporting

contracting parties with a view to avoiding to the fullest practicable extent such prejudicial effects.

10. The provisions of this Article shall not prevent any contracting party from establishing or maintaining internal quantitative regulations relating to exposed cinematograph films and meeting the requirements of Article IV.

Article IV

Special Provisions relating to Cinematograph Films

If any contracting party establishes or maintains internal quantitative regulations relating to exposed cinematograph films, such regulations shall take the form of screen quotas which shall conform to the following requirements:

(*a*) Screen quotas may require the exhibition of cinematograph films of national origin during a specified minimum proportion of the total screen time actually utilized, over a specified period of not less than one year, in the commercial exhibition of all films of whatever origin, and shall be computed on the basis of screen time per theatre per year or the equivalent thereof;

(*b*) With the exception of screen time reserved for films of national origin under a screen quota, screen time including that released by administrative action from screen time reserved for films of national origin, shall not be allocated formally or in effect among sources of supply;

(*c*) Notwithstanding the provisions of subparagraph (*b*) of this Article, any contracting party may maintain screen quotas conforming to the requirements of subparagraph (*a*) of this Article which reserve a minimum proportion of screen time for films of a specified origin other than that of the contracting party imposing such screen quotas; *Provided* that no such minimum proportion of screen time shall be increased above the level in effect on April 10, 1947;

(*d*) Screen quotas shall be subject to negotiation for their limitation, liberalization or elimination.

Article V

Freedom of Transit

1. Goods (including baggage), and also vessels and other means of transport, shall be deemed to be in transit across the territory of a contracting party when the passage across such territory, with or without trans-shipment, warehousing, breaking bulk, or change in the mode of transport, is only a portion of a complete journey beginning and terminating beyond the frontier of the contracting party across whose territory the traffic passes. Traffic of this nature is termed in this article "traffic in transit".

2. There shall be freedom of transit through the territory of each contracting party, via the routes most convenient for international transit, for traffic in transit to or from the territory of other contracting parties. No distinction shall be made which is based on the flag of vessels, the place of origin, departure, entry, exit or destination, or on any circumstances relating to the ownership of goods, of vessels or of other means of transport.

3. Any contracting party may require that traffic in transit through its territory be entered at the proper custom house, but, except in cases of failure to comply with applicable customs laws and regulations, such traffic coming from or going to the territory of other contracting parties shall not be subject to any unnecessary delays or restrictions and shall be exempt from customs duties and from all transit duties or other charges imposed in respect of transit, except charges for transportation or those commensurate with administrative expenses entailed by transit or with the cost of services rendered.

4. All charges and regulations imposed by contracting parties on traffic in transit to or from the territories of other contracting parties shall be reasonable, having regard to the conditions of the traffic.

5. With respect to all charges, regulations and formalities in connection with transit, each contracting party shall accord to traffic in transit to or from the territory of any other contracting party treatment no less favourable than the treatment accorded to traffic in transit to or from any third country.*

6. Each contracting party shall accord to products which have been in transit through the territory of any other contracting party treatment no less favourable than that which would have been accorded to such products had they been transported from their place of origin to their destination without going through the territory of such other contracting party. Any contracting party shall, however, be free to maintain its requirements of direct consignment existing on the date of this Agreement, in respect of any goods in regard to which such direct consignment is a requisite condition of eligibility for entry of the goods at preferential rates of duty or has relation to the contracting party's prescribed method of valuation for duty purposes.

7. The provisions of this Article shall not apply to the operation of aircraft in transit, but shall apply to air transit of goods (including baggage).

Article VI

Anti-dumping and Countervailing Duties

1. The contracting parties recognize that dumping, by which products of one country are introduced into the commerce of another country at less than the normal value of the products, is to be condemned if it causes or threatens material injury to an established industry in the territory of a contracting party or materially retards the establishment of a domestic industry. For the purposes of this Article, a product is to be

considered as being introduced into the commerce of an importing country at less than its normal value, if the price of the product exported from one country to another

(*a*) is less than the comparable price, in the ordinary course of trade, for the like product when destined for consumption in the exporting country, or,

(*b*) in the absence of such domestic price, is less than either

(i) the highest comparable price for the like product for export to any third country in the ordinary course of trade, or

(ii) the cost of production of the product in the country of origin plus a reasonable addition for selling cost and profit.

Due allowance shall be made in each case for differences in conditions and terms of sale, for differences in taxation, and for other differences affecting price comparability.*

2. In order to offset or prevent dumping, a contracting party may levy on any dumped product an anti-dumping duty not greater in amount than the margin of dumping in respect of such product. For the purposes of this Article, the margin of dumping is the price difference determined in accordance with the provisions of paragraph 1.*

3. No countervailing duty shall be levied on any product of the territory of any contracting party imported into the territory of another contracting party in excess of an amount equal to the estimated bounty or subsidy determined to have been granted, directly or indirectly, on the manufacture, production or export of such product in the country of origin or exportation, including any special subsidy to the transportation of a particular product. The term "countervailing duty" shall be understood to mean a special duty levied for the purpose of offsetting any bounty or subsidy bestowed, directly, or indirectly, upon the manufacture, production or export of any merchandise.*

4. No product of the territory of any contracting party imported into the territory of any other contracting party shall be subject to anti-dumping or countervailing duty by reason of the exemption of such product from duties or taxes borne by the like product when destined for consumption in the country of origin or exportation, or by reason of the refund of such duties or taxes.

5. No product of the territory of any contracting party imported into the territory of any other contracting party shall be subject to both anti-dumping and countervailing duties to compensate for the same situation of dumping or export subsidization.

6. (*a*) No contracting party shall levy any anti-dumping or countervailing duty on the importation of any product of the territory of another contracting party unless it determines that the effect of the dumping or subsidization, as the case may be, is such as to cause or threaten material injury to an established domestic industry, or is such as to retard materially the establishment of a domestic industry.

(*b*) The CONTRACTING PARTIES may waive the requirement of subparagraph (*a*) of this paragraph so as to permit a contracting party to levy an anti-dumping or countervailing duty on the importation of any product for the purpose of offsetting dumping or subsidization which causes or threatens material injury to an industry in the territory of another contracting party exporting the product concerned to the territory of the importing contracting party. The CONTRACTING PARTIES shall waive the requirements of subparagraph (*a*) of this paragraph, so as to permit the levying of a countervailing duty, in cases in which they find that a subsidy is causing or threatening material injury to an industry in the territory of another contracting party exporting the product concerned to the territory of the importing contracting party.*

(*c*) In exceptional circumstances, however, where delay might cause damage which would be difficult to repair, a contracting party may levy a

countervailing duty for the purpose referred to in subparagraph (*b*) of this paragraph without the prior approval of the CONTRACTING PARTIES; *Provided* that such action shall be reported immediately to the CONTRACTING PARTIES and that the countervailing duty shall be withdrawn promptly if the CONTRACTING PARTIES disapprove.

7. A system for the stabilization of the domestic price or of the return to domestic producers of a primary commodity, independently of the movements of export prices, which results at times in the sale of the commodity for export at a price lower than the comparable price charged for the like commodity to buyers in the domestic market, shall be presumed not to result in material injury within the meaning of paragraph 6 if it is determined by consultation among the contracting parties substantially interested in the commodity concerned that:

(*a*) the system has also resulted in the sale of the commodity for export at a price higher than the comparable price charged for the like commodity to buyers in the domestic market, and

(*b*) the system is so operated, either because of the effective regulation of production, or otherwise, as not to stimulate exports unduly or otherwise seriously prejudice the interests of other contracting parties.

Article VII

Valuation for Customs Purposes

1. The contracting parties recognize the validity of the general principles of valuation set forth in the following paragraphs of this Article, and they undertake to give effect to such principles, in respect of all products subject to duties or other charges* or restrictions on importation and exportation based upon or regulated in any manner by value. Moreover, they shall, upon a request by another contracting party review the operation of any of their laws or regulations relating to value for customs purposes in the light of these principles. The

CONTRACTING PARTIES may request from contracting parties reports on steps taken by them in pursuance of the provisions of this Article.

2. (*a*) The value for customs purposes of imported merchandise should be based on the actual value of the imported merchandise on which duty is assessed, or of like merchandise, and should not be based on the value of merchandise of national origin or on arbitrary or fictitious values.*

(*b*) "Actual value" should be the price at which, at a time and place determined by the legislation of the country of importation, such or like merchandise is sold or offered for sale in the ordinary course of trade under fully competitive conditions. To the extent to which the price of such or like merchandise is governed by the quantity in a particular transaction, the price to be considered should uniformly be related to either (i) comparable quantities, or (ii) quantities not less favourable to importers than those in which the greater volume of the merchandise is sold in the trade between the countries of exportation and importation.*

(*c*) When the actual value is not ascertainable in accordance with subparagraph (*b*) of this paragraph, the value for customs purposes should be based on the nearest ascertainable equivalent of such value.*

3. The value for customs purposes of any imported product should not include the amount of any internal tax, applicable within the country of origin or export, from which the imported product has been exempted or has been or will be relieved by means of refund.

4. (*a*) Except as otherwise provided for in this paragraph, where it is necessary for the purposes of paragraph 2 of this Article for a contracting party to convert into its own currency a price expressed in the currency of another country, the conversion rate of exchange to be used shall be based, for each currency involved, on the par value as established pursuant to the Articles of Agreement of the International Monetary Fund or on the rate of exchange recognized by the Fund, or on

the par value established in accordance with a special exchange agreement entered into pursuant to Article XV of this Agreement.

(*b*) Where no such established par value and no such recognized rate of exchange exist, the conversion rate shall reflect effectively the current value of such currency in commercial transactions.

(*c*) The CONTRACTING PARTIES, in agreement with the International Monetary Fund, shall formulate rules governing the conversion by contracting parties of any foreign currency in respect of which multiple rates of exchange are maintained consistently with the Articles of Agreement of the International Monetary Fund. Any contracting party may apply such rules in respect of such foreign currencies for the purposes of paragraph 2 of this Article as an alternative to the use of par values. Until such rules are adopted by the Contracting Parties, any contracting party may employ, in respect of any such foreign currency, rules of conversion for the purposes of paragraph 2 of this Article which are designed to reflect effectively the value of such foreign currency in commercial transactions.

(*d*) Nothing in this paragraph shall be construed to require any contracting party to alter the method of converting currencies for customs purposes which is applicable in its territory on the date of this Agreement, if such alteration would have the effect of increasing generally the amounts of duty payable.

5. The bases and methods for determining the value of products subject to duties or other charges or restrictions based upon or regulated in any manner by value should be stable and should be given sufficient publicity to enable traders to estimate, with a reasonable degree of certainty, the value for customs purposes.

Article VIII

*Fees and Formalities connected with Importation and Exportation**

1. (*a*) All fees and charges of whatever character (other than import and export duties and other than taxes within the purview of Article III) imposed by contracting parties on or in connection with importation or exportation shall be limited in amount to the approximate cost of services rendered and shall not represent an indirect protection to domestic products or a taxation of imports or exports for fiscal purposes.

(*b*) The contracting parties recognize the need for reducing the number and diversity of fees and charges referred to in subparagraph (*a*).

(*c*) The contracting parties also recognize the need for minimizing the incidence and complexity of import and export formalities and for decreasing and simplifying import and export documentation requirements.*

2. A contracting party shall, upon request by another contracting party or by the CONTRACTING PARTIES, review the operation of its laws and regulations in the light of the provisions of this Article.

3. No contracting party shall impose substantial penalties for minor breaches of customs regulations or procedural requirements. In particular, no penalty in respect of any omission or mistake in customs documentation which is easily rectifiable and obviously made without fraudulent intent or gross negligence shall be greater than necessary to serve merely as a warning.

4. The provisions of this Article shall extend to fees, charges, formalities and requirements imposed by governmental authorities in connection with importation and exportation, including those relating to:

(*a*) consular transactions, such as consular invoices and certificates;

(*b*) quantitative restrictions;

(*c*) licensing;

(*d*) exchange control;

(*e*) statistical services;

(*f*) documents, documentation and certification;

(*g*) analysis and inspection; and

(*h*) quarantine, sanitation and fumigation.

Article IX

Marks of Origin

1. Each contracting party shall accord to the products of the territories of other contracting parties treatment with regard to marking requirements no less favourable than the treatment accorded to like products of any third country.

2. The contracting parties recognize that, in adopting and enforcing laws and regulations relating to marks of origin, the difficulties and inconveniences which such measures may cause to the commerce and industry of exporting countries should be reduced to a minimum, due regard being had to the necessity of protecting consumers against fraudulent or misleading indications.

3. Whenever it is administratively practicable to do so, contracting parties should permit required marks of origin to be affixed at the time of importation.

4. The laws and regulations of contracting parties relating to the marking of imported products shall be such as to permit compliance without seriously damaging the products, or materially reducing their value, or unreasonably increasing their cost.

5. As a general rule, no special duty or penalty should be imposed by any contracting party for failure to comply with marking requirements prior to importation unless corrective marking is unreasonably delayed or deceptive marks have been affixed or the required marking has been intentionally omitted.

6. The contracting parties shall co-operate with each other with a view to preventing the use of trade names in such manner as to

misrepresent the true origin of a product, to the detriment of such distinctive regional or geographical names of products of the territory of a contracting party as are protected by its legislation. Each contracting party shall accord full and sympathetic consideration to such requests or representations as may be made by any other contracting party regarding the application of the undertaking set forth in the preceding sentence to names of products which have been communicated to it by the other contracting party.

Article X

Publication and Administration of Trade Regulations

1. Laws, regulations, judicial decisions and administrative rulings of general application, made effective by any contracting party, pertaining to the classification or the valuation of products for customs purposes, or to rates of duty, taxes or other charges, or to requirements, restrictions or prohibitions on imports or exports or on the transfer of payments therefor, or affecting their sale, distribution, transportation, insurance, warehousing inspection, exhibition, processing, mixing or other use, shall be published promptly in such a manner as to enable governments and traders to become acquainted with them. Agreements affecting international trade policy which are in force between the government or a governmental agency of any contracting party and the government or governmental agency of any other contracting party shall also be published. The provisions of this paragraph shall not require any contracting party to disclose confidential information which would impede law enforcement or otherwise be contrary to the public interest or would prejudice the legitimate commercial interests of particular enterprises, public or private.

2. No measure of general application taken by any contracting party effecting an advance in a rate of duty or other charge on imports under

an established and uniform practice, or imposing a new or more burdensome requirement, restriction or prohibition on imports, or on the transfer of payments therefor, shall be enforced before such measure has been officially published.

3. (*a*) Each contracting party shall administer in a uniform, impartial and reasonable manner all its laws, regulations, decisions and rulings of the kind described in paragraph 1 of this Article.

(*b*) Each contracting party shall maintain, or institute as soon as practicable, judicial, arbitral or administrative tribunals or procedures for the purpose, *inter alia*, of the prompt review and correction of administrative action relating to customs matters. Such tribunals or procedures shall be independent of the agencies entrusted with administrative enforcement and their decisions shall be implemented by, and shall govern the practice of, such agencies unless an appeal is lodged with a court or tribunal of superior jurisdiction within the time prescribed for appeals to be lodged by importers; *Provided* that the central administration of such agency may take steps to obtain a review of the matter in another proceeding if there is good cause to believe that the decision is inconsistent with established principles of law or the actual facts.

(*c*) The provisions of subparagraph (*b*) of this paragraph shall not require the elimination or substitution of procedures in force in the territory of a contracting party on the date of this Agreement which in fact provide for an objective and impartial review of administrative action even though such procedures are not fully or formally independent of the agencies entrusted with administrative enforcement. Any contracting party employing such procedures shall, upon request, furnish the CONTRACTING PARTIES with full information thereon in order that they may determine whether such procedures conform to the requirements of this subparagraph.

Article XI*

General Elimination of Quantitative Restrictions

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

2. The provisions of paragraph 1 of this Article shall not extend to the following:

(*a*) Export prohibitions or restrictions temporarily applied to prevent or relieve critical shortages of foodstuffs or other products essential to the exporting contracting party;

(*b*) Import and export prohibitions or restrictions necessary to the application of standards or regulations for the classification, grading or marketing of commodities in international trade;

(*c*) Import restrictions on any agricultural or fisheries product, imported in any form,* necessary to the enforcement of governmental measures which operate:

(i) to restrict the quantities of the like domestic product permitted to be marketed or produced, or, if there is no substantial domestic production of the like product, of a domestic product for which the imported product can be directly substituted; or

(ii) to remove a temporary surplus of the like domestic product, or, if there is no substantial domestic production of the like product, of a domestic product for which the imported product can be directly substituted, by making the surplus available to certain groups of domestic consumers free of charge or at prices below the current market level; or

(iii) to restrict the quantities permitted to be produced of any animal product the production of which is directly dependent, wholly or mainly, on the imported commodity, if the domestic production of that commodity is relatively negligible.

Any contracting party applying restrictions on the importation of any product pursuant to subparagraph (*c*) of this paragraph shall give public notice of the total quantity or value of the product permitted to be imported during a specified future period and of any change in such quantity or value. Moreover, any restrictions applied under (i) above shall not be such as will reduce the total of imports relative to the total of domestic production, as compared with the proportion which might reasonably be expected to rule between the two in the absence of restrictions. In determining this proportion, the contracting party shall pay due regard to the proportion prevailing during a previous representative period and to any special factors* which may have affected or may be affecting the trade in the product concerned.

Article XII*

Restrictions to Safeguard the Balance of Payments

1. Notwithstanding the provisions of paragraph 1 of Article XI, any contracting party, in order to safeguard its external financial position and its balance of payments, may restrict the quantity or value of merchandise permitted to be imported, subject to the provisions of the following paragraphs of this Article.

2. (*a*) Import restrictions instituted, maintained or intensified by a contracting party under this Article shall not exceed those necessary:

(i) to forestall the imminent threat of, or to stop, a serious decline in its monetary reserves; or

(ii) in the case of a contracting party with very low monetary reserves, to achieve a reasonable rate of increase in its reserves.

Due regard shall be paid in either case to any special factors which may be affecting the reserves of such contracting party or its need for reserves, including, where special external credits or other resources are available to it, the need to provide for the appropriate use of such credits or resources.

(*b*) Contracting parties applying restrictions under sub-paragraph (*a*) of this paragraph shall progressively relax them as such conditions improve, maintaining them only to the extent that the conditions specified in that sub-paragraph still justify their application. They shall eliminate the restrictions when conditions would no longer justify their institution or maintenance under that subparagraph.

3. (*a*) Contracting parties undertake, in carrying out their domestic policies, to pay due regard to the need for maintaining or restoring equilibrium in their balance of payments on a sound and lasting basis and to the desirability of avoiding an uneconomic employment of productive resources. They recognize that, in order to achieve these ends, it is desirable so far as possible to adopt measures which expand rather than contract international trade.

(*b*) Contracting parties applying restrictions under this Article may determine the incidence of the restrictions on imports of different products or classes of products in such a way as to give priority to the importation of those products which are more essential.

(*c*) Contracting parties applying restrictions under this Article undertake:

(i) to avoid unnecessary damage to the commercial or economic interests of any other contracting party;*

(ii) not to apply restrictions so as to prevent unreasonably the importation of any description of goods in minimum commercial quantities the exclusion of which would impair regular channels of trade; and

(iii) not to apply restrictions which would prevent the importations of commercial samples or prevent compliance with patent, trade mark, copyright, or similar procedures.

(*d*) The contracting parties recognize that, as a result of domestic policies directed towards the achievement and maintenance of full and productive employment or towards the development of economic resources, a contracting party may experience a high level of demand for imports involving a threat to its monetary reserves of the sort referred to in paragraph 2 (*a*) of this Article. Accordingly, a contracting party otherwise complying with the provisions of this Article shall not be required to withdraw or modify restrictions on the ground that a change in those policies would render unnecessary restrictions which it is applying under this Article.

4. (*a*) Any contracting party applying new restrictions or raising the general level of its existing restrictions by a substantial intensification of the measures applied under this Article shall immediately after instituting or intensifying such restrictions (or, in circumstances in which prior consultation is practicable, before doing so) consult with the CONTRACTING PARTIES as to the nature of its balance of payments difficulties, alternative corrective measures which may be available, and the possible effect of the restrictions on the economies of other contracting parties.

(*b*) On a date to be determined by them,* the CONTRACTING PARTIES shall review all restrictions still applied under this Article on that date. Beginning one year after that date, contracting parties applying import restrictions under this Article shall enter into consultations of the type provided for in subparagraph (*a*) of this paragraph with the CONTRACTING PARTIES annually.

(*c*) (i) If, in the course of consultations with a contracting party under subparagraph (*a*) or (*b*) above, the CONTRACTING PARTIES find

that the restrictions are not consistent with provisions of this Article or with those of Article XIII (subject to the provisions of Article XIV), they shall indicate the nature of the inconsistency and may advise that the restrictions be suitably modified.

(ii) If, however, as a result of the consultations, the CONTRACTING PARTIES determine that the restrictions are being applied in a manner involving an inconsistency of a serious nature with the provisions of this Article or with those of Article XIII (subject to the provisions of Article XIV) and that damage to the trade of any contracting party is caused or threatened thereby, they shall so inform the contracting party applying the restrictions and shall make appropriate recommendations for securing conformity with such provisions within the specified period of time. If such contracting party does not comply with these recommendations within the specified period, the CONTRACTING PARTIES may release any contracting party the trade of which is adversely affected by the restrictions from such obligations under this Agreement towards the contracting party applying the restrictions as they determine to be appropriate in the circumstances.

(*d*) The CONTRACTING PARTIES shall invite any contracting party which is applying restrictions under this Article to enter into consultations with them at the request of any contracting party which can establish a *prima facie* case that the restrictions are inconsistent with the provisions of this Article or with those of Article XIII (subject to the provisions of Article XIV) and that its trade is adversely affected thereby. However, no such invitation shall be issued unless the CONTRACTING PARTIES have ascertained that direct discussions between the contracting parties concerned have not been successful. If, as a result of the consultations with the CONTRACTING PARTIES, no agreement is reached and they determine that the restrictions are being applied inconsistently with such provisions, and that damage to the

trade of the contracting party initiating the procedure is caused or threatened thereby, they shall recommend the withdrawal or modification of the restrictions. If the restrictions are not withdrawn or modified within such time as the CONTRACTING PARTIES may prescribe, they may release the contracting party initiating the procedure from such obligations under this Agreement towards the contracting party applying the restrictions as they determine to be appropriate in the circumstances.

(*e*) In proceeding under this paragraph, the CONTRACTING PARTIES shall have due regard to any special external factors adversely affecting the export trade of the contracting party applying the restrictions.*

(*f*) Determinations under this paragraph shall be rendered expeditiously and, if possible, within sixty days of the initiation of the consultations.

5. If there is a persistent and widespread application of import restrictions under this Article, indicating the existence of a general disequilibrium which is restricting international trade, the CONTRACTING PARTIES shall initiate discussions to consider whether other measures might be taken, either by those contracting parties the balance of payments of which are under pressure or by those the balance of payments of which are tending to be exceptionally favourable, or by any appropriate intergovernmental organization, to remove the underlying causes of the disequilibrium. On the invitation of the CONTRACTING PARTIES, contracting parties shall participate in such discussions.

Article XIII*

Non-discriminatory Administration of Quantitative Restrictions

1. No prohibition or restriction shall be applied by any contracting party on the importation of any product of the territory of any other contracting party or on the exportation of any product destined for the territory of any other contracting party, unless the importation of the like product of all third countries or the exportation of the like product to all third countries is similarly prohibited or restricted.

2. In applying import restrictions to any product, contracting parties shall aim at a distribution of trade in such product approaching as closely as possible the shares which the various contracting parties might be expected to obtain in the absence of such restrictions and to this end shall observe the following provisions:

(*a*) Wherever practicable, quotas representing the total amount of permitted imports (whether allocated among supplying countries or not) shall be fixed, and notice given of their amount in accordance with paragraph 3 (*b*) of this Article;

(*b*) In cases in which quotas are not practicable, the restrictions may be applied by means of import licences or permits without a quota;

(*c*) Contracting parties shall not, except for purposes of operating quotas allocated in accordance with subparagraph (*d*) of this paragraph, require that import licences or permits be utilized for the importation of the product concerned from a particular country or source;

(*d*) In cases in which a quota is allocated among supplying countries the contracting party applying the restrictions may seek agreement with respect to the allocation of shares in the quota with all other contracting parties having a substantial interest in supplying the product concerned. In cases in which this method is not reasonably practicable, the contracting party concerned shall allot to contracting

parties having a substantial interest in supplying the product shares based upon the proportions, supplied by such contracting parties during a previous representative period, of the total quantity or value of imports of the product, due account being taken of any special factors which may have affected or may be affecting the trade in the product. No conditions or formalities shall be imposed which would prevent any contracting party from utilizing fully the share of any such total quantity or value which has been allotted to it, subject to importation being made within any prescribed period to which the quota may relate.*

3. (*a*) In cases in which import licences are issued in connection with import restrictions, the contracting party applying the restrictions shall provide, upon the request of any contracting party having an interest in the trade in the product concerned, all relevant information concerning the administration of the restrictions, the import licences granted over a recent period and the distribution of such licences among supplying countries; *Provided* that there shall be no obligation to supply information as to the names of importing or supplying enterprises.

(*b*) In the case of import restrictions involving the fixing of quotas, the contracting party applying the restrictions shall give public notice of the total quantity or value of the product or products which will be permitted to be imported during a specified future period and of any change in such quantity or value. Any supplies of the product in question which were *en route* at the time at which public notice was given shall not be excluded from entry; *Provided* that they may be counted so far as practicable, against the quantity permitted to be imported in the period in question, and also, where necessary, against the quantities permitted to be imported in the next following period or periods; and *Provided* further that if any contracting party customarily exempts from such restrictions products entered for consumption or withdrawn from warehouse for consumption during a period of thirty days after the day of

such public notice, such practice shall be considered full compliance with this subparagraph.

(*c*) In the case of quotas allocated among supplying countries, the contracting party applying the restrictions shall promptly inform all other contracting parties having an interest in supplying the product concerned of the shares in the quota currently allocated, by quantity or value, to the various supplying countries and shall give public notice thereof.

4. With regard to restrictions applied in accordance with paragraph 2 (*d*) of this Article or under paragraph 2 (*c*) of Article XI, the selection of a representative period for any product and the appraisal of any special factors* affecting the trade in the product shall be made initially by the contracting party applying the restriction; *Provided* that such contracting party shall, upon the request of any other contracting party having a substantial interest in supplying that product or upon the request of the CONTRACTING PARTIES, consult promptly with the other contracting party or the CONTRACTING PARTIES regarding the need for an adjustment of the proportion determined or of the base period selected, or for the reappraisal of the special factors involved, or for the elimination of conditions, formalities or any other provisions established unilaterally relating to the allocation of an adequate quota or its unrestricted utilization.

5. The provisions of this Article shall apply to any tariff quota instituted or maintained by any contracting party, and, in so far as applicable, the principles of this Article shall also extend to export restrictions.

Article XIV*

Exceptions to the Rule of Non-discrimination

1. A contracting party which applies restrictions under Article XII or under Section B of Article XVIII may, in the application of such restrictions, deviate from the provisions of Article XIII in a manner having equivalent effect to restrictions on payments and transfers for current international transactions which that contracting party may at that time apply under Article VIII or XIV of the Articles of Agreement of the International Monetary Fund, or under analogous provisions of a special exchange agreement entered into pursuant to paragraph 6 of Article XV.*

2. A contracting party which is applying import restrictions under Article XII or under Section B of Article XVIII may, with the consent of the CONTRACTING PARTIES, temporarily deviate from the provisions of Article XIII in respect of a small part of its external trade where the benefits to the contracting party or contracting parties concerned substantially outweigh any injury which may result to the trade of other contracting parties.*

3. The provisions of Article XIII shall not preclude a group of territories having a common quota in the International Monetary Fund from applying against imports from other countries, but not among themselves, restrictions in accordance with the provisions of Article XII or of Section B of Article XVIII on condition that such restrictions are in all other respects consistent with the provisions of Article XIII.

4. A contracting party applying import restrictions under Article XII or under Section B of Article XVIII shall not be precluded by Articles XI to XV or Section B of Article XVIII of this Agreement from applying measures to direct its exports in such a manner as to increase its earnings of currencies which it can use without deviation from the provisions of Article XIII.

5. A contracting party shall not be precluded by Articles XI to XV, inclusive, or by Section B of Article XVIII, of this Agreement from applying quantitative restrictions:

(*a*) having equivalent effect to exchange restrictions authorized under Section 3 (*b*) of Article VII of the Articles of Agreement of the International Monetary Fund, or

(*b*) under the preferential arrangements provided for in Annex A of this Agreement, pending the outcome of the negotiations referred to therein.

Article XV

Exchange Arrangements

1. The CONTRACTING PARTIES shall seek co-operation with the International Monetary Fund to the end that the CONTRACTING PARTIES and the Fund may pursue a co-ordinated policy with regard to exchange questions within the jurisdiction of the Fund and questions of quantitative restrictions and other trade measures within the jurisdiction of the CONTRACTING PARTIES.

2. In all cases in which the CONTRACTING PARTIES are called upon to consider or deal with problems concerning monetary reserves, balances of payments or foreign exchange arrangements, they shall consult fully with the International Monetary Fund. In such consultations, the CONTRACTING PARTIES shall accept all findings of statistical and other facts presented by the Fund relating to foreign exchange, monetary reserves and balances of payments, and shall accept the determination of the Fund as to whether action by a contracting party in exchange matters is in accordance with the Articles of Agreement of the International Monetary Fund, or with the terms of a special exchange agreement between that contracting party and the CONTRACTING PARTIES. The CONTRACTING PARTIES in reaching their final decision in cases involving the criteria set forth in paragraph 2 (*a*) of Article XII or in paragraph 9 of Article XVIII, shall accept the determination of the Fund as to what constitutes a serious decline in the

contracting party's monetary reserves, a very low level of its monetary reserves or a reasonable rate of increase in its monetary reserves, and as to the financial aspects of other matters covered in consultation in such cases.

3. The CONTRACTING PARTIES shall seek agreement with the Fund regarding procedures for consultation under paragraph 2 of this Article.

4. Contracting parties shall not, by exchange action, frustrate* the intent of the provisions of this Agreement, nor, by trade action, the intent of the provisions of the Articles of Agreement of the International Monetary Fund.

5. If the CONTRACTING PARTIES consider, at any time, that exchange restrictions on payments and transfers in connection with imports are being applied by a contracting party in a manner inconsistent with the exceptions provided for in this Agreement for quantitative restrictions, they shall report thereon to the Fund.

6. Any contracting party which is not a member of the Fund shall, within a time to be determined by the CONTRACTING PARTIES after consultation with the Fund, become a member of the Fund, or, failing that, enter into a special exchange agreement with the CONTRACTING PARTIES. A contracting party which ceases to be a member of the Fund shall forthwith enter into a special exchange agreement with the CONTRACTING PARTIES. Any special exchange agreement entered into by a contracting party under this paragraph shall thereupon become part of its obligations under this Agreement.

7. (*a*) A special exchange agreement between a contracting party and the CONTRACTING PARTIES under paragraph 6 of this Article shall provide to the satisfaction of the CONTRACTING PARTIES that the objectives of this Agreement will not be frustrated as a result of action in exchange matters by the contracting party in question.

(*b*) The terms of any such agreement shall not impose obligations on the contracting party in exchange matters generally more restrictive than those imposed by the Articles of Agreement of the International Monetary Fund on members of the Fund.

8. A contracting party which is not a member of the Fund shall furnish such information within the general scope of section 5 of Article VIII of the Articles of Agreement of the International Monetary Fund as the CONTRACTING PARTIES may require in order to carry out their functions under this Agreement.

9. Nothing in this Agreement shall preclude:

(*a*) the use by a contracting party of exchange controls or exchange restrictions in accordance with the Articles of Agreement of the International Monetary Fund or with that contracting party's special exchange agreement with the CONTRACTING PARTIES, or

(*b*) the use by a contracting party of restrictions or controls in imports or exports, the sole effect of which, additional to the effects permitted under Articles XI, XII, XIII and XIV, is to make effective such exchange controls or exchange restrictions.

Article XVI*

Subsidies

Section A - Subsidies in General

1. If any contracting party grants or maintains any subsidy, including any form of income or price support, which operates directly or indirectly to increase exports of any product from, or to reduce imports of any product into, its territory, it shall notify the CONTRACTING PARTIES in writing of the extent and nature of the subsidization, of the estimated effect of the subsidization on the quantity of the affected product or products imported into or exported from its territory and of the circumstances making the subsidization necessary. In any case in which

it is determined that serious prejudice to the interests of any other contracting party is caused or threatened by any such subsidization, the contracting party granting the subsidy shall, upon request, discuss with the other contracting party or parties concerned, or with the CONTRACTING PARTIES, the possibility of limiting the subsidization.

Section B - Additional Provisions on Export Subsidies*

2. The contracting parties recognize that the granting by a contracting party of a subsidy on the export of any product may have harmful effects for other contracting parties, both importing and exporting, may cause undue disturbance to their normal commercial interests, and may hinder the achievement of the objectives of this Agreement.

3. Accordingly, contracting parties should seek to avoid the use of subsidies on the export of primary products. If, however, a contracting party grants directly or indirectly any form of subsidy which operates to increase the export of any primary product from its territory, such subsidy shall not be applied in a manner which results in that contracting party having more than an equitable share of world export trade in that product, account being taken of the shares of the contracting parties in such trade in the product during a previous representative period, and any special factors which may have affected or may be affecting such trade in the product.*

4. Further, as from 1 January 1958 or the earliest practicable date thereafter, contracting parties shall cease to grant either directly or indirectly any form of subsidy on the export of any product other than a primary product which subsidy results in the sale of such product for export at a price lower than the comparable price charged for the like product to buyers in the domestic market. Until 31 December 1957 no contracting party shall extend the scope of any such subsidization

beyond that existing on 1 January 1955 by the introduction of new, or the extension of existing, subsidies.*

5. The CONTRACTING PARTIES shall review the operation of the provisions of this Article from time to time with a view to examining its effectiveness, in the light of actual experience, in promoting the objectives of this Agreement and avoiding subsidization seriously prejudicial to the trade or interests of contracting parties.

Article XVII

State Trading Enterprises

1.* (*a*) Each contracting party undertakes that if it establishes or maintains a State enterprise, wherever located, or grants to any enterprise, formally or in effect, exclusive or special privileges,* such enterprise shall, in its purchases or sales involving either imports or exports, act in a manner consistent with the general principles of non-discriminatory treatment prescribed in this Agreement for governmental measures affecting imports or exports by private traders.

(*b*) The provisions of subparagraph (*a*) of this paragraph shall be understood to require that such enterprises shall, having due regard to the other provisions of this Agreement, make any such purchases or sales solely in accordance with commercial considerations,* including price, quality, availability, marketability, transportation and other conditions of purchase or sale, and shall afford the enterprises of the other contracting parties adequate opportunity, in accordance with customary business practice, to compete for participation in such purchases or sales.

(*c*) No contracting party shall prevent any enterprise (whether or not an enterprise described in subparagraph (*a*) of this paragraph) under its jurisdiction from acting in accordance with the principles of subparagraphs (*a*) and (*b*) of this paragraph.

2. The provisions of paragraph 1 of this Article shall not apply to imports of products for immediate or ultimate consumption in governmental use and not otherwise for resale or use in the production of goods* for sale. With respect to such imports, each contracting party shall accord to the trade of the other contracting parties fair and equitable treatment.

3. The contracting parties recognize that enterprises of the kind described in paragraph 1 (*a*) of this Article might be operated so as to create serious obstacles to trade; thus negotiations on a reciprocal and mutually advantageous basis designed to limit or reduce such obstacles are of importance to the expansion of international trade.*

4. (*a*) Contracting parties shall notify the CONTRACTING PARTIES of the products which are imported into or exported from their territories by enterprises of the kind described in paragraph 1 (*a*) of this Article.

(*b*) A contracting party establishing, maintaining or authorizing an import monopoly of a product, which is not the subject of a concession under Article II, shall, on the request of another contracting party having a substantial trade in the product concerned, inform the CONTRACTING PARTIES of the import mark-up* on the product during a recent representative period, or, when it is not possible to do so, of the price charged on the resale of the product.

(*c*) The CONTRACTING PARTIES may, at the request of a contracting party which has reason to believe that its interest under this Agreement are being adversely affected by the operations of an enterprise of the kind described in paragraph 1 (*a*), request the contracting party establishing, maintaining or authorizing such enterprise to supply information about its operations related to the carrying out of the provisions of this Agreement.

(*d*) The provisions of this paragraph shall not require any contracting party to disclose confidential information which would impede law

enforcement or otherwise be contrary to the public interest or would prejudice the legitimate commercial interests of particular enterprises.

Article XVIII*

Governmental Assistance to Economic Development

1. The contracting parties recognize that the attainment of the objectives of this Agreement will be facilitated by the progressive development of their economies, particularly of those contracting parties the economies of which can only support low standards of living* and are in the early stages of development.*

2. The contracting parties recognize further that it may be necessary for those contracting parties, in order to implement programmes and policies of economic development designed to raise the general standard of living of their people, to take protective or other measures affecting imports, and that such measures are justified in so far as they facilitate the attainment of the objectives of this Agreement. They agree, therefore, that those contracting parties should enjoy additional facilities to enable them (*a*) to maintain sufficient flexibility in their tariff structure to be able to grant the tariff protection required for the establishment of a particular industry* and (*b*) to apply quantitative restrictions for balance of payments purposes in a manner which takes full account of the continued high level of demand for imports likely to be generated by their programmes of economic development.

3. The contracting parties recognize finally that, with those additional facilities which are provided for in Sections A and B of this Article, the provisions of this Agreement would normally be sufficient to enable contracting parties to meet the requirements of their economic development. They agree, however, that there may be circumstances where no measure consistent with those provisions is practicable to permit a contracting party in the process of economic development to

grant the governmental assistance required to promote the establishment of particular industries* with a view to raising the general standard of living of its people. Special procedures are laid down in Sections C and D of this Article to deal with those cases.

4. (*a*) Consequently, a contracting party, the economy of which can only support low standards of living* and is in the early stages of development,* shall be free to deviate temporarily from the provisions of the other Articles of this Agreement, as provided in Sections A, B and C of this Article.

(*b*) A contracting party, the economy of which is in the process of development, but which does not come within the scope of subparagraph (*a*) above, may submit applications to the CONTRACTING PARTIES under Section D of this Article.

5. The contracting parties recognize that the export earnings of contracting parties, the economies of which are of the type described in paragraph 4 (*a*) and (*b*) above and which depend on exports of a small number of primary commodities, may be seriously reduced by a decline in the sale of such commodities. Accordingly, when the exports of primary commodities by such a contracting party are seriously affected by measures taken by another contracting party, it may have resort to the consultation provisions of Article XXII of this Agreement.

6. The CONTRACTING PARTIES shall review annually all measures applied pursuant to the provisions of Sections C and D of this Article.

Section A

7. (*a*) If a contracting party coming within the scope of paragraph 4 (*a*) of this Article considers it desirable, in order to promote the establishment of a particular industry* with a view to raising the general standard of living of its people, to modify or withdraw a concession included in the appropriate Schedule annexed to this Agreement, it shall

notify the CONTRACTING PARTIES to this effect and enter into negotiations with any contracting party with which such concession was initially negotiated, and with any other contracting party determined by the CONTRACTING PARTIES to have a substantial interest therein. If agreement is reached between such contracting parties concerned, they shall be free to modify or withdraw concessions under the appropriate Schedules to this Agreement in order to give effect to such agreement, including any compensatory adjustments involved.

(*b*) If agreement is not reached within sixty days after the notification provided for in subparagraph (*a*) above, the contracting party which proposes to modify or withdraw the concession may refer the matter to the CONTRACTING PARTIES which shall promptly examine it. If they find that the contracting party which proposes to modify or withdraw the concession has made every effort to reach an agreement and that the compensatory adjustment offered by it is adequate, that contracting party shall be free to modify or withdraw the concession if, at the same time, it gives effect to the compensatory adjustment. If the CONTRACTING PARTIES do not find that the compensation offered by a contracting party proposing to modify or withdraw the concession is adequate, but find that it has made every reasonable effort to offer adequate compensation, that contracting party shall be free to proceed with such modification or withdrawal. If such action is taken, any other contracting party referred to in subparagraph (*a*) above shall be free to modify or withdraw substantially equivalent concessions initially negotiated with the contracting party which has taken the action.*

Section B

8. The contracting parties recognize that contracting parties coming within the scope of paragraph 4 (*a*) of this Article tend, when they are in rapid process of development, to experience balance of payments

difficulties arising mainly from efforts to expand their internal markets as well as from the instability in their terms of trade.

9. In order to safeguard its external financial position and to ensure a level of reserves adequate for the implementation of its programme of economic development, a contracting party coming within the scope of paragraph 4 (*a*) of this Article may, subject to the provisions of paragraphs 10 to 12, control the general level of its imports by restricting the quantity or value of merchandise permitted to be imported; *Provided* that the import restrictions instituted, maintained or intensified shall not exceed those necessary:

(*a*) to forestall the threat of, or to stop, a serious decline in its monetary reserves, or

(*b*) in the case of a contracting party with inadequate monetary reserves, to achieve a reasonable rate of increase in its reserves.

Due regard shall be paid in either case to any special factors which may be affecting the reserves of the contracting party or its need for reserves, including, where special external credits or other resources are available to it, the need to provide for the appropriate use of such credits or resources.

10. In applying these restrictions, the contracting party may determine their incidence on imports of different products or classes of products in such a way as to give priority to the importation of those products which are more essential in the light of its policy of economic development; *Provided* that the restrictions are so applied as to avoid unnecessary damage to the commercial or economic interests of any other contracting party and not to prevent unreasonably the importation of any description of goods in minimum commercial quantities the exclusion of which would impair regular channels of trade; and *Provided* further that the restrictions are not so applied as to prevent the importation of

commercial samples or to prevent compliance with patent, trade mark, copyright or similar procedures.

11. In carrying out its domestic policies, the contracting party concerned shall pay due regard to the need for restoring equilibrium in its balance of payments on a sound and lasting basis and to the desirability of assuring an economic employment of productive resources. It shall progressively relax any restrictions applied under this Section as conditions improve, maintaining them only to the extent necessary under the terms of paragraph 9 of this Article and shall eliminate them when conditions no longer justify such maintenance; *Provided* that no contracting party shall be required to withdraw or modify restrictions on the ground that a change in its development policy would render unnecessary the restrictions which it is applying under this Section.*

12. (*a*) Any contracting party applying new restrictions or raising the general level of its existing restrictions by a substantial intensification of the measures applied under this Section, shall immediately after instituting or intensifying such restrictions (or, in circumstances in which prior consultation is practicable, before doing so) consult with the CONTRACTING PARTIES as to the nature of its balance of payments difficulties, alternative corrective measures which may be available, and the possible effect of the restrictions on the economies of other contracting parties.

(*b*) On a date to be determined by them* the CONTRACTING PARTIES shall review all restrictions still applied under this Section on that date. Beginning two years after that date, contracting parties applying restrictions under this Section shall enter into consultations of the type provided for in subparagraph (*a*) above with the CONTRACTING PARTIES at intervals of approximately, but not less than, two years according to a programme to be drawn up each year by the CONTRACTING PARTIES; *Provided* that no consultation under this subparagraph shall take place

within two years after the conclusion of a consultation of a general nature under any other provision of this paragraph.

(*c*) (i) If, in the course of consultations with a contracting party under subparagraph (*a*) or (*b*) of this paragraph, the CONTRACTING PARTIES find that the restrictions are not consistent with the provisions of this Section or with those of Article XIII (subject to the provisions of Article XIV), they shall indicate the nature of the inconsistency and may advise that the restrictions be suitably modified.

(ii) If, however, as a result of the consultations, the CONTRACTING PARTIES determine that the restrictions are being applied in a manner involving an inconsistency of a serious nature with the provisions of this Section or with those of Article XIII (subject to the provisions of Article XIV) and that damage to the trade of any contracting party is caused or threatened thereby, they shall so inform the contracting party applying the restrictions and shall make appropriate recommendations for securing conformity with such provisions within a specified period. If such contracting party does not comply with these recommendations within the specified period, the CONTRACTING PARTIES may release any contracting party the trade of which is adversely affected by the restrictions from such obligations under this Agreement towards the contracting party applying the restrictions as they determine to be appropriate in the circumstances.

(*d*) The CONTRACTING PARTIES shall invite any contracting party which is applying restrictions under this Section to enter into consultations with them at the request of any contracting party which can establish a *prima facie* case that the restrictions are inconsistent with the provisions of this Section or with those of Article XIII (subject to the provisions of Article XIV) and that its trade is adversely affected thereby. However, no such invitation shall be issued unless the CONTRACTING PARTIES have ascertained that direct discussions

between the contracting parties concerned have not been successful. If, as a result of the consultations with the CONTRACTING PARTIES no agreement is reached and they determine that the restrictions are being applied inconsistently with such provisions, and that damage to the trade of the contracting party initiating the procedure is caused or threatened thereby, they shall recommend the withdrawal or modification of the restrictions. If the restrictions are not withdrawn or modified within such time as the CONTRACTING PARTIES may prescribe, they may release the contracting party initiating the procedure from such obligations under this Agreement towards the contracting party applying the restrictions as they determine to be appropriate in the circumstances.

(*e*) If a contracting party against which action has been taken in accordance with the last sentence of subparagraph (*c*) (ii) or (*d*) of this paragraph, finds that the release of obligations authorized by the CONTRACTING PARTIES adversely affects the operation of its programme and policy of economic development, it shall be free, not later than sixty days after such action is taken, to give written notice to the Executive Secretary[i] to the Contracting Parties of its intention to withdraw from this Agreement and such withdrawal shall take effect on the sixtieth day following the day on which the notice is received by him.

(*f*) In proceeding under this paragraph, the CONTRACTING PARTIES shall have due regard to the factors referred to in paragraph 2 of this Article. Determinations under this paragraph shall be rendered expeditiously and, if possible, within sixty days of the initiation of the consultations.

Section C

13. If a contracting party coming within the scope of paragraph 4 (*a*) of this Article finds that governmental assistance is required to promote

the establishment of a particular industry* with a view to raising the general standard of living of its people, but that no measure consistent with the other provisions of this Agreement is practicable to achieve that objective, it may have recourse to the provisions and procedures set out in this Section.*

14. The contracting party concerned shall notify the CONTRACTING PARTIES of the special difficulties which it meets in the achievement of the objective outlined in paragraph 13 of this Article and shall indicate the specific measure affecting imports which it proposes to introduce in order to remedy these difficulties. It shall not introduce that measure before the expiration of the time-limit laid down in paragraph 15 or 17, as the case may be, or if the measure affects imports of a product which is the subject of a concession included in the appropriate Schedule annexed to this Agreement, unless it has secured the concurrence of the CONTRACTING PARTIES in accordance with provisions of paragraph 18; *Provided* that, if the industry receiving assistance has already started production, the contracting party may, after informing the CONTRACTING PARTIES, take such measures as may be necessary to prevent, during that period, imports of the product or products concerned from increasing substantially above a normal level.*

15. If, within thirty days of the notification of the measure, the CONTRACTING PARTIES do not request the contracting party concerned to consult with them,* that contracting party shall be free to deviate from the relevant provisions of the other Articles of this Agreement to the extent necessary to apply the proposed measure.

16. If it is requested by the CONTRACTING PARTIES to do so, *the contracting party concerned shall consult with them as to the purpose of the proposed measure, as to alternative measures which may be available under this Agreement, and as to the possible effect of the measure proposed on the commercial and economic interests of other

contracting parties. If, as a result of such consultation, the CONTRACTING PARTIES agree that there is no measure consistent with the other provisions of this Agreement which is practicable in order to achieve the objective outlined in paragraph 13 of this Article, and concur* in the proposed measure, the contracting party concerned shall be released from its obligations under the relevant provisions of the other Articles of this Agreement to the extent necessary to apply that measure.

17. If, within ninety days after the date of the notification of the proposed measure under paragraph 14 of this Article, the CONTRACTING PARTIES have not concurred in such measure, the contracting party concerned may introduce the measure proposed after informing the CONTRACTING PARTIES.

18. If the proposed measure affects a product which is the subject of a concession included in the appropriate Schedule annexed to this Agreement, the contracting party concerned shall enter into consultations with any other contracting party with which the concession was initially negotiated, and with any other contracting party determined by the CONTRACTING PARTIES to have a substantial interest therein. The CONTRACTING PARTIES shall concur* in the measure if they agree that there is no measure consistent with the other provisions of this Agreement which is practicable in order to achieve the objective set forth in paragraph 13 of this Article, and if they are satisfied:

(*a*) that agreement has been reached with such other contracting parties as a result of the consultations referred to above, or

(*b*) if no such agreement has been reached within sixty days after the notification provided for in paragraph 14 has been received by the CONTRACTING PARTIES, that the contracting party having recourse to this Section has made all reasonable efforts to reach an agreement and that the interests of other contracting parties are adequately safeguarded.*

The contracting party having recourse to this Section shall thereupon be released from its obligations under the relevant provisions of the other Articles of this Agreement to the extent necessary to permit it to apply the measure.

19. If a proposed measure of the type described in paragraph 13 of this Article concerns an industry the establishment of which has in the initial period been facilitated by incidental protection afforded by restrictions imposed by the contracting party concerned for balance of payments purposes under the relevant provisions of this Agreement, that contracting party may resort to the provisions and procedures of this Section; *Provided* that it shall not apply the proposed measure without the concurrence* of the CONTRACTING PARTIES.*

20. Nothing in the preceding paragraphs of this Section shall authorize any deviation from the provisions of Articles I, II and XIII of this Agreement. The provisos to paragraph 10 of this Article shall also be applicable to any restriction under this Section.

21. At any time while a measure is being applied under paragraph 17 of this Article any contracting party substantially affected by it may suspend the application to the trade of the contracting party having recourse to this Section of such substantially equivalent concessions or other obligations under this Agreement the suspension of which the CONTRACTING PARTIES do not disapprove;* *Provided* that sixty days' notice of such suspension is given to the CONTRACTING PARTIES not later than six months after the measure has been introduced or changed substantially to the detriment of the contracting party affected. Any such contracting party shall afford adequate opportunity for consultation in accordance with the provisions of Article XXII of this Agreement.

Section D

22. A contracting party coming within the scope of subparagraph 4 (*b*) of this Article desiring, in the interest of the development of its economy, to introduce a measure of the type described in paragraph 13 of this Article in respect of the establishment of a particular industry* may apply to the CONTRACTING PARTIES for approval of such measure. The CONTRACTING PARTIES shall promptly consult with such contracting party and shall, in making their decision, be guided by the considerations set out in paragraph 16. If the CONTRACTING PARTIES concur* in the proposed measure the contracting party concerned shall be released from its obligations under the relevant provisions of the other Articles of this Agreement to the extent necessary to permit it to apply the measure. If the proposed measure affects a product which is the subject of a concession included in the appropriate Schedule annexed to this Agreement, the provisions of paragraph 18 shall apply.*

23. Any measure applied under this Section shall comply with the provisions of paragraph 20 of this Article.

Article XIX

Emergency Action on Imports of Particular Products

1. (*a*) If, as a result of unforeseen developments and of the effect of the obligations incurred by a contracting party under this Agreement, including tariff concessions, any product is being imported into the territory of that contracting party in such increased quantities and under such conditions as to cause or threaten serious injury to domestic producers in that territory of like or directly competitive products, the contracting party shall be free, in respect of such product, and to the extent and for such time as may be necessary to prevent or remedy such injury, to suspend the obligation in whole or in part or to withdraw or modify the concession.

(*b*) If any product, which is the subject of a concession with respect to a preference, is being imported into the territory of a contracting party in the circumstances set forth in subparagraph (*a*) of this paragraph, so as to cause or threaten serious injury to domestic producers of like or directly competitive products in the territory of a contracting party which receives or received such preference, the importing contracting party shall be free, if that other contracting party so requests, to suspend the relevant obligation in whole or in part or to withdraw or modify the concession in respect of the product, to the extent and for such time as may be necessary to prevent or remedy such injury.

2. Before any contracting party shall take action pursuant to the provisions of paragraph 1 of this Article, it shall give notice in writing to the CONTRACTING PARTIES as far in advance as may be practicable and shall afford the CONTRACTING PARTIES and those contracting parties having a substantial interest as exporters of the product concerned an opportunity to consult with it in respect of the proposed action. When such notice is given in relation to a concession with respect to a preference, the notice shall name the contracting party which has requested the action. In critical circumstances, where delay would cause damage which it would be difficult to repair, action under paragraph 1 of this Article may be taken provisionally without prior consultation, on the condition that consultation shall be effected immediately after taking such action.

3. (*a*) If agreement among the interested contracting parties with respect to the action is not reached, the contracting party which proposes to take or continue the action shall, nevertheless, be free to do so, and if such action is taken or continued, the affected contracting parties shall then be free, not later than ninety days after such action is taken, to suspend, upon the expiration of thirty days from the day on which written notice of such suspension is received by the

CONTRACTING PARTIES, the application to the trade of the contracting party taking such action, or, in the case envisaged in paragraph 1 (*b*) of this Article, to the trade of the contracting party requesting such action, of such substantially equivalent concessions or other obligations under this Agreement the suspension of which the CONTRACTING PARTIES do not disapprove.

(*b*) Notwithstanding the provisions of subparagraph (*a*) of this paragraph, where action is taken under paragraph 2 of this Article without prior consultation and causes or threatens serious injury in the territory of a contracting party to the domestic producers of products affected by the action, that contracting party shall, where delay would cause damage difficult to repair, be free to suspend, upon the taking of the action and throughout the period of consultation, such concessions or other obligations as may be necessary to prevent or remedy the injury.

Article XX

General Exceptions

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

(*a*) necessary to protect public morals;

(*b*) necessary to protect human, animal or plant life or health;

(*c*) relating to the importations or exportations of gold or 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 which conforms to criteria submitted to the CONTRACTING PARTIES and not disapproved by them or which is itself so submitted and not so disapproved;*

(*i*) involving restrictions on exports of domestic materials necessary to ensure essential quantities of such materials to a domestic processing industry during periods when the domestic price of such materials is held below the world price as part of a governmental stabilization plan; *Provided* that such restrictions shall not operate to increase the exports of or the protection afforded to such domestic industry, and shall not depart from the provisions of this Agreement relating to non-discrimination;

(*j*) essential to the acquisition or distribution of products in general or local short supply; *Provided* that any such measures shall be consistent with the principle that all contracting parties are entitled to an equitable share of the international supply of such products, and that any such measures, which are inconsistent with the other provisions of the Agreement shall be discontinued as soon as the conditions giving rise to them have ceased to exist. The CONTRACTING PARTIES shall review the need for this sub-paragraph not later than 30 June 1960.

Article XXI

Security Exceptions

Nothing in this Agreement shall be construed

(*a*) to require any contracting party to furnish any information the disclosure of which it considers contrary to its essential security interests; or

(*b*) to prevent any contracting party from taking 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 contracting party from taking any action in pursuance of its obligations under the United Nations Charter for the maintenance of international peace and security.

Article XXII

Consultation

1. Each contracting party shall accord sympathetic consideration to, and shall afford adequate opportunity for consultation regarding, such representations as may be made by another contracting party with respect to any matter affecting the operation of this Agreement.

2. The CONTRACTING PARTIES may, at the request of a contracting party, consult with any contracting party or parties in respect of any matter for which it has not been possible to find a satisfactory solution through consultation under paragraph 1.

Article XXIII

Nullification or Impairment

1. If any contracting party should consider that any benefit accruing to it directly or indirectly under this Agreement is being nullified or impaired or that the attainment of any objective of the Agreement is being impeded as the result of

(*a*) the failure of another contracting party to carry out its obligations under this Agreement, or

(*b*) the application by another contracting party of any measure, whether or not it conflicts with the provisions of this Agreement, or

(*c*) the existence of any other situation,

the contracting party may, with a view to the satisfactory adjustment of the matter, make written representations or proposals to the other contracting party or parties which it considers to be concerned. Any contracting party thus approached shall give sympathetic consideration to the representations or proposals made to it.

2. If no satisfactory adjustment is effected between the contracting parties concerned within a reasonable time, or if the difficulty is of the type described in paragraph 1 (*c*) of this Article, the matter may be referred to the CONTRACTING PARTIES. The CONTRACTING PARTIES shall promptly investigate any matter so referred to them and shall make appropriate recommendations to the contracting parties which they consider to be concerned, or give a ruling on the matter, as appropriate. The CONTRACTING PARTIES may consult with contracting parties, with the Economic and Social Council of the United Nations and with any appropriate inter-governmental organization in cases where they consider such consultation necessary. If the CONTRACTING PARTIES consider that the circumstances are serious enough to justify such action, they may authorize a contracting party or parties to suspend the application to any other contracting party or parties of such concessions or other obligations under this Agreement as they determine to be

appropriate in the circumstances. If the application to any contracting party of any concession or other obligation is in fact suspended, that contracting party shall then be free, not later than sixty days after such action is taken, to give written notice to the Executive Secretary[i] to the Contracting Parties of its intention to withdraw from this Agreement and such withdrawal shall take effect upon the sixtieth day following the day on which such notice is received by him.

PART III

Article XXIV

Territorial Application - Frontier Traffic - Customs Unions and Free-trade Areas

1. The provisions of this Agreement shall apply to the metropolitan customs territories of the contracting parties and to any other customs territories in respect of which this Agreement has been accepted under Article XXVI or is being applied under Article XXXIII or pursuant to the Protocol of Provisional Application. Each such customs territory shall, exclusively for the purposes of the territorial application of this Agreement, be treated as though it were a contracting party; *Provided* that the provisions of this paragraph shall not be construed to create any rights or obligations as between two or more customs territories in respect of which this Agreement has been accepted under Article XXVI or is being applied under Article XXXIII or pursuant to the Protocol of Provisional Application by a single contracting party.

2. For the purposes of this Agreement a customs territory shall be understood to mean any territory with respect to which separate tariffs or other regulations of commerce are maintained for a substantial part of the trade of such territory with other territories.

3. The provisions of this Agreement shall not be construed to prevent:

(*a*) Advantages accorded by any contracting party to adjacent countries in order to facilitate frontier traffic;

(*b*) Advantages accorded to the trade with the Free Territory of Trieste by countries contiguous to that territory, provided that such advantages are not in conflict with the Treaties of Peace arising out of the Second World War.

4. The contracting parties recognize the desirability of increasing freedom of trade by the development, through voluntary agreements, of closer integration between the economies of the countries parties to such agreements. They also recognize that the purpose of a customs union or of a free-trade area should be to facilitate trade between the constituent territories and not to raise barriers to the trade of other contracting parties with such territories.

5. Accordingly, the provisions of this Agreement shall not prevent, as between the territories of contracting parties, the formation of a customs union or of a free-trade area or the adoption of an interim agreement necessary for the formation of a customs union or of a free-trade area; *Provided* that:

(*a*) with respect to a customs union, or an interim agreement leading to a formation of a customs union, the duties and other regulations of commerce imposed at the institution of any such union or interim agreement in respect of trade with contracting parties not parties to such union or agreement shall not on the whole be higher or more restrictive than the general incidence of the duties and regulations of commerce applicable in the constituent territories prior to the formation of such union or the adoption of such interim agreement, as the case may be;

(*b*) with respect to a free-trade area, or an interim agreement leading to the formation of a free-trade area, the duties and other regulations of commerce maintained in each of the constituent territories and applicable at the formation of such free-trade area or the adoption of

such interim agreement to the trade of contracting parties not included in such area or not parties to such agreement shall not be higher or more restrictive than the corresponding duties and other regulations of commerce existing in the same constituent territories prior to the formation of the free-trade area, or interim agreement as the case may be; and

(*c*) any interim agreement referred to in subparagraphs (*a*) and (*b*) shall include a plan and schedule for the formation of such a customs union or of such a free-trade area within a reasonable length of time.

6. If, in fulfilling the requirements of subparagraph 5 (*a*), a contracting party proposes to increase any rate of duty inconsistently with the provisions of Article II, the procedure set forth in Article XXVIII shall apply. In providing for compensatory adjustment, due account shall be taken of the compensation already afforded by the reduction brought about in the corresponding duty of the other constituents of the union.

7. (*a*) Any contracting party deciding to enter into a customs union or free-trade area, or an interim agreement leading to the formation of such a union or area, shall promptly notify the CONTRACTING PARTIES and shall make available to them such information regarding the proposed union or area as will enable them to make such reports and recommendations to contracting parties as they may deem appropriate.

(*b*) If, after having studied the plan and schedule included in an interim agreement referred to in paragraph 5 in consultation with the parties to that agreement and taking due account of the information made available in accordance with the provisions of subparagraph (*a*), the CONTRACTING PARTIES find that such agreement is not likely to result in the formation of a customs union or of a free-trade area within the period contemplated by the parties to the agreement or that such period is not a reasonable one, the CONTRACTING PARTIES shall make

recommendations to the parties to the agreement. The parties shall not maintain or put into force, as the case may be, such agreement if they are not prepared to modify it in accordance with these recommendations.

(*c*) Any substantial change in the plan or schedule referred to in paragraph 5 (*c*) shall be communicated to the CONTRACTING PARTIES, which may request the contracting parties concerned to consult with them if the change seems likely to jeopardize or delay unduly the formation of the customs union or of the free-trade area.

8. For the purposes of this Agreement:

(*a*) A customs union shall be understood to mean the substitution of a single customs territory for two or more customs territories, so that

(i) duties and other restrictive regulations of commerce (except, where necessary, those permitted under Articles XI, XII, XIII, XIV, XV and XX) are eliminated with respect to substantially all the trade between the constituent territories of the union or at least with respect to substantially all the trade in products originating in such territories, and,

(ii) subject to the provisions of paragraph 9, substantially the same duties and other regulations of commerce are applied by each of the members of the union to the trade of territories not included in the union;

(*b*) A free-trade area shall be understood to mean a group of two or more customs territories in which the duties and other restrictive regulations of commerce (except, where necessary, those permitted under Articles XI, XII, XIII, XIV, XV and XX) are eliminated on substantially all the trade between the constituent territories in products originating in such territories.

9. The preferences referred to in paragraph 2 of Article I shall not be affected by the formation of a customs union or of a free-trade area but may be eliminated or adjusted by means of negotiations with contracting

parties affected.* This procedure of negotiations with affected contracting parties shall, in particular, apply to the elimination of preferences required to conform with the provisions of paragraph 8 (*a*)(i) and paragraph 8 (*b*).

10. The CONTRACTING PARTIES may by a two-thirds majority approve proposals which do not fully comply with the requirements of paragraphs 5 to 9 inclusive, provided that such proposals lead to the formation of a customs union or a free-trade area in the sense of this Article.

11. Taking into account the exceptional circumstances arising out of the establishment of India and Pakistan as independent States and recognizing the fact that they have long constituted an economic unit, the contracting parties agree that the provisions of this Agreement shall not prevent the two countries from entering into special arrangements with respect to the trade between them, pending the establishment of their mutual trade relations on a definitive basis.*

12. Each contracting party shall take such reasonable measures as may be available to it to ensure observance of the provisions of this Agreement by the regional and local governments and authorities within its territories.

Article XXV

Joint Action by the Contracting Parties

1. Representatives of the contracting parties shall meet from time to time for the purpose of giving effect to those provisions of this Agreement which involve joint action and, generally, with a view to facilitating the operation and furthering the objectives of this Agreement. Wherever reference is made in this Agreement to the contracting parties acting jointly they are designated as the CONTRACTING PARTIES.

2. The Secretary-General of the United Nations is requested to convene the first meeting of the CONTRACTING PARTIES, which shall take place not later than March 1, 1948.

3. Each contracting party shall be entitled to have one vote at all meetings of the CONTRACTING PARTIES.

4. Except as otherwise provided for in this Agreement, decisions of the CONTRACTING PARTIES shall be taken by a majority of the votes cast.

5. In exceptional circumstances not elsewhere provided for in this Agreement, the CONTRACTING PARTIES may waive an obligation imposed upon a contracting party by this Agreement; *Provided* that any such decision shall be approved by a two-thirds majority of the votes cast and that such majority shall comprise more than half of the contracting parties. The CONTRACTING PARTIES may also by such a vote

(i) define certain categories of exceptional circumstances to which other voting requirements shall apply for the waiver of obligations, and

(ii) prescribe such criteria as may be necessary for the application of this paragraph[i].

Article XXVI

Acceptance, Entry into Force and Registration

1. The date of this Agreement shall be 30 October 1947.

2. This Agreement shall be open for acceptance by any contracting party which, on 1 March 1955, was a contracting party or was negotiating with a view to accession to this Agreement.

3. This Agreement, done in a single English original and a single French original, both texts authentic, shall be deposited with the Secretary-General of the United Nations, who shall furnish certified copies thereof to all interested governments.

4. Each government accepting this Agreement shall deposit an instrument of acceptance with the Executive Secretary[i] to the Contracting Parties, who will inform all interested governments of the date of deposit of each instrument of acceptance and of the day on which this Agreement enters into force under paragraph 6 of this Article.

5. (*a*) Each government accepting this Agreement does so in respect of its metropolitan territory and of the other territories for which it has international responsibility, except such separate customs territories as it shall notify to the Executive Secretary[5] to the CONTRACTING PARTIES at the time of its own acceptance.

(*b*) Any government, which has so notified the Executive Secretary[5] under the exceptions in subparagraph (*a*) of this paragraph, may at any time give notice to the Executive Secretary[5] that its acceptance shall be effective in respect of any separate customs territory or territories so excepted and such notice shall take effect on the thirtieth day following the day on which it is received by the Executive Secretary.[5]

(*c*) If any of the customs territories, in respect of which a contracting party has accepted this Agreement, possesses or acquires full autonomy in the conduct of its external commercial relations and of the other matters provided for in this Agreement, such territory shall, upon sponsorship through a declaration by the responsible contracting party establishing the above-mentioned fact, be deemed to be a contracting party.

6. This Agreement shall enter into force, as among the governments which have accepted it, on the thirtieth day following the day on which instruments of acceptance have been deposited with Executive Secretary[i] to the Contracting Parties on behalf of governments named in Annex H, the territories of which account for 85 per centum of the total external trade of the territories of such governments, computed in accordance with the applicable column of percentages set forth therein. The

instrument of acceptance of each other government shall take effect on the thirtieth day following the day on which such instrument has been deposited.

7. The United Nations is authorized to effect registration of this Agreement as soon as it enters into force.

Article XXVII

Withholding or Withdrawal of Concessions

Any contracting party shall at any time be free to withhold or to withdraw in whole or in part any concession, provided for in the appropriate Schedule annexed to this Agreement, in respect of which such contracting party determines that it was initially negotiated with a government which has not become, or has ceased to be, a contracting party. A contracting party taking such action shall notify the CONTRACTING PARTIES and, upon request, consult with contracting parties which have a substantial interest in the product concerned.

Article XXVIII*

Modification of Schedules

1. On the first day of each three-year period, the first period beginning on 1 January 1958 (or on the first day of any other period* that may be specified by the CONTRACTING PARTIES by two-thirds of the votes cast) a contracting party (hereafter in this Article referred to as the "applicant contracting party") may, by negotiation and agreement with any contracting party with which such concession was initially negotiated and with any other contracting party determined by the CONTRACTING PARTIES to have a principal supplying interest* (which two preceding categories of contracting parties, together with the applicant contracting party, are in this Article hereinafter referred to as the "contracting parties primarily concerned"), and subject to

consultation with any other contracting party determined by the CONTRACTING PARTIES to have a substantial interest* in such concession, modify or withdraw a concession* included in the appropriate schedule annexed to this Agreement.

2. In such negotiations and agreement, which may include provision for compensatory adjustment with respect to other products, the contracting parties concerned shall endeavour to maintain a general level of reciprocal and mutually advantageous concessions not less favourable to trade than that provided for in this Agreement prior to such negotiations.

3. (*a*) If agreement between the contracting parties primarily concerned cannot be reached before 1 January 1958 or before the expiration of a period envisaged in paragraph 1 of this Article, the contracting party which proposes to modify or withdraw the concession shall, nevertheless, be free to do so and if such action is taken any contracting party with which such concession was initially negotiated, any contracting party determined under paragraph 1 to have a principal supplying interest and any contracting party determined under paragraph 1 to have a substantial interest shall then be free not later than six months after such action is taken, to withdraw, upon the expiration of thirty days from the day on which written notice of such withdrawal is received by the CONTRACTING PARTIES, substantially equivalent concessions initially negotiated with the applicant contracting party.

(*b*) If agreement between the contracting parties primarily concerned is reached but any other contracting party determined under paragraph 1 of this Article to have a substantial interest is not satisfied, such other contracting party shall be free, not later than six months after action under such agreement is taken, to withdraw, upon the expiration of thirty days from the day on which written notice of such withdrawal is

received by the CONTRACTING PARTIES, substantially equivalent concessions initially negotiated with the applicant contracting party.

4. The CONTRACTING PARTIES may, at any time, in special circumstances, authorize* a contracting party to enter into negotiations for modification or withdrawal of a concession included in the appropriate Schedule annexed to this Agreement subject to the following procedures and conditions:

(*a*) Such negotiations* and any related consultations shall be conducted in accordance with the provisions of paragraph 1 and 2 of this Article.

(*b*) If agreement between the contracting parties primarily concerned is reached in the negotiations, the provisions of paragraph 3 (*b*) of this Article shall apply.

(*c*) If agreement between the contracting parties primarily concerned is not reached within a period of sixty days* after negotiations have been authorized, or within such longer period as the CONTRACTING PARTIES may have prescribed, the applicant contracting party may refer the matter to the CONTRACTING PARTIES.

(*d*) Upon such reference, the CONTRACTING PARTIES shall promptly examine the matter and submit their views to the contracting parties primarily concerned with the aim of achieving a settlement. If a settlement is reached, the provisions of paragraph 3 (*b*) shall apply as if agreement between the contracting parties primarily concerned had been reached. If no settlement is reached between the contracting parties primarily concerned, the applicant contracting party shall be free to modify or withdraw the concession, unless the CONTRACTING PARTIES determine that the applicant contracting party has unreasonably failed to offer adequate compensation.* If such action is taken, any contracting party with which the concession was initially negotiated, any contracting party determined under paragraph 4 (*a*) to have a principal supplying

interest and any contracting party determined under paragraph 4 (*a*) to have a substantial interest, shall be free, not later than six months after such action is taken, to modify or withdraw, upon the expiration of thirty days from the day on which written notice of such withdrawal is received by the CONTRACTING PARTIES, substantially equivalent concessions initially negotiated with applicant contracting party.

5. Before 1 January 1958 and before the end of any period envisaged in paragraph 1 a contracting party may elect by notifying the CONTRACTING PARTIES to reserve the right, for the duration of the next period, to modify the appropriate Schedule in accordance with the procedures of paragraph 1 to 3. If a contracting party so elects, other contracting parties shall have the right, during the same period, to modify or withdraw, in accordance with the same procedures, concessions initially negotiated with that contracting party.

Article XXVIII bis

Tariff Negotiations

1. The contracting parties recognize that customs duties often constitute serious obstacles to trade; thus negotiations on a reciprocal and mutually advantageous basis, directed to the substantial reduction of the general level of tariffs and other charges on imports and exports and in particular to the reduction of such high tariffs as discourage the importation even of minimum quantities, and conducted with due regard to the objectives of this Agreement and the varying needs of individual contracting parties, are of great importance to the expansion of international trade. The CONTRACTING PARTIES may therefore sponsor such negotiations from time to time.

2. (*a*) Negotiations under this Article may be carried out on a selective product-by-product basis or by the application of such multilateral procedures as may be accepted by the contracting parties

concerned. Such negotiations may be directed towards the reduction of duties, the binding of duties at then existing levels or undertakings that individual duties or the average duties on specified categories of products shall not exceed specified levels. The binding against increase of low duties or of duty-free treatment shall, in principle, be recognized as a concession equivalent in value to the reduction of high duties.

(*b*) The contracting parties recognize that in general the success of multilateral negotiations would depend on the participation of all contracting parties which conduct a substantial proportion of their external trade with one another.

3. Negotiations shall be conducted on a basis which affords adequate opportunity to take into account:

(*a*) the needs of individual contracting parties and individual industries;

(*b*) the needs of less-developed countries for a more flexible use of tariff protection to assist their economic development and the special needs of these countries to maintain tariffs for revenue purposes; and

(*c*) all other relevant circumstances, including the fiscal,* developmental, strategic and other needs of the contracting parties concerned.

Article XXIX

The Relation of this Agreement to the Havana Charter

1. The contracting parties undertake to observe to the fullest extent of their executive authority the general principles of Chapters I to VI inclusive and of Chapter IX of the Havana Charter pending their acceptance of it in accordance with their constitutional procedures.*

2. Part II of this Agreement shall be suspended on the day on which the Havana Charter enters into force.

3. If by September 30, 1949, the Havana Charter has not entered into force, the contracting parties shall meet before December 31, 1949, to agree whether this Agreement shall be amended, supplemented or maintained.

4. If at any time the Havana Charter should cease to be in force, the CONTRACTING PARTIES shall meet as soon as practicable thereafter to agree whether this Agreement shall be supplemented, amended or maintained. Pending such agreement, Part II of this Agreement shall again enter into force; *Provided* that the provisions of Part II other than Article XXIII shall be replaced, *mutatis mutandis,* in the form in which they then appeared in the Havana Charter; and *Provided* further that no contracting party shall be bound by any provisions which did not bind it at the time when the Havana Charter ceased to be in force.

5. If any contracting party has not accepted the Havana Charter by the date upon which it enters into force, the CONTRACTING PARTIES shall confer to agree whether, and if so in what way, this Agreement in so far as it affects relations between such contracting party and other contracting parties, shall be supplemented or amended. Pending such agreement the provisions of Part II of this Agreement shall, notwithstanding the provisions of paragraph 2 of this Article, continue to apply as between such contracting party and other contracting parties.

6. Contracting parties which are Members of the International Trade Organization shall not invoke the provisions of this Agreement so as to prevent the operation of any provision of the Havana Charter. The application of the principle underlying this paragraph to any contracting party which is not a Member of the International Trade Organization shall be the subject of an agreement pursuant to paragraph 5 of this Article.

Article XXX

Amendments

1. Except where provision for modification is made elsewhere in this Agreement, amendments to the provisions of Part I of this Agreement or the provisions of Article XXIX or of this Article shall become effective upon acceptance by all the contracting parties, and other amendments to this Agreement shall become effective, in respect of those contracting parties which accept them, upon acceptance by two-thirds of the contracting parties and thereafter for each other contracting party upon acceptance by it.

2. Any contracting party accepting an amendment to this Agreement shall deposit an instrument of acceptance with the Secretary-General of the United Nations within such period as the CONTRACTING PARTIES may specify. The CONTRACTING PARTIES may decide that any amendment made effective under this Article is of such a nature that any contracting party which has not accepted it within a period specified by the CONTRACTING PARTIES shall be free to withdraw from this Agreement, or to remain a contracting party with the consent of the CONTRACTING PARTIES.

Article XXXI

Withdrawal

Without prejudice to the provisions of paragraph 12 of Article XVIII, of Article XXIII or of paragraph 2 of Article XXX, any contracting party may withdraw from this Agreement, or may separately withdraw on behalf of any of the separate customs territories for which it has international responsibility and which at the time possesses full autonomy in the conduct of its external commercial relations and of the other matters provided for in this Agreement. The withdrawal shall take effect upon the expiration of six months from the day on which written

notice of withdrawal is received by the Secretary-General of the United Nations.

Article XXXII

Contracting Parties

1. The contracting parties to this Agreement shall be understood to mean those governments which are applying the provisions of this Agreement under Articles XXVI or XXXIII or pursuant to the Protocol of Provisional Application.

2. At any time after the entry into force of this Agreement pursuant to paragraph 6 of Article XXVI, those contracting parties which have accepted this Agreement pursuant to paragraph 4 of Article XXVI may decide that any contracting party which has not so accepted it shall cease to be a contracting party.

Article XXXIII

Accession

A government not party to this Agreement, or a government acting on behalf of a separate customs territory possessing full autonomy in the conduct of its external commercial relations and of the other matters provided for in this Agreement, may accede to this Agreement, on its own behalf or on behalf of that territory, on terms to be agreed between such government and the CONTRACTING PARTIES. Decisions of the CONTRACTING PARTIES under this paragraph shall be taken by a two-thirds majority.

Article XXXIV

Annexes

The annexes to this Agreement are hereby made an integral part of this Agreement.

Article XXXV

Non-application of the Agreement between Particular Contracting Parties

1. This Agreement, or alternatively Article II of this Agreement, shall not apply as between any contracting party and any other contracting party if:

(*a*) the two contracting parties have not entered into tariff negotiations with each other, and

(*b*) either of the contracting parties, at the time either becomes a contracting party, does not consent to such application.

2. The CONTRACTING PARTIES may review the operation of this Article in particular cases at the request of any contracting party and make appropriate recommendations.

PART IV*

TRADE AND DEVELOPMENT

Article XXXVI

Principles and Objectives

1.* The contracting parties,

(*a*) recalling that the basic objectives of this Agreement include the raising of standards of living and the progressive development of the economies of all contracting parties, and considering that the attainment of these objectives is particularly urgent for less-developed contracting parties;

(*b*) considering that export earnings of the less-developed contracting parties can play a vital part in their economic development and that the extent of this contribution depends on the prices paid by the less-developed contracting parties for essential imports, the volume of their exports, and the prices received for these exports;

(*c*) noting, that there is a wide gap between standards of living in less-developed countries and in other countries;

(*d*) recognizing that individual and joint action is essential to further the development of the economies of less-developed contracting parties and to bring about a rapid advance in the standards of living in these countries;

(*e*) recognizing that international trade as a means of achieving economic and social advancement should be governed by such rules and procedures - and measures in conformity with such rules and procedures - as are consistent with the objectives set forth in this Article;

(*f*) noting that the CONTRACTING PARTIES may enable less-developed contracting parties to use special measures to promote their trade and development;

agree as follows.

2. There is need for a rapid and sustained expansion of the export earnings of the less-developed contracting parties.

3. There is need for positive efforts designed to ensure that less-developed contracting parties secure a share in the growth in international trade commensurate with the needs of their economic development.

4. Given the continued dependence of many less-developed contracting parties on the exportation of a limited range of primary products,* there is need to provide in the largest possible measure more favourable and acceptable conditions of access to world markets for these products, and wherever appropriate to devise measures designed to stabilize and improve conditions of world markets in these products, including in particular measures designed to attain stable, equitable and remunerative prices, thus permitting an expansion of world trade and demand and a dynamic and steady growth of the real export earnings of

these countries so as to provide them with expanding resources for their economic development.

5. The rapid expansion of the economies of the less-developed contracting parties will be facilitated by a diversification* of the structure of their economies and the avoidance of an excessive dependence on the export of primary products. There is, therefore, need for increased access in the largest possible measure to markets under favourable conditions for processed and manufactured products currently or potentially of particular export interest to less-developed contracting parties.

6. Because of the chronic deficiency in the export proceeds and other foreign exchange earnings of less-developed contracting parties, there are important inter-relationships between trade and financial assistance to development. There is, therefore, need for close and continuing collaboration between the CONTRACTING PARTIES and the international lending agencies so that they can contribute most effectively to alleviating the burdens these less-developed contracting parties assume in the interest of their economic development.

7. There is need for appropriate collaboration between the CONTRACTING PARTIES, other intergovernmental bodies and the organs and agencies of the United Nations system, whose activities relate to the trade and economic development of less-developed countries.

8. The developed contracting parties do not expect reciprocity for commitments made by them in trade negotiations to reduce or remove tariffs and other barriers to the trade of less-developed contracting parties.*

9. The adoption of measures to give effect to these principles and objectives shall be a matter of conscious and purposeful effort on the part of the contracting parties both individually and jointly.

Article XXXVII

Commitments

1. The developed contracting parties shall to the fullest extent possible - that is, except when compelling reasons, which may include legal reasons, make it impossible - give effect to the following provisions:

(*a*) accord high priority to the reduction and elimination of barriers to products currently or potentially of particular export interest to less-developed contracting parties, including customs duties and other restrictions which differentiate unreasonably between such products in their primary and in their processed forms;*

(*b)* refrain from introducing, or increasing the incidence of, customs duties or non-tariff import barriers on products currently or potentially of particular export interest to less-developed contracting parties; and

(*c*) (i) refrain from imposing new fiscal measures, and

(ii) in any adjustments of fiscal policy accord high priority to the reduction and elimination of fiscal measures, which would hamper, or which hamper, significantly the growth of consumption of primary products, in raw or processed form, wholly or mainly produced in the territories of less-developed contracting parties, and which are applied specifically to those products.

2. (*a*) Whenever it is considered that effect is not being given to any of the provisions of subparagraph (*a*), (*b*) or (*c*) of paragraph 1, the matter shall be reported to the CONTRACTING PARTIES either by the contracting party not so giving effect to the relevant provisions or by any other interested contracting party.

(b) (i) The CONTRACTING PARTIES shall, if requested so to do by any interested contracting party, and without prejudice to any bilateral consultations that may be undertaken, consult with the contracting party concerned and all interested contracting parties with respect to the matter with a view to reaching solutions satisfactory to all

contracting parties concerned in order to further the objectives set forth in Article XXXVI. In the course of these consultations, the reasons given in cases where effect was not being given to the provisions of subparagraph (*a*), (*b*) or (*c*) of paragraph 1 shall be examined.

(ii) As the implementation of the provisions of subparagraph (*a)*, (*b*) or (*c*) of paragraph 1 by individual contracting parties may in some cases be more readily achieved where action is taken jointly with other developed contracting parties, such consultation might, where appropriate, be directed towards this end.

(iii) The consultations by the CONTRACTING PARTIES might also, in appropriate cases, be directed towards agreement on joint action designed to further the objectives of this Agreement as envisaged in paragraph 1 of Article XXV.

3. The developed contracting parties shall:

(*a*) make every effort, in cases where a government directly or indirectly determines the resale price of products wholly or mainly produced in the territories of less-developed contracting parties, to maintain trade margins at equitable levels;

(*b*) give active consideration to the adoption of other measures* designed to provide greater scope for the development of imports from less-developed contracting parties and collaborate in appropriate international action to this end;

(*c*) have special regard to the trade interests of less-developed contracting parties when considering the application of other measures permitted under this Agreement to meet particular problems and explore all possibilities of constructive remedies before applying such measures where they would affect essential interests of those contracting parties.

4. Less-developed contracting parties agree to take appropriate action in implementation of the provisions of Part IV for the benefit of the trade of other less-developed contracting parties, in so far as such action is

consistent with their individual present and future development, financial and trade needs taking into account past trade developments as well as the trade interests of less-developed contracting parties as a whole.

5. In the implementation of the commitments set forth in paragraph 1 to 4 each contracting party shall afford to any other interested contracting party or contracting parties full and prompt opportunity for consultations under the normal procedures of this Agreement with respect to any matter or difficulty which may arise.

Article XXXVIII

Joint Action

1. The contracting parties shall collaborate jointly, with the framework of this Agreement and elsewhere, as appropriate, to further the objectives set forth in Article XXXVI.

2. In particular, the CONTRACTING PARTIES shall:

(*a*) where appropriate, take action, including action through international arrangements, to provide improved and acceptable conditions of access to world markets for primary products of particular interest to less-developed contracting parties and to devise measures designed to stabilize and improve conditions of world markets in these products including measures designed to attain stable, equitable and remunerative prices for exports of such products;

(*b*) seek appropriate collaboration in matters of trade and development policy with the United Nations and its organs and agencies, including any institutions that may be created on the basis of recommendations by the United Nations Conference on Trade and Development;

(*c*) collaborate in analysing the development plans and policies of individual less-developed contracting parties and in examining trade and aid relationships with a view to devising concrete measures to promote

the development of export potential and to facilitate access to export markets for the products of the industries thus developed and, in this connection, seek appropriate collaboration with governments and international organizations, and in particular with organizations having competence in relation to financial assistance for economic development, in systematic studies of trade and aid relationships in individual less-developed contracting parties aimed at obtaining a clear analysis of export potential, market prospects and any further action that may be required;

(*d*) keep under continuous review the development of world trade with special reference to the rate of growth of the trade of less-developed contracting parties and make such recommendations to contracting parties as may, in the circumstances, be deemed appropriate;

(*e*) collaborate in seeking feasible methods to expand trade for the purpose of economic development, through international harmonization and adjustment of national policies and regulations, through technical and commercial standards affecting production, transportation and marketing, and through export promotion by the establishment of facilities for the increased flow of trade information and the development of market research; and

(*f*) establish such institutional arrangements as may be necessary to further the objectives set forth in Article XXXVI and to give effect to the provision of this Part.

Annex II

[ii] AGREEMENT ESTABLISHING THE WORLD TRADE ORGANIZATION

The *Parties* to this Agreement,

Recognizing that their relations in the field of trade and economic endeavour should be conducted with a view to raising standards of living, ensuring full employment and a large and steadily growing volume of real income and effective demand, and expanding the production of and trade in goods and services, while allowing for the optimal use of the world's resources in accordance with the objective of sustainable development, seeking both to protect and preserve the environment and to enhance the means for doing so in a manner consistent with their respective needs and concerns at different levels of economic development,

Recognizing further that there is need for positive efforts designed to ensure that developing countries, and especially the least developed among them, secure a share in the growth in international trade commensurate with the needs of their economic development,

Being desirous of contributing to these objectives by entering into reciprocal and mutually advantageous arrangements directed to the substantial reduction of tariffs and other barriers to trade and to the elimination of discriminatory treatment in international trade relations,

Resolved, therefore, to develop an integrated, more viable and durable multilateral trading system encompassing the General Agreement on Tariffs and Trade, the results of past trade liberalization efforts, and all of the results of the Uruguay Round of Multilateral Trade Negotiations,

Determined to preserve the basic principles and to further the objectives underlying this multilateral trading system,

Agree as follows:

Article I

Establishment of the Organization

The World Trade Organization (hereinafter referred to as "the WTO") is hereby established.

Article II

Scope of the WTO

1. The WTO shall provide the common institutional framework for the conduct of trade relations among its Members in matters related to the agreements and associated legal instruments included in the Annexes to this Agreement.

2. The agreements and associated legal instruments included in Annexes 1, 2 and 3 (hereinafter referred to as "Multilateral Trade Agreements") are integral parts of this Agreement, binding on all Members.

3. The agreements and associated legal instruments included in Annex 4 (hereinafter referred to as "Plurilateral Trade Agreements") are also part of this Agreement for those Members that have accepted them, and are binding on those Members. The Plurilateral Trade Agreements do not create either obligations or rights for Members that have not accepted them.

4. The General Agreement on Tariffs and Trade 1994 as specified in Annex 1A (hereinafter referred to as "GATT 1994") is legally distinct from the General Agreement on Tariffs and Trade, dated 30 October 1947, annexed to the Final Act Adopted at the Conclusion of the Second Session of the Preparatory Committee of the United Nations Conference on Trade and Employment, as subsequently rectified, amended or modified (hereinafter referred to as "GATT 1947").

Article III

Functions of the WTO

1. The WTO shall facilitate the implementation, administration and operation, and further the objectives, of this Agreement and of the Multilateral Trade Agreements, and shall also provide the framework for the implementation, administration and operation of the Plurilateral Trade Agreements.

2. The WTO shall provide the forum for negotiations among its Members concerning their multilateral trade relations in matters dealt with under the agreements in the Annexes to this Agreement. The WTO may also provide a forum for further negotiations among its Members concerning their multilateral trade relations, and a framework for the implementation of the results of such negotiations, as may be decided by the Ministerial Conference.

3. The WTO shall administer the Understanding on Rules and Procedures Governing the Settlement of Disputes (hereinafter referred to as the "Dispute Settlement Understanding" or "DSU") in Annex 2 to this Agreement.

4. The WTO shall administer the Trade Policy Review Mechanism (hereinafter referred to as the "TPRM") provided for in Annex 3 to this Agreement.

5. With a view to achieving greater coherence in global economic policy-making, the WTO shall cooperate, as appropriate, with the International Monetary Fund and with the International Bank for Reconstruction and Development and its affiliated agencies.

Article IV

Structure of the WTO

1. There shall be a Ministerial Conference composed of representatives of all the Members, which shall meet at least once every two years. The

Ministerial Conference shall carry out the functions of the WTO and take actions necessary to this effect. The Ministerial Conference shall have the authority to take decisions on all matters under any of the Multilateral Trade Agreements, if so requested by a Member, in accordance with the specific requirements for decision-making in this Agreement and in the relevant Multilateral Trade Agreement.

2. There shall be a General Council composed of representatives of all the Members, which shall meet as appropriate. In the intervals between meetings of the Ministerial Conference, its functions shall be conducted by the General Council. The General Council shall also carry out the functions assigned to it by this Agreement. The General Council shall establish its rules of procedure and approve the rules of procedure for the Committees provided for in paragraph 7.

3. The General Council shall convene as appropriate to discharge the responsibilities of the Dispute Settlement Body provided for in the Dispute Settlement Understanding. The Dispute Settlement Body may have its own chairman and shall establish such rules of procedure as it deems necessary for the fulfilment of those responsibilities.

4. The General Council shall convene as appropriate to discharge the responsibilities of the Trade Policy Review Body provided for in the TPRM. The Trade Policy Review Body may have its own chairman and shall establish such rules of procedure as it deems necessary for the fulfilment of those responsibilities.

5. There shall be a Council for Trade in Goods, a Council for Trade in Services and a Council for Trade-Related Aspects of Intellectual Property Rights (hereinafter referred to as the "Council for TRIPS"), which shall operate under the general guidance of the General Council. The Council for Trade in Goods shall oversee the functioning of the Multilateral Trade Agreements in Annex 1A. The Council for Trade in Services shall oversee the functioning of the General Agreement on Trade in Services

(hereinafter referred to as "GATS"). The Council for TRIPS shall oversee the functioning of the Agreement on Trade-Related Aspects of Intellectual Property Rights (hereinafter referred to as the "Agreement on TRIPS"). These Councils shall carry out the functions assigned to them by their respective agreements and by the General Council. They shall establish their respective rules of procedure subject to the approval of the General Council. Membership in these Councils shall be open to representatives of all Members. These Councils shall meet as necessary to carry out their functions.

6. The Council for Trade in Goods, the Council for Trade in Services and the Council for TRIPS shall establish subsidiary bodies as required. These subsidiary bodies shall establish their respective rules of procedure subject to the approval of their respective Councils.

7. The Ministerial Conference shall establish a Committee on Trade and Development, a Committee on Balance-of-Payments Restrictions and a Committee on Budget, Finance and Administration, which shall carry out the functions assigned to them by this Agreement and by the Multilateral Trade Agreements, and any additional functions assigned to them by the General Council, and may establish such additional Committees with such functions as it may deem appropriate. As part of its functions, the Committee on Trade and Development shall periodically review the special provisions in the Multilateral Trade Agreements in favour of the least-developed country Members and report to the General Council for appropriate action. Membership in these Committees shall be open to representatives of all Members.

8. The bodies provided for under the Plurilateral Trade Agreements shall carry out the functions assigned to them under those Agreements and shall operate within the institutional framework of the WTO. These bodies shall keep the General Council informed of their activities on a

regular basis.

Article V

Relations with Other Organizations

1. The General Council shall make appropriate arrangements for effective cooperation with other intergovernmental organizations that have responsibilities related to those of the WTO.

2. The General Council may make appropriate arrangements for consultation and cooperation with non-governmental organizations concerned with matters related to those of the WTO.

Article VI

The Secretariat

1. There shall be a Secretariat of the WTO (hereinafter referred to as "the Secretariat") headed by a Director-General.

2. The Ministerial Conference shall appoint the Director-General and adopt regulations setting out the powers, duties, conditions of service and term of office of the Director-General.

3. The Director-General shall appoint the members of the staff of the Secretariat and determine their duties and conditions of service in accordance with regulations adopted by the Ministerial Conference.

4. The responsibilities of the Director-General and of the staff of the Secretariat shall be exclusively international in character. In the discharge of their duties, the Director-General and the staff of the Secretariat shall not seek or accept instructions from any government or any other authority external to the WTO. They shall refrain from any action which might adversely reflect on their position as international officials. The Members of the WTO shall respect the international character of the responsibilities of the Director-General and of the staff of the Secretariat and shall not seek to influence them in the discharge of

their duties.

Article VII

Budget and Contributions

1. The Director-General shall present to the Committee on Budget, Finance and Administration the annual budget estimate and financial statement of the WTO. The Committee on Budget, Finance and Administration shall review the annual budget estimate and the financial statement presented by the Director-General and make recommendations thereon to the General Council. The annual budget estimate shall be subject to approval by the General Council.

2. The Committee on Budget, Finance and Administration shall propose to the General Council financial regulations which shall include provisions setting out:

(a) the scale of contributions apportioning the expenses of the WTO among its Members; and

(b) the measures to be taken in respect of Members in arrears.

The financial regulations shall be based, as far as practicable, on the regulations and practices of GATT 1947.

3. The General Council shall adopt the financial regulations and the annual budget estimate by a two-thirds majority comprising more than half of the Members of the WTO.

4. Each Member shall promptly contribute to the WTO its share in the expenses of the WTO in accordance with the financial regulations adopted by the General Council.

Article VIII

Status of the WTO

1. The WTO shall have legal personality, and shall be accorded by each of its Members such legal capacity as may be necessary for the exercise of its functions.
2. The WTO shall be accorded by each of its Members such privileges and immunities as are necessary for the exercise of its functions.
3. The officials of the WTO and the representatives of the Members shall similarly be accorded by each of its Members such privileges and immunities as are necessary for the independent exercise of their functions in connection with the WTO.
4. The privileges and immunities to be accorded by a Member to the WTO, its officials, and the representatives of its Members shall be similar to the privileges and immunities stipulated in the Convention on the Privileges and Immunities of the Specialized Agencies, approved by the General Assembly of the United Nations on 21 November 1947.
5. The WTO may conclude a headquarters agreement.

Article IX
Decision-Making

1. The WTO shall continue the practice of decision-making by consensus followed under GATT 1947.[1] Except as otherwise provided, where a decision cannot be arrived at by consensus, the matter at issue shall be decided by voting. At meetings of the Ministerial Conference and the General Council, each Member of the WTO shall have one vote. Where the European Communities exercise their right to vote, they shall have a number of votes equal to the number of their member States[2] which are Members of the WTO. Decisions of the Ministerial Conference and the General Council shall be taken by a majority of the votes cast, unless otherwise provided in this Agreement or in the relevant Multilateral Trade Agreement.[3]

2. The Ministerial Conference and the General Council shall have the exclusive authority to adopt interpretations of this Agreement and of the Multilateral Trade Agreements. In the case of an interpretation of a Multilateral Trade Agreement in Annex 1, they shall exercise their authority on the basis of a recommendation by the Council overseeing the functioning of that Agreement. The decision to adopt an interpretation shall be taken by a three-fourths majority of the Members. This paragraph shall not be used in a manner that would undermine the amendment provisions in Article X.

3. In exceptional circumstances, the Ministerial Conference may decide to waive an obligation imposed on a Member by this Agreement or any of the Multilateral Trade Agreements, provided that any such decision shall be taken by three fourths[4] of the Members unless otherwise provided for in this paragraph.

(a) A request for a waiver concerning this Agreement shall be submitted to the Ministerial Conference for consideration pursuant to the practice of decision-making by consensus. The Ministerial Conference shall establish a time-period, which shall not exceed 90 days, to consider the request. If consensus is not reached during the time-period, any decision to grant a waiver shall be taken by three fourths4 of the Members.

(b) A request for a waiver concerning the Multilateral Trade Agreements in Annexes 1A or 1B or 1C and their annexes shall be submitted initially to the Council for Trade in Goods, the Council for Trade in Services or the Council for TRIPS, respectively, for consideration during a time-period which shall not exceed 90 days. At the end of the time-period, the relevant Council shall submit a report to the Ministerial Conference.

4. A decision by the Ministerial Conference granting a waiver shall state the exceptional circumstances justifying the decision, the terms and conditions governing the application of the waiver, and the date on which

the waiver shall terminate. Any waiver granted for a period of more than one year shall be reviewed by the Ministerial Conference not later than one year after it is granted, and thereafter annually until the waiver terminates. In each review, the Ministerial Conference shall examine whether the exceptional circumstances justifying the waiver still exist and whether the terms and conditions attached to the waiver have been met. The Ministerial Conference, on the basis of the annual review, may extend, modify or terminate the waiver.

5. Decisions under a Plurilateral Trade Agreement, including any decisions on interpretations and waivers, shall be governed by the provisions of that Agreement.

Article X

*Amendment*s

1. Any Member of the WTO may initiate a proposal to amend the provisions of this Agreement or the Multilateral Trade Agreements in Annex 1 by submitting such proposal to the Ministerial Conference. The Councils listed in paragraph 5 of Article IV may also submit to the Ministerial Conference proposals to amend the provisions of the corresponding Multilateral Trade Agreements in Annex 1 the functioning of which they oversee. Unless the Ministerial Conference decides on a longer period, for a period of 90 days after the proposal has been tabled formally at the Ministerial Conference any decision by the Ministerial Conference to submit the proposed amendment to the Members for acceptance shall be taken by consensus. Unless the provisions of paragraphs 2, 5 or 6 apply, that decision shall specify whether the provisions of paragraphs 3 or 4 shall apply. If consensus is reached, the Ministerial Conference shall forthwith submit the proposed amendment to the Members for acceptance. If consensus is not reached at a meeting of the Ministerial Conference within the established period, the

Ministerial Conference shall decide by a two-thirds majority of the Members whether to submit the proposed amendment to the Members for acceptance. Except as provided in paragraphs 2, 5 and 6, the provisions of paragraph 3 shall apply to the proposed amendment, unless the Ministerial Conference decides by a three-fourths majority of the Members that the provisions of paragraph 4 shall apply.

2. Amendments to the provisions of this Article and to the provisions of the following Articles shall take effect only upon acceptance by all Members:

Article IX of this Agreement;

Articles I and II of GATT 1994;

Article II:1 of GATS;

Article 4 of the Agreement on TRIPS.

3. Amendments to provisions of this Agreement, or of the Multilateral Trade Agreements in Annexes 1A and 1C, other than those listed in paragraphs 2 and 6, of a nature that would alter the rights and obligations of the Members, shall take effect for the Members that have accepted them upon acceptance by two thirds of the Members and thereafter for each other Member upon acceptance by it. The Ministerial Conference may decide by a three-fourths majority of the Members that any amendment made effective under this paragraph is of such a nature that any Member which has not accepted it within a period specified by the Ministerial Conference in each case shall be free to withdraw from the WTO or to remain a Member with the consent of the Ministerial Conference.

4. Amendments to provisions of this Agreement or of the Multilateral Trade Agreements in Annexes 1A and 1C, other than those listed in paragraphs 2 and 6, of a nature that would not alter the rights and obligations of the Members, shall take effect for all Members upon acceptance by two thirds of the Members.

5. Except as provided in paragraph 2 above, amendments to Parts I, II and III of GATS and the respective annexes shall take effect for the Members that have accepted them upon acceptance by two thirds of the Members and thereafter for each Member upon acceptance by it. The Ministerial Conference may decide by a three-fourths majority of the Members that any amendment made effective under the preceding provision is of such a nature that any Member which has not accepted it within a period specified by the Ministerial Conference in each case shall be free to withdraw from the WTO or to remain a Member with the consent of the Ministerial Conference. Amendments to Parts IV, V and VI of GATS and the respective annexes shall take effect for all Members upon acceptance by two thirds of the Members.

6. Notwithstanding the other provisions of this Article, amendments to the Agreement on TRIPS meeting the requirements of paragraph 2 of Article 71 thereof may be adopted by the Ministerial Conference without further formal acceptance process.

7. Any Member accepting an amendment to this Agreement or to a Multilateral Trade Agreement in Annex 1 shall deposit an instrument of acceptance with the Director-General of the WTO within the period of acceptance specified by the Ministerial Conference.

8. Any Member of the WTO may initiate a proposal to amend the provisions of the Multilateral Trade Agreements in Annexes 2 and 3 by submitting such proposal to the Ministerial Conference. The decision to approve amendments to the Multilateral Trade Agreement in Annex 2 shall be made by consensus and these amendments shall take effect for all Members upon approval by the Ministerial Conference. Decisions to approve amendments to the Multilateral Trade Agreement in Annex 3 shall take effect for all Members upon approval by the Ministerial Conference.

9. The Ministerial Conference, upon the request of the Members parties to a trade agreement, may decide exclusively by consensus to add that agreement to Annex 4. The Ministerial Conference, upon the request of the Members parties to a Plurilateral Trade Agreement, may decide to delete that Agreement from Annex 4.
10. Amendments to a Plurilateral Trade Agreement shall be governed by the provisions of that Agreement.

Article XI
Original Membership
1. The contracting parties to GATT 1947 as of the date of entry into force of this Agreement, and the European Communities, which accept this Agreement and the Multilateral Trade Agreements and for which Schedules of Concessions and Commitments are annexed to GATT 1994 and for which Schedules of Specific Commitments are annexed to GATS shall become original Members of the WTO.
2. The least-developed countries recognized as such by the United Nations will only be required to undertake commitments and concessions to the extent consistent with their individual development, financial and trade needs or their administrative and institutional capabilities.

Article XII
Accession
1. Any State or separate customs territory possessing full autonomy in the conduct of its external commercial relations and of the other matters provided for in this Agreement and the Multilateral Trade Agreements may accede to this Agreement, on terms to be agreed between it and the WTO. Such accession shall apply to this Agreement and the Multilateral Trade Agreements annexed thereto.

2. Decisions on accession shall be taken by the Ministerial Conference. The Ministerial Conference shall approve the agreement on the terms of accession by a two-thirds majority of the Members of the WTO.
3. Accession to a Plurilateral Trade Agreement shall be governed by the provisions of that Agreement.

Article XIII
Non-Application of Multilateral Trade Agreements
between Particular Members
1. This Agreement and the Multilateral Trade Agreements in Annexes 1 and 2 shall not apply as between any Member and any other Member if either of the Members, at the time either becomes a Member, does not consent to such application.
2. Paragraph 1 may be invoked between original Members of the WTO which were contracting parties to GATT 1947 only where Article XXXV of that Agreement had been invoked earlier and was effective as between those contracting parties at the time of entry into force for them of this Agreement.
3. Paragraph 1 shall apply between a Member and another Member which has acceded under Article XII only if the Member not consenting to the application has so notified the Ministerial Conference before the approval of the agreement on the terms of accession by the Ministerial Conference.
4. The Ministerial Conference may review the operation of this Article in particular cases at the request of any Member and make appropriate recommendations.
5. Non-application of a Plurilateral Trade Agreement between parties to that Agreement shall be governed by the provisions of that Agreement.

Article XIV

Acceptance, Entry into Force and Deposit

1. This Agreement shall be open for acceptance, by signature or otherwise, by contracting parties to GATT 1947, and the European Communities, which are eligible to become original Members of the WTO in accordance with Article XI of this Agreement. Such acceptance shall apply to this Agreement and the Multilateral Trade Agreements annexed hereto. This Agreement and the Multilateral Trade Agreements annexed hereto shall enter into force on the date determined by Ministers in accordance with paragraph 3 of the Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations and shall remain open for acceptance for a period of two years following that date unless the Ministers decide otherwise. An acceptance following the entry into force of this Agreement shall enter into force on the 30th day following the date of such acceptance.

2. A Member which accepts this Agreement after its entry into force shall implement those concessions and obligations in the Multilateral Trade Agreements that are to be implemented over a period of time starting with the entry into force of this Agreement as if it had accepted this Agreement on the date of its entry into force.

3. Until the entry into force of this Agreement, the text of this Agreement and the Multilateral Trade Agreements shall be deposited with the Director-General to the CONTRACTING PARTIES to GATT 1947. The Director-General shall promptly furnish a certified true copy of this Agreement and the Multilateral Trade Agreements, and a notification of each acceptance thereof, to each government and the European Communities having accepted this Agreement. This Agreement and the Multilateral Trade Agreements, and any amendments thereto, shall, upon the entry into force of this Agreement, be deposited with the Director-General of the WTO.

4. The acceptance and entry into force of a Plurilateral Trade Agreement shall be governed by the provisions of that Agreement. Such Agreements shall be deposited with the Director-General to the CONTRACTING PARTIES to GATT 1947. Upon the entry into force of this Agreement, such Agreements shall be deposited with the Director-General of the WTO.

Article XV

Withdrawal

1. Any Member may withdraw from this Agreement. Such withdrawal shall apply both to this Agreement and the Multilateral Trade Agreements and shall take effect upon the expiration of six months from the date on which written notice of withdrawal is received by the Director-General of the WTO.

2. Withdrawal from a Plurilateral Trade Agreement shall be governed by the provisions of that Agreement.

Article XVI

Miscellaneous Provisions

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

2. To the extent practicable, the Secretariat of GATT 1947 shall become the Secretariat of the WTO, and the Director-General to the CONTRACTING PARTIES to GATT 1947, until such time as the Ministerial Conference has appointed a Director-General in accordance with paragraph 2 of Article VI of this Agreement, shall serve as Director-General of the WTO.

3. In the event of a conflict between a provision of this Agreement and a provision of any of the Multilateral Trade Agreements, the provision of this Agreement shall prevail to the extent of the conflict.

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

5. No reservations may be made in respect of any provision of this Agreement. Reservations in respect of any of the provisions of the Multilateral Trade Agreements may only be made to the extent provided for in those Agreements. Reservations in respect of a provision of a Plurilateral Trade Agreement shall be governed by the provisions of that Agreement.

6. This Agreement shall be registered in accordance with the provisions of Article 102 of the Charter of the United Nations.

DONE at Marrakesh this fifteenth day of April one thousand nine hundred and ninety-four, in a single copy, in the English, French and Spanish languages, each text being authentic.

Explanatory Notes:

The terms "country" or "countries" as used in this Agreement and the Multilateral Trade Agreements are to be understood to include any separate customs territory Member of the WTO.

In the case of a separate customs territory Member of the WTO, where an expression in this Agreement and the Multilateral Trade Agreements is qualified by the term "national", such expression shall be read as pertaining to that customs territory, unless otherwise specified.

LIST OF ANNEXES

ANNEX 1

ANNEX 1A: Multilateral Agreements on Trade in Goods

General Agreement on Tariffs and Trade 1994

Agreement on Agriculture

Agreement on the Application of Sanitary and Phytosanitary Measures

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Agreement on Technical Barriers to Trade

Agreement on Trade-Related Investment Measures

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Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade 1994

Agreement on Preshipment Inspection

Agreement on Rules of Origin

Agreement on Import Licensing Procedures

Agreement on Subsidies and Countervailing Measures

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ANNEX 1B: General Agreement on Trade in Services and Annexes

ANNEX 1C: Agreement on Trade-Related Aspects of Intellectual Property Rights

ANNEX 2

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ANNEX 3

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ANNEX 4

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Agreement on Trade in Civil Aircraft

Agreement on Government Procurement

International Dairy Agreement

International Bovine Meat Agreement

Annex III

[iii] GENERAL AGREEMENT ON TARIFFS AND TRADE 1994

1. The General Agreement on Tariffs and Trade 1994 ("GATT 1994") shall consist of:

a) the provisions in the General Agreement on Tariffs and Trade, dated 30 October 1947, annexed to the Final Act Adopted at the Conclusion of the Second Session of the Preparatory Committee of the United Nations Conference on Trade and Employment (excluding the Protocol of Provisional Application), as rectified, amended or modified by the terms of legal instruments which have entered into force before the date of entry into force of the WTO Agreement;

b) the provisions of the legal instruments set forth below that have entered into force under the GATT 1947 before the date of entry into force of the WTO Agreement:

(i) protocols and certifications relating to tariff concessions;

(ii) protocols of accession (excluding the provisions (*a*) concerning provisional application and withdrawal of provisional application and (*b*) providing that Part II of GATT 1947 shall be applied provisionally to the fullest extent not inconsistent with legislation existing on the date of the Protocol);

(iii) decisions on waivers granted under Article XXV of GATT 1947 and still in force on the date of entry into force of the WTO Agreement[iii];

(iv) other decisions of the CONTRACTING PARTIES to GATT 1947;

c) the Understandings set forth below:

(i) Understanding on the Interpretation of Article II:1(b) of the General Agreement on Tariffs and Trade 1994;

(ii) Understanding on the Interpretation of Article XVII of the General Agreement on Tariffs and Trade 1994;

(iii) Understanding on Balance-of-Payments Provisions of the General Agreement on Tariffs and Trade 1994;

(iv) Understanding on the Interpretation of Article XXIV of the General Agreement on Tariffs and Trade 1994;

(v) Understanding in Respect of Waivers of Obligations under the General Agreement on Tariffs and Trade 1994;

(vi) Understanding on the Interpretation of Article XXVIII of the General Agreement on Tariffs and Trade 1994; and

d) the Marrakesh Protocol to GATT 1994.

2. *Explanatory Notes*

a) The references to "contracting party" in the provisions of GATT 1994 shall be deemed to read "Member". The references to "less-developed contracting party" and "developed contracting party" shall be deemed to read "developing country Member" and "developed country Member". The references to "Executive Secretary" shall be deemed to read "Director-General of the WTO".

b) The references to the CONTRACTING PARTIES acting jointly in Articles XV:1, XV:2, XV:8, XXXVIII and the Notes *Ad* Article XII and XVIII; and in the provisions on special exchange agreements in Articles XV:2, XV:3, XV:6, XV:7 and XV:9 of GATT 1994 shall be deemed to be references to the WTO. The other functions that the provisions of GATT 1994 assign to the CONTRACTING PARTIES acting jointly shall be allocated by the Ministerial Conference.

c) (i) The text of GATT 1994 shall be authentic in English, French and Spanish.

(ii) The text of GATT 1994 in the French language shall be subject to the rectifications of terms indicated in Annex A to document MTN.TNC/41.

(iii) The authentic text of GATT 1994 in the Spanish language shall be the text in Volume IV of the Basic Instruments and

Selected Documents series, subject to the rectifications of terms indicated in Annex B to document MTN.TNC/41.

3. (a) The provisions of Part II of GATT 1994 shall not apply to measures taken by a Member under specific mandatory legislation, enacted by that Member before it became a contracting party to GATT 1947, that prohibits the use, sale or lease of foreign-built or foreign-reconstructed vessels in commercial applications between points in national waters or the waters of an exclusive economic zone. This exemption applies to: (*a*) the continuation or prompt renewal of a non-conforming provision of such legislation; and (*b*) the amendment to a non-conforming provision of such legislation to the extent that the amendment does not decrease the conformity of the provision with Part II of GATT 1947. This exemption is limited to measures taken under legislation described above that is notified and specified prior to the date of entry into force of the WTO Agreement. If such legislation is subsequently modified to decrease its conformity with Part II of GATT 1994, it will no longer qualify for coverage under this paragraph.

(b) The Ministerial Conference shall review this exemption not later than five years after the date of entry into force of the WTO Agreement and thereafter every two years for as long as the exemption is in force for the purpose of examining whether the conditions which created the need for the exemption still prevail.

(c) A Member whose measures are covered by this exemption shall annually submit a detailed statistical notification consisting of a five-year moving average of actual and expected deliveries of relevant vessels as well as additional information on the use, sale, lease or repair of relevant vessels covered by this exemption.

(d) A Member that considers that this exemption operates in such a manner as to justify a reciprocal and proportionate limitation on the use, sale, lease or repair of vessels constructed in the territory of the

Member invoking the exemption shall be free to introduce such a limitation subject to prior notification to the Ministerial Conference.

(e) This exemption is without prejudice to solutions concerning specific aspects of the legislation covered by this exemption negotiated in sectoral agreements or in other fora.

[iv] ANNEX IV

AGREEMENT ON SUBSIDIES AND COUNTERVAILING MEASURES

Members hereby agree as follows:

PART I: GENERAL PROVISIONS

Article 1

Definition of a Subsidy

1.1 For the purpose of this Agreement, a subsidy shall be deemed to exist if:

(a)(1) there is a financial contribution by a government or any public body within the territory of a Member (referred to in this Agreement as "government"), i.e. where:

(i) a government practice involves a direct transfer of funds (e.g. grants, loans, and equity infusion), potential direct transfers of funds or liabilities (e.g. loan guarantees);

(ii) government revenue that is otherwise due is foregone or not collected (e.g. fiscal incentives such as tax credits) [iv];

(iii) a government provides goods or services other than general infrastructure, or purchases goods;

(iv) a government makes payments to a funding mechanism, or entrusts or directs a private body to carry out one or more of the type of functions illustrated in (i) to (iii) above which would normally be vested in the government and the practice, in no real sense, differs from practices normally followed by governments; or

(a)(2) there is any form of income or price support in the sense of Article XVI of GATT 1994; and

(b) a benefit is thereby conferred.

1.2 A subsidy as defined in paragraph 1 shall be subject to the provisions of Part II or shall be subject to the provisions of Part III or V

only if such a subsidy is specific in accordance with the provisions of Article 2.

Article 2

Specificity

2.1 In order to determine whether a subsidy, as defined in paragraph 1 of Article 1, is specific to an enterprise or industry or group of enterprises or industries (referred to in this Agreement as "certain enterprises") within the jurisdiction of the granting authority, the following principles shall apply:

(a) Where the granting authority, or the legislation pursuant to which the granting authority operates, explicitly limits access to a subsidy to certain enterprises, such subsidy shall be specific.

(b) Where the granting authority, or the legislation pursuant to which the granting authority operates, establishes objective criteria or conditions[iv] governing the eligibility for, and the amount of, a subsidy, specificity shall not exist, provided that the eligibility is automatic and that such criteria and conditions are strictly adhered to. The criteria or conditions must be clearly spelled out in law, regulation, or other official document, so as to be capable of verification.

(c) If, notwithstanding any appearance of non-specificity resulting from the application of the principles laid down in subparagraphs (a) and (b), there are reasons to believe that the subsidy may in fact be specific, other factors may be considered. Such factors are: use of a subsidy programme by a limited number of certain enterprises, predominant use by certain enterprises, the granting of disproportionately large amounts of subsidy to certain enterprises, and the manner in which discretion has been exercised by the granting authority in the decision to grant a subsidy.[iv] In applying this subparagraph, account shall be taken of the extent of diversification of economic activities within the jurisdiction of

the granting authority, as well as of the length of time during which the subsidy programme has been in operation.

2.2 A subsidy which is limited to certain enterprises located within a designated geographical region within the jurisdiction of the granting authority shall be specific. It is understood that the setting or change of generally applicable tax rates by all levels of government entitled to do so shall not be deemed to be a specific subsidy for the purposes of this Agreement.

2.3 Any subsidy falling under the provisions of Article 3 shall be deemed to be specific.

2.4 Any determination of specificity under the provisions of this Article shall be clearly substantiated on the basis of positive evidence.

PART II: PROHIBITED SUBSIDIES

Article 3

Prohibition

3.1 Except as provided in the Agreement on Agriculture, the following subsidies, within the meaning of Article 1, shall be prohibited:

(a) subsidies contingent, in law or in fact[iv], whether solely or as one of several other conditions, upon export performance, including those illustrated in Annex I[iv];

(b) subsidies contingent, whether solely or as one of several other conditions, upon the use of domestic over imported goods.

3.2 A Member shall neither grant nor maintain subsidies referred to in paragraph 1.

Article 4

Remedies

4.1 Whenever a Member has reason to believe that a prohibited subsidy is being granted or maintained by another Member, such Member may request consultations with such other Member.

4.2 A request for consultations under paragraph 1 shall include a statement of available evidence with regard to the existence and nature of the subsidy in question.

4.3 Upon request for consultations under paragraph 1, the Member believed to be granting or maintaining the subsidy in question shall enter into such consultations as quickly as possible. The purpose of the consultations shall be to clarify the facts of the situation and to arrive at a mutually agreed solution.

4.4 If no mutually agreed solution has been reached within 30 days[iv] of the request for consultations, any Member party to such consultations may refer the matter to the Dispute Settlement Body ("DSB") for the immediate establishment of a panel, unless the DSB decides by consensus not to establish a panel.

4.5 Upon its establishment, the panel may request the assistance of the Permanent Group of Experts[iv] (referred to in this Agreement as the "PGE") with regard to whether the measure in question is a prohibited subsidy. If so requested, the PGE shall immediately review the evidence with regard to the existence and nature of the measure in question and shall provide an opportunity for the Member applying or maintaining the measure to demonstrate that the measure in question is not a prohibited subsidy. The PGE shall report its conclusions to the panel within a time-limit determined by the panel. The PGE's conclusions on the issue of whether or not the measure in question is a prohibited subsidy shall be accepted by the panel without modification.

4.6 The panel shall submit its final report to the parties to the dispute. The report shall be circulated to all Members within 90 days of the date of the composition and the establishment of the panel's terms of reference.

4.7 If the measure in question is found to be a prohibited subsidy, the panel shall recommend that the subsidizing Member withdraw the

subsidy without delay. In this regard, the panel shall specify in its recommendation the time-period within which the measure must be withdrawn.

4.8 Within 30 days of the issuance of the panel's report to all Members, the report shall be adopted by the DSB unless one of the parties to the dispute formally notifies the DSB of its decision to appeal or the DSB decides by consensus not to adopt the report.

4.9 Where a panel report is appealed, the Appellate Body shall issue its decision within 30 days from the date when the party to the dispute formally notifies its intention to appeal. When the Appellate Body considers that it cannot provide its report within 30 days, it shall inform the DSB in writing of the reasons for the delay together with an estimate of the period within which it will submit its report. In no case shall the proceedings exceed 60 days. The appellate report shall be adopted by the DSB and unconditionally accepted by the parties to the dispute unless the DSB decides by consensus not to adopt the appellate report within 20 days following its issuance to the Members.[iv]

4.10 In the event the recommendation of the DSB is not followed within the time-period specified by the panel, which shall commence from the date of adoption of the panel's report or the Appellate Body's report, the DSB shall grant authorization to the complaining Member to take appropriate[iv] countermeasures, unless the DSB decides by consensus to reject the request.

4.11 In the event a party to the dispute requests arbitration under paragraph 6 of Article 22 of the Dispute Settlement Understanding ("DSU"), the arbitrator shall determine whether the countermeasures are appropriate.[iv]

4.12 For purposes of disputes conducted pursuant to this Article, except for time-periods specifically prescribed in this Article, time-periods

applicable under the DSU for the conduct of such disputes shall be half the time prescribed therein.

PART III: ACTIONABLE SUBSIDIES

Article 5

Adverse Effects

No Member should cause, through the use of any subsidy referred to in paragraphs 1 and 2 of Article 1, adverse effects to the interests of other Members, i.e.:

(a) injury to the domestic industry of another Member[iv];

(b) nullification or impairment of benefits accruing directly or indirectly to other Members under GATT 1994 in particular the benefits of concessions bound under Article II of GATT 1994[iv];

(c) serious prejudice to the interests of another Member.[iv]

This Article does not apply to subsidies maintained on agricultural products as provided in Article 13 of the Agreement on Agriculture.

Article 6

Serious Prejudice

6.1 Serious prejudice in the sense of paragraph (c) of Article 5 shall be deemed to exist in the case of:

(a) the total ad valorem subsidization[iv] of a product exceeding 5 per cent[iv];

(b) subsidies to cover operating losses sustained by an industry;

(c) subsidies to cover operating losses sustained by an enterprise, other than one-time measures which are non-recurrent and cannot be repeated for that enterprise and which are given merely to provide time for the development of long-term solutions and to avoid acute social problems;

(d) direct forgiveness of debt, i.e. forgiveness of government-held debt, and grants to cover debt repayment.[iv]

6.2 Notwithstanding the provisions of paragraph 1, serious prejudice shall not be found if the subsidizing Member demonstrates that the subsidy in question has not resulted in any of the effects enumerated in paragraph 3.

6.3 Serious prejudice in the sense of paragraph (c) of Article 5 may arise in any case where one or several of the following apply:

(a) the effect of the subsidy is to displace or impede the imports of a like product of another Member into the market of the subsidizing Member;

(b) the effect of the subsidy is to displace or impede the exports of a like product of another Member from a third country market;

(c) the effect of the subsidy is a significant price undercutting by the subsidized product as compared with the price of a like product of another Member in the same market or significant price suppression, price depression or lost sales in the same market;

(d) the effect of the subsidy is an increase in the world market share of the subsidizing Member in a particular subsidized primary product or commodity[iv] as compared to the average share it had during the previous period of three years and this increase follows a consistent trend over a period when subsidies have been granted.

6.4 For the purpose of paragraph 3(b), the displacement or impeding of exports shall include any case in which, subject to the provisions of paragraph 7, it has been demonstrated that there has been a change in relative shares of the market to the disadvantage of the non-subsidized like product (over an appropriately representative period sufficient to demonstrate clear trends in the development of the market for the product concerned, which, in normal circumstances, shall be at least one year). "Change in relative shares of the market" shall include any of the following situations: (a) there is an increase in the market share of the subsidized product; (b) the market share of the subsidized product

remains constant in circumstances in which, in the absence of the subsidy, it would have declined; (c) the market share of the subsidized product declines, but at a slower rate than would have been the case in the absence of the subsidy.

6.5 For the purpose of paragraph 3(c), price undercutting shall include any case in which such price undercutting has been demonstrated through a comparison of prices of the subsidized product with prices of a non-subsidized like product supplied to the same market. The comparison shall be made at the same level of trade and at comparable times, due account being taken of any other factor affecting price comparability. However, if such a direct comparison is not possible, the existence of price undercutting may be demonstrated on the basis of export unit values.

6.6 Each Member in the market of which serious prejudice is alleged to have arisen shall, subject to the provisions of paragraph 3 of Annex V, make available to the parties to a dispute arising under Article 7, and to the panel established pursuant to paragraph 4 of Article 7, all relevant information that can be obtained as to the changes in market shares of the parties to the dispute as well as concerning prices of the products involved.

6.7 Displacement or impediment resulting in serious prejudice shall not arise under paragraph 3 where any of the following circumstances exist[iv] during the relevant period:

(a) prohibition or restriction on exports of the like product from the complaining Member or on imports from the complaining Member into the third country market concerned;

(b) decision by an importing government operating a monopoly of trade or state trading in the product concerned to shift, for non-commercial reasons, imports from the complaining Member to another country or countries;

(c) natural disasters, strikes, transport disruptions or other force majeure substantially affecting production, qualities, quantities or prices of the product available for export from the complaining Member;

(d) existence of arrangements limiting exports from the complaining Member;

(e) voluntary decrease in the availability for export of the product concerned from the complaining Member (including, inter alia, a situation where firms in the complaining Member have been autonomously reallocating exports of this product to new markets);

(f) failure to conform to standards and other regulatory requirements in the importing country.

6.8 In the absence of circumstances referred to in paragraph 7, the existence of serious prejudice should be determined on the basis of the information submitted to or obtained by the panel, including information submitted in accordance with the provisions of Annex V.

6.9 This Article does not apply to subsidies maintained on agricultural products as provided in Article 13 of the Agreement on Agriculture.

Article 7

Remedies

7.1 Except as provided in Article 13 of the Agreement on Agriculture, whenever a Member has reason to believe that any subsidy referred to in Article 1, granted or maintained by another Member, results in injury to its domestic industry, nullification or impairment or serious prejudice, such Member may request consultations with such other Member.

7.2 A request for consultations under paragraph 1 shall include a statement of available evidence with regard to (a) the existence and nature of the subsidy in question, and (b) the injury caused to the domestic industry, or the nullification or impairment, or serious prejudice[iv] caused to the interests of the Member requesting consultations.

7.3 Upon request for consultations under paragraph 1, the Member believed to be granting or maintaining the subsidy practice in question shall enter into such consultations as quickly as possible. The purpose of the consultations shall be to clarify the facts of the situation and to arrive at a mutually agreed solution.

7.4 If consultations do not result in a mutually agreed solution within 60 days[iv], any Member party to such consultations may refer the matter to the DSB for the establishment of a panel, unless the DSB decides by consensus not to establish a panel. The composition of the panel and its terms of reference shall be established within 15 days from the date when it is established.

7.5 The panel shall review the matter and shall submit its final report to the parties to the dispute. The report shall be circulated to all Members within 120 days of the date of the composition and establishment of the panel's terms of reference.

7.6 Within 30 days of the issuance of the panel's report to all Members, the report shall be adopted by the DSB[iv] unless one of the parties to the dispute formally notifies the DSB of its decision to appeal or the DSB decides by consensus not to adopt the report.

7.7 Where a panel report is appealed, the Appellate Body shall issue its decision within 60 days from the date when the party to the dispute formally notifies its intention to appeal. When the Appellate Body considers that it cannot provide its report within 60 days, it shall inform the DSB in writing of the reasons for the delay together with an estimate of the period within which it will submit its report. In no case shall the proceedings exceed 90 days. The appellate report shall be adopted by the DSB and unconditionally accepted by the parties to the dispute unless the DSB decides by consensus not to adopt the appellate report within 20 days following its issuance to the Members.[iv]

7.8 Where a panel report or an Appellate Body report is adopted in which it is determined that any subsidy has resulted in adverse effects to the interests of another Member within the meaning of Article 5, the Member granting or maintaining such subsidy shall take appropriate steps to remove the adverse effects or shall withdraw the subsidy.

7.9 In the event the Member has not taken appropriate steps to remove the adverse effects of the subsidy or withdraw the subsidy within six months from the date when the DSB adopts the panel report or the Appellate Body report, and in the absence of agreement on compensation, the DSB shall grant authorization to the complaining Member to take countermeasures, commensurate with the degree and nature of the adverse effects determined to exist, unless the DSB decides by consensus to reject the request.

7.10 In the event that a party to the dispute requests arbitration under paragraph 6 of Article 22 of the DSU, the arbitrator shall determine whether the countermeasures are commensurate with the degree and nature of the adverse effects determined to exist.

PART IV: NON-ACTIONABLE SUBSIDIES

Article 8

Identification of Non-Actionable Subsidies

8.1 The following subsidies shall be considered as non-actionable[iv]:

(a) subsidies which are not specific within the meaning of Article 2;

(b) subsidies which are specific within the meaning of Article 2 but which meet all of the conditions provided for in paragraphs 2(a), 2(b) or 2(c) below.

8.2 Notwithstanding the provisions of Parts III and V, the following subsidies shall be non-actionable:

(a) assistance for research activities conducted by firms or by higher education or research establishments on a contract basis with firms if:[iv] ,[iv] ,[iv]

the assistance covers[iv] not more than 75 per cent of the costs of industrial research[iv] or 50 per cent of the costs of pre-competitive development activity[iv], [iv]; and provided that such assistance is limited exclusively to:

(i) costs of personnel (researchers, technicians and other supporting staff employed exclusively in the research activity);

(ii) costs of instruments, equipment, land and buildings used exclusively and permanently (except when disposed of on a commercial basis) for the research activity;

(iii) costs of consultancy and equivalent services used exclusively for the research activity, including bought-in research, technical knowledge, patents, etc.;

(iv) additional overhead costs incurred directly as a result of the research activity;

(v) other running costs (such as those of materials, supplies and the like), incurred directly as a result of the research activity.

(b) assistance to disadvantaged regions within the territory of a Member given pursuant to a general framework of regional development [iv] and non-specific (within the meaning of Article 2) within eligible regions provided that:

(i) each disadvantaged region must be a clearly designated contiguous geographical area with a definable economic and administrative identity;

(ii) the region is considered as disadvantaged on the basis of neutral and objective criteria[iv], indicating that the region's difficulties arise out of more than temporary circumstances; such criteria must be clearly spelled out in law, regulation, or other official document, so as to be capable of verification;

(iii) the criteria shall include a measurement of economic development which shall be based on at least one of the following factors:

- one of either income per capita or household income per capita, or GDP per capita, which must not be above 85 per cent of the average for the territory concerned;
- unemployment rate, which must be at least 110 per cent of the average for the territory concerned;

as measured over a three-year period; such measurement, however, may be a composite one and may include other factors.

(c) assistance to promote adaptation of existing facilities[iv] to new environmental requirements imposed by law and/or regulations which result in greater constraints and financial burden on firms, provided that the assistance:

(i) is a one-time non-recurring measure; and

(ii) is limited to 20 per cent of the cost of adaptation; and

(iii) does not cover the cost of replacing and operating the assisted investment, which must be fully borne by firms; and

(iv) is directly linked to and proportionate to a firm's planned reduction of nuisances and pollution, and does not cover any manufacturing cost savings which may be achieved; and

(v) is available to all firms which can adopt the new equipment and/or production processes.

8.3 A subsidy programme for which the provisions of paragraph 2 are invoked shall be notified in advance of its implementation to the Committee in accordance with the provisions of Part VII. Any such notification shall be sufficiently precise to enable other Members to evaluate the consistency of the programme with the conditions and criteria provided for in the relevant provisions of paragraph 2. Members shall also provide the Committee with yearly updates of such notifications, in particular by supplying information on global expenditure for each programme, and on any modification of the

programme. Other Members shall have the right to request information about individual cases of subsidization under a notified programme.[iv]

8.4 Upon request of a Member, the Secretariat shall review a notification made pursuant to paragraph 3 and, where necessary, may require additional information from the subsidizing Member concerning the notified programme under review. The Secretariat shall report its findings to the Committee. The Committee shall, upon request, promptly review the findings of the Secretariat (or, if a review by the Secretariat has not been requested, the notification itself), with a view to determining whether the conditions and criteria laid down in paragraph 2 have not been met. The procedure provided for in this paragraph shall be completed at the latest at the first regular meeting of the Committee following the notification of a subsidy programme, provided that at least two months have elapsed between such notification and the regular meeting of the Committee. The review procedure described in this paragraph shall also apply, upon request, to substantial modifications of a programme notified in the yearly updates referred to in paragraph 3.

8.5 Upon the request of a Member, the determination by the Committee referred to in paragraph 4, or a failure by the Committee to make such a determination, as well as the violation, in individual cases, of the conditions set out in a notified programme, shall be submitted to binding arbitration. The arbitration body shall present its conclusions to the Members within 120 days from the date when the matter was referred to the arbitration body. Except as otherwise provided in this paragraph, the DSU shall apply to arbitrations conducted under this paragraph.

Article 9

Consultations and Authorized Remedies

9.1 If, in the course of implementation of a programme referred to in paragraph 2 of Article 8, notwithstanding the fact that the programme is

consistent with the criteria laid down in that paragraph, a Member has reasons to believe that this programme has resulted in serious adverse effects to the domestic industry of that Member, such as to cause damage which would be difficult to repair, such Member may request consultations with the Member granting or maintaining the subsidy.

9.2 Upon request for consultations under paragraph 1, the Member granting or maintaining the subsidy programme in question shall enter into such consultations as quickly as possible. The purpose of the consultations shall be to clarify the facts of the situation and to arrive at a mutually acceptable solution.

9.3 If no mutually acceptable solution has been reached in consultations under paragraph 2 within 60 days of the request for such consultations, the requesting Member may refer the matter to the Committee.

9.4 Where a matter is referred to the Committee, the Committee shall immediately review the facts involved and the evidence of the effects referred to in paragraph 1. If the Committee determines that such effects exist, it may recommend to the subsidizing Member to modify this programme in such a way as to remove these effects. The Committee shall present its conclusions within 120 days from the date when the matter is referred to it under paragraph 3. In the event the recommendation is not followed within six months, the Committee shall authorize the requesting Member to take appropriate countermeasures commensurate with the nature and degree of the effects determined to exist.

PART V: COUNTERVAILING MEASURES

Article 10

Application of Article VI of GATT 1994[iv]

Members shall take all necessary steps to ensure that the imposition of a countervailing duty[iv] on any product of the territory of

any Member imported into the territory of another Member is in accordance with the provisions of Article VI of GATT 1994 and the terms of this Agreement. Countervailing duties may only be imposed pursuant to investigations initiated[iv] and conducted in accordance with the provisions of this Agreement and the Agreement on Agriculture.

Article 11

Initiation and Subsequent Investigation

11.1 Except as provided in paragraph 6, an investigation to determine the existence, degree and effect of any alleged subsidy shall be initiated upon a written application by or on behalf of the domestic industry.

11.2 An application under paragraph 1 shall include sufficient evidence of the existence of (a) a subsidy and, if possible, its amount, (b) injury within the meaning of Article VI of GATT 1994 as interpreted by this Agreement, and (c) a causal link between the subsidized imports and the alleged injury. Simple assertion, unsubstantiated by relevant evidence, cannot be considered sufficient to meet the requirements of this paragraph. The application shall contain such information as is reasonably available to the applicant on the following:

(i) the identity of the applicant and a description of the volume and value of the domestic production of the like product by the applicant. Where a written application is made on behalf of the domestic industry, the application shall identify the industry on behalf of which the application is made by a list of all known domestic producers of the like product (or associations of domestic producers of the like product) and, to the extent possible, a description of the volume and value of domestic production of the like product accounted for by such producers;

(ii) a complete description of the allegedly subsidized product, the names of the country or countries of origin or export in question, the identity of each known exporter or foreign producer and a list of known persons importing the product in question;

(iii) evidence with regard to the existence, amount and nature of the subsidy in question;

(iv) evidence that alleged injury to a domestic industry is caused by subsidized imports through the effects of the subsidies; this evidence includes information on the evolution of the volume of the allegedly subsidized imports, the effect of these imports on prices of the like product in the domestic market and the consequent impact of the imports on the domestic industry, as demonstrated by relevant factors and indices having a bearing on the state of the domestic industry, such as those listed in paragraphs 2 and 4 of Article 15.

11.3 The authorities shall review the accuracy and adequacy of the evidence provided in the application to determine whether the evidence is sufficient to justify the initiation of an investigation.

11.4 An investigation shall not be initiated pursuant to paragraph 1 unless the authorities have determined, on the basis of an examination of the degree of support for, or opposition to, the application expressed[iv] by domestic producers of the like product, that the application has been made by or on behalf of the domestic industry.[iv] The application shall be considered to have been made "by or on behalf of the domestic industry" if it is supported by those domestic producers whose collective output constitutes more than 50 per cent of the total production of the like product produced by that portion of the domestic industry expressing either support for or opposition to the application. However, no investigation shall be initiated when domestic producers expressly supporting the application account for less than 25 per cent of total production of the like product produced by the domestic industry.

11.5 The authorities shall avoid, unless a decision has been made to initiate an investigation, any publicizing of the application for the initiation of an investigation.

11.6 If, in special circumstances, the authorities concerned decide to initiate an investigation without having received a written application by or on behalf of a domestic industry for the initiation of such investigation, they shall proceed only if they have sufficient evidence of the existence of a subsidy, injury and causal link, as described in paragraph 2, to justify the initiation of an investigation.

11.7 The evidence of both subsidy and injury shall be considered simultaneously (a) in the decision whether or not to initiate an investigation and (b) thereafter, during the course of the investigation, starting on a date not later than the earliest date on which in accordance with the provisions of this Agreement provisional measures may be applied.

11.8 In cases where products are not imported directly from the country of origin but are exported to the importing Member from an intermediate country, the provisions of this Agreement shall be fully applicable and the transaction or transactions shall, for the purposes of this Agreement, be regarded as having taken place between the country of origin and the importing Member.

11.9 An application under paragraph 1 shall be rejected and an investigation shall be terminated promptly as soon as the authorities concerned are satisfied that there is not sufficient evidence of either subsidization or of injury to justify proceeding with the case. There shall be immediate termination in cases where the amount of a subsidy is de minimis , or where the volume of subsidized imports, actual or potential, or the injury, is negligible. For the purpose of this paragraph, the amount of the subsidy shall be considered to be de minimis if the subsidy is less than 1 per cent ad valorem.

11.10 An investigation shall not hinder the procedures of customs clearance.

11.11 Investigations shall, except in special circumstances, be concluded within one year, and in no case more than 18 months, after their initiation.

Article 12

Evidence

12.1 Interested Members and all interested parties in a countervailing duty investigation shall be given notice of the information which the authorities require and ample opportunity to present in writing all evidence which they consider relevant in respect of the investigation in question.

12.1.1 Exporters, foreign producers or interested Members receiving questionnaires used in a countervailing duty investigation shall be given at least 30 days for reply.[iv] Due consideration should be given to any request for an extension of the 30-day period and, upon cause shown, such an extension should be granted whenever practicable.

12.1.2 Subject to the requirement to protect confidential information, evidence presented in writing by one interested Member or interested party shall be made available promptly to other interested Members or interested parties participating in the investigation.

12.1.3 As soon as an investigation has been initiated, the authorities shall provide the full text of the written application received under paragraph 1 of Article 11 to the known exporters[iv] and to the authorities of the exporting Member and shall make it available, upon request, to other interested parties involved. Due regard shall be paid to the protection of confidential information, as provided for in paragraph 4.

12.2. Interested Members and interested parties also shall have the right, upon justification, to present information orally. Where such information is provided orally, the interested Members and interested parties subsequently shall be required to reduce such submissions to writing. Any decision of the investigating authorities can only be based

on such information and arguments as were on the written record of this authority and which were available to interested Members and interested parties participating in the investigation, due account having been given to the need to protect confidential information.

12.3 The authorities shall whenever practicable provide timely opportunities for all interested Members and interested parties to see all information that is relevant to the presentation of their cases, that is not confidential as defined in paragraph 4, and that is used by the authorities in a countervailing duty investigation, and to prepare presentations on the basis of this information.

12.4 Any information which is by nature confidential (for example, because its disclosure would be of significant competitive advantage to a competitor or because its disclosure would have a significantly adverse effect upon a person supplying the information or upon a person from whom the supplier acquired the information), or which is provided on a confidential basis by parties to an investigation shall, upon good cause shown, be treated as such by the authorities. Such information shall not be disclosed without specific permission of the party submitting it.[iv]

12.4.1 The authorities shall require interested Members or interested parties providing confidential information to furnish non-confidential summaries thereof. These summaries shall be in sufficient detail to permit a reasonable understanding of the substance of the information submitted in confidence. In exceptional circumstances, such Members or parties may indicate that such information is not susceptible of summary. In such exceptional circumstances, a statement of the reasons why summarization is not possible must be provided.

12.4.2 If the authorities find that a request for confidentiality is not warranted and if the supplier of the information is either unwilling to make the information public or to authorize its disclosure in generalized or summary form, the authorities may disregard such information unless

it can be demonstrated to their satisfaction from appropriate sources that the information is correct.[iv]

12.5 Except in circumstances provided for in paragraph 7, the authorities shall during the course of an investigation satisfy themselves as to the accuracy of the information supplied by interested Members or interested parties upon which their findings are based.

12.6 The investigating authorities may carry out investigations in the territory of other Members as required, provided that they have notified in good time the Member in question and unless that Member objects to the investigation. Further, the investigating authorities may carry out investigations on the premises of a firm and may examine the records of a firm if (a) the firm so agrees and (b) the Member in question is notified and does not object. The procedures set forth in Annex VI shall apply to investigations on the premises of a firm. Subject to the requirement to protect confidential information, the authorities shall make the results of any such investigations available, or shall provide disclosure thereof pursuant to paragraph 8, to the firms to which they pertain and may make such results available to the applicants.

12.7 In cases in which any interested Member or interested party refuses access to, or otherwise does not provide, necessary information within a reasonable period or significantly impedes the investigation, preliminary and final determinations, affirmative or negative, may be made on the basis of the facts available.

12.8 The authorities shall, before a final determination is made, inform all interested Members and interested parties of the essential facts under consideration which form the basis for the decision whether to apply definitive measures. Such disclosure should take place in sufficient time for the parties to defend their interests.

12.9 For the purposes of this Agreement, "interested parties" shall include:

(i) an exporter or foreign producer or the importer of a product subject to investigation, or a trade or business association a majority of the members of which are producers, exporters or importers of such product; and

(ii) a producer of the like product in the importing Member or a trade and business association a majority of the members of which produce the like product in the territory of the importing Member.

This list shall not preclude Members from allowing domestic or foreign parties other than those mentioned above to be included as interested parties.

12.10 The authorities shall provide opportunities for industrial users of the product under investigation, and for representative consumer organizations in cases where the product is commonly sold at the retail level, to provide information which is relevant to the investigation regarding subsidization, injury and causality.

12.11 The authorities shall take due account of any difficulties experienced by interested parties, in particular small companies, in supplying information requested, and shall provide any assistance practicable.

12.12 The procedures set out above are not intended to prevent the authorities of a Member from proceeding expeditiously with regard to initiating an investigation, reaching preliminary or final determinations, whether affirmative or negative, or from applying provisional or final measures, in accordance with relevant provisions of this Agreement.

Article 13

Consultations

13.1 As soon as possible after an application under Article 11 is accepted, and in any event before the initiation of any investigation, Members the products of which may be subject to such investigation shall be invited for consultations with the aim of clarifying the situation

as to the matters referred to in paragraph 2 of Article 11 and arriving at a mutually agreed solution.

13.2 Furthermore, throughout the period of investigation, Members the products of which are the subject of the investigation shall be afforded a reasonable opportunity to continue consultations, with a view to clarifying the factual situation and to arriving at a mutually agreed solution.[iv]

13.3 Without prejudice to the obligation to afford reasonable opportunity for consultation, these provisions regarding consultations are not intended to prevent the authorities of a Member from proceeding expeditiously with regard to initiating the investigation, reaching preliminary or final determinations, whether affirmative or negative, or from applying provisional or final measures, in accordance with the provisions of this Agreement.

13.4 The Member which intends to initiate any investigation or is conducting such an investigation shall permit, upon request, the Member or Members the products of which are subject to such investigation access to non-confidential evidence, including the non-confidential summary of confidential data being used for initiating or conducting the investigation.

Article 14

Calculation of the Amount of a Subsidy in Terms of the Benefit to the Recipient

For the purpose of Part V, any method used by the investigating authority to calculate the benefit to the recipient conferred pursuant to paragraph 1 of Article 1 shall be provided for in the national legislation or implementing regulations of the Member concerned and its application to each particular case shall be transparent and adequately explained. Furthermore, any such method shall be consistent with the following guidelines:

(a) government provision of equity capital shall not be considered as conferring a benefit, unless the investment decision can be regarded as inconsistent with the usual investment practice (including for the provision of risk capital) of private investors in the territory of that Member;

(b) a loan by a government shall not be considered as conferring a benefit, unless there is a difference between the amount that the firm receiving the loan pays on the government loan and the amount the firm would pay on a comparable commercial loan which the firm could actually obtain on the market. In this case the benefit shall be the difference between these two amounts;

(c) a loan guarantee by a government shall not be considered as conferring a benefit, unless there is a difference between the amount that the firm receiving the guarantee pays on a loan guaranteed by the government and the amount that the firm would pay on a comparable commercial loan absent the government guarantee. In this case the benefit shall be the difference between these two amounts adjusted for any differences in fees;

(d) the provision of goods or services or purchase of goods by a government shall not be considered as conferring a benefit unless the provision is made for less than adequate remuneration, or the purchase is made for more than adequate remuneration. The adequacy of remuneration shall be determined in relation to prevailing market conditions for the good or service in question in the country of provision or purchase (including price, quality, availability, marketability, transportation and other conditions of purchase or sale).

Article 15

Determination of Injury[iv]

15.1 A determination of injury for purposes of Article VI of GATT 1994 shall be based on positive evidence and involve an objective examination

of both (a) the volume of the subsidized imports and the effect of the subsidized imports on prices in the domestic market for like products[iv] and (b) the consequent impact of these imports on the domestic producers of such products.

15.2 With regard to the volume of the subsidized imports, the investigating authorities shall consider whether there has been a significant increase in subsidized imports, either in absolute terms or relative to production or consumption in the importing Member. With regard to the effect of the subsidized imports on prices, the investigating authorities shall consider whether there has been a significant price undercutting by the subsidized imports as compared with the price of a like product of the importing Member, or whether the effect of such imports is otherwise to depress prices to a significant degree or to prevent price increases, which otherwise would have occurred, to a significant degree. No one or several of these factors can necessarily give decisive guidance.

15.3 Where imports of a product from more than one country are simultaneously subject to countervailing duty investigations, the investigating authorities may cumulatively assess the effects of such imports only if they determine that (a) the amount of subsidization established in relation to the imports from each country is more than de minimis as defined in paragraph 9 of Article 11 and the volume of imports from each country is not negligible and (b) a cumulative assessment of the effects of the imports is appropriate in light of the conditions of competition between the imported products and the conditions of competition between the imported products and the like domestic product.

15.4 The examination of the impact of the subsidized imports on the domestic industry shall include an evaluation of all relevant economic factors and indices having a bearing on the state of the industry,

including actual and potential decline in output, sales, market share, profits, productivity, return on investments, or utilization of capacity; factors affecting domestic prices; actual and potential negative effects on cash flow, inventories, employment, wages, growth, ability to raise capital or investments and, in the case of agriculture, whether there has been an increased burden on government support programmes. This list is not exhaustive, nor can one or several of these factors necessarily give decisive guidance.

15.5 It must be demonstrated that the subsidized imports are, through the effects[iv] of subsidies, causing injury within the meaning of this Agreement. The demonstration of a causal relationship between the subsidized imports and the injury to the domestic industry shall be based on an examination of all relevant evidence before the authorities. The authorities shall also examine any known factors other than the subsidized imports which at the same time are injuring the domestic industry, and the injuries caused by these other factors must not be attributed to the subsidized imports. Factors which may be relevant in this respect include, inter alia, the volumes and prices of non-subsidized imports of the product in question, contraction in demand or changes in the patterns of consumption, trade restrictive practices of and competition between the foreign and domestic producers, developments in technology and the export performance and productivity of the domestic industry.

15.6 The effect of the subsidized imports shall be assessed in relation to the domestic production of the like product when available data permit the separate identification of that production on the basis of such criteria as the production process, producers' sales and profits. If such separate identification of that production is not possible, the effects of the subsidized imports shall be assessed by the examination of the

production of the narrowest group or range of products, which includes the like product, for which the necessary information can be provided.

15.7 A determination of a threat of material injury shall be based on facts and not merely on allegation, conjecture or remote possibility. The change in circumstances which would create a situation in which the subsidy would cause injury must be clearly foreseen and imminent. In making a determination regarding the existence of a threat of material injury, the investigating authorities should consider, inter alia, such factors as:

(i) nature of the subsidy or subsidies in question and the trade effects likely to arise therefrom;

(ii) a significant rate of increase of subsidized imports into the domestic market indicating the likelihood of substantially increased importation;

(iii) sufficient freely disposable, or an imminent, substantial increase in, capacity of the exporter indicating the likelihood of substantially increased subsidized exports to the importing Member's market, taking into account the availability of other export markets to absorb any additional exports;

(iv) whether imports are entering at prices that will have a significant depressing or suppressing effect on domestic prices, and would likely increase demand for further imports; and

(v) inventories of the product being investigated.

No one of these factors by itself can necessarily give decisive guidance but the totality of the factors considered must lead to the conclusion that further subsidized exports are imminent and that, unless protective action is taken, material injury would occur.

15.8 With respect to cases where injury is threatened by subsidized imports, the application of countervailing measures shall be considered and decided with special care.

Article 16

Definition of Domestic Industry

16.1 For the purposes of this Agreement, the term "domestic industry" shall, except as provided in paragraph 2, be interpreted as referring to the domestic producers as a whole of the like products or to those of them whose collective output of the products constitutes a major proportion of the total domestic production of those products, except that when producers are related[iv] to the exporters or importers or are themselves importers of the allegedly subsidized product or a like product from other countries, the term "domestic industry" may be interpreted as referring to the rest of the producers.

16.2. In exceptional circumstances, the territory of a Member may, for the production in question, be divided into two or more competitive markets and the producers within each market may be regarded as a separate industry if (a) the producers within such market sell all or almost all of their production of the product in question in that market, and (b) the demand in that market is not to any substantial degree supplied by producers of the product in question located elsewhere in the territory. In such circumstances, injury may be found to exist even where a major portion of the total domestic industry is not injured, provided there is a concentration of subsidized imports into such an isolated market and provided further that the subsidized imports are causing injury to the producers of all or almost all of the production within such market.

16.3 When the domestic industry has been interpreted as referring to the producers in a certain area, i.e. a market as defined in paragraph 2, countervailing duties shall be levied only on the products in question consigned for final consumption to that area. When the constitutional law of the importing Member does not permit the levying of countervailing duties on such a basis, the importing Member may levy

the countervailing duties without limitation only if (a) the exporters shall have been given an opportunity to cease exporting at subsidized prices to the area concerned or otherwise give assurances pursuant to Article 18, and adequate assurances in this regard have not been promptly given, and (b) such duties cannot be levied only on products of specific producers which supply the area in question.

16.4 Where two or more countries have reached under the provisions of paragraph 8(a) of Article XXIV of GATT 1994 such a level of integration that they have the characteristics of a single, unified market, the industry in the entire area of integration shall be taken to be the domestic industry referred to in paragraphs 1 and 2.

16.5 The provisions of paragraph 6 of Article 15 shall be applicable to this Article.

Article 17

Provisional Measures

17.1 Provisional measures may be applied only if:

(a) an investigation has been initiated in accordance with the provisions of Article 11, a public notice has been given to that effect and interested Members and interested parties have been given adequate opportunities to submit information and make comments;

(b) a preliminary affirmative determination has been made that a subsidy exists and that there is injury to a domestic industry caused by subsidized imports; and

(c) the authorities concerned judge such measures necessary to prevent injury being caused during the investigation.

17.2 Provisional measures may take the form of provisional countervailing duties guaranteed by cash deposits or bonds equal to the amount of the provisionally calculated amount of subsidization.

17.3 Provisional measures shall not be applied sooner than 60 days from the date of initiation of the investigation.

17.4 The application of provisional measures shall be limited to as short a period as possible, not exceeding four months.

17.5 The relevant provisions of Article 19 shall be followed in the application of provisional measures.

Article 18

Undertakings

18.1 Proceedings may[iv] be suspended or terminated without the imposition of provisional measures or countervailing duties upon receipt of satisfactory voluntary undertakings under which:

(a) the government of the exporting Member agrees to eliminate or limit the subsidy or take other measures concerning its effects; or

(b) the exporter agrees to revise its prices so that the investigating authorities are satisfied that the injurious effect of the subsidy is eliminated. Price increases under such undertakings shall not be higher than necessary to eliminate the amount of the subsidy. It is desirable that the price increases be less than the amount of the subsidy if such increases would be adequate to remove the injury to the domestic industry.

18.2 Undertakings shall not be sought or accepted unless the authorities of the importing Member have made a preliminary affirmative determination of subsidization and injury caused by such subsidization and, in case of undertakings from exporters, have obtained the consent of the exporting Member.

18.3 Undertakings offered need not be accepted if the authorities of the importing Member consider their acceptance impractical, for example if the number of actual or potential exporters is too great, or for other reasons, including reasons of general policy. Should the case arise and where practicable, the authorities shall provide to the exporter the

reasons which have led them to consider acceptance of an undertaking as inappropriate, and shall, to the extent possible, give the exporter an opportunity to make comments thereon.

18.4 If an undertaking is accepted, the investigation of subsidization and injury shall nevertheless be completed if the exporting Member so desires or the importing Member so decides. In such a case, if a negative determination of subsidization or injury is made, the undertaking shall automatically lapse, except in cases where such a determination is due in large part to the existence of an undertaking. In such cases, the authorities concerned may require that an undertaking be maintained for a reasonable period consistent with the provisions of this Agreement. In the event that an affirmative determination of subsidization and injury is made, the undertaking shall continue consistent with its terms and the provisions of this Agreement.

18.5 Price undertakings may be suggested by the authorities of the importing Member, but no exporter shall be forced to enter into such undertakings. The fact that governments or exporters do not offer such undertakings, or do not accept an invitation to do so, shall in no way prejudice the consideration of the case. However, the authorities are free to determine that a threat of injury is more likely to be realized if the subsidized imports continue.

18.6 Authorities of an importing Member may require any government or exporter from whom an undertaking has been accepted to provide periodically information relevant to the fulfilment of such an undertaking, and to permit verification of pertinent data. In case of violation of an undertaking, the authorities of the importing Member may take, under this Agreement in conformity with its provisions, expeditious actions which may constitute immediate application of provisional measures using the best information available. In such cases, definitive duties may be levied in accordance with this Agreement

on products entered for consumption not more than 90 days before the application of such provisional measures, except that any such retroactive assessment shall not apply to imports entered before the violation of the undertaking.

Article 19

Imposition and Collection of Countervailing Duties

19.1 If, after reasonable efforts have been made to complete consultations, a Member makes a final determination of the existence and amount of the subsidy and that, through the effects of the subsidy, the subsidized imports are causing injury, it may impose a countervailing duty in accordance with the provisions of this Article unless the subsidy or subsidies are withdrawn.

19.2 The decision whether or not to impose a countervailing duty in cases where all requirements for the imposition have been fulfilled, and the decision whether the amount of the countervailing duty to be imposed shall be the full amount of the subsidy or less, are decisions to be made by the authorities of the importing Member. It is desirable that the imposition should be permissive in the territory of all Members, that the duty should be less than the total amount of the subsidy if such lesser duty would be adequate to remove the injury to the domestic industry, and that procedures should be established which would allow the authorities concerned to take due account of representations made by domestic interested parties[iv] whose interests might be adversely affected by the imposition of a countervailing duty.

19.3 When a countervailing duty is imposed in respect of any product, such countervailing duty shall be levied, in the appropriate amounts in each case, on a non-discriminatory basis on imports of such product from all sources found to be subsidized and causing injury, except as to imports from those sources which have renounced any subsidies in question or from which undertakings under the terms of this Agreement

have been accepted. Any exporter whose exports are subject to a definitive countervailing duty but who was not actually investigated for reasons other than a refusal to cooperate, shall be entitled to an expedited review in order that the investigating authorities promptly establish an individual countervailing duty rate for that exporter.

19.4 No countervailing duty shall be levied[iv] on any imported product in excess of the amount of the subsidy found to exist, calculated in terms of subsidization per unit of the subsidized and exported product.

Article 20

Retroactivity

20.1 Provisional measures and countervailing duties shall only be applied to products which enter for consumption after the time when the decision under paragraph 1 of Article 17 and paragraph 1 of Article 19, respectively, enters into force, subject to the exceptions set out in this Article.

20.2 Where a final determination of injury (but not of a threat thereof or of a material retardation of the establishment of an industry) is made or, in the case of a final determination of a threat of injury, where the effect of the subsidized imports would, in the absence of the provisional measures, have led to a determination of injury, countervailing duties may be levied retroactively for the period for which provisional measures, if any, have been applied.

20.3 If the definitive countervailing duty is higher than the amount guaranteed by the cash deposit or bond, the difference shall not be collected. If the definitive duty is less than the amount guaranteed by the cash deposit or bond, the excess amount shall be reimbursed or the bond released in an expeditious manner.

20.4 Except as provided in paragraph 2, where a determination of threat of injury or material retardation is made (but no injury has yet occurred) a definitive countervailing duty may be imposed only from the date of the

determination of threat of injury or material retardation, and any cash deposit made during the period of the application of provisional measures shall be refunded and any bonds released in an expeditious manner.

20.5 Where a final determination is negative, any cash deposit made during the period of the application of provisional measures shall be refunded and any bonds released in an expeditious manner.

20.6 In critical circumstances where for the subsidized product in question the authorities find that injury which is difficult to repair is caused by massive imports in a relatively short period of a product benefiting from subsidies paid or bestowed inconsistently with the provisions of GATT 1994 and of this Agreement and where it is deemed necessary, in order to preclude the recurrence of such injury, to assess countervailing duties retroactively on those imports, the definitive countervailing duties may be assessed on imports which were entered for consumption not more than 90 days prior to the date of application of provisional measures.

Article 21

Duration and Review of Countervailing Duties and Undertakings

21.1 A countervailing duty shall remain in force only as long as and to the extent necessary to counteract subsidization which is causing injury.

21.2 The authorities shall review the need for the continued imposition of the duty, where warranted, on their own initiative or, provided that a reasonable period of time has elapsed since the imposition of the definitive countervailing duty, upon request by any interested party which submits positive information substantiating the need for a review. Interested parties shall have the right to request the authorities to examine whether the continued imposition of the duty is necessary to offset subsidization, whether the injury would be likely to continue or recur if the duty were removed or varied, or both. If, as a result of the

review under this paragraph, the authorities determine that the countervailing duty is no longer warranted, it shall be terminated immediately.

21.3 Notwithstanding the provisions of paragraphs 1 and 2, any definitive countervailing duty shall be terminated on a date not later than five years from its imposition (or from the date of the most recent review under paragraph 2 if that review has covered both subsidization and injury, or under this paragraph), unless the authorities determine, in a review initiated before that date on their own initiative or upon a duly substantiated request made by or on behalf of the domestic industry within a reasonable period of time prior to that date, that the expiry of the duty would be likely to lead to continuation or recurrence of subsidization and injury.[iv] The duty may remain in force pending the outcome of such a review.

21.4 The provisions of Article 12 regarding evidence and procedure shall apply to any review carried out under this Article. Any such review shall be carried out expeditiously and shall normally be concluded within 12 months of the date of initiation of the review.

21.5 The provisions of this Article shall apply mutatis mutandis to undertakings accepted under Article 18.

Article 22

Public Notice and Explanation of

Determinations

22.1 When the authorities are satisfied that there is sufficient evidence to justify the initiation of an investigation pursuant to Article 11, the Member or Members the products of which are subject to such investigation and other interested parties known to the investigating authorities to have an interest therein shall be notified and a public notice shall be given.

22.2 A public notice of the initiation of an investigation shall contain, or otherwise make available through a separate report[iv], adequate information on the following:

(i) the name of the exporting country or countries and the product involved;

(ii) the date of initiation of the investigation;

(iii) a description of the subsidy practice or practices to be investigated;

(iv) a summary of the factors on which the allegation of injury is based;

(v) the address to which representations by interested Members and interested parties should be directed; and

(vi) the time-limits allowed to interested Members and interested parties for making their views known.

22.3 Public notice shall be given of any preliminary or final determination, whether affirmative or negative, of any decision to accept an undertaking pursuant to Article 18, of the termination of such an undertaking, and of the termination of a definitive countervailing duty. Each such notice shall set forth, or otherwise make available through a separate report, in sufficient detail the findings and conclusions reached on all issues of fact and law considered material by the investigating authorities. All such notices and reports shall be forwarded to the Member or Members the products of which are subject to such determination or undertaking and to other interested parties known to have an interest therein.

22.4 A public notice of the imposition of provisional measures shall set forth, or otherwise make available through a separate report, sufficiently detailed explanations for the preliminary determinations on the existence of a subsidy and injury and shall refer to the matters of fact and law which have led to arguments being accepted or rejected. Such a notice

or report shall, due regard being paid to the requirement for the protection of confidential information, contain in particular:

(i) the names of the suppliers or, when this is impracticable, the supplying countries involved;

(ii) a description of the product which is sufficient for customs purposes;

(iii) the amount of subsidy established and the basis on which the existence of a subsidy has been determined;

(iv) considerations relevant to the injury determination as set out in Article 15;

(v) the main reasons leading to the determination.

22.5 A public notice of conclusion or suspension of an investigation in the case of an affirmative determination providing for the imposition of a definitive duty or the acceptance of an undertaking shall contain, or otherwise make available through a separate report, all relevant information on the matters of fact and law and reasons which have led to the imposition of final measures or the acceptance of an undertaking, due regard being paid to the requirement for the protection of confidential information. In particular, the notice or report shall contain the information described in paragraph 4, as well as the reasons for the acceptance or rejection of relevant arguments or claims made by interested Members and by the exporters and importers.

22.6 A public notice of the termination or suspension of an investigation following the acceptance of an undertaking pursuant to Article 18 shall include, or otherwise make available through a separate report, the non-confidential part of this undertaking.

22.7 The provisions of this Article shall apply mutatis mutandis to the initiation and completion of reviews pursuant to Article 21 and to decisions under Article 20 to apply duties retroactively.

Article 23

Judicial Review

Each Member whose national legislation contains provisions on countervailing duty measures shall maintain judicial, arbitral or administrative tribunals or procedures for the purpose, inter alia, of the prompt review of administrative actions relating to final determinations and reviews of determinations within the meaning of Article 21. Such tribunals or procedures shall be independent of the authorities responsible for the determination or review in question, and shall provide all interested parties who participated in the administrative proceeding and are directly and individually affected by the administrative actions with access to review.

PART VI: INSTITUTIONS

Article 24

Committee on Subsidies and Countervailing Measures and Subsidiary Bodies

24.1 There is hereby established a Committee on Subsidies and Countervailing Measures composed of representatives from each of the Members. The Committee shall elect its own Chairman and shall meet not less than twice a year and otherwise as envisaged by relevant provisions of this Agreement at the request of any Member. The Committee shall carry out responsibilities as assigned to it under this Agreement or by the Members and it shall afford Members the opportunity of consulting on any matter relating to the operation of the Agreement or the furtherance of its objectives. The WTO Secretariat shall act as the secretariat to the Committee.

24.2 The Committee may set up subsidiary bodies as appropriate.

24.3 The Committee shall establish a Permanent Group of Experts composed of five independent persons, highly qualified in the fields of subsidies and trade relations. The experts will be elected by the Committee and one of them will be replaced every year. The PGE may be

requested to assist a panel, as provided for in paragraph 5 of Article 4. The Committee may also seek an advisory opinion on the existence and nature of any subsidy.

24.4 The PGE may be consulted by any Member and may give advisory opinions on the nature of any subsidy proposed to be introduced or currently maintained by that Member. Such advisory opinions will be confidential and may not be invoked in proceedings under Article 7.

24.5 In carrying out their functions, the Committee and any subsidiary bodies may consult with and seek information from any source they deem appropriate. However, before the Committee or a subsidiary body seeks such information from a source within the jurisdiction of a Member, it shall inform the Member involved.

PART VII: NOTIFICATION AND SURVEILLANCE

Article 25

Notifications

25.1 Members agree that, without prejudice to the provisions of paragraph 1 of Article XVI of GATT 1994, their notifications of subsidies shall be submitted not later than 30 June of each year and shall conform to the provisions of paragraphs 2 through 6.

25.2 Members shall notify any subsidy as defined in paragraph 1 of Article 1, which is specific within the meaning of Article 2, granted or maintained within their territories.

25.3 The content of notifications should be sufficiently specific to enable other Members to evaluate the trade effects and to understand the operation of notified subsidy programmes. In this connection, and without prejudice to the contents and form of the questionnaire on subsidies[iv], Members shall ensure that their notifications contain the following information:

(i) form of a subsidy (i.e. grant, loan, tax concession, etc.);

(ii) subsidy per unit or, in cases where this is not possible, the total amount or the annual amount budgeted for that subsidy (indicating, if possible, the average subsidy per unit in the previous year);

(iii) policy objective and/or purpose of a subsidy;

(iv) duration of a subsidy and/or any other time-limits attached to it;

(v) statistical data permitting an assessment of the trade effects of a subsidy.

25.4 Where specific points in paragraph 3 have not been addressed in a notification, an explanation shall be provided in the notification itself.

25.5 If subsidies are granted to specific products or sectors, the notifications should be organized by product or sector.

25.6 Members which consider that there are no measures in their territories requiring notification under paragraph 1 of Article XVI of GATT 1994 and this Agreement shall so inform the Secretariat in writing.

25.7 Members recognize that notification of a measure does not prejudge either its legal status under GATT 1994 and this Agreement, the effects under this Agreement, or the nature of the measure itself.

25.8 Any Member may, at any time, make a written request for information on the nature and extent of any subsidy granted or maintained by another Member (including any subsidy referred to in Part IV), or for an explanation of the reasons for which a specific measure has been considered as not subject to the requirement of notification.

25.9 Members so requested shall provide such information as quickly as possible and in a comprehensive manner, and shall be ready, upon request, to provide additional information to the requesting Member. In particular, they shall provide sufficient details to enable the other Member to assess their compliance with the terms of this Agreement. Any Member which considers that such information has not been provided may bring the matter to the attention of the Committee.

25.10 Any Member which considers that any measure of another Member having the effects of a subsidy has not been notified in accordance with the provisions of paragraph 1 of Article XVI of GATT 1994 and this Article may bring the matter to the attention of such other Member. If the alleged subsidy is not thereafter notified promptly, such Member may itself bring the alleged subsidy in question to the notice of the Committee.

25.11 Members shall report without delay to the Committee all preliminary or final actions taken with respect to countervailing duties. Such reports shall be available in the Secretariat for inspection by other Members. Members shall also submit, on a semi-annual basis, reports on any countervailing duty actions taken within the preceding six months. The semi-annual reports shall be submitted on an agreed standard form.

25.12 Each Member shall notify the Committee (a) which of its authorities are competent to initiate and conduct investigations referred to in Article 11 and (b) its domestic procedures governing the initiation and conduct of such investigations.

Article 26

Surveillance

26.1 The Committee shall examine new and full notifications submitted under paragraph 1 of Article XVI of GATT 1994 and paragraph 1 of Article 25 of this Agreement at special sessions held every third year. Notifications submitted in the intervening years (updating notifications) shall be examined at each regular meeting of the Committee.

26.2 The Committee shall examine reports submitted under paragraph 11 of Article 25 at each regular meeting of the Committee.

PART VIII: DEVELOPING COUNTRY MEMBERS

Article 27

Special and Differential Treatment of Developing Country Members

27.1 Members recognize that subsidies may play an important role in economic development programmes of developing country Members.

27.2 The prohibition of paragraph 1(a) of Article 3 shall not apply to:

(a) developing country Members referred to in Annex VII.

(b) other developing country Members for a period of eight years from the date of entry into force of the WTO Agreement, subject to compliance with the provisions in paragraph 4.

27.3 The prohibition of paragraph 1(b) of Article 3 shall not apply to developing country Members for a period of five years, and shall not apply to least developed country Members for a period of eight years, from the date of entry into force of the WTO Agreement.

27.4 Any developing country Member referred to in paragraph 2(b) shall phase out its export subsidies within the eight-year period, preferably in a progressive manner. However, a developing country Member shall not increase the level of its export subsidies[iv], and shall eliminate them within a period shorter than that provided for in this paragraph when the use of such export subsidies is inconsistent with its development needs. If a developing country Member deems it necessary to apply such subsidies beyond the 8-year period, it shall not later than one year before the expiry of this period enter into consultation with the Committee, which will determine whether an extension of this period is justified, after examining all the relevant economic, financial and development needs of the developing country Member in question. If the Committee determines that the extension is justified, the developing country Member concerned shall hold annual consultations with the Committee to determine the necessity of maintaining the subsidies. If no such determination is made by the Committee, the developing country Member shall phase out the remaining export subsidies within two years from the end of the last authorized period.

27.5 A developing country Member which has reached export competitiveness in any given product shall phase out its export subsidies for such product(s) over a period of two years. However, for a developing country Member which is referred to in Annex VII and which has reached export competitiveness in one or more products, export subsidies on such products shall be gradually phased out over a period of eight years.

27.6 Export competitiveness in a product exists if a developing country Member's exports of that product have reached a share of at least 3.25 per cent in world trade of that product for two consecutive calendar years. Export competitiveness shall exist either (a) on the basis of notification by the developing country Member having reached export competitiveness, or (b) on the basis of a computation undertaken by the Secretariat at the request of any Member. For the purpose of this paragraph, a product is defined as a section heading of the Harmonized System Nomenclature. The Committee shall review the operation of this provision five years from the date of the entry into force of the WTO Agreement.

27.7 The provisions of Article 4 shall not apply to a developing country Member in the case of export subsidies which are in conformity with the provisions of paragraphs 2 through 5. The relevant provisions in such a case shall be those of Article 7.

27.8 There shall be no presumption in terms of paragraph 1 of Article 6 that a subsidy granted by a developing country Member results in serious prejudice, as defined in this Agreement. Such serious prejudice, where applicable under the terms of paragraph 9, shall be demonstrated by positive evidence, in accordance with the provisions of paragraphs 3 through 8 of Article 6.

27.9 Regarding actionable subsidies granted or maintained by a developing country Member other than those referred to in paragraph 1 of Article 6, action may not be authorized or taken under Article 7 unless

nullification or impairment of tariff concessions or other obligations under GATT 1994 is found to exist as a result of such a subsidy, in such a way as to displace or impede imports of a like product of another Member into the market of the subsidizing developing country Member or unless injury to a domestic industry in the market of an importing Member occurs.

27.10 Any countervailing duty investigation of a product originating in a developing country Member shall be terminated as soon as the authorities concerned determine that:

(a) the overall level of subsidies granted upon the product in question does not exceed 2 per cent of its value calculated on a per unit basis; or

(b) the volume of the subsidized imports represents less than 4 per cent of the total imports of the like product in the importing Member, unless imports from developing country Members whose individual shares of total imports represent less than 4 per cent collectively account for more than 9 per cent of the total imports of the like product in the importing Member.

27.11 For those developing country Members within the scope of paragraph 2(b) which have eliminated export subsidies prior to the expiry of the period of eight years from the date of entry into force of the WTO Agreement, and for those developing country Members referred to in Annex VII, the number in paragraph 10(a) shall be 3 per cent rather than 2 per cent. This provision shall apply from the date that the elimination of export subsidies is notified to the Committee, and for so long as export subsidies are not granted by the notifying developing country Member. This provision shall expire eight years from the date of entry into force of the WTO Agreement.

27.12 The provisions of paragraphs 10 and 11 shall govern any determination of de minimis under paragraph 3 of Article 15.

27.13 The provisions of Part III shall not apply to direct forgiveness of debts, subsidies to cover social costs, in whatever form, including relinquishment of government revenue and other transfer of liabilities when such subsidies are granted within and directly linked to a privatization programme of a developing country Member, provided that both such programme and the subsidies involved are granted for a limited period and notified to the Committee and that the programme results in eventual privatization of the enterprise concerned.

27.14 The Committee shall, upon request by an interested Member, undertake a review of a specific export subsidy practice of a developing country Member to examine whether the practice is in conformity with its development needs.

27.15 The Committee shall, upon request by an interested developing country Member, undertake a review of a specific countervailing measure to examine whether it is consistent with the provisions of paragraphs 10 and 11 as applicable to the developing country Member in question.

PART IX: TRANSITIONAL ARRANGEMENTS

Article 28

Existing Programmes

28.1 Subsidy programmes which have been established within the territory of any Member before the date on which such a Member signed the WTO Agreement and which are inconsistent with the provisions of this Agreement shall be:

(a) notified to the Committee not later than 90 days after the date of entry into force of the WTO Agreement for such Member; and

(b) brought into conformity with the provisions of this Agreement within three years of the date of entry into force of the WTO Agreement for such Member and until then shall not be subject to Part II.

28.2 No Member shall extend the scope of any such programme, nor shall such a programme be renewed upon its expiry.

Article 29

Transformation into a Market Economy

29.1 Members in the process of transformation from a centrally-planned into a market, free-enterprise economy may apply programmes and measures necessary for such a transformation.

29.2 For such Members, subsidy programmes falling within the scope of Article 3, and notified according to paragraph 3, shall be phased out or brought into conformity with Article 3 within a period of seven years from the date of entry into force of the WTO Agreement. In such a case, Article 4 shall not apply. In addition during the same period:

(a) Subsidy programmes falling within the scope of paragraph 1(d) of Article 6 shall not be actionable under Article 7;

(b) With respect to other actionable subsidies, the provisions of paragraph 9 of Article 27 shall apply.

29.3 Subsidy programmes falling within the scope of Article 3 shall be notified to the Committee by the earliest practicable date after the date of entry into force of the WTO Agreement. Further notifications of such subsidies may be made up to two years after the date of entry into force of the WTO Agreement.

29.4 In exceptional circumstances Members referred to in paragraph 1 may be given departures from their notified programmes and measures and their time-frame by the Committee if such departures are deemed necessary for the process of transformation.

PART X: DISPUTE SETTLEMENT

Article 30

The provisions of Articles XXII and XXIII of GATT 1994 as elaborated and applied by the Dispute Settlement Understanding shall apply to consultations and the settlement of disputes under this Agreement, except as otherwise specifically provided herein.

PART XI: FINAL PROVISIONS

Article 31

Provisional Application

The provisions of paragraph 1 of Article 6 and the provisions of Article 8 and Article 9 shall apply for a period of five years, beginning with the date of entry into force of the WTO Agreement. Not later than 180 days before the end of this period, the Committee shall review the operation of those provisions, with a view to determining whether to extend their application, either as presently drafted or in a modified form, for a further period.

Article 32

Other Final Provisions

32.1 No specific action against a subsidy of another Member can be taken except in accordance with the provisions of GATT 1994, as interpreted by this Agreement.[iv]

32.2 Reservations may not be entered in respect of any of the provisions of this Agreement without the consent of the other Members.

32.3 Subject to paragraph 4, the provisions of this Agreement shall apply to investigations, and reviews of existing measures, initiated pursuant to applications which have been made on or after the date of entry into force for a Member of the WTO Agreement.

32.4 For the purposes of paragraph 3 of Article 21, existing countervailing measures shall be deemed to be imposed on a date not later than the date of entry into force for a Member of the WTO Agreement, except in cases in which the domestic legislation of a Member in force at that date already included a clause of the type provided for in that paragraph.

32.5 Each Member shall take all necessary steps, of a general or particular character, to ensure, not later than the date of entry into force of the WTO Agreement for it, the conformity of its laws, regulations and

administrative procedures with the provisions of this Agreement as they may apply to the Member in question.

32.6 Each Member shall inform the Committee of any changes in its laws and regulations relevant to this Agreement and in the administration of such laws and regulations.

32.7 The Committee shall review annually the implementation and operation of this Agreement, taking into account the objectives thereof. The Committee shall inform annually the Council for Trade in Goods of developments during the period covered by such reviews.

32.8 The Annexes to this Agreement constitute an integral part thereof.

(ANNEX I)

ILLUSTRATIVE LIST OF EXPORT SUBSIDIES

(a) The provision by governments of direct subsidies to a firm or an industry contingent upon export performance.

(b) Currency retention schemes or any similar practices which involve a bonus on exports.

(c) Internal transport and freight charges on export shipments, provided or mandated by governments, on terms more favourable than for domestic shipments.

(d) The provision by governments or their agencies either directly or indirectly through government-mandated schemes, of imported or domestic products or services for use in the production of exported goods, on terms or conditions more favourable than for provision of like or directly competitive products or services for use in the production of goods for domestic consumption, if (in the case of products) such terms or conditions are more favourable than those commercially available[iv] on world markets to their exporters.

(e) The full or partial exemption remission, or deferral specifically related to exports, of direct taxes[iv] or social welfare charges paid or payable by industrial or commercial enterprises.[iv]

(f) The allowance of special deductions directly related to exports or export performance, over and above those granted in respect to production for domestic consumption, in the calculation of the base on which direct taxes are charged.

(g) The exemption or remission, in respect of the production and distribution of exported products, of indirect taxes58 in excess of those levied in respect of the production and distribution of like products when sold for domestic consumption.

(h) The exemption, remission or deferral of prior-stage cumulative indirect taxes58 on goods or services used in the production of exported products in excess of the exemption, remission or deferral of like prior-stage cumulative indirect taxes on goods or services used in the production of like products when sold for domestic consumption; provided, however, that prior-stage cumulative indirect taxes may be exempted, remitted or deferred on exported products even when not exempted, remitted or deferred on like products when sold for domestic consumption, if the prior-stage cumulative indirect taxes are levied on inputs that are consumed in the production of the exported product (making normal allowance for waste).[iv] This item shall be interpreted in accordance with the guidelines on consumption of inputs in the production process contained in Annex II.

(i) The remission or drawback of import charges58 in excess of those levied on imported inputs that are consumed in the production of the exported product (making normal allowance for waste); provided, however, that in particular cases a firm may use a quantity of home market inputs equal to, and having the same quality and characteristics as, the imported inputs as a substitute for them in order to benefit from

this provision if the import and the corresponding export operations both occur within a reasonable time period, not to exceed two years. This item shall be interpreted in accordance with the guidelines on consumption of inputs in the production process contained in Annex II and the guidelines in the determination of substitution drawback systems as export subsidies contained in Annex III.

(j) The provision by governments (or special institutions controlled by governments) of export credit guarantee or insurance programmes, of insurance or guarantee programmes against increases in the cost of exported products or of exchange risk programmes, at premium rates which are inadequate to cover the long-term operating costs and losses of the programmes.

(k) The grant by governments (or special institutions controlled by and/or acting under the authority of governments) of export credits at rates below those which they actually have to pay for the funds so employed (or would have to pay if they borrowed on international capital markets in order to obtain funds of the same maturity and other credit terms and denominated in the same currency as the export credit), or the payment by them of all or part of the costs incurred by exporters or financial institutions in obtaining credits, in so far as they are used to secure a material advantage in the field of export credit terms.

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

(l) Any other charge on the public account constituting an export subsidy in the sense of Article XVI of GATT 1994.

(ANNEX II)

GUIDELINES ON CONSUMPTION OF INPUTS IN THE PRODUCTION PROCESS[iv]

I

1. Indirect tax rebate schemes can allow for exemption, remission or deferral of prior-stage cumulative indirect taxes levied on inputs that are consumed in the production of the exported product (making normal allowance for waste). Similarly, drawback schemes can allow for the remission or drawback of import charges levied on inputs that are consumed in the production of the exported product (making normal allowance for waste).

2. The Illustrative List of Export Subsidies in Annex I of this Agreement makes reference to the term "inputs that are consumed in the production of the exported product" in paragraphs (h) and (i). Pursuant to paragraph (h), indirect tax rebate schemes can constitute an export subsidy to the extent that they result in exemption, remission or deferral of prior-stage cumulative indirect taxes in excess of the amount of such taxes actually levied on inputs that are consumed in the production of the exported product. Pursuant to paragraph (i), drawback schemes can constitute an export subsidy to the extent that they result in a remission or drawback of import charges in excess of those actually levied on inputs that are consumed in the production of the exported product. Both paragraphs stipulate that normal allowance for waste must be made in findings regarding consumption of inputs in the production of the exported product. Paragraph (i) also provides for substitution, where appropriate.

II

In examining whether inputs are consumed in the production of the exported product, as part of a countervailing duty investigation pursuant to this Agreement, investigating authorities should proceed on the following basis:

1. Where it is alleged that an indirect tax rebate scheme, or a drawback scheme, conveys a subsidy by reason of over-rebate or excess drawback of indirect taxes or import charges on inputs consumed in the production of the exported product, the investigating authorities should first determine whether the government of the exporting Member has in place and applies a system or procedure to confirm which inputs are consumed in the production of the exported product and in what amounts. Where such a system or procedure is determined to be applied, the investigating authorities should then examine the system or procedure to see whether it is reasonable, effective for the purpose intended, and based on generally accepted commercial practices in the country of export. The investigating authorities may deem it necessary to carry out, in accordance with paragraph 6 of Article 12, certain practical tests in order to verify information or to satisfy themselves that the system or procedure is being effectively applied.

2. Where there is no such system or procedure, where it is not reasonable, or where it is instituted and considered reasonable but is found not to be applied or not to be applied effectively, a further examination by the exporting Member based on the actual inputs involved would need to be carried out in the context of determining whether an excess payment occurred. If the investigating authorities deemed it necessary, a further examination would be carried out in accordance with paragraph 1.

3. Investigating authorities should treat inputs as physically incorporated if such inputs are used in the production process and are physically present in the product exported. The Members note that an

input need not be present in the final product in the same form in which it entered the production process.

4. In determining the amount of a particular input that is consumed in the production of the exported product, a "normal allowance for waste" should be taken into account, and such waste should be treated as consumed in the production of the exported product. The term "waste" refers to that portion of a given input which does not serve an independent function in the production process, is not consumed in the production of the exported product (for reasons such as inefficiencies) and is not recovered, used or sold by the same manufacturer.

5. The investigating authority's determination of whether the claimed allowance for waste is "normal" should take into account the production process, the average experience of the industry in the country of export, and other technical factors, as appropriate. The investigating authority should bear in mind that an important question is whether the authorities in the exporting Member have reasonably calculated the amount of waste, when such an amount is intended to be included in the tax or duty rebate or remission.

(ANNEX III)

GUIDELINES IN THE DETERMINATION OF SUBSTITUTION DRAWBACK SYSTEMS AS EXPORT SUBSIDIES

I

Drawback systems can allow for the refund or drawback of import charges on inputs which are consumed in the production process of another product and where the export of this latter product contains domestic inputs having the same quality and characteristics as those substituted for the imported inputs. Pursuant to paragraph (i) of the Illustrative List of Export Subsidies in Annex I, substitution drawback systems can constitute an export subsidy to the extent that they result in

an excess drawback of the import charges levied initially on the imported inputs for which drawback is being claimed.

II

In examining any substitution drawback system as part of a countervailing duty investigation pursuant to this Agreement, investigating authorities should proceed on the following basis:

1. Paragraph (i) of the Illustrative List stipulates that home market inputs may be substituted for imported inputs in the production of a product for export provided such inputs are equal in quantity to, and have the same quality and characteristics as, the imported inputs being substituted. The existence of a verification system or procedure is important because it enables the government of the exporting Member to ensure and demonstrate that the quantity of inputs for which drawback is claimed does not exceed the quantity of similar products exported, in whatever form, and that there is not drawback of import charges in excess of those originally levied on the imported inputs in question.

2. Where it is alleged that a substitution drawback system conveys a subsidy, the investigating authorities should first proceed to determine whether the government of the exporting Member has in place and applies a verification system or procedure. Where such a system or procedure is determined to be applied, the investigating authorities should then examine the verification procedures to see whether they are reasonable, effective for the purpose intended, and based on generally accepted commercial practices in the country of export. To the extent that the procedures are determined to meet this test and are effectively applied, no subsidy should be presumed to exist. It may be deemed necessary by the investigating authorities to carry out, in accordance with paragraph 6 of Article 12, certain practical tests in order to verify information or to satisfy themselves that the verification procedures are being effectively applied.

3. Where there are no verification procedures, where they are not reasonable, or where such procedures are instituted and considered reasonable but are found not to be actually applied or not applied effectively, there may be a subsidy. In such cases a further examination by the exporting Member based on the actual transactions involved would need to be carried out to determine whether an excess payment occurred. If the investigating authorities deemed it necessary, a further examination would be carried out in accordance with paragraph 2.

4. The existence of a substitution drawback provision under which exporters are allowed to select particular import shipments on which drawback is claimed should not of itself be considered to convey a subsidy.

5. An excess drawback of import charges in the sense of paragraph (i) would be deemed to exist where governments paid interest on any monies refunded under their drawback schemes, to the extent of the interest actually paid or payable.

(ANNEX IV)

CALCULATION OF THE TOTAL AD VALOREM SUBSIDIZATION

(PARAGRAPH 1(A) OF ARTICLE 6)[iv]

1. Any calculation of the amount of a subsidy for the purpose of paragraph 1(a) of Article 6 shall be done in terms of the cost to the granting government.

2. Except as provided in paragraphs 3 through 5, in determining whether the overall rate of subsidization exceeds 5 per cent of the value of the product, the value of the product shall be calculated as the total value of the recipient firm's[iv] sales in the most recent 12-month period, for which sales data is available, preceding the period in which the subsidy is granted.[iv]

3. Where the subsidy is tied to the production or sale of a given product, the value of the product shall be calculated as the total value of

the recipient firm's sales of that product in the most recent 12-month period, for which sales data is available, preceding the period in which the subsidy is granted.

4. Where the recipient firm is in a start-up situation, serious prejudice shall be deemed to exist if the overall rate of subsidization exceeds 15 per cent of the total funds invested. For purposes of this paragraph, a start-up period will not extend beyond the first year of production.[iv]

5. Where the recipient firm is located in an inflationary economy country, the value of the product shall be calculated as the recipient firm's total sales (or sales of the relevant product, if the subsidy is tied) in the preceding calendar year indexed by the rate of inflation experienced in the 12 months preceding the month in which the subsidy is to be given.

6. In determining the overall rate of subsidization in a given year, subsidies given under different programmes and by different authorities in the territory of a Member shall be aggregated.

7. Subsidies granted prior to the date of entry into force of the WTO Agreement, the benefits of which are allocated to future production, shall be included in the overall rate of subsidization.

8. Subsidies which are non-actionable under relevant provisions of this Agreement shall not be included in the calculation of the amount of a subsidy for the purpose of paragraph 1(a) of Article 6.

(ANNEX V)

PROCEDURES FOR DEVELOPING INFORMATION CONCERNING SERIOUS PREJUDICE

1. Every Member shall cooperate in the development of evidence to be examined by a panel in procedures under paragraphs 4 through 6 of

Article 7. The parties to the dispute and any third-country Member concerned shall notify to the DSB, as soon as the provisions of paragraph 4 of Article 7 have been invoked, the organization responsible for administration of this provision within its territory and the procedures to be used to comply with requests for information.

2. In cases where matters are referred to the DSB under paragraph 4 of Article 7, the DSB shall, upon request, initiate the procedure to obtain such information from the government of the subsidizing Member as necessary to establish the existence and amount of subsidization, the value of total sales of the subsidized firms, as well as information necessary to analyze the adverse effects caused by the subsidized product.[iv] This process may include, where appropriate, presentation of questions to the government of the subsidizing Member and of the complaining Member to collect information, as well as to clarify and obtain elaboration of information available to the parties to a dispute through the notification procedures set forth in Part VII.[iv]

3. In the case of effects in third-country markets, a party to a dispute may collect information, including through the use of questions to the government of the third-country Member, necessary to analyse adverse effects, which is not otherwise reasonably available from the complaining Member or the subsidizing Member. This requirement should be administered in such a way as not to impose an unreasonable burden on the third-country Member. In particular, such a Member is not expected to make a market or price analysis specially for that purpose. The information to be supplied is that which is already available or can be readily obtained by this Member (e.g. most recent statistics which have already been gathered by relevant statistical services but which have not yet been published, customs data concerning imports and declared values of the products concerned, etc.). However, if a party to a dispute undertakes a detailed market analysis at its own expense, the

task of the person or firm conducting such an analysis shall be facilitated by the authorities of the third-country Member and such a person or firm shall be given access to all information which is not normally maintained confidential by the government.

4. The DSB shall designate a representative to serve the function of facilitating the information-gathering process. The sole purpose of the representative shall be to ensure the timely development of the information necessary to facilitate expeditious subsequent multilateral review of the dispute. In particular, the representative may suggest ways to most efficiently solicit necessary information as well as encourage the cooperation of the parties.

5. The information-gathering process outlined in paragraphs 2 through 4 shall be completed within 60 days of the date on which the matter has been referred to the DSB under paragraph 4 of Article 7. The information obtained during this process shall be submitted to the panel established by the DSB in accordance with the provisions of Part X. This information should include, inter alia, data concerning the amount of the subsidy in question (and, where appropriate, the value of total sales of the subsidized firms), prices of the subsidized product, prices of the non-subsidized product, prices of other suppliers to the market, changes in the supply of the subsidized product to the market in question and changes in market shares. It should also include rebuttal evidence, as well as such supplemental information as the panel deems relevant in the course of reaching its conclusions.

6. If the subsidizing and/or third-country Member fail to cooperate in the information-gathering process, the complaining Member will present its case of serious prejudice, based on evidence available to it, together with facts and circumstances of the non-cooperation of the subsidizing and/or third-country Member. Where information is unavailable due to non-cooperation by the subsidizing and/or third-country Member, the

panel may complete the record as necessary relying on best information otherwise available.

7. In making its determination, the panel should draw adverse inferences from instances of non- cooperation by any party involved in the information-gathering process.

8. In making a determination to use either best information available or adverse inferences, the panel shall consider the advice of the DSB representative nominated under paragraph 4 as to the reasonableness of any requests for information and the efforts made by parties to comply with these requests in a cooperative and timely manner.

9. Nothing in the information-gathering process shall limit the ability of the panel to seek such additional information it deems essential to a proper resolution to the dispute, and which was not adequately sought or developed during that process. However, ordinarily the panel should not request additional information to complete the record where the information would support a particular party's position and the absence of that information in the record is the result of unreasonable non-cooperation by that party in the information-gathering process.

(ANNEX VI)

PROCEDURES FOR ON-THE-SPOT INVESTIGATIONS PURSUANT TO PARAGRAPH 6 OF ARTICLE 12

1. Upon initiation of an investigation, the authorities of the exporting Member and the firms known to be concerned should be informed of the intention to carry out on-the-spot investigations.

2. If in exceptional circumstances it is intended to include non-governmental experts in the investigating team, the firms and the authorities of the exporting Member should be so informed. Such non-governmental experts should be subject to effective sanctions for breach of confidentiality requirements.

3. It should be standard practice to obtain explicit agreement of the firms concerned in the exporting Member before the visit is finally scheduled.

4. As soon as the agreement of the firms concerned has been obtained, the investigating authorities should notify the authorities of the exporting Member of the names and addresses of the firms to be visited and the dates agreed.

5. Sufficient advance notice should be given to the firms in question before the visit is made.

6. Visits to explain the questionnaire should only be made at the request of an exporting firm. In case of such a request the investigating authorities may place themselves at the disposal of the firm; such a visit may only be made if (a) the authorities of the importing Member notify the representatives of the government of the Member in question and (b) the latter do not object to the visit.

7. As the main purpose of the on-the-spot investigation is to verify information provided or to obtain further details, it should be carried out after the response to the questionnaire has been received unless the firm agrees to the contrary and the government of the exporting Member is informed by the investigating authorities of the anticipated visit and does not object to it; further, it should be standard practice prior to the visit to advise the firms concerned of the general nature of the information to be verified and of any further information which needs to be provided, though this should not preclude requests to be made on the spot for further details to be provided in the light of information obtained.

8. Enquiries or questions put by the authorities or firms of the exporting Members and essential to a successful on-the-spot investigation should, whenever possible, be answered before the visit is made.

ANNEX VII

DEVELOPING COUNTRY MEMBERS REFERRED TO
IN PARAGRAPH 2(A) OF ARTICLE 27

The developing country Members not subject to the provisions of paragraph 1(a) of Article 3 under the terms of paragraph 2(a) of Article 27 are:

(a) Least-developed countries designated as such by the United Nations which are Members of the WTO.

(b) Each of the following developing countries which are Members of the WTO shall be subject to the provisions which are applicable to other developing country Members according to paragraph 2(b) of Article 27 when GNP per capita has reached $1,000 per annum[iv]: Bolivia, Cameroon, Congo, Côte d'Ivoire, Dominican Republic, Egypt, Ghana, Guatemala, Guyana, India, Indonesia, Kenya, Morocco, Nicaragua, Nigeria, Pakistan, Philippines, Senegal, Sri Lanka and Zimbabwe.

[v] ANNEX 5

AGREEMENT ON TECHNICAL BARRIERS TO TRADE

Members,

Having regard to the Uruguay Round of Multilateral Trade Negotiations;

Desiring to further the objectives of GATT 1994;

Recognizing the important contribution that international standards and conformity assessment systems can make in this regard by improving efficiency of production and facilitating the conduct of international trade;

Desiring therefore to encourage the development of such international standards and conformity assessment systems;

Desiring however to ensure that technical regulations and standards, including packaging, marking and labelling requirements, and procedures for assessment of conformity with technical regulations and standards do not create unnecessary obstacles to international trade;

Recognizing that no country should be prevented from taking measures necessary to ensure the quality of its exports, or for the protection of human, animal or plant life or health, of the environment, or for the prevention of deceptive practices, at the levels it considers appropriate, subject to the requirement that they are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail or a disguised restriction on international trade, and are otherwise in accordance with the provisions of this Agreement;

Recognizing that no country should be prevented from taking measures necessary for the protection of its essential security interest;

Recognizing the contribution which international standardization can make to the transfer of technology from developed to developing countries;

Recognizing that developing countries may encounter special difficulties in the formulation and application of technical regulations and standards and procedures for assessment of conformity with technical regulations and standards, and desiring to assist them in their endeavours in this regard;

Hereby *agree* as follows:

Article 1

General Provisions

1.1 General terms for standardization and procedures for assessment of conformity shall normally have the meaning given to them by definitions adopted within the United Nations system and by international standardizing bodies taking into account their context and in the light of the object and purpose of this Agreement.

1.2 However, for the purposes of this Agreement the meaning of the terms given in Annex 1 applies.

1.3 All products, including industrial and agricultural products, shall be subject to the provisions of this Agreement.

1.4 Purchasing specifications prepared by governmental bodies for production or consumption requirements of governmental bodies are not subject to the provisions of this Agreement but are addressed in the Agreement on Government Procurement, according to its coverage.

1.5 The provisions of this Agreement do not apply to sanitary and phytosanitary measures as defined in Annex A of the Agreement on the Application of Sanitary and Phytosanitary Measures.

1.6 All references in this Agreement to technical regulations, standards and conformity assessment procedures shall be construed to include any amendments thereto and any additions to the rules or the product

coverage thereof, except amendments and additions of an insignificant nature.

TECHNICAL REGULATIONS AND STANDARDS

Article 2

Preparation, Adoption and Application of Technical Regulations by Central Government Bodies

With respect to their central government bodies:

2.1 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.

2.2 Members shall ensure that technical regulations are not prepared, adopted or applied with a view to or with the effect of creating unnecessary obstacles to international trade. For this purpose, technical regulations shall not be more trade-restrictive than necessary to fulfil a legitimate objective, taking account of the risks non-fulfilment would create. Such legitimate objectives are, *inter alia:* national security requirements; the prevention of deceptive practices; protection of human health or safety, animal or plant life or health, or the environment. In assessing such risks, relevant elements of consideration are, *inter alia:* available scientific and technical information, related processing technology or intended end-uses of products.

2.3 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.

2.4 Where technical regulations are required and relevant international standards exist or their completion is imminent, Members shall use them, or the relevant parts of them, as a basis for their technical regulations except when such international standards or relevant parts

would be an ineffective or inappropriate means for the fulfilment of the legitimate objectives pursued, for instance because of fundamental climatic or geographical factors or fundamental technological problems.

2.5 A Member preparing, adopting or applying a technical regulation which may have a significant effect on trade of other Members shall, upon the request of another Member, explain the justification for that technical regulation in terms of the provisions of paragraphs 2 to 4. Whenever a technical regulation is prepared, adopted or applied for one of the legitimate objectives explicitly mentioned in paragraph 2, and is in accordance with relevant international standards, it shall be rebuttably presumed not to create an unnecessary obstacle to international trade.

2.6 With a view to harmonizing technical regulations on as wide a basis as possible, Members shall play a full part, within the limits of their resources, in the preparation by appropriate international standardizing bodies of international standards for products for which they either have adopted, or expect to adopt, technical regulations.

2.7 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.

2.8 Wherever appropriate, Members shall specify technical regulations based on product requirements in terms of performance rather than design or descriptive characteristics.

2.9 Whenever a relevant international standard does not exist or the technical content of a proposed technical regulation is not in accordance with the technical content of relevant international standards, and if the technical regulation may have a significant effect on trade of other Members, Members shall:

2.9.1 publish a notice in a publication at an early appropriate stage, in such a manner as to enable interested parties in other Members to

become acquainted with it, that they propose to introduce a particular technical regulation;

2.9.2 notify other Members through the Secretariat of the products to be covered by the proposed technical regulation, together with a brief indication of its objective and rationale. Such notifications shall take place at an early appropriate stage, when amendments can still be introduced and comments taken into account;

2.9.3 upon request, provide to other Members particulars or copies of the proposed technical regulation and, whenever possible, identify the parts which in substance deviate from relevant international standards;

2.9.4 without discrimination, allow reasonable time for other Members to make comments in writing, discuss these comments upon request, and take these written comments and the results of these discussions into account.

2.10 Subject to the provisions in the lead-in to paragraph 9, where urgent problems of safety, health, environmental protection or national security arise or threaten to arise for a Member, that Member may omit such of the steps enumerated in paragraph 9 as it finds necessary, provided that the Member, upon adoption of a technical regulation, shall:

2.10.1 notify immediately other Members through the Secretariat of the particular technical regulation and the products covered, with a brief indication of the objective and the rationale of the technical regulation, including the nature of the urgent problems;

2.10.2 upon request, provide other Members with copies of the technical regulation;

2.10.3 without discrimination, allow other Members to present their comments in writing, discuss these comments upon request, and take these written comments and the results of these discussions into account.

2.11 Members shall ensure that all technical regulations which have been adopted are published promptly or otherwise made available in such a manner as to enable interested parties in other Members to become acquainted with them.

2.12 Except in those urgent circumstances referred to in paragraph 10, Members shall allow a reasonable interval between the publication of technical regulations and their entry into force in order to allow time for producers in exporting Members, and particularly in developing country Members, to adapt their products or methods of production to the requirements of the importing Member.

Article 3

Preparation, Adoption and Application of Technical Regulations by Local Government Bodies and Non-Governmental Bodies

With respect to their local government and non-governmental bodies within their territories:

3.1 Members shall take such reasonable measures as may be available to them to ensure compliance by such bodies with the provisions of Article 2, with the exception of the obligation to notify as referred to in paragraphs 9.2 and 10.1 of Article 2.

3.2 Members shall ensure that the technical regulations of local governments on the level directly below that of the central government in Members are notified in accordance with the provisions of paragraphs 9.2 and 10.1 of Article 2, noting that notification shall not be required for technical regulations the technical content of which is substantially the same as that of previously notified technical regulations of central government bodies of the Member concerned.

3.3 Members may require contact with other Members, including the notifications, provision of information, comments and discussions referred to in paragraphs 9 and 10 of Article 2, to take place through the central government.

3.4 Members shall not take measures which require or encourage local government bodies or non-governmental bodies within their territories to act in a manner inconsistent with the provisions of Article 2.

3.5 Members are fully responsible under this Agreement for the observance of all provisions of Article 2. Members shall formulate and implement positive measures and mechanisms in support of the observance of the provisions of Article 2 by other than central government bodies.

Article 4

Preparation, Adoption and Application of Standards

4.1 Members shall ensure that their central government standardizing bodies accept and comply with the Code of Good Practice for the Preparation, Adoption and Application of Standards in Annex 3 to this Agreement (referred to in this Agreement as the "Code of Good Practice"). They shall take such reasonable measures as may be available to them to ensure that local government and non-governmental standardizing bodies within their territories, as well as regional standardizing bodies of which they or one or more bodies within their territories are members, accept and comply with this Code of Good Practice. In addition, Members shall not take measures which have the effect of, directly or indirectly, requiring or encouraging such standardizing bodies to act in a manner inconsistent with the Code of Good Practice. The obligations of Members with respect to compliance of standardizing bodies with the provisions of the Code of Good Practice shall apply irrespective of whether or not a standardizing body has accepted the Code of Good Practice.

4.2 Standardizing bodies that have accepted and are complying with the Code of Good Practice shall be acknowledged by the Members as complying with the principles of this Agreement.

CONFORMITY WITH TECHNICAL REGULATIONS AND STANDARDS

Article 5

Procedures for Assessment of Conformity by Central Government Bodies

5.1 Members shall ensure that, in cases where a positive assurance of conformity with technical regulations or standards is required, their central government bodies apply the following provisions to products originating in the territories of other Members:

5.1.1 conformity assessment procedures are prepared, adopted and applied so as to grant access for suppliers of like products originating in the territories of other Members under conditions no less favourable than those accorded to suppliers of like products of national origin or originating in any other country, in a comparable situation; access entails suppliers' right to an assessment of conformity under the rules of the procedure, including, when foreseen by this procedure, the possibility to have conformity assessment activities undertaken at the site of facilities and to receive the mark of the system;

5.1.2 conformity assessment procedures are not prepared, adopted or applied with a view to or with the effect of creating unnecessary obstacles to international trade. This means, *inter alia*, that conformity assessment procedures shall not be more strict or be applied more strictly than is necessary to give the importing Member adequate confidence that products conform with the applicable technical regulations or standards, taking account of the risks non-conformity would create.

5.2 When implementing the provisions of paragraph 1, Members shall ensure that:

5.2.1 conformity assessment procedures are undertaken and completed as expeditiously as possible and in a no less favourable order for

products originating in the territories of other Members than for like domestic products;

5.2.2 the standard processing period of each conformity assessment procedure is published or that the anticipated processing period is communicated to the applicant upon request; when receiving an application, the competent body promptly examines the completeness of the documentation and informs the applicant in a precise and complete manner of all deficiencies; the competent body transmits as soon as possible the results of the assessment in a precise and complete manner to the applicant so that corrective action may be taken if necessary; even when the application has deficiencies, the competent body proceeds as far as practicable with the conformity assessment if the applicant so requests; and that, upon request, the applicant is informed of the stage of the procedure, with any delay being explained;

5.2.3 information requirements are limited to what is necessary to assess conformity and determine fees;

5.2.4 the confidentiality of information about products originating in the territories of other Members arising from or supplied in connection with such conformity assessment procedures is respected in the same way as for domestic products and in such a manner that legitimate commercial interests are protected;

5.2.5 any fees imposed for assessing the conformity of products originating in the territories of other Members are equitable in relation to any fees chargeable for assessing the conformity of like products of national origin or originating in any other country, taking into account communication, transportation and other costs arising from differences between location of facilities of the applicant and the conformity assessment body;

5.2.6 the siting of facilities used in conformity assessment procedures and the selection of samples are not such as to cause unnecessary inconvenience to applicants or their agents;

5.2.7 whenever specifications of a product are changed subsequent to the determination of its conformity to the applicable technical regulations or standards, the conformity assessment procedure for the modified product is limited to what is necessary to determine whether adequate confidence exists that the product still meets the technical regulations or standards concerned;

5.2.8 a procedure exists to review complaints concerning the operation of a conformity assessment procedure and to take corrective action when a complaint is justified.

5.3 Nothing in paragraphs 1 and 2 shall prevent Members from carrying out reasonable spot checks within their territories.

5.4 In cases where a positive assurance is required that products conform with technical regulations or standards, and relevant guides or recommendations issued by international standardizing bodies exist or their completion is imminent, Members shall ensure that central government bodies use them, or the relevant parts of them, as a basis for their conformity assessment procedures, except where, as duly explained upon request, such guides or recommendations or relevant parts are inappropriate for the Members concerned, for, *inter alia*, such reasons as: national security requirements; the prevention of deceptive practices; protection of human health or safety, animal or plant life or health, or the environment; fundamental climatic or other geographical factors; fundamental technological or infrastructural problems.

5.5 With a view to harmonizing conformity assessment procedures on as wide a basis as possible, Members shall play a full part, within the limits of their resources, in the preparation by appropriate international

standardizing bodies of guides and recommendations for conformity assessment procedures.

5.6 Whenever a relevant guide or recommendation issued by an international standardizing body does not exist or the technical content of a proposed conformity assessment procedure is not in accordance with relevant guides and recommendations issued by international standardizing bodies, and if the conformity assessment procedure may have a significant effect on trade of other Members, Members shall:

5.6.1 publish a notice in a publication at an early appropriate stage, in such a manner as to enable interested parties in other Members to become acquainted with it, that they propose to introduce a particular conformity assessment procedure;

5.6.2 notify other Members through the Secretariat of the products to be covered by the proposed conformity assessment procedure, together with a brief indication of its objective and rationale. Such notifications shall take place at an early appropriate stage, when amendments can still be introduced and comments taken into account;

5.6.3 upon request, provide to other Members particulars or copies of the proposed procedure and, whenever possible, identify the parts which in substance deviate from relevant guides or recommendations issued by international standardizing bodies;

5.6.4 without discrimination, allow reasonable time for other Members to make comments in writing, discuss these comments upon request, and take these written comments and the results of these discussions into account.

5.7 Subject to the provisions in the lead-in to paragraph 6, where urgent problems of safety, health, environmental protection or national security arise or threaten to arise for a Member, that Member may omit such of the steps enumerated in paragraph 6 as it finds necessary, provided that the Member, upon adoption of the procedure, shall:

5.7.1 notify immediately other Members through the Secretariat of the particular procedure and the products covered, with a brief indication of the objective and the rationale of the procedure, including the nature of the urgent problems;

5.7.2 upon request, provide other Members with copies of the rules of the procedure;

5.7.3 without discrimination, allow other Members to present their comments in writing, discuss these comments upon request, and take these written comments and the results of these discussions into account.

5.8 Members shall ensure that all conformity assessment procedures which have been adopted are published promptly or otherwise made available in such a manner as to enable interested parties in other Members to become acquainted with them.

5.9 Except in those urgent circumstances referred to in paragraph 7, Members shall allow a reasonable interval between the publication of requirements concerning conformity assessment procedures and their entry into force in order to allow time for producers in exporting Members, and particularly in developing country Members, to adapt their products or methods of production to the requirements of the importing Member.

Article 6

Recognition of Conformity Assessment by Central Government Bodies

With respect to their central government bodies:

6.1 Without prejudice to the provisions of paragraphs 3 and 4, Members shall ensure, whenever possible, that results of conformity assessment procedures in other Members are accepted, even when those procedures differ from their own, provided they are satisfied that those procedures offer an assurance of conformity with applicable technical

regulations or standards equivalent to their own procedures. It is recognized that prior consultations may be necessary in order to arrive at a mutually satisfactory understanding regarding, in particular:

6.1.1 adequate and enduring technical competence of the relevant conformity assessment bodies in the exporting Member, so that confidence in the continued reliability of their conformity assessment results can exist; in this regard, verified compliance, for instance through accreditation, with relevant guides or recommendations issued by international standardizing bodies shall be taken into account as an indication of adequate technical competence;

6.1.2 limitation of the acceptance of conformity assessment results to those produced by designated bodies in the exporting Member.

6.2 Members shall ensure that their conformity assessment procedures permit, as far as practicable, the implementation of the provisions in paragraph 1.

6.3 Members are encouraged, at the request of other Members, to be willing to enter into negotiations for the conclusion of agreements for the mutual recognition of results of each other's conformity assessment procedures. Members may require that such agreements fulfil the criteria of paragraph 1 and give mutual satisfaction regarding their potential for facilitating trade in the products concerned.

6.4 Members are encouraged to permit participation of conformity assessment bodies located in the territories of other Members in their conformity assessment procedures under conditions no less favourable than those accorded to bodies located within their territory or the territory of any other country.

Article 7

Procedures for Assessment of Conformity by Local Government Bodies

With respect to their local government bodies within their territories:

7.1 Members shall take such reasonable measures as may be available to them to ensure compliance by such bodies with the provisions of Articles 5 and 6, with the exception of the obligation to notify as referred to in paragraphs 6.2 and 7.1 of Article 5.

7.2 Members shall ensure that the conformity assessment procedures of local governments on the level directly below that of the central government in Members are notified in accordance with the provisions of paragraphs 6.2 and 7.1 of Article 5, noting that notifications shall not be required for conformity assessment procedures the technical content of which is substantially the same as that of previously notified conformity assessment procedures of central government bodies of the Members concerned.

7.3 Members may require contact with other Members, including the notifications, provision of information, comments and discussions referred to in paragraphs 6 and 7 of Article 5, to take place through the central government.

7.4 Members shall not take measures which require or encourage local government bodies within their territories to act in a manner inconsistent with the provisions of Articles 5 and 6.

7.5 Members are fully responsible under this Agreement for the observance of all provisions of Articles 5 and 6. Members shall formulate and implement positive measures and mechanisms in support of the observance of the provisions of Articles 5 and 6 by other than central government bodies.

Article 8

Procedures for Assessment of Conformity by Non-Governmental Bodies

8.1 Members shall take such reasonable measures as may be available to them to ensure that non-governmental bodies within their territories which operate conformity assessment procedures comply with the provisions of Articles 5 and 6, with the exception of the obligation to notify proposed conformity assessment procedures. In addition, Members shall not take measures which have the effect of, directly or indirectly, requiring or encouraging such bodies to act in a manner inconsistent with the provisions of Articles 5 and 6.

8.2 Members shall ensure that their central government bodies rely on conformity assessment procedures operated by non-governmental bodies only if these latter bodies comply with the provisions of Articles 5 and 6, with the exception of the obligation to notify proposed conformity assessment procedures.

Article 9

International and Regional Systems

9.1 Where a positive assurance of conformity with a technical regulation or standard is required, Members shall, wherever practicable, formulate and adopt international systems for conformity assessment and become members thereof or participate therein.

9.2 Members shall take such reasonable measures as may be available to them to ensure that international and regional systems for conformity assessment in which relevant bodies within their territories are members or participants comply with the provisions of Articles 5 and 6. In addition, Members shall not take any measures which have the effect of, directly or indirectly, requiring or encouraging such systems to act in a manner inconsistent with any of the provisions of Articles 5 and 6.

9.3 Members shall ensure that their central government bodies rely on international or regional conformity assessment systems only to the extent that these systems comply with the provisions of Articles 5 and 6, as applicable.

INFORMATION AND ASSISTANCE

Article 10

Information about Technical Regulations, Standards and Conformity Assessment Procedures

10.1 Each Member shall ensure that an enquiry point exists which is able to answer all reasonable enquiries from other Members and interested parties in other Members as well as to provide the relevant documents regarding:

10.1.1 any technical regulations adopted or proposed within its territory by central or local government bodies, by non-governmental bodies which have legal power to enforce a technical regulation, or by regional standardizing bodies of which such bodies are members or participants;

10.1.2 any standards adopted or proposed within its territory by central or local government bodies, or by regional standardizing bodies of which such bodies are members or participants;

10.1.3 any conformity assessment procedures, or proposed conformity assessment procedures, which are operated within its territory by central or local government bodies, or by non-governmental bodies which have legal power to enforce a technical regulation, or by regional bodies of which such bodies are members or participants;

10.1.4 the membership and participation of the Member, or of relevant central or local government bodies within its territory, in international and regional standardizing bodies and conformity assessment systems, as well as in bilateral and multilateral arrangements within the scope of this Agreement; it shall also be able to provide reasonable information on the provisions of such systems and arrangements;

10.1.5 the location of notices published pursuant to this Agreement, or the provision of information as to where such information can be obtained; and

10.1.6 the location of the enquiry points mentioned in paragraph 3.

10.2 If, however, for legal or administrative reasons more than one enquiry point is established by a Member, that Member shall provide to the other Members complete and unambiguous information on the scope of responsibility of each of these enquiry points. In addition, that Member shall ensure that any enquiries addressed to an incorrect enquiry point shall promptly be conveyed to the correct enquiry point.

10.3 Each Member shall take such reasonable measures as may be available to it to ensure that one or more enquiry points exist which are able to answer all reasonable enquiries from other Members and interested parties in other Members as well as to provide the relevant documents or information as to where they can be obtained regarding:

10.3.1 any standards adopted or proposed within its territory by non-governmental standardizing bodies, or by regional standardizing bodies of which such bodies are members or participants; and

10.3.2 any conformity assessment procedures, or proposed conformity assessment procedures, which are operated within its territory by non-governmental bodies, or by regional bodies of which such bodies are members or participants;

10.3.3 the membership and participation of relevant non-governmental bodies within its territory in international and regional standardizing bodies and conformity assessment systems, as well as in bilateral and multilateral arrangements within the scope of this Agreement; they shall also be able to provide reasonable information on the provisions of such systems and arrangements.

10.4 Members shall take such reasonable measures as may be available to them to ensure that where copies of documents are requested by other

Members or by interested parties in other Members, in accordance with the provisions of this Agreement, they are supplied at an equitable price (if any) which shall, apart from the real cost of delivery, be the same for the nationals[v] of the Member concerned or of any other Member.

10.5 Developed country Members shall, if requested by other Members, provide, in English, French or Spanish, translations of the documents covered by a specific notification or, in case of voluminous documents, of summaries of such documents.

10.6 The Secretariat shall, when it receives notifications in accordance with the provisions of this Agreement, circulate copies of the notifications to all Members and interested international standardizing and conformity assessment bodies, and draw the attention of developing country Members to any notifications relating to products of particular interest to them.

10.7 Whenever a Member has reached an agreement with any other country or countries on issues related to technical regulations, standards or conformity assessment procedures which may have a significant effect on trade, at least one Member party to the agreement shall notify other Members through the Secretariat of the products to be covered by the agreement and include a brief description of the agreement. Members concerned are encouraged to enter, upon request, into consultations with other Members for the purposes of concluding similar agreements or of arranging for their participation in such agreements.

10.8 Nothing in this Agreement shall be construed as requiring:

10.8.1 the publication of texts other than in the language of the Member;

10.8.2 the provision of particulars or copies of drafts other than in the language of the Member except as stated in paragraph 5; or

10.8.3 Members to furnish any information, the disclosure of which they consider contrary to their essential security interests.

10.9 Notifications to the Secretariat shall be in English, French or Spanish.

10.10 Members shall designate a single central government authority that is responsible for the implementation on the national level of the provisions concerning notification procedures under this Agreement except those included in Annex 3.

10.11 If, however, for legal or administrative reasons the responsibility for notification procedures is divided among two or more central government authorities, the Member concerned shall provide to the other Members complete and unambiguous information on the scope of responsibility of each of these authorities.

Article 11

Technical Assistance to Other Members

11.1 Members shall, if requested, advise other Members, especially the developing country Members, on the preparation of technical regulations.

11.2 Members shall, if requested, advise other Members, especially the developing country Members, and shall grant them technical assistance on mutually agreed terms and conditions regarding the establishment of national standardizing bodies, and participation in the international standardizing bodies, and shall encourage their national standardizing bodies to do likewise.

11.3 Members shall, if requested, take such reasonable measures as may be available to them to arrange for the regulatory bodies within their territories to advise other Members, especially the developing country Members, and shall grant them technical assistance on mutually agreed terms and conditions regarding:

11.3.1 the establishment of regulatory bodies, or bodies for the assessment of conformity with technical regulations; and

11.3.2 the methods by which their technical regulations can best be met.

11.4 Members shall, if requested, take such reasonable measures as may be available to them to arrange for advice to be given to other Members, especially the developing country Members, and shall grant them technical assistance on mutually agreed terms and conditions regarding the establishment of bodies for the assessment of conformity with standards adopted within the territory of the requesting Member.

11.5 Members shall, if requested, advise other Members, especially the developing country Members, and shall grant them technical assistance on mutually agreed terms and conditions regarding the steps that should be taken by their producers if they wish to have access to systems for conformity assessment operated by governmental or non-governmental bodies within the territory of the Member receiving the request.

11.6 Members which are members or participants of international or regional systems for conformity assessment shall, if requested, advise other Members, especially the developing country Members, and shall grant them technical assistance on mutually agreed terms and conditions regarding the establishment of the institutions and legal framework which would enable them to fulfil the obligations of membership or participation in such systems.

11.7 Members shall, if so requested, encourage bodies within their territories which are members or participants of international or regional systems for conformity assessment to advise other Members, especially the developing country Members, and should consider requests for technical assistance from them regarding the establishment of the institutions which would enable the relevant bodies within their territories to fulfil the obligations of membership or participation.

11.8 In providing advice and technical assistance to other Members in terms of paragraphs 1 to 7, Members shall give priority to the needs of the least-developed country Members.

Article 12

Special and Differential Treatment of Developing Country Members

12.1 Members shall provide differential and more favourable treatment to developing country Members to this Agreement, through the following provisions as well as through the relevant provisions of other Articles of this Agreement.

12.2 Members shall give particular attention to the provisions of this Agreement concerning developing country Members' rights and obligations and shall take into account the special development, financial and trade needs of developing country Members in the implementation of this Agreement, both nationally and in the operation of this Agreement's institutional arrangements.

12.3 Members shall, in the preparation and application of technical regulations, standards and conformity assessment procedures, take account of the special development, financial and trade needs of developing country Members, with a view to ensuring that such technical regulations, standards and conformity assessment procedures do not create unnecessary obstacles to exports from developing country Members.

12.4 Members recognize that, although international standards, guides or recommendations may exist, in their particular technological and socio-economic conditions, developing country Members adopt certain technical regulations, standards or conformity assessment procedures aimed at preserving indigenous technology and production methods and processes compatible with their development needs. Members therefore recognize that developing country Members should not be expected to use international standards as a basis for their technical regulations or standards, including test methods, which are not appropriate to their development, financial and trade needs.

12.5 Members shall take such reasonable measures as may be available to them to ensure that international standardizing bodies and

international systems for conformity assessment are organized and operated in a way which facilitates active and representative participation of relevant bodies in all Members, taking into account the special problems of developing country Members.

12.6 Members shall take such reasonable measures as may be available to them to ensure that international standardizing bodies, upon request of developing country Members, examine the possibility of, and, if practicable, prepare international standards concerning products of special interest to developing country Members.

12.7 Members shall, in accordance with the provisions of Article 11, provide technical assistance to developing country Members to ensure that the preparation and application of technical regulations, standards and conformity assessment procedures do not create unnecessary obstacles to the expansion and diversification of exports from developing country Members. In determining the terms and conditions of the technical assistance, account shall be taken of the stage of development of the requesting Members and in particular of the least-developed country Members.

12.8 It is recognized that developing country Members may face special problems, including institutional and infrastructural problems, in the field of preparation and application of technical regulations, standards and conformity assessment procedures. It is further recognized that the special development and trade needs of developing country Members, as well as their stage of technological development, may hinder their ability to discharge fully their obligations under this Agreement. Members, therefore, shall take this fact fully into account. Accordingly, with a view to ensuring that developing country Members are able to comply with this Agreement, the Committee on Technical Barriers to Trade provided for in Article 13 (referred to in this Agreement as the "Committee") is enabled to grant, upon request, specified, time-limited exceptions in

whole or in part from obligations under this Agreement. When considering such requests the Committee shall take into account the special problems, in the field of preparation and application of technical regulations, standards and conformity assessment procedures, and the special development and trade needs of the developing country Member, as well as its stage of technological development, which may hinder its ability to discharge fully its obligations under this Agreement. The Committee shall, in particular, take into account the special problems of the least-developed country Members.

12.9 During consultations, developed country Members shall bear in mind the special difficulties experienced by developing country Members in formulating and implementing standards and technical regulations and conformity assessment procedures, and in their desire to assist developing country Members with their efforts in this direction, developed country Members shall take account of the special needs of the former in regard to financing, trade and development.

12.10 The Committee shall examine periodically the special and differential treatment, as laid down in this Agreement, granted to developing country Members on national and international levels.

INSTITUTIONS, CONSULTATION AND DISPUTE SETTLEMENT

Article 13

The Committee on Technical Barriers to Trade

13.1 A Committee on Technical Barriers to Trade is hereby established, and shall be composed of representatives from each of the Members. The Committee shall elect its own Chairman and shall meet as necessary, but no less than once a year, for the purpose of affording Members the opportunity of consulting on any matters relating to the operation of this Agreement or the furtherance of its objectives, and shall carry out such responsibilities as assigned to it under this Agreement or by the Members.

13.2 The Committee shall establish working parties or other bodies as may be appropriate, which shall carry out such responsibilities as may be assigned to them by the Committee in accordance with the relevant provisions of this Agreement.

13.3 It is understood that unnecessary duplication should be avoided between the work under this Agreement and that of governments in other technical bodies. The Committee shall examine this problem with a view to minimizing such duplication.

Article 14

Consultation and Dispute Settlement

14.1 Consultations and the settlement of disputes with respect to any matter affecting the operation of this Agreement shall take place under the auspices of the Dispute Settlement Body and shall follow, *mutatis mutandis*, the provisions of Articles XXII and XXIII of GATT 1994, as elaborated and applied by the Dispute Settlement Understanding.

14.2 At the request of a party to a dispute, or at its own initiative, a panel may establish a technical expert group to assist in questions of a technical nature, requiring detailed consideration by experts.

14.3 Technical expert groups shall be governed by the procedures of Annex 2.

14.4 The dispute settlement provisions set out above can be invoked in cases where a Member considers that another Member has not achieved satisfactory results under Articles 3, 4, 7, 8 and 9 and its trade interests are significantly affected. In this respect, such results shall be equivalent to those as if the body in question were a Member.

FINAL PROVISIONS

Article 15

Final Provisions

Reservations

15.1 Reservations may not be entered in respect of any of the provisions of this Agreement without the consent of the other Members.

Review

15.2 Each Member shall, promptly after the date on which the WTO Agreement enters into force for it, inform the Committee of measures in existence or taken to ensure the implementation and administration of this Agreement. Any changes of such measures thereafter shall also be notified to the Committee.

15.3 The Committee shall review annually the implementation and operation of this Agreement taking into account the objectives thereof.

15.4 Not later than the end of the third year from the date of entry into force of the WTO Agreement and at the end of each three-year period thereafter, the Committee shall review the operation and implementation of this Agreement, including the provisions relating to transparency, with a view to recommending an adjustment of the rights and obligations of this Agreement where necessary to ensure mutual economic advantage and balance of rights and obligations, without prejudice to the provisions of Article 12. Having regard, *inter alia,* to the experience gained in the implementation of the Agreement, the Committee shall, where appropriate, submit proposals for amendments to the text of this Agreement to the Council for Trade in Goods.

Annexes

15.5 The annexes to this Agreement constitute an integral part thereof.

(ANNEX 1)

TERMS AND THEIR DEFINITIONS FOR THE

PURPOSE OF THIS AGREEMENT

The terms presented in the sixth edition of the ISO/IEC Guide 2: 1991, General Terms and Their Definitions Concerning Standardization and Related Activities, shall, when used in this Agreement, have the

same meaning as given in the definitions in the said Guide taking into account that services are excluded from the coverage of this Agreement.

For the purpose of this Agreement, however, the following definitions shall apply:

1. *Technical regulation*

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.

Explanatory note

The definition in ISO/IEC Guide 2 is not self-contained, but based on the so-called "building block" system.

2. *Standard*

Document approved by a recognized body, that provides, for common and repeated use, rules, guidelines or characteristics for products or related processes and production methods, with which compliance is not mandatory. It may also include or deal exclusively with terminology, symbols, packaging, marking or labelling requirements as they apply to a product, process or production method.

Explanatory note

The terms as defined in ISO/IEC Guide 2 cover products, processes and services. This Agreement deals only with technical regulations, standards and conformity assessment procedures related to products or processes and production methods. Standards as defined by ISO/IEC Guide 2 may be mandatory or voluntary. For the purpose of this Agreement standards are defined as voluntary and technical regulations as mandatory documents. Standards prepared by the international

standardization community are based on consensus. This Agreement covers also documents that are not based on consensus.

3. *Conformity assessment procedures*

Any procedure used, directly or indirectly, to determine that relevant requirements in technical regulations or standards are fulfilled.

Explanatory note

Conformity assessment procedures include, *inter alia*, procedures for sampling, testing and inspection; evaluation, verification and assurance of conformity; registration, accreditation and approval as well as their combinations.

4. *International body or system*

Body or system whose membership is open to the relevant bodies of at least all Members.

5. *Regional body or system*

Body or system whose membership is open to the relevant bodies of only some of the Members.

6. *Central government body*

Central government, its ministries and departments or any body subject to the control of the central government in respect of the activity in question.

Explanatory note:

In the case of the European Communities the provisions governing central government bodies apply. However, regional bodies or conformity assessment systems may be established within the European Communities, and in such cases would be subject to the provisions of this Agreement on regional bodies or conformity assessment systems.

7. *Local government body*

Government other than a central government (e.g. states, provinces, Länder, cantons, municipalities, etc.), its ministries or

departments or any body subject to the control of such a government in respect of the activity in question.

8. *Non-governmental body*

Body other than a central government body or a local government body, including a non-governmental body which has legal power to enforce a technical regulation.

(ANNEX 2)

TECHNICAL EXPERT GROUPS

The following procedures shall apply to technical expert groups established in accordance with the provisions of Article 14.

1. Technical expert groups are under the panel's authority. Their terms of reference and detailed working procedures shall be decided by the panel, and they shall report to the panel.

2. Participation in technical expert groups shall be restricted to persons of professional standing and experience in the field in question.

3. Citizens of parties to the dispute shall not serve on a technical expert group without the joint agreement of the parties to the dispute, except in exceptional circumstances when the panel considers that the need for specialized scientific expertise cannot be fulfilled otherwise. Government officials of parties to the dispute shall not serve on a technical expert group. Members of technical expert groups shall serve in their individual capacities and not as government representatives, nor as representatives of any organization. Governments or organizations shall therefore not give them instructions with regard to matters before a technical expert group.

4. Technical expert groups may consult and seek information and technical advice from any source they deem appropriate. Before a technical expert group seeks such information or advice from a source within the jurisdiction of a Member, it shall inform the government of

that Member. Any Member shall respond promptly and fully to any request by a technical expert group for such information as the technical expert group considers necessary and appropriate.

5. The parties to a dispute shall have access to all relevant information provided to a technical expert group, unless it is of a confidential nature. Confidential information provided to the technical expert group shall not be released without formal authorization from the government, organization or person providing the information. Where such information is requested from the technical expert group but release of such information by the technical expert group is not authorized, a non-confidential summary of the information will be provided by the government, organization or person supplying the information.

6. The technical expert group shall submit a draft report to the Members concerned with a view to obtaining their comments, and taking them into account, as appropriate, in the final report, which shall also be circulated to the Members concerned when it is submitted to the panel.

ANNEX 3

CODE OF GOOD PRACTICE FOR THE PREPARATION, ADOPTION AND

APPLICATION OF STANDARDS

General Provisions

A. For the purposes of this Code the definitions in Annex 1 of this Agreement shall apply.

B. This Code is open to acceptance by any standardizing body within the territory of a Member of the WTO, whether a central government body, a local government body, or a non-governmental body; to any governmental regional standardizing body one or more members of which are Members of the WTO; and to any non-governmental regional

standardizing body one or more members of which are situated within the territory of a Member of the WTO (referred to in this Code collectively as "standardizing bodies" and individually as "the standardizing body").

C. Standardizing bodies that have accepted or withdrawn from this Code shall notify this fact to the ISO/IEC Information Centre in Geneva. The notification shall include the name and address of the body concerned and the scope of its current and expected standardization activities. The notification may be sent either directly to the ISO/IEC Information Centre, or through the national member body of ISO/IEC or, preferably, through the relevant national member or international affiliate of ISONET, as appropriate.

SUBSTANTIVE PROVISIONS

D. In respect of standards, the standardizing body shall accord treatment to products originating in the territory of any other Member of the WTO no less favourable than that accorded to like products of national origin and to like products originating in any other country.

E. The standardizing body shall ensure that standards are not prepared, adopted or applied with a view to, or with the effect of, creating unnecessary obstacles to international trade.

F. Where international standards exist or their completion is imminent, the standardizing body shall use them, or the relevant parts of them, as a basis for the standards it develops, except where such international standards or relevant parts would be ineffective or inappropriate, for instance, because of an insufficient level of protection or fundamental climatic or geographical factors or fundamental technological problems.

G. With a view to harmonizing standards on as wide a basis as possible, the standardizing body shall, in an appropriate way, play a full part, within the limits of its resources, in the preparation by relevant

international standardizing bodies of international standards regarding subject matter for which it either has adopted, or expects to adopt, standards. For standardizing bodies within the territory of a Member, participation in a particular international standardization activity shall, whenever possible, take place through one delegation representing all standardizing bodies in the territory that have adopted, or expect to adopt, standards for the subject matter to which the international standardization activity relates.

H. The standardizing body within the territory of a Member shall make every effort to avoid duplication of, or overlap with, the work of other standardizing bodies in the national territory or with the work of relevant international or regional standardizing bodies. They shall also make every effort to achieve a national consensus on the standards they develop. Likewise the regional standardizing body shall make every effort to avoid duplication of, or overlap with, the work of relevant international standardizing bodies.

I. Wherever appropriate, the standardizing body shall specify standards based on product requirements in terms of performance rather than design or descriptive characteristics.

J. At least once every six months, the standardizing body shall publish a work programme containing its name and address, the standards it is currently preparing and the standards which it has adopted in the preceding period. A standard is under preparation from the moment a decision has been taken to develop a standard until that standard has been adopted. The titles of specific draft standards shall, upon request, be provided in English, French or Spanish. A notice of the existence of the work programme shall be published in a national or, as the case may be, regional publication of standardization activities.

The work programme shall for each standard indicate, in accordance with any ISONET rules, the classification relevant to the

subject matter, the stage attained in the standard's development, and the references of any international standards taken as a basis. No later than at the time of publication of its work programme, the standardizing body shall notify the existence thereof to the ISO/IEC Information Centre in Geneva.

The notification shall contain the name and address of the standardizing body, the name and issue of the publication in which the work programme is published, the period to which the work programme applies, its price (if any), and how and where it can be obtained. The notification may be sent directly to the ISO/IEC Information Centre, or, preferably, through the relevant national member or international affiliate of ISONET, as appropriate.

K. The national member of ISO/IEC shall make every effort to become a member of ISONET or to appoint another body to become a member as well as to acquire the most advanced membership type possible for the ISONET member. Other standardizing bodies shall make every effort to associate themselves with the ISONET member.

L. Before adopting a standard, the standardizing body shall allow a period of at least 60 days for the submission of comments on the draft standard by interested parties within the territory of a Member of the WTO. This period may, however, be shortened in cases where urgent problems of safety, health or environment arise or threaten to arise. No later than at the start of the comment period, the standardizing body shall publish a notice announcing the period for commenting in the publication referred to in paragraph J. Such notification shall include, as far as practicable, whether the draft standard deviates from relevant international standards.

M. On the request of any interested party within the territory of a Member of the WTO, the standardizing body shall promptly provide, or arrange to provide, a copy of a draft standard which it has submitted for

comments. Any fees charged for this service shall, apart from the real cost of delivery, be the same for foreign and domestic parties.

N. The standardizing body shall take into account, in the further processing of the standard, the comments received during the period for commenting. Comments received through standardizing bodies that have accepted this Code of Good Practice shall, if so requested, be replied to as promptly as possible. The reply shall include an explanation why a deviation from relevant international standards is necessary.

O. Once the standard has been adopted, it shall be promptly published.

P. On the request of any interested party within the territory of a Member of the WTO, the standardizing body shall promptly provide, or arrange to provide, a copy of its most recent work programme or of a standard which it produced. Any fees charged for this service shall, apart from the real cost of delivery, be the same for foreign and domestic parties.

Q. The standardizing body shall afford sympathetic consideration to, and adequate opportunity for, consultation regarding representations with respect to the operation of this Code presented by standardizing bodies that have accepted this Code of Good Practice. It shall make an objective effort to solve any complaints.

[vi] **ANNEX 8**

UNDERSTANDING ON RULES AND PROCEDURES GOVERNING THE SETTLEMENT OF DISPUTES

Members hereby *agree* as follows:

Article 1

Coverage and Application

1. The rules and procedures of this Understanding shall apply to disputes brought pursuant to the consultation and dispute settlement provisions of the agreements listed in Appendix 1 to this Understanding (referred to in this Understanding as the "covered agreements"). The rules and procedures of this Understanding shall also apply to consultations and the settlement of disputes between Members concerning their rights and obligations under the provisions of the Agreement Establishing the World Trade Organization (referred to in this Understanding as the "WTO Agreement") and of this Understanding taken in isolation or in combination with any other covered agreement.

2. The rules and procedures of this Understanding shall apply subject to such special or additional rules and procedures on dispute settlement contained in the covered agreements as are identified in Appendix 2 to this Understanding. To the extent that there is a difference between the rules and procedures of this Understanding and the special or additional rules and procedures set forth in Appendix 2, the special or additional rules and procedures in Appendix 2 shall prevail. In disputes involving rules and procedures under more than one covered agreement, if there is a conflict between special or additional rules and procedures of such agreements under review, and where the parties to the dispute cannot agree on rules and procedures within 20 days of the establishment of the panel, the Chairman of the Dispute Settlement Body provided for in paragraph 1 of Article 2 (referred to in this Understanding as the "DSB"), in consultation with the parties to the dispute, shall determine the rules and procedures to be followed within 10 days after a request by either Member. The Chairman shall be guided by the principle that special or additional rules and procedures should be used where possible, and the rules and procedures set out in this Understanding should be used to the extent necessary to avoid conflict.

Article 2

Administration

1. The Dispute Settlement Body is hereby established to administer these rules and procedures and, except as otherwise provided in a covered agreement, the consultation and dispute settlement provisions of the covered agreements. Accordingly, the DSB shall have the authority to establish panels, adopt panel and Appellate Body reports, maintain surveillance of implementation of rulings and recommendations, and authorize suspension of concessions and other obligations under the covered agreements. With respect to disputes arising under a covered agreement which is a Plurilateral Trade Agreement, the term "Member" as used herein shall refer only to those Members that are parties to the relevant Plurilateral Trade Agreement. Where the DSB administers the dispute settlement provisions of a Plurilateral Trade Agreement, only those Members that are parties to that Agreement may participate in decisions or actions taken by the DSB with respect to that dispute.

2. The DSB shall inform the relevant WTO Councils and Committees of any developments in disputes related to provisions of the respective covered agreements.

3. The DSB shall meet as often as necessary to carry out its functions within the time-frames provided in this Understanding.

4. Where the rules and procedures of this Understanding provide for the DSB to take a decision, it shall do so by consensus.[vi]

Article 3

General Provisions

1. Members affirm their adherence to the principles for the management of disputes heretofore applied under Articles XXII and XXIII of GATT 1947, and the rules and procedures as further elaborated and modified herein.

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

3. The prompt settlement of situations in which a Member considers that any benefits accruing to it directly or indirectly under the covered agreements are being impaired by measures taken by another Member is essential to the effective functioning of the WTO and the maintenance of a proper balance between the rights and obligations of Members.

4. Recommendations or rulings made by the DSB shall be aimed at achieving a satisfactory settlement of the matter in accordance with the rights and obligations under this Understanding and under the covered agreements.

5. All solutions to matters formally raised under the consultation and dispute settlement provisions of the covered agreements, including arbitration awards, shall be consistent with those agreements and shall not nullify or impair benefits accruing to any Member under those agreements, nor impede the attainment of any objective of those agreements.

6. Mutually agreed solutions to matters formally raised under the consultation and dispute settlement provisions of the covered agreements shall be notified to the DSB and the relevant Councils and Committees, where any Member may raise any point relating thereto.

7. Before bringing a case, a Member shall exercise its judgement as to whether action under these procedures would be fruitful. The aim of the dispute settlement mechanism is to secure a positive solution to a

dispute. A solution mutually acceptable to the parties to a dispute and consistent with the covered agreements is clearly to be preferred. In the absence of a mutually agreed solution, the first objective of the dispute settlement mechanism is usually to secure the withdrawal of the measures concerned if these are found to be inconsistent with the provisions of any of the covered agreements. The provision of compensation should be resorted to only if the immediate withdrawal of the measure is impracticable and as a temporary measure pending the withdrawal of the measure which is inconsistent with a covered agreement. The last resort which this Understanding provides to the Member invoking the dispute settlement procedures is the possibility of suspending the application of concessions or other obligations under the covered agreements on a discriminatory basis vis-à-vis the other Member, subject to authorization by the DSB of such measures.

8. In cases where there is an infringement of the obligations assumed under a covered agreement, the action is considered *prima facie* to constitute a case of nullification or impairment. This means that there is normally a presumption that a breach of the rules has an adverse impact on other Members parties to that covered agreement, and in such cases, it shall be up to the Member against whom the complaint has been brought to rebut the charge.

9. The provisions of this Understanding are without prejudice to the rights of Members to seek authoritative interpretation of provisions of a covered agreement through decision-making under the WTO Agreement or a covered agreement which is a Plurilateral Trade Agreement.

10. It is understood that requests for conciliation and the use of the dispute settlement procedures should not be intended or considered as contentious acts and that, if a dispute arises, all Members will engage in these procedures in good faith in an effort to resolve the dispute. It is

also understood that complaints and counter-complaints in regard to distinct matters should not be linked.

11. This Understanding shall be applied only with respect to new requests for consultations under the consultation provisions of the covered agreements made on or after the date of entry into force of the WTO Agreement. With respect to disputes for which the request for consultations was made under GATT 1947 or under any other predecessor agreement to the covered agreements before the date of entry into force of the WTO Agreement, the relevant dispute settlement rules and procedures in effect immediately prior to the date of entry into force of the WTO Agreement shall continue to apply.[vi]

12. Notwithstanding paragraph 11, if a complaint based on any of the covered agreements is brought by a developing country Member against a developed country Member, the complaining party shall have the right to invoke, as an alternative to the provisions contained in Articles 4, 5, 6 and 12 of this Understanding, the corresponding provisions of the Decision of 5 April 1966 (BISD 14S/18), except that where the Panel considers that the time-frame provided for in paragraph 7 of that Decision is insufficient to provide its report and with the agreement of the complaining party, that time-frame may be extended. To the extent that there is a difference between the rules and procedures of Articles 4, 5, 6 and 12 and the corresponding rules and procedures of the Decision, the latter shall prevail.

Article 4

Consultations

1. Members affirm their resolve to strengthen and improve the effectiveness of the consultation procedures employed by Members.

2. Each Member undertakes to accord sympathetic consideration to and afford adequate opportunity for consultation regarding any

representations made by another Member concerning measures affecting the operation of any covered agreement taken within the territory of the former.[vi]

3. If a request for consultations is made pursuant to a covered agreement, the Member to which the request is made shall, unless otherwise mutually agreed, reply to the request within 10 days after the date of its receipt and shall enter into consultations in good faith within a period of no more than 30 days after the date of receipt of the request, with a view to reaching a mutually satisfactory solution. If the Member does not respond within 10 days after the date of receipt of the request, or does not enter into consultations within a period of no more than 30 days, or a period otherwise mutually agreed, after the date of receipt of the request, then the Member that requested the holding of consultations may proceed directly to request the establishment of a panel.

4. All such requests for consultations shall be notified to the DSB and the relevant Councils and Committees by the Member which requests consultations. Any request for consultations shall be submitted in writing and shall give the reasons for the request, including identification of the measures at issue and an indication of the legal basis for the complaint.

5. In the course of consultations in accordance with the provisions of a covered agreement, before resorting to further action under this Understanding, Members should attempt to obtain satisfactory adjustment of the matter.

6. Consultations shall be confidential, and without prejudice to the rights of any Member in any further proceedings.

7. If the consultations fail to settle a dispute within 60 days after the date of receipt of the request for consultations, the complaining party may request the establishment of a panel. The complaining party may

request a panel during the 60-day period if the consulting parties jointly consider that consultations have failed to settle the dispute.

8. In cases of urgency, including those which concern perishable goods, Members shall enter into consultations within a period of no more than 10 days after the date of receipt of the request. If the consultations have failed to settle the dispute within a period of 20 days after the date of receipt of the request, the complaining party may request the establishment of a panel.

9. In cases of urgency, including those which concern perishable goods, the parties to the dispute, panels and the Appellate Body shall make every effort to accelerate the proceedings to the greatest extent possible.

10. During consultations Members should give special attention to the particular problems and interests of developing country Members.

11. Whenever a Member other than the consulting Members considers that it has a substantial trade interest in consultations being held pursuant to paragraph 1 of Article XXII of GATT 1994, paragraph 1 of Article XXII of GATS, or the corresponding provisions in other covered agreements[vi], such Member may notify the consulting Members and the DSB, within 10 days after the date of the circulation of the request for consultations under said Article, of its desire to be joined in the consultations. Such Member shall be joined in the consultations, provided that the Member to which the request for consultations was addressed agrees that the claim of substantial interest is well-founded. In that event they shall so inform the DSB. If the request to be joined in the consultations is not accepted, the applicant Member shall be free to request consultations under paragraph 1 of Article XXII or paragraph 1 of Article XXIII of GATT 1994, paragraph 1 of Article XXII or paragraph 1 of Article XXIII of GATS, or the corresponding provisions in other covered agreements.

Article 5

Good Offices, Conciliation and Mediation

1. Good offices, conciliation and mediation are procedures that are undertaken voluntarily if the parties to the dispute so agree.

2. Proceedings involving good offices, conciliation and mediation, and in particular positions taken by the parties to the dispute during these proceedings, shall be confidential, and without prejudice to the rights of either party in any further proceedings under these procedures.

3. Good offices, conciliation or mediation may be requested at any time by any party to a dispute. They may begin at any time and be terminated at any time. Once procedures for good offices, conciliation or mediation are terminated, a complaining party may then proceed with a request for the establishment of a panel.

4. When good offices, conciliation or mediation are entered into within 60 days after the date of receipt of a request for consultations, the complaining party must allow a period of 60 days after the date of receipt of the request for consultations before requesting the establishment of a panel. The complaining party may request the establishment of a panel during the 60-day period if the parties to the dispute jointly consider that the good offices, conciliation or mediation process has failed to settle the dispute.

5. If the parties to a dispute agree, procedures for good offices, conciliation or mediation may continue while the panel process proceeds.

6. The Director-General may, acting in an *ex officio* capacity, offer good offices, conciliation or mediation with the view to assisting Members to settle a dispute.

Article 6

Establishment of Panels

1. If the complaining party so requests, a panel shall be established at the latest at the DSB meeting following that at which the request first appears as an item on the DSB's agenda, unless at that meeting the DSB decides by consensus not to establish a panel.[vi]

2. The request for the establishment of a panel shall be made in writing. It shall indicate whether consultations were held, identify the specific measures at issue and provide a brief summary of the legal basis of the complaint sufficient to present the problem clearly. In case the applicant requests the establishment of a panel with other than standard terms of reference, the written request shall include the proposed text of special terms of reference.

Article 7

Terms of Reference of Panels

1. Panels shall have the following terms of reference unless the parties to the dispute agree otherwise within 20 days from the establishment of the panel:

"To examine, in the light of the relevant provisions in (name of the covered agreement(s) cited by the parties to the dispute), the matter referred to the DSB by (name of party) in document ... and to make such findings as will assist the DSB in making the recommendations or in giving the rulings provided for in that/those agreement(s)."

2. Panels shall address the relevant provisions in any covered agreement or agreements cited by the parties to the dispute.

3. In establishing a panel, the DSB may authorize its Chairman to draw up the terms of reference of the panel in consultation with the parties to the dispute, subject to the provisions of paragraph 1. The terms of reference thus drawn up shall be circulated to all Members. If other than standard terms of reference are agreed upon, any Member may raise any point relating thereto in the DSB.

Article 8

Composition of Panels

1. Panels shall be composed of well-qualified governmental and/or non-governmental individuals, including persons who have served on or presented a case to a panel, served as a representative of a Member or of a contracting party to GATT 1947 or as a representative to the Council or Committee of any covered agreement or its predecessor agreement, or in the Secretariat, taught or published on international trade law or policy, or served as a senior trade policy official of a Member.

2. Panel members should be selected with a view to ensuring the independence of the members, a sufficiently diverse background and a wide spectrum of experience.

3. Citizens of Members whose governments[vi] are parties to the dispute or third parties as defined in paragraph 2 of Article 10 shall not serve on a panel concerned with that dispute, unless the parties to the dispute agree otherwise.

4. To assist in the selection of panelists, the Secretariat shall maintain an indicative list of governmental and non-governmental individuals possessing the qualifications outlined in paragraph 1, from which panelists may be drawn as appropriate. That list shall include the roster of non-governmental panelists established on 30 November 1984 (BISD 31S/9), and other rosters and indicative lists established under any of the covered agreements, and shall retain the names of persons on those rosters and indicative lists at the time of entry into force of the WTO Agreement. Members may periodically suggest names of governmental and non-governmental individuals for inclusion on the indicative list, providing relevant information on their knowledge of international trade and of the sectors or subject matter of the covered agreements, and those names shall be added to the list upon approval by

the DSB. For each of the individuals on the list, the list shall indicate specific areas of experience or expertise of the individuals in the sectors or subject matter of the covered agreements.

5. Panels shall be composed of three panelists unless the parties to the dispute agree, within 10 days from the establishment of the panel, to a panel composed of five panelists. Members shall be informed promptly of the composition of the panel.

6. The Secretariat shall propose nominations for the panel to the parties to the dispute. The parties to the dispute shall not oppose nominations except for compelling reasons.

7. If there is no agreement on the panelists within 20 days after the date of the establishment of a panel, at the request of either party, the Director-General, in consultation with the Chairman of the DSB and the Chairman of the relevant Council or Committee, shall determine the composition of the panel by appointing the panelists whom the Director-General considers most appropriate in accordance with any relevant special or additional rules or procedures of the covered agreement or covered agreements which are at issue in the dispute, after consulting with the parties to the dispute. The Chairman of the DSB shall inform the Members of the composition of the panel thus formed no later than 10 days after the date the Chairman receives such a request.

8. Members shall undertake, as a general rule, to permit their officials to serve as panelists.

9. Panelists shall serve in their individual capacities and not as government representatives, nor as representatives of any organization. Members shall therefore not give them instructions nor seek to influence them as individuals with regard to matters before a panel.

10. When a dispute is between a developing country Member and a developed country Member the panel shall, if the developing country

Member so requests, include at least one panelist from a developing country Member.

11. Panelists' expenses, including travel and subsistence allowance, shall be met from the WTO budget in accordance with criteria to be adopted by the General Council, based on recommendations of the Committee on Budget, Finance and Administration.

Article 9

Procedures for Multiple Complainants

1. Where more than one Member requests the establishment of a panel related to the same matter, a single panel may be established to examine these complaints taking into account the rights of all Members concerned. A single panel should be established to examine such complaints whenever feasible.

2. The single panel shall organize its examination and present its findings to the DSB in such a manner that the rights which the parties to the dispute would have enjoyed had separate panels examined the complaints are in no way impaired. If one of the parties to the dispute so requests, the panel shall submit separate reports on the dispute concerned. The written submissions by each of the complainants shall be made available to the other complainants, and each complainant shall have the right to be present when any one of the other complainants presents its views to the panel.

3. If more than one panel is established to examine the complaints related to the same matter, to the greatest extent possible the same persons shall serve as panelists on each of the separate panels and the timetable for the panel process in such disputes shall be harmonized.

Article 10

Third Parties

1. The interests of the parties to a dispute and those of other Members under a covered agreement at issue in the dispute shall be fully taken into account during the panel process.
2. Any Member having a substantial interest in a matter before a panel and having notified its interest to the DSB (referred to in this Understanding as a "third party") shall have an opportunity to be heard by the panel and to make written submissions to the panel. These submissions shall also be given to the parties to the dispute and shall be reflected in the panel report.
3. Third parties shall receive the submissions of the parties to the dispute to the first meeting of the panel.
4. If a third party considers that a measure already the subject of a panel proceeding nullifies or impairs benefits accruing to it under any covered agreement, that Member may have recourse to normal dispute settlement procedures under this Understanding. Such a dispute shall be referred to the original panel wherever possible.

Article 11

Function of Panels

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.

Article 12

Panel Procedures

1. Panels shall follow the Working Procedures in Appendix 3 unless the panel decides otherwise after consulting the parties to the dispute.

2. Panel procedures should provide sufficient flexibility so as to ensure high-quality panel reports, while not unduly delaying the panel process.

3. After consulting the parties to the dispute, the panelists shall, as soon as practicable and whenever possible within one week after the composition and terms of reference of the panel have been agreed upon, fix the timetable for the panel process, taking into account the provisions of paragraph 9 of Article 4, if relevant.

4. In determining the timetable for the panel process, the panel shall provide sufficient time for the parties to the dispute to prepare their submissions.

5. Panels should set precise deadlines for written submissions by the parties and the parties should respect those deadlines.

6. Each party to the dispute shall deposit its written submissions with the Secretariat for immediate transmission to the panel and to the other party or parties to the dispute. The complaining party shall submit its first submission in advance of the responding party's first submission unless the panel decides, in fixing the timetable referred to in paragraph 3 and after consultations with the parties to the dispute, that the parties should submit their first submissions simultaneously. When there are sequential arrangements for the deposit of first submissions, the panel shall establish a firm time-period for receipt of the responding party's submission. Any subsequent written submissions shall be submitted simultaneously.

7. Where the parties to the dispute have failed to develop a mutually satisfactory solution, the panel shall submit its findings in the form of a

written report to the DSB. In such cases, the report of a panel shall set out the findings of fact, the applicability of relevant provisions and the basic rationale behind any findings and recommendations that it makes. Where a settlement of the matter among the parties to the dispute has been found, the report of the panel shall be confined to a brief description of the case and to reporting that a solution has been reached.

8. In order to make the procedures more efficient, the period in which the panel shall conduct its examination, from the date that the composition and terms of reference of the panel have been agreed upon until the date the final report is issued to the parties to the dispute, shall, as a general rule, not exceed six months. In cases of urgency, including those relating to perishable goods, the panel shall aim to issue its report to the parties to the dispute within three months.

9. When the panel considers that it cannot issue its report within six months, or within three months in cases of urgency, it shall inform the DSB in writing of the reasons for the delay together with an estimate of the period within which it will issue its report. In no case should the period from the establishment of the panel to the circulation of the report to the Members exceed nine months.

10. In the context of consultations involving a measure taken by a developing country Member, the parties may agree to extend the periods established in paragraphs 7 and 8 of Article 4. If, after the relevant period has elapsed, the consulting parties cannot agree that the consultations have concluded, the Chairman of the DSB shall decide, after consultation with the parties, whether to extend the relevant period and, if so, for how long. In addition, in examining a complaint against a developing country Member, the panel shall accord sufficient time for the developing country Member to prepare and present its argumentation. The provisions of paragraph 1 of Article 20 and paragraph 4 of Article 21 are not affected by any action pursuant to this paragraph.

11. Where one or more of the parties is a developing country Member, the panel's report shall explicitly indicate the form in which account has been taken of relevant provisions on differential and more-favourable treatment for developing country Members that form part of the covered agreements which have been raised by the developing country Member in the course of the dispute settlement procedures.

12. The panel may suspend its work at any time at the request of the complaining party for a period not to exceed 12 months. In the event of such a suspension, the time-frames set out in paragraphs 8 and 9 of this Article, paragraph 1 of Article 20, and paragraph 4 of Article 21 shall be extended by the amount of time that the work was suspended. If the work of the panel has been suspended for more than 12 months, the authority for establishment of the panel shall lapse.

Article 13

Right to Seek Information

1. Each panel shall have the right to seek information and technical advice from any individual or body which it deems appropriate. However, before a panel seeks such information or advice from any individual or body within the jurisdiction of a Member it shall inform the authorities of that Member. A Member should respond promptly and fully to any request by a panel for such information as the panel considers necessary and appropriate. Confidential information which is provided shall not be revealed without formal authorization from the individual, body, or authorities of the Member providing the information.

2. Panels may seek information from any relevant source and may consult experts to obtain their opinion on certain aspects of the matter. With respect to a factual issue concerning a scientific or other technical matter raised by a party to a dispute, a panel may request an advisory report in writing from an expert review group. Rules for the

establishment of such a group and its procedures are set forth in Appendix 4.

Article 14

Confidentiality

1. Panel deliberations shall be confidential.

2. The reports of panels shall be drafted without the presence of the parties to the dispute in the light of the information provided and the statements made.

3. Opinions expressed in the panel report by individual panelists shall be anonymous.

Article 15

Interim Review Stage

1. Following the consideration of rebuttal submissions and oral arguments, the panel shall issue the descriptive (factual and argument) sections of its draft report to the parties to the dispute. Within a period of time set by the panel, the parties shall submit their comments in writing.

2. Following the expiration of the set period of time for receipt of comments from the parties to the dispute, the panel shall issue an interim report to the parties, including both the descriptive sections and the panel's findings and conclusions. Within a period of time set by the panel, a party may submit a written request for the panel to review precise aspects of the interim report prior to circulation of the final report to the Members. At the request of a party, the panel shall hold a further meeting with the parties on the issues identified in the written comments. If no comments are received from any party within the comment period, the interim report shall be considered the final panel report and circulated promptly to the Members.

3. The findings of the final panel report shall include a discussion of the arguments made at the interim review stage. The interim review stage shall be conducted within the time-period set out in paragraph 8 of Article 12.

Article 16

Adoption of Panel Reports

1. In order to provide sufficient time for the Members to consider panel reports, the reports shall not be considered for adoption by the DSB until 20 days after the date they have been circulated to the Members.

2. Members having objections to a panel report shall give written reasons to explain their objections for circulation at least 10 days prior to the DSB meeting at which the panel report will be considered.

3. The parties to a dispute shall have the right to participate fully in the consideration of the panel report by the DSB, and their views shall be fully recorded.

4. Within 60 days after the date of circulation of a panel report to the Members, the report shall be adopted at a DSB meeting[vi] unless a party to the dispute formally notifies the DSB of its decision to appeal or the DSB decides by consensus not to adopt the report. If a party has notified its decision to appeal, the report by the panel shall not be considered for adoption by the DSB until after completion of the appeal. This adoption procedure is without prejudice to the right of Members to express their views on a panel report.

Article 17

Appellate Review

Standing Appellate Body

1. A standing Appellate Body shall be established by the DSB. The Appellate Body shall hear appeals from panel cases. It shall be composed of seven persons, three of whom shall serve on any one case. Persons serving on the Appellate Body shall serve in rotation. Such rotation shall be determined in the working procedures of the Appellate Body.

2. The DSB shall appoint persons to serve on the Appellate Body for a four-year term, and each person may be reappointed once. However, the terms of three of the seven persons appointed immediately after the entry into force of the WTO Agreement shall expire at the end of two years, to be determined by lot. Vacancies shall be filled as they arise. A person appointed to replace a person whose term of office has not expired shall hold office for the remainder of the predecessor's term.

3. The Appellate Body shall comprise persons of recognized authority, with demonstrated expertise in law, international trade and the subject matter of the covered agreements generally. They shall be unaffiliated with any government. The Appellate Body membership shall be broadly representative of membership in the WTO. All persons serving on the Appellate Body shall be available at all times and on short notice, and shall stay abreast of dispute settlement activities and other relevant activities of the WTO. They shall not participate in the consideration of any disputes that would create a direct or indirect conflict of interest.

4. Only parties to the dispute, not third parties, may appeal a panel report. Third parties which have notified the DSB of a substantial interest in the matter pursuant to paragraph 2 of Article 10 may make written submissions to, and be given an opportunity to be heard by, the Appellate Body.

5. As a general rule, the proceedings shall not exceed 60 days from the date a party to the dispute formally notifies its decision to appeal to the date the Appellate Body circulates its report. In fixing its timetable

the Appellate Body shall take into account the provisions of paragraph 9 of Article 4, if relevant. When the Appellate Body considers that it cannot provide its report within 60 days, it shall inform the DSB in writing of the reasons for the delay together with an estimate of the period within which it will submit its report. In no case shall the proceedings exceed 90 days.

6. An appeal shall be limited to issues of law covered in the panel report and legal interpretations developed by the panel.

7. The Appellate Body shall be provided with appropriate administrative and legal support as it requires.

8. The expenses of persons serving on the Appellate Body, including travel and subsistence allowance, shall be met from the WTO budget in accordance with criteria to be adopted by the General Council, based on recommendations of the Committee on Budget, Finance and Administration.

Procedures for Appellate Review

9. Working procedures shall be drawn up by the Appellate Body in consultation with the Chairman of the DSB and the Director-General, and communicated to the Members for their information.

10. The proceedings of the Appellate Body shall be confidential. The reports of the Appellate Body shall be drafted without the presence of the parties to the dispute and in the light of the information provided and the statements made.

11. Opinions expressed in the Appellate Body report by individuals serving on the Appellate Body shall be anonymous.

12. The Appellate Body shall address each of the issues raised in accordance with paragraph 6 during the appellate proceeding.

13. The Appellate Body may uphold, modify or reverse the legal findings and conclusions of the panel.

Adoption of Appellate Body Reports

14. An Appellate Body report shall be adopted by the DSB and unconditionally accepted by the parties to the dispute unless the DSB decides by consensus not to adopt the Appellate Body report within 30 days following its circulation to the Members.[vi] This adoption procedure is without prejudice to the right of Members to express their views on an Appellate Body report.

Article 18

Communications with the Panel or Appellate Body

1. There shall be no *ex parte* communications with the panel or Appellate Body concerning matters under consideration by the panel or Appellate Body.

2. Written submissions to the panel or the Appellate Body shall be treated as confidential, but shall be made available to the parties to the dispute. Nothing in this Understanding shall preclude a party to a dispute from disclosing statements of its own positions to the public. Members shall treat as confidential information submitted by another Member to the panel or the Appellate Body which that Member has designated as confidential. A party to a dispute shall also, upon request of a Member, provide a non-confidential summary of the information contained in its written submissions that could be disclosed to the public.

Article 19

Panel and Appellate Body Recommendations

1. Where a panel or the Appellate Body concludes that a measure is inconsistent with a covered agreement, it shall recommend that the Member concerned[vi] bring the measure into conformity with that

agreement.[vi] In addition to its recommendations, the panel or Appellate Body may suggest ways in which the Member concerned could implement the recommendations.

2. In accordance with paragraph 2 of Article 3, in their findings and recommendations, the panel and Appellate Body cannot add to or diminish the rights and obligations provided in the covered agreements.

Article 20

Time-frame for DSB Decisions

Unless otherwise agreed to by the parties to the dispute, the period from the date of establishment of the panel by the DSB until the date the DSB considers the panel or appellate report for adoption shall as a general rule not exceed nine months where the panel report is not appealed or 12 months where the report is appealed. Where either the panel or the Appellate Body has acted, pursuant to paragraph 9 of Article 12 or paragraph 5 of Article 17, to extend the time for providing its report, the additional time taken shall be added to the above periods.

Article 21

Surveillance of Implementation of Recommendations and Rulings

1. Prompt compliance with recommendations or rulings of the DSB is essential in order to ensure effective resolution of disputes to the benefit of all Members.

2. Particular attention should be paid to matters affecting the interests of developing country Members with respect to measures which have been subject to dispute settlement.

3. At a DSB meeting held within 30 days[vi] after the date of adoption of the panel or Appellate Body report, the Member concerned shall inform the DSB of its intentions in respect of implementation of the recommendations and rulings of the DSB. If it is impracticable to

comply immediately with the recommendations and rulings, the Member concerned shall have a reasonable period of time in which to do so. The reasonable period of time shall be:

(a) the period of time proposed by the Member concerned, provided that such period is approved by the DSB; or, in the absence of such approval,

(b) a period of time mutually agreed by the parties to the dispute within 45 days after the date of adoption of the recommendations and rulings; or, in the absence of such agreement,

(c) a period of time determined through binding arbitration within 90 days after the date of adoption of the recommendations and rulings.[vi] In such arbitration, a guideline for the arbitrator[vi] should be that the reasonable period of time to implement panel or Appellate Body recommendations should not exceed 15 months from the date of adoption of a panel or Appellate Body report. However, that time may be shorter or longer, depending upon the particular circumstances.

4. Except where the panel or the Appellate Body has extended, pursuant to paragraph 9 of Article 12 or paragraph 5 of Article 17, the time of providing its report, the period from the date of establishment of the panel by the DSB until the date of determination of the reasonable period of time shall not exceed 15 months unless the parties to the dispute agree otherwise. Where either the panel or the Appellate Body has acted to extend the time of providing its report, the additional time taken shall be added to the 15-month period; provided that unless the parties to the dispute agree that there are exceptional circumstances, the total time shall not exceed 18 months.

5. Where there is disagreement as to the existence or consistency with a covered agreement of measures taken to comply with the recommendations and rulings such dispute shall be decided through recourse to these dispute settlement procedures, including wherever

possible resort to the original panel. The panel shall circulate its report within 90 days after the date of referral of the matter to it. When the panel considers that it cannot provide its report within this time frame, it shall inform the DSB in writing of the reasons for the delay together with an estimate of the period within which it will submit its report.

6. The DSB shall keep under surveillance the implementation of adopted recommendations or rulings. The issue of implementation of the recommendations or rulings may be raised at the DSB by any Member at any time following their adoption. Unless the DSB decides otherwise, the issue of implementation of the recommendations or rulings shall be placed on the agenda of the DSB meeting after six months following the date of establishment of the reasonable period of time pursuant to paragraph 3 and shall remain on the DSB's agenda until the issue is resolved. At least 10 days prior to each such DSB meeting, the Member concerned shall provide the DSB with a status report in writing of its progress in the implementation of the recommendations or rulings.

7. If the matter is one which has been raised by a developing country Member, the DSB shall consider what further action it might take which would be appropriate to the circumstances.

8. If the case is one brought by a developing country Member, in considering what appropriate action might be taken, the DSB shall take into account not only the trade coverage of measures complained of, but also their impact on the economy of developing country Members concerned.

Article 22

Compensation and the Suspension of Concessions

1. Compensation and the suspension of concessions or other obligations are temporary measures available in the event that the recommendations and rulings are not implemented within a reasonable

period of time. However, neither compensation nor the suspension of concessions or other obligations is preferred to full implementation of a recommendation to bring a measure into conformity with the covered agreements. Compensation is voluntary and, if granted, shall be consistent with the covered agreements.

2. If the Member concerned fails to bring the measure found to be inconsistent with a covered agreement into compliance therewith or otherwise comply with the recommendations and rulings within the reasonable period of time determined pursuant to paragraph 3 of Article 21, such Member shall, if so requested, and no later than the expiry of the reasonable period of time, enter into negotiations with any party having invoked the dispute settlement procedures, with a view to developing mutually acceptable compensation. If no satisfactory compensation has been agreed within 20 days after the date of expiry of the reasonable period of time, any party having invoked the dispute settlement procedures may request authorization from the DSB to suspend the application to the Member concerned of concessions or other obligations under the covered agreements.

3. In considering what concessions or other obligations to suspend, the complaining party shall apply the following principles and procedures:

(a) the general principle is that the complaining party should first seek to suspend concessions or other obligations with respect to the same sector(s) as that in which the panel or Appellate Body has found a violation or other nullification or impairment;

(b) if that party considers that it is not practicable or effective to suspend concessions or other obligations with respect to the same sector(s), it may seek to suspend concessions or other obligations in other sectors under the same agreement;

(c) if that party considers that it is not practicable or effective to suspend concessions or other obligations with respect to other sectors under the same agreement, and that the circumstances are serious enough, it may seek to suspend concessions or other obligations under another covered agreement;

(d) in applying the above principles, that party shall take into account:

(i) the trade in the sector or under the agreement under which the panel or Appellate Body has found a violation or other nullification or impairment, and the importance of such trade to that party;

(ii) the broader economic elements related to the nullification or impairment and the broader economic consequences of the suspension of concessions or other obligations;

(e) if that party decides to request authorization to suspend concessions or other obligations pursuant to subparagraphs (b) or (c), it shall state the reasons therefor in its request. At the same time as the request is forwarded to the DSB, it also shall be forwarded to the relevant Councils and also, in the case of a request pursuant to subparagraph (b), the relevant sectoral bodies;

(f) for purposes of this paragraph, "sector" means:

(i) with respect to goods, all goods;

(ii) with respect to services, a principal sector as identified in the current "Services Sectoral Classification List" which identifies such sectors;[vi]

(iii) with respect to trade-related intellectual property rights, each of the categories of intellectual property rights covered in Section 1, or Section 2, or Section 3, or Section 4, or Section 5, or Section 6, or Section 7 of Part II, or the obligations under Part III, or Part IV of the Agreement on TRIPS;

(g) for purposes of this paragraph, "agreement" means:

(i) with respect to goods, the agreements listed in Annex 1A of the WTO Agreement, taken as a whole as well as the Plurilateral Trade Agreements in so far as the relevant parties to the dispute are parties to these agreements;

(ii) with respect to services, the GATS;

(iii) with respect to intellectual property rights, the Agreement on TRIPS.

4. The level of the suspension of concessions or other obligations authorized by the DSB shall be equivalent to the level of the nullification or impairment.

5. The DSB shall not authorize suspension of concessions or other obligations if a covered agreement prohibits such suspension.

6. When the situation described in paragraph 2 occurs, the DSB, upon request, shall grant authorization to suspend concessions or other obligations within 30 days of the expiry of the reasonable period of time unless the DSB decides by consensus to reject the request. However, if the Member concerned objects to the level of suspension proposed, or claims that the principles and procedures set forth in paragraph 3 have not been followed where a complaining party has requested authorization to suspend concessions or other obligations pursuant to paragraph 3(b) or (c), the matter shall be referred to arbitration. Such arbitration shall be carried out by the original panel, if members are available, or by an arbitrator[vi] appointed by the Director-General and shall be completed within 60 days after the date of expiry of the reasonable period of time. Concessions or other obligations shall not be suspended during the course of the arbitration.

7. The arbitrator[vi] acting pursuant to paragraph 6 shall not examine the nature of the concessions or other obligations to be suspended but shall determine whether the level of such suspension is equivalent to the level of nullification or impairment. The arbitrator may also determine if

the proposed suspension of concessions or other obligations is allowed under the covered agreement. However, if the matter referred to arbitration includes a claim that the principles and procedures set forth in paragraph 3 have not been followed, the arbitrator shall examine that claim. In the event the arbitrator determines that those principles and procedures have not been followed, the complaining party shall apply them consistent with paragraph 3. The parties shall accept the arbitrator's decision as final and the parties concerned shall not seek a second arbitration. The DSB shall be informed promptly of the decision of the arbitrator and shall upon request, grant authorization to suspend concessions or other obligations where the request is consistent with the decision of the arbitrator, unless the DSB decides by consensus to reject the request.

8. The suspension of concessions or other obligations shall be temporary and shall only be applied until such time as the measure found to be inconsistent with a covered agreement has been removed, or the Member that must implement recommendations or rulings provides a solution to the nullification or impairment of benefits, or a mutually satisfactory solution is reached. In accordance with paragraph 6 of Article 21, the DSB shall continue to keep under surveillance the implementation of adopted recommendations or rulings, including those cases where compensation has been provided or concessions or other obligations have been suspended but the recommendations to bring a measure into conformity with the covered agreements have not been implemented.

9. The dispute settlement provisions of the covered agreements may be invoked in respect of measures affecting their observance taken by regional or local governments or authorities within the territory of a Member. When the DSB has ruled that a provision of a covered agreement has not been observed, the responsible Member shall take

such reasonable measures as may be available to it to ensure its observance. The provisions of the covered agreements and this Understanding relating to compensation and suspension of concessions or other obligations apply in cases where it has not been possible to secure such observance.[vi]

Article 23

Strengthening of the Multilateral System

1. When Members seek the redress of a violation of obligations or other nullification or impairment of benefits under the covered agreements or an impediment to the attainment of any objective of the covered agreements, they shall have recourse to, and abide by, the rules and procedures of this Understanding.

2. In such cases, Members shall:

(a) not make a determination to the effect that a violation has occurred, that benefits have been nullified or impaired or that the attainment of any objective of the covered agreements has been impeded, except through recourse to dispute settlement in accordance with the rules and procedures of this Understanding, and shall make any such determination consistent with the findings contained in the panel or Appellate Body report adopted by the DSB or an arbitration award rendered under this Understanding;

(b) follow the procedures set forth in Article 21 to determine the reasonable period of time for the Member concerned to implement the recommendations and rulings; and

(c) follow the procedures set forth in Article 22 to determine the level of suspension of concessions or other obligations and obtain DSB authorization in accordance with those procedures before suspending concessions or other obligations under the covered agreements in

response to the failure of the Member concerned to implement the recommendations and rulings within that reasonable period of time.

Article 24

Special Procedures Involving Least-Developed Country Members

1. At all stages of the determination of the causes of a dispute and of dispute settlement procedures involving a least-developed country Member, particular consideration shall be given to the special situation of least-developed country Members. In this regard, Members shall exercise due restraint in raising matters under these procedures involving a least-developed country Member. If nullification or impairment is found to result from a measure taken by a least-developed country Member, complaining parties shall exercise due restraint in asking for compensation or seeking authorization to suspend the application of concessions or other obligations pursuant to these procedures.

2. In dispute settlement cases involving a least-developed country Member, where a satisfactory solution has not been found in the course of consultations the Director-General or the Chairman of the DSB shall, upon request by a least-developed country Member offer their good offices, conciliation and mediation with a view to assisting the parties to settle the dispute, before a request for a panel is made. The Director-General or the Chairman of the DSB, in providing the above assistance, may consult any source which either deems appropriate.

Article 25

Arbitration

1. Expeditious arbitration within the WTO as an alternative means of dispute settlement can facilitate the solution of certain disputes that concern issues that are clearly defined by both parties.

2. Except as otherwise provided in this Understanding, resort to arbitration shall be subject to mutual agreement of the parties which shall agree on the procedures to be followed. Agreements to resort to arbitration shall be notified to all Members sufficiently in advance of the actual commencement of the arbitration process.

3. Other Members may become party to an arbitration proceeding only upon the agreement of the parties which have agreed to have recourse to arbitration. The parties to the proceeding shall agree to abide by the arbitration award. Arbitration awards shall be notified to the DSB and the Council or Committee of any relevant agreement where any Member may raise any point relating thereto.

4. Articles 21 and 22 of this Understanding shall apply *mutatis mutandis* to arbitration awards.

Article 26

1. *Non-Violation Complaints of the Type Described in Paragraph 1(b) of Article XXIII of GATT 1994*

Where the provisions of paragraph 1(b) of Article XXIII of GATT 1994 are applicable to a covered agreement, a panel or the Appellate Body may only make rulings and recommendations where a party to the dispute considers that any benefit accruing to it directly or indirectly under the relevant covered agreement is being nullified or impaired or the attainment of any objective of that Agreement is being impeded as a result of the application by a Member of any measure, whether or not it conflicts with the provisions of that Agreement. Where and to the extent that such party considers and a panel or the Appellate Body determines that a case concerns a measure that does not conflict with the provisions

of a covered agreement to which the provisions of paragraph 1(b) of Article XXIII of GATT 1994 are applicable, the procedures in this Understanding shall apply, subject to the following:

(a) the complaining party shall present a detailed justification in support of any complaint relating to a measure which does not conflict with the relevant covered agreement;

(b) where a measure has been found to nullify or impair benefits under, or impede the attainment of objectives, of the relevant covered agreement without violation thereof, there is no obligation to withdraw the measure. However, in such cases, the panel or the Appellate Body shall recommend that the Member concerned make a mutually satisfactory adjustment;

(c) notwithstanding the provisions of Article 21, the arbitration provided for in paragraph 3 of Article 21, upon request of either party, may include a determination of the level of benefits which have been nullified or impaired, and may also suggest ways and means of reaching a mutually satisfactory adjustment; such suggestions shall not be binding upon the parties to the dispute;

(d) notwithstanding the provisions of paragraph 1 of Article 22, compensation may be part of a mutually satisfactory adjustment as final settlement of the dispute.

2. *Complaints of the Type Described in Paragraph 1(c) of Article XXIII of GATT 1994*

Where the provisions of paragraph 1(c) of Article XXIII of GATT 1994 are applicable to a covered agreement, a panel may only make rulings and recommendations where a party considers that any benefit accruing to it directly or indirectly under the relevant covered agreement is being nullified or impaired or the attainment of any objective of that Agreement is being impeded as a result of the existence of any situation

other than those to which the provisions of paragraphs 1(a) and 1(b) of Article XXIII of GATT 1994 are applicable. Where and to the extent that such party considers and a panel determines that the matter is covered by this paragraph, the procedures of this Understanding shall apply only up to and including the point in the proceedings where the panel report has been circulated to the Members. The dispute settlement rules and procedures contained in the Decision of 12 April 1989 (BISD 36S/61-67) shall apply to consideration for adoption, and surveillance [here, surveillance is meant to mean monitoring] and implementation of recommendations and rulings. The following shall also apply:

(a) the complaining party shall present a detailed justification in support of any argument made with respect to issues covered under this paragraph;

(b) in cases involving matters covered by this paragraph, if a panel finds that cases also involve dispute settlement matters other than those covered by this paragraph, the panel shall circulate a report to the DSB addressing any such matters and a separate report on matters falling under this paragraph.

Article 27

Responsibilities of the Secretariat

1. The Secretariat shall have the responsibility of assisting panels, especially on the legal, historical and procedural aspects of the matters dealt with, and of providing secretarial and technical support.

2. While the Secretariat assists Members in respect of dispute settlement at their request, there may also be a need to provide additional legal advice and assistance in respect of dispute settlement to developing country Members. To this end, the Secretariat shall make available a qualified legal expert from the WTO technical cooperation services to any developing country Member which so requests. This

expert shall assist the developing country Member in a manner ensuring the continued impartiality of the Secretariat.

3. The Secretariat shall conduct special training courses for interested Members concerning these dispute settlement procedures and practices so as to enable Members' experts to be better informed in this regard.

(APPENDIX 1)

AGREEMENTS COVERED BY THE UNDERSTANDING

(A) Agreement Establishing the World Trade Organization

(B) Multilateral Trade Agreements

Annex 1A: Multilateral Agreements on Trade in Goods

Annex 1B: General Agreement on Trade in Services

Annex 1C: Agreement on Trade-Related Aspects of Intellectual Property Rights

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

(C) Plurilateral Trade Agreements

Annex 4: Agreement on Trade in Civil Aircraft

Agreement on Government Procurement

International Dairy Agreement

International Bovine Meat Agreement

The applicability of this Understanding to the Plurilateral Trade Agreements shall be subject to the adoption of a decision by the parties to each agreement setting out the terms for the application of the Understanding to the individual agreement, including any special or additional rules or procedures for inclusion in Appendix 2, as notified to the DSB.

(APPENDIX 2)

SPECIAL OR ADDITIONAL RULES AND PROCEDURES

CONTAINED IN THE COVERED AGREEMENTS

Agreement Rules and Procedures

Agreement on the Application of Sanitary and Phytosanitary Measures	1
Agreement on Textiles and Clothing	2.14, 2.21, 4.4, 5.2, 5.4, 5.6, 6.9, 6.10, 6.11, 8.1 through 8.12
Agreement on Technical Barriers to Trade	14.2 through 14.4, Annex 2
Agreement on Implementation of Article VI of GATT 1994	17.4 through 17.7
Agreement on Implementation of Article VII of GATT 1994	19.3 through 19.5, Annex II.2(f), 3, 9, 21
Agreement on Subsidies and Countervailing Measures	4.2 through 4.12, 6.6, 7.2 through 7.10, 8.5, footnote 35, 24.4, 27.7, Annex V
General Agreement on Trade in Services	XXII:3, XXIII:3
Annex on Financial Services	4
Annex on Air Transport Services	4
Decision on Certain Dispute Settlement Procedures for the GATS	1 through 5

The list of rules and procedures in this Appendix includes provisions where only a part of the provision may be relevant in this context.

Any special or additional rules or procedures in the Plurilateral Trade Agreements as determined by the competent bodies of each agreement and as notified to the DSB.

(APPENDIX 3)

WORKING PROCEDURES

l. In its proceedings the panel shall follow the relevant provisions of this Understanding. In addition, the following working procedures shall apply.

2. The panel shall meet in closed session. The parties to the dispute, and interested parties, shall be present at the meetings only when invited by the panel to appear before it.

3. The deliberations of the panel and the documents submitted to it shall be kept confidential. Nothing in this Understanding shall preclude a party to a dispute from disclosing statements of its own positions to the public. Members shall treat as confidential information submitted by another Member to the panel which that Member has designated as confidential. Where a party to a dispute submits a confidential version of its written submissions to the panel, it shall also, upon request of a Member, provide a non-confidential summary of the information contained in its submissions that could be disclosed to the public.

4. Before the first substantive meeting of the panel with the parties, the parties to the dispute shall transmit to the panel written submissions in which they present the facts of the case and their arguments.

5. At its first substantive meeting with the parties, the panel shall ask the party which has brought the complaint to present its case. Subsequently, and still at the same meeting, the party against which the complaint has been brought shall be asked to present its point of view.

6. All third parties which have notified their interest in the dispute to the DSB shall be invited in writing to present their views during a session of the first substantive meeting of the panel set aside for that purpose. All such third parties may be present during the entirety of this session.

7. Formal rebuttals shall be made at a second substantive meeting of the panel. The party complained against shall have the right to take the floor first to be followed by the complaining party. The parties shall submit, prior to that meeting, written rebuttals to the panel.

8. The panel may at any time put questions to the parties and ask them for explanations either in the course of a meeting with the parties or in writing.

9. The parties to the dispute and any third party invited to present its views in accordance with Article 10 shall make available to the panel a written version of their oral statements.

10. In the interest of full transparency, the presentations, rebuttals and statements referred to in paragraphs 5 to 9 shall be made in the presence of the parties. Moreover, each party's written submissions, including any comments on the descriptive part of the report and responses to questions put by the panel, shall be made available to the other party or parties.

11. Any additional procedures specific to the panel.

12. Proposed timetable for panel work:

(a) Receipt of first written submissions of the parties:

(1) complaining Party:---3-6 weeks

(2) Party complained against:--- 2-3 weeks

(b) Date, time and place of first substantive meeting with the parties; third party session:---1-2 weeks

(c) Receipt of written rebuttals of the parties:--- 2-3 weeks

(d) Date, time and place of second substantive meeting with the parties:--- 1-2 weeks

(e) Issuance of descriptive part of the report to the parties:--- 2-4 weeks

(f) Receipt of comments by the parties on the descriptive part of the report:--- 2 weeks

(g) Issuance of the interim report, including the findings and conclusions, to the parties:--- 2-4 weeks

(h) Deadline for party to request review of part(s) of report:--- 1 week

(i) Period of review by panel, including possible additional meeting with parties:--- 2 weeks

(j) Issuance of final report to parties to dispute:--- 2 weeks

(k) Circulation of the final report to the Members:--- 3 weeks

The above calendar may be changed in the light of unforeseen developments. Additional meetings with the parties shall be scheduled if required.

(APPENDIX 4)

EXPERT REVIEW GROUPS

The following rules and procedures shall apply to expert review groups established in accordance with the provisions of paragraph 2 of Article 13.

1. Expert review groups are under the panel's authority. Their terms of reference and detailed working procedures shall be decided by the panel, and they shall report to the panel.

2. Participation in expert review groups shall be restricted to persons of professional standing and experience in the field in question.

3. Citizens of parties to the dispute shall not serve on an expert review group without the joint agreement of the parties to the dispute, except in exceptional circumstances when the panel considers that the need for specialized scientific expertise cannot be fulfilled otherwise. Government officials of parties to the dispute shall not serve on an expert review group. Members of expert review groups shall serve in their individual capacities and not as government representatives, nor as representatives of any organization. Governments or organizations shall therefore not give them instructions with regard to matters before an expert review group.

4. Expert review groups may consult and seek information and technical advice from any source they deem appropriate. Before an expert review group seeks such information or advice from a source

within the jurisdiction of a Member, it shall inform the government of that Member. Any Member shall respond promptly and fully to any request by an expert review group for such information as the expert review group considers necessary and appropriate.

5. The parties to a dispute shall have access to all relevant information provided to an expert review group, unless it is of a confidential nature. Confidential information provided to the expert review group shall not be released without formal authorization from the government, organization or person providing the information. Where such information is requested from the expert review group but release of such information by the expert review group is not authorized, a non-confidential summary of the information will be provided by the government, organization or person supplying the information.

6. The expert review group shall submit a draft report to the parties to the dispute with a view to obtaining their comments, and taking them into account, as appropriate, in the final report, which shall also be issued to the parties to the dispute when it is submitted to the panel. The final report of the expert review group shall be advisory only.