

Part I: Free Trade: Effects and Challenges

Chapter One: Conceptual Framework: Arguments for and against Free Trade

1.1 Basic Concepts of Economics

According to Paul A. Samuelson, the world knows of three kinds of economic systems. He begins by describing the three fundamental problems every human society is confronted with.

Problems of Economic Organization

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?

- **How** shall goods be produced? By whom and with what resources and in what technological manner are they to be produced?
- **For whom** shall goods be produced?

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.

These three problems are fundamental and common to all economies. But different societies try to solve them by using different institutions (market, command, and custom).

No economy today is one of these pure forms. Rather, societies are of mixed economies, with elements of market, command, and custom.

- ❖ **The Law of Scarcity:-** Goods are limited while wants seem unbounded. And the problems arise because people want to consume far more than an economy can produce. By this reason, we concerned with the fundamental questions of what, how, and for whom?
- ❖ **Opportunity Cost:-** Because resources are scarce, we are constantly deciding which good we want to buy or which activity we will pursue. 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.
- ❖ **The Law of Diminishing Returns:-** This law concerns the relationship between inputs and outputs in the productive process. It holds that we will get less and less extra output when we add successive doses of inputs while holding other inputs fixed. The law of diminishing returns is an important and often-observed economic relationship. But it is not valid for all technologies.
- ❖ **Economies of Scale:-** Economies of scale or increasing returns to scale exist if increasing expenditures on all inputs (with input prices constant) increase the output quantity 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.
 - ✓ **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.
 - ✓ **Oligopoly:-** a few large firms dominate the global industry, perhaps because of substantial scale economies. The large firms in an oligopoly know that they can control or influence prices.

1.2 International Free Trade Theories

1.2.1 Classical or country-Based Trade Theories

A, **Mercantilism** (1500s-1800s)

- Believed that a country should increase its holdings of gold & silver by promoting exports and discouraging imports.
- Support protectionist policies (favor their industries and firms)
- Free trade advocates highlight how free trade benefits all members of the global community, while mercantilism's protectionist policies only benefit select industries, at the expense of both consumers and other companies, within and outside of the industry.

B, **Absolute Advantage (Adam Smith Trade Theory)** (Developed in 1776)

- ❖ It focused on the ability of a country to produce a good more efficiently than another country
- ❖ A. Smith argued that trade between countries should not be regulated or restricted by government policy or intervention
- ❖ Trade should flow naturally according to market forces
- A nation's wealth should not be judged by how much gold & silver it had but rather by the living standards of its people

C, **Comparative Advantage (David Ricardo Theory)** (Developed in 1817)

- ✓ Argued that even if one country had the absolute advantage in the production of both products, specialization and trade could still occur between two countries
- ✓ The principle of "comparative advantage" says that countries prosper first by taking advantage of their assets in order to concentrate on what they can produce best, and then by trading these products for products that other countries produce best.
- ✓ Liberal trade policies — policies that allow the unrestricted flow of goods and services — sharpen competition, motivate innovation and breed success.
- Comparative advantage focuses on the relative productivity differences, whereas absolute advantage looks at the absolute productivity

D, Eli Heckscher-Bertli Ohlin Theory (new trade theory) (Factor Proportions Theory) (Developed in 1900s)

- It focused on how a country could gain comparative advantage by producing products that utilized factors that were in abundance in the country
- This theory is based on a country's production factors of land, labor, and capital, which provide the funds or investment in plants and equipment
- It states that endowment of factors of production is the determining cause for trade between countries
- The cost of any factor or resource was a function of supply and demand
- Countries would produce and export goods that required resources or factors in great supply and cheaper production factors

1.2.2 Modern or Firm-Based Trade Theories

i. Country Similarity Theory

- Developed by Stefan Linder in 1961
- It proposed that consumers in countries that are in the same or similar stage of development would have similar preferences
- First produce for domestic consumption
- Most trade in manufactured goods will be between countries with similar per capital incomes
- Brand names and product reputations are important factors in the buyers' decision making and purchasing processes

ii. Product Life Cycle Theory

- ✓ Developed by Raymond Vernon in 1960s
- ✓ A product life cycle has three distinct stages: (1) new product, (2) maturing product, & (3) standardized product
- ✓ It assumed that production of the new product will occur completely in the home country of its innovation
- The product life cycle theory has been less able to explain current trade patterns where innovation and manufacturing occur around the world

1.2.3 Global Strategic Rivalry Theory

- Emerged in the 1980s by Paul Krugman & Kelvin Lancaster
- It focused on MNCs and their efforts to gain a competitive advantage against other global firms in their industry

- The critical ways that firms can obtain a sustainable competitive advantage are called the barriers to entry for that industry
- The barriers to entry that corporations may seek to optimize include:
 - i. Research & development
 - ii. The ownership of intellectual property rights
 - iii. Unique business processes or methods as well as extensive experience in the industry, and
 - iv. The control of resources or favorable access to raw materials

1.2.4 Porter's National Competitive Advantage theory

- ❖ Developed by Michael Porter in 1990
- ❖ A nation's competitiveness in an industry depends on the capacity of the industry to innovate and upgrade
- ❖ The four determinants are: (1) local market resources and capabilities, (2) local market demand conditions, (3) local suppliers and complementary industries, and (4) local firm characteristics

Part II: The Need for Curving Out International Trade Regime

Chapter Two: Historical Development of International Trade Law Regime

2.1 WTO and GATT

2.1.1 The Transition from GATT to WTO

- The negotiation of the GATT dates back to the 1940's.
- It was part of the post-war project to reconstruct a multilateral system of world trade through the elimination of discrimination, the reduction of tariffs and the dismantlement of other trade barriers.
- The initial objective was to create an International Trade Organization (the ITO) to handle the trade side of international economic cooperation, which was meant to join the two "Bretton Woods" institutions, the World Bank and the International Monetary Fund (IMF).

- The GATT was never intended to be an international organization but only to be a subsidiary agreement under the ITO Charter. Nevertheless, the ITO did not materialize and the GATT came into force by means of a Provisional Protocol, signed on 30 October 1947 and effective since 1 January 1948.
- From 1948 to 1994, before the WTO was created, the GATT provided the legal framework for the bulk of world trade.
- The GATT developed rules for a multilateral trading system (MTS) through a series of trade negotiations or rounds.
- From **1947 to 1994**, the GATT contracting parties organized **eight rounds of negotiations**.
- The early rounds dealt mainly with **tariff reductions on goods**, but later rounds included other areas, **such as, anti-dumping and non-tariff barriers**.
- The last round lasted from 1986 to 1994 and is generally known as the "Uruguay Round", which led to the creation of the WTO in 1994.
- 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 Uruguay Round brought about the biggest reform to the world trading system since the GATT was established.
- Since 1995, the WTO has performed the role of an international organization for trade rules.
- The GATT still exists as the WTO's treaty for trade in goods.

2.1.2 Functions and Basic Principles of WTO

- ❖ Trade liberalization is the main approach that the WTO has adopted to help Member countries **achieve economic growth and raise living standards**
- ❖ Generally, the WTO is an international body that **promotes and enforces** the provisions of **trade laws and regulations**.
- ❖ The main role of WTO, like its predecessor, is to ensure that member governments **keep their trade policies within the agreed limits**.

- ❖ The Preamble of the Marrakech Agreement states that trade liberalization is not an end by itself, rather a **means towards** the larger objective of **improving the living standards of WTO member nations**.
- ❖ The overriding **purpose** of the WTO system is to **help trade flow as freely, fairly, smoothly and predictably as possible**.
- ❖ Therefore, the **WTO** has these **four main functions**:
 - i. **facilitating the implementation and operation** of the Multilateral Trade Agreements;
 - ii. **providing a forum for negotiations** on already covered or new issues;
 - iii. **administering** the understanding reached on Dispute Settlement and TPRM;
 - iv. Finally, **cooperating** with the World Bank and the IMF to achieve greater coherence in global economic policy making.
- ❖ The **fundamental five principles** instilled in all of the **WTO** agreements serve as the **basic foundation of the multilateral trading system** and at the same time, which make the **organization's functions achievable** are:

1. Non-Discrimination

- This principle has **two components**, namely the **Most-Favored-Nation (MFN) rule** and **National Treatment(NT)**
- The MFN principle is one of the cornerstones of the WTO
- Under the WTO Agreements, a country should not discriminate between its trading parties
- According to the MFN principle, any advantage, favor, privilege or immunity granted by a Member to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product of all Members
- 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
- In case of NT, treating foreigners and locals equally
- Within national territory, WTO Members cannot favor domestic products over imported products

2. Reciprocity

- It requires that if one country made tariff concessions, then the other country should do the same
- Minimum market access conditions are guaranteed by commitments undertaken by Members regarding customs duties (tariff concessions for goods - Article II of the GATT 1994) and market access for the supply of services (specific commitments - Article XVI of the GATS)

3. Enforceable Commitments

- ❖ 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

4. Transparency

- It is fundamentally important that **regulations and policies** are **transparent**
- 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

5. Safety Conditions

- The WTO 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**:
 - i. The first are articles that allow the **use of trade measures to attain non-economic objectives** (e.g. protect public health or national security)
 - ii. 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
 - iii. 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**

2.2 WTO Objectives Challenged

- ❖ The **objectives of WTO** are laid down in the **Preamble** of the agreement that formed the organization. These are:
 - ✓ **raise living standards;**
 - ✓ **ensure full employment;**
 - ✓ **ensure** a large and steadily growing volume of **real income** and **effective demand;**
 - ✓ **expand** 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**
 - ✓ **ensure** that **developing countries, particularly LDCs**, will have a **proper share** in the **growth of international trade**
- ❖ The **WTO adds three new dimensions** to the objectives in the Preamble of the **GATT 1947**, including:
 - ✓ the expansion of "**the production of and trade in goods and services**" to take into consideration the extension of the coverage of the WTO subject matters
 - ✓ "**the objective of sustainable development** seeking both to protect and preserve the environment and to enhance the means for doing so"; and,
 - ✓ the "**development dimension**" aiming at helping "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 **WTO fulfills its objective** by:
 - ✓ **administering** the trade agreements between its Members;
 - ✓ **serving as a forum** for **trade negotiations;**
 - ✓ **settling international trade disputes** among its Members;
 - ✓ **reviewing Members' trade policies;**
 - ✓ **ensuring greater coherence** in global economic **policy-making**, including **cooperating with the IMF** and the **World Bank;** and,
 - ✓ **providing technical assistance (TA)** to **developing country** Members
- ❖ 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 **NGOs**) would like to see added emphasis on the **public interest goals**
- ❖ others (**private companies** and **some industrialized countries**, for instance) **favor faster removal of obstacles to free trade**
- ❖ 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 organization. Rather it is quite evident that WTO is “passionately **against protectionism** and just as **profoundly for trade liberalization**”
- ❖ The WTO claims to conduct trade ‘**fairly**’ by making conditions of trade **stable, predictable and transparent**. Nonetheless, the organization 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**)
- ❖ 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**

2.3 GATT Round of Talks

2.3.1 The Tokyo Round

- The Tokyo Round lasted from 1973 to 1979, with 102 countries participating
- Under **Tokyo Round of trade negotiation**, the following **tariffs, non-tariff measures, "framework" agreement Subjects are Covered**:
 - ✓ first negotiations on **non-tariff barriers**;
 - ✓ creation of **plurilateral** codes; and

- ✓ creation of the **Enabling Clause** i.e. the Decision on **Differential and More Favorable Treatment, Reciprocity and Fuller Participation of Developing Countries**
- ✓ It **supplemented** the **Generalized System of Preferences (GSP)** which was adopted before the Tokyo Round in 1971 and
- ✓ **Extended** further and **differential treatment** and more **favorable treatment in favor of developing countries**.

2.3.2 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**”
- ❖ 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**
- ❖ The **basic principles** remained the same and like GATT, **WTO operates by consensus of its members**
- ❖ The **major changes** have also taken place. These are:
 - ✓ 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)**.

2.3.3 Implementation Issues

- Although the **Uruguay Round** resulted in some **far-reaching improvements** in the **worlds 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.

Chapter Three: Basic Principles of GATT

3.1 The First Principle: MFN Treatment and GATT Article I

3.1.1 MFN, as an Obligatory Principle

- ❖ 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).
- ❖ 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.
- ❖ GATT is a legal instrument primarily concerned with products and not services or IPRs
- ❖ The major GATT, MFN clause in Article I, paragraph 1, is devisable into two concepts:
 - i. The scope of the clause i.e., to what activity it applies. 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. These are:
 - a) Customs duties and charges of any kind imposed on or in connection with:
 - ✓ importation,
 - ✓ exportation,
 - ✓ internal transfer of payments for imports or exports;
 - b) The method of levying such duties and charges;
 - c) All rules and formalities in connection with:
 - ✓ importation, and
 - ✓ exportation
 - d) All matters referred to in Article III, paragraph 2 and 4 i.e., those covering internal taxes and regulatory laws;
 - e) All of the above apply only to products.
 - ii. The obligation of the clause – i.e., what it requires. It reads as follows:
 - ✓ Any 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.
 - ✚ This clause contains numerous interpretive problems as enumerated below.

- a) As refers to “**advantage, favour, privilege or immunity**”
- b) As refers to **some “any product”**
- c) As refers to “**originating in**”
- d) As refers to “**any other country**”
- e) As refers to “**like products**”

3.1.2 The Conventional Wisdom about Unconditional MFN Treatment

- “What distinguishes the **conditional** from the **unconditional MFN obligation**?” is that “the hallmark of the conditional MFN commitment is **reciprocity**”, whereas that of unconditional MFN is non-discrimination; i.e., **not requiring reciprocity**.
- **Public choice theory** and the **need for the MFN obligation**; i.e., the usual normative analysis of international trade rests on conventional welfare economics. An ‘optimal’ policy will thus strive to maximize the sum of producer and consumer surplus, as well as government tariff revenue if not otherwise distributed to consumers or producers.
- **Political and moral exceptions to the MFN obligation**; i.e., 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 other, as GATT obliges nations to extend trade concessions to all other countries. Some exceptions of MFN obligation includes (RTAs, FTA or customs union or duty-free & preferential treatment accorded by developed Members to third World Members)

3.2 Second Principle: Tariff and Non-Tariff Barriers

3.2.1 Tariffs

❖ The Economics of Tariffs

- ✓ 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

- ✓ Tariff as a tax has been an important income by the less developed country; while in developed countries, tariff is employed for nonrevenue objective
- ❖ **“Bound” Tariff**
 - ✓ Once a tariff concession is made on a particular item, that item is bound against increase above the agreed level
 - ✓ 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

3.3 Non-Tariff Barriers: ‘Unfair’ Trading Practices

3.3.1 Subsidies Under GATT 1947

- A subsidy is **financial** or **in-kind assistance** by governments to producers or exporters of commodities, manufactures and services
- subsidies therefore **promote** the appropriate **allocation of resources** and **encourage imports of competitive goods**
- 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**
 - ✓ An **export subsidy** is a **financial** or **in-kind assistance** granted to a product contingent on its **exportation**
- Under GATT 1947, 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

3.3.2 Dumping

- ❖ **Dumping** is, in general, a situation of **international price discrimination**, where the price of a product when sold in the **importing country** is less than the price of that product in the market of the **exporting country**
- ❖ It is the introduction of a product into the commerce of another country at less than its normal value

- ❖ 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

3.3.3 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’**
- 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

3.4 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
- ❖ **“Domestic industry”** for the purposes of the AD and SCM Agreement refers to the **producers** as a whole of the **like products**
- ❖ Anti-dumping duties and countervailing measures are **designed to negate the pricedistorting effects of subsidized or dumped imports**

3.5 Determining Material Injury

3.5.1 Establishing Causation

- 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**
- whether dumping **“causes or threatens to cause material injury”** to a domestic industry, domestic authorities must consider:
 - i. the **volume** of the dumped imports, and the **effect** of the dumped imports on **prices** in the **domestic market for like products**;
 - ii. the **consequent impact** of the dumped goods **on domestic producers of the like products**

3.6 Third Principle: Implementing Customs Law

3.6.1 Country of Origin Markings and Non-Preferential Rules of Origin

- ❖ 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 fraudulent or misleading indications”**
- ❖ 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**
- ❖ 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**

3.6.2 Foreign Trade Zones

- 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**
- In addition to minimizing tariff liability, FTZs serve the following four purposes:
 - i. FTZs expedite and encourage foreign commerce

- ii. Facilitate marketing
- iii. Promote assembly and manufacturing operations within local territory
- iv. Minimize, or avoid, transportation costs, delay,.. of manufactured, assembled items for the local market

3.6.3 Classification

- 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**
- The requirement relates to “**Harmonized Tariff Schedule**”(HTS) which is based upon the **internationally adopted Harmonized Commodity Description and Coding System** (known as the **Harmonized System or HS**) of the Customs Cooperation Council
- 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**
- Countries are **shifting away** from the **previous HS** to the **widely accepted HTS** as they become **WTO Member countries**
- **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 simple arithmetic formula: $\text{Duty Owed} = (\text{Tariff applicable to classification of article}) \times (\text{Value of article})$
- “**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 worldwide, has been **hammered out**
- **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**
- Because 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

3.6.4 Drawback, PSI 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
- ❖ International trade practices necessitate that **Pre-Shipment Inspections (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.
- ❖ 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.**
- ❖ **GATT Article XXII** and the **WTO Understanding on Dispute Settlement** will apply to **consultations** and **dispute settlement** under the agreement

3.6.5 National Treatment: International Taxes, “Like Products” and GATT Article III:1-2

- “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**

3.6.7 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

3.7 **The Fourth Principle: Non-Tariff Barriers**

3.7.1 **Transparency and GATT Article X**

- The new array of **protectionist approaches** that began to proliferate after the 1930s are “**Non-Tariff Barriers**” (NTBs)
- 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**), and
 - 3) **Measures ostensibly designed** to protect an array of **interests**, including **human, animal or plant life/health, labor rights**
- 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**.
- **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.
- **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**
- 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**
- 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.

3.7.2 Exceptions to the Rule against Quantitative Restrictions

- ❖ 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 commodities”**
- ❖ 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...**imposition of import quotas on certain products**
- ❖ A Member imposing a **quantitative restriction** for **BOP reasons** under Article XII **must enter into annual consultations** with the rest of the Membership

3.7.3 Technical Barriers to Trade

- **Technical barriers** are conditions that limit the **utilitarian significance** of a **commodity within a given country**
- International Trade Law concern over **TBT** lies only in so far as such **barriers become tools** or means of “**disguised protectionist measures**”; i.e., **indirect NTBs**
- 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**
- But in case, when that **particular methodology** and **technical standard** can truly **not be met by a Member country**, the question cannot be resolved. For instance 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

Chapter Four: Challenges to Multilateralism: Custom Union and Free-Trade Areas

4.1 The Weak Discipline of GATT Article on RTAs

- ❖ 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**
- ❖ **Countries of the various Continents** are increasingly forming trade blocks through **customs unions** and **special provisions, arrangements** e.g. EU, NAFTA, ECOWAS, SADEC, etc.
- ❖ 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 and from among “most-favored-nations (MFN); i.e., even if some/all are WTO Member countries because of **the need to achieve greater economic integration**
- ❖ Continents like **Africa**, where **territorial contentions** have **still not been fully resolved** and coupled with **poor kind of governance** and **custom regulations, practices** could most probably make it difficult for governments to **cherish the economic fruits** such blocks without having **fear of losing control, endangering national security** or the **sovereignty** of their respective States

Chapter Five: WTO’s Dispute Settlement Mechanism

5.1 Principles of the Dispute Settlement System

- The **WTO dispute settlement system** consists one of the **major outcomes** of the **Uruguay Round**

- The **mechanism is aimed** at providing a **fast, efficient** and **rule-oriented system** to resolve trade disputes
- By doing so, it provides **security** and **predictability** to the Members and more particularly private economic operators
- 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**”
- Generally, **the main functions and objectives of the WTO dispute settlement system** includes:
 - i. **Provide Security and Predictability to the Multilateral Trading System**
 - ii. **Preserve the Rights and Obligations of WTO Members** i.e. correctly apply the rights and obligations as they are set out in the WTO Agreements
 - iii. **Clarify Provisions of the WTO Agreements through Interpretation** i.e. clarify the provisions of the WTO covered Agreements in accordance with customary rules of interpretation of public international law
 - iv. **Favor Mutually Agreed Solutions** i.e. a solution mutually acceptable to the parties to a dispute, and consistent with the WTO Agreements is clearly to be preferred
 - v. **Detailed Procedures and Prompt Settlement of Disputes** i.e. the Dispute Settlement Understanding (DSU) sets out in considerable detail the procedures and corresponding deadlines to be followed in resolving disputes
 - vi. **Secure Withdrawal of Inconsistent Measures** i.e. secure the withdrawal of measures which have been found to be inconsistent with a provision of the WTO covered Agreements

5.1.1 **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
- ❖ **(1) Consultation**

- ✓ the objective of consultations is to **allow parties to obtain satisfactory adjustment** of the matter before resorting to any further action
- ✓ it is the **first stage** of formal dispute settlement
- ✓ it is a **mandatory stage** and any mutually agreed solution reached during this **stage must be notified** to the **Dispute Settlement Body (DSB)**
- ✓ if **after 60 days of consultation**, the **parties do not reach an agreement**, the **complaining party** may **request the formation** of a **Panel**

❖ (2) The Panel Process

- ✓ Panels consists normally of **three experts selected for each specific dispute**, who **examine the legal and factual aspects of the case** and **submit a report to the DSB**
- ✓ The panel's **report** includes its **conclusions** as to whether the challenge measure is **consistent or not with the WTO covered Agreements**
- ✓ Either party may **appeal the report of the panel** but only with respect to **issues of law**

❖ (3) The Appellate Process

- ✓ Unlike the panel, the **Appellate Body composed of seven members-** is a **permanent body**
- ✓ The Appellate Body may **uphold, modify or reverse the legal findings and conclusions of the panel**
- ✓ Approximately, the total time of a dispute is **12 months** (up to the **panel stage**) and **one year and three months** if there is an **appeal**

❖ (4) Implementation of a Decision

- ✓ The **last stage of dispute settlement procedure** under the **DSU of WTO** is the **implementation of the reports** after their adoption by the DSB, which maintains surveillance of the implementation of the rulings until their compliance
- ✓ if **immediate compliance** is **not possible**, the respondent has a **reasonable period of time to comply**

- ✓ The **DSU** provides to the **complainant remedies** applicable in case of **non-compliance with the reports: trade compensation** (almost never used); and, **suspension of concessions**
- ✓ The **suspension of concessions** is a **remedy of last resort**, which has been used only on **a few occasions**

5.1.2 Adoption of Panel Reports

- The **reports of the panels and Appellate Body** are **binding** after being **adopted by the DSB**
- The **reports of the panels and Appellate Body** are adopted by the **DSB quasi-automatically** through **negative consensus**, that is, unless all WTO Members decide against their adoption unlike the **previous rules of GATT Council**, i.e. Panel Reports had to be adopted by **consensus of the GATT Council** (was a major weakness)

5.1.3 GATT Article XXIII: The Substantive Aspects of Dispute Settlement

- ❖ While the **DSU** provides the **procedural rules of dispute settlement** under the **WTO**, **GATT XXIII** is the **principal substantive dispute settlement provision** (i.e. The DSU expressly incorporates GATT Article XXIII, at Article 3.1.)
- ❖ Under **GATT XXIII**, 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**,
- ❖ In other words, if a member considers that **XXIII:1(a),(b) or (c)** have been **fulfilled**, it may **initiate dispute settlement proceedings**

5.2 Violation Cases

- **‘Violation’ cases** are disputes where **one contracting member alleges** that another is **violation its obligations** under the **GATT** (or **other relevant agreement**)
- **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**

5.3 Non-Violation Cases

- ❖ In **‘non-violation’ cases**, a **contracting member** essentially **claims** that another is **required to change** its **behavior**, even though it is **not violating** an **obligation of the GATT**
- ❖ It is rare in the law-essentially **a party attempts** to change another’s **domestic economic policy**, even though they have **not violated any obligation**
- ❖ **Article XXIII:1(b)** 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**

5.3.1 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**