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THE WTO AND DOMESTIC REGULATION

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BACKGROUND

In 1998 Guy de Jonquières wrote an article in the FT "Rules for the regulators" in which he argued that future trade negotiations would no longer be about tariffs quotas and other measures clearly targeting trade but would rather be about domestic regulations that had an indirect effect on trade:

> "Increasingly, regulation is becoming the focus of international competition and conflict. As the borders come down in the world economy, the repercussions of inadequate or flawed regulation are becoming more immediate and more likely to cross national frontiers. This is thrusting the main global body for resolving trade disputes, into new territory. As liberalisation extends deeper into countries' domestic economies, the opening of markets increasingly requires global disciplines on national regulatory policies."[1]

Some observers might disagree with the author's argument that erosion of sovereignty in this area was desirable but there is no doubt that this comment was highly prescient.

This has proved to be particularly true in transatlantic trade diplomacy. One of the toughest trade battles at the WTO between the EU and the US has been the "Beef Hormone" dispute in which the US and Canada challenged the EU's right to ban the sale in its markets of beef treated with growth promoting hormones, a ban which had the effect of excluding almost all US beef from the EU market, since this method of rearing is usual in North America. The looming battle over GM foods is a similar case: here the primary effect of any EU rules would be to govern the use of GM crops within the EU, but there would also be a significant effect on trade and therefore it comes within the remit of the WTO.

The intermingling of trade and regulation has a long history within the EU, though its profile has been very low until recently in the multilateral system. The traditional British jokes about "Brussels" seeking to harmonise standards foice cream and to force British ice cream to be labelled "iced vegetable fat", whilst mythological do have a basis in fact. When the Rome Treaty was written the authors realised that it would not be enough to outlaw all barriers to imports that acted at borders, because border measures could be replaced by domestic measures that had an equivalent effect. In the crudest example, France could remove all

customs duties on scotch whisky but introduces a sales tax that affects whisky products but not cognac.

If the UK eliminates a 10% tariff on German cars but at the same time raises VAT by 10% on all cars *and* introduces a production subsidy of 10% we are back where we started. Technical regulations have similar effects: even a requirement that all products be packaged and labelled in pounds and ounces in one country but in metric units in a neighbour can create a barrier to trade.

The Basic Economics of NTBs

The basic economics of protection by tariffs and indeed subsidies is fairly familiar but it is worth recalling the difference between these measures and the effects of regulatory protection. Where tariff protectionism is used, imports are taxed and the price to consumers of imported goods is raised by the amount of the tariff (as a first approximation). On imported goods this price increase goes to the state as revenue. In the case of domestic substitutes for imports, traditional theory assumes that producers match the price of imports with an equivalent rise, in which case there is a transfer of revenue from consumers to domestic producers. In the case of quotas or quantitative restrictions we can also assume that prices rise but in this case the scarcity rent goes to the exporter.

In the case of regulatory non tariff barriers the effects are different. Here the impact of the NTB is to raise the costs of supply *for everyone* in such a way as to restrict market penetration by imports. The typical regulatory barrier takes the form of a technical regulation that requires some product or process specification, which is somehow more burdensome on foreign producers than on home producers.

It is however worth at this point noting the very important distinction between: standards which are in themselves not trade barriers. But they can become barriers if there are forces to require the use of one standard rather than another. There may be regulations which may make standards compulsory, or complex. conformity assessment procedures. These are testing and certification systems that a product (or service) has to go through to show it really does comply with a regulation or standard, and one country's certificates may not be recognised by another even if products actually are identical.The latter often creates the most

tricky barriers as testing and certification can be very costly and is sometimes in the hands of private domestic producers who can create DIY trade barriers.

It has been recognised that private firms may have an incentive to lobby for national regulations that raise both their own costs and those of foreigners when a similar cost amounts to a greater burden for the foreigner, eg because they have lower profit margins anyway and may be forced to exit or because a fixed cost can be more easily spread over the whole market by local firms (see Mattoo 2001).

The early economic theoretical literature (like GATT law as we shall see) mainly focussed on tariff barriers and taxation, but there was a literature on non-tariff barriers: these were mostly analysed in terms of subsidies and quotas. The theoretical analysis of the impact of regulatory differences, including technical barriers, service regulations etc is relatively recent. The main reason is almost certainly that trade economists have been anxious to stress the benefits to consumers of diversity of regulations and have been aware that discussions of "distortions" caused by domestic regulations in other countries' domestic regulations is likely to lead to demands for harmonisation which if not met lead in turn to pressures for traditional protectionism. As we shall note below most trade economists are seek to minimise the scope for international rules to harmonise domestic regulations.[2]

Domestic Policy and International Trade in the Economics Literature

It has long been recognised in principle that many domestic policy measures can have an effect to distort trade. A long tradition of literature in international economics identified the conditions under which taxes and subsidies might have an effect on trade, notably by Johnson Wonnacott and Shibata. Johnson (1960) developed the famous theoretical result that for the promotion of domestic industry an internal subsidy was more appropriate than a tariff, which is simultaneously a production subsidy and a consumption tax. To reduce consumption of the item in question (eg luxury goods in developing countries) a tax on all sales not just imports is appropriate. Conversely this literature showed that combinations of taxes and subsidies could achieve exactly the same effect as taxes. The effect of a tariff can be mimicked by a tax on all sales of the item combined with a subsidy on domestic production. Interestingly the economics literature was less worried about subsidies than tariffs: the trade literature was clearly concerned about distortions but the public finance

literature gave broad support to subsidies in cases where there were externalities. It was only in the 1970s and 1980s that the trade literature began to join the *public choice* literature.[3]

We should however distinguish between the broad principle of taxation as they affect the relative price of all imports and domestic goods how they might alter the relative prices of home vs foreign variants of individual commodities.

There was extensive literature in the 1960s on the trade neutrality of internal sales tax systems, ie origin vs destination based tax systems. Under the destination principle sales taxes or VAT are levied on imports but not exports and vice versa for the origin principle. The destination principle is less likely to distort trade, given the location of production but it could influence investment decisions.[4]

What is notable about these measures is that in most cases it is possible to design a measure that does not actually formally discriminate between home and foreign goods (apart from the example of the production subsidy which by its nature only affects domestic goods, though it might not differentiate between the nationality of firms).

It is therefore clear that any set of rules governing trade liberalisation must also address domestic regulations and taxation if removal of barriers directly affecting trade are not to be simply replaced by indirect measures.

Sceptics may well ask whether the retention of alternative policy instruments might not be a good idea. This perspective however risks missing what many trade economists see as the key aim of trade liberalisation, namely the creation of a regime of predictable rules, rather than necessarily a system of totally free trade, whether we are thinking of the EU or the WTO. Those who believe in the merits of the multilateral trade system or the single market regime do not necessarily believe that governments must abolish all interference with trade, but rather it is increasingly argued that unpredictability of public policy has serious adverse consequences. Curiously the point is made most often in the context of macro-economic policy where rules (including contingent rules) are considered by many authors superior to policy framework with total discretion.

The concept of a rule-based trade regime is based on a similar idea. Trade liberalisation is motivated by the desire to signal clearly to investors that they should not invest in sectors where the country does not have a comparative advantage. Where as there may be arguments against the introduction of such reforms in a big bang, there is very reason to ensure that transition periods are predictable and not disrupted by offsetting subsidies or other measures.

"DEEP INTEGRATION" VS SHALLOW IN THE EU & THE WTO

Historically there has been a divide between the rule framework of the multilateral trading system and that of more ambitious regional integration schemes such as the EU. This is exemplified by the perception that the GATT dealt with trade barriers while the European Common Market was intended to go further in harmonising domestic legislation.

In fact since the 1960s it has been primarily legal analysis that has explored the relationship between trade and regulation. In a masterly account of the relationship between the EU and the GATT/WTO system, Weiler (1999) observes that both the Rome Treaty and the GATT did address non-border regulatory measures but in different ways. Article III of the GATT 1947[5] provided that domestic taxes and regulations should not be applied so as to discriminate against imported goods. In other words signatories of GATT could apply whatever discriminatory barriers they had scheduled at border but once inside the country foreign goods had to be treated exactly as domestic goods. The "National Treatment" provisions of GATT enshrined non discrimination as the cornerstone of the GATT approach to taxes and regulations. A pure non-discrimination rule allows a country to have any tax regime or regulatory framework it wishes so long as the same rules apply to domestic and foreign goods (or services).

It soon becomes clear that such a principle is extremely tolerant of measures that are designed to effectively deny entry to foreign goods if it confined to banning explicit *de jury* or "facial" discrimination. In the simplest case we can mimic a tariff by a tax system that bears far more heavily on types of car that are imported than on types produced at home, or has different tax rates on spirits based on different kinds of alcohol. And for technical regulations where there are economies of scale and scope the requirement in a regulation that standards commonly used at home are compulsory for all goods may exclude foreign products even when the same regulations apply to them as to home products.

The classic example in recent times has been the EU ban on the sale of hormone treated beef. This affects all beef regardless of origin, but it can be argued that it affects imported beef more since hormone treatment of beef is not customary inside the EU but it is elsewhere.
The basic disciplines on domestic regulations are Most Favoured Nation, National Treatment, Mutual Recognition, and Harmonisation.:

Most favoured nation (MFN): this is the core of GATT and the WTO. Your rules may discriminate against foreigners but must treat all imported like products the same. This provision prevents you for example from using administrative measures that for example exempt country A's goods from a technical requirement that is imposed on country B's goods, *for no good reason*. This provision is more significant where technical barriers to trade are concerned than for tariffs – but in particular as we shall see it has much more relevance to services than goods.

The MFN principle has been at the heart of the GATT since 1947 for a good political economy reason. It is intended to ensure that weaker players secure all the same market access opportunities that stronger ones have. The only basic exception is for thorough-going regional integration schemes, (as laid out in GATT Art. XXIV, and GATS Art V) but it is clear that as the EU and the US pursue bilateral trade arrangements the MFN principle is under threat. The relevance for regulations is of course that countries must not impose regulatory requirements on some countries but not others.

"National treatment" is the basic principle of non discrimination. It says your regulations may be what you wish but they must be applied evenly between home and foreign goods. The sting on the tail that this must be de facto as well as *de jure*.

Harmonisation of law is a system for preventing technical barriers to trade: neither the GATT nor the WTO have a means for agreeing common legislation, but it is arguable that some provisions, particularly the TRIPS agreement get close to this.

Mutual recognition (MR) is a principle that was developed by the ECJ in the 1970s in the face of the unwillingness of member states to remove the national differences in rules that created trade barriers. MR means Each EU members state agree to accept goods made to every other's standards and you agree to accept goods made to ours even if they are slightly

different. Inevitably this must be a selective affair: there must be a basic compatibility between the partners' approaches. Moreover it is if little value unless there is also MR of testing and certification procedures. The WTO provisions have two aspects: members are enjoined to accept products made to other countries' standards when these are based on international standards. (The exact nature of this obligation will be discussed below). But there are special rules governing bilateral mutual recognition agreements which will normally be needed to extend MR into testing and certification.

Each regime has different governance implications. Looser obligations require less complex arrangements for defining common norms but if they are binding leave enormous power and discretion in the hands of the dispute settlement body or court.It is a far from trivial economic issue to determine what are "like products" which must be subject to the same rules or taxes.

	Meaning	WTO	Governance
Most favoured nation	Discriminate against foreigners but not between them	Key principle of GATT	Minimal constraints on autonomy
National treatment	treat foreign and home firms equally but rules as idiosyncratic as you like	Art III also key. Sometimes impact underest'd TBTs; GATS subject to c'tments	Impact slight without binding DS. Could be big with binding DS- if implicit discrimination addressed.
Mutual recogn-ition	Equivalence assumed but subject to challenge	SPS if equivalence can be shown	Depends on freedom to choose partners and if binding DS
Harmon-isation/ Approx-imation	Everyone has same/similar rules	TRIPs Telecoms reference paper	Explicit agreement in detail needed; EU QMV WTO consensus if multilateral

Domestic Measures in GATT

It is possible to argue that before the creation of the WTO the difference between the EC and the WTO was that the former concerned itself with the removal of non-border barriers that distorted trade flows. As a matter of practical politics this is more or less accurate but legally it is misleading. Like the Rome treaty the GATT did deal with within the border non-tariff barriers, but this was not really taken seriously.

The original discipline on domestic regulations in the GATT comes in the form of Article III of the GATT (1947):

> "Article III: National Treatment on Internal Taxation and Regulation
> 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."

This is the core non discrimination requirement (National treatment) of GATT. It states that once an imported good has crossed the frontier it must thereafter be treated the same as "like" domestic products.

This rule had some exceptions: it did not apply to public procurement and quite importantly, it only applied to *new* measures until the creation of the WTO in 1994. We should note at this point that that competition laws are almost certainly covered by Article III, and whilst for trade in goods there is no obligation on a member state to have a competition law, any such law must conform to Article III. Curiously as we shall note below the position is somewhat different with respect to services.[6]

In fact Article III is not the only measure of relevance to domestic regulation in the original GATT . Article XI bans any measure other than "duties, taxes or other charges" may be used to restrict imports; it outlaws quantitative restrictions. A total ban on the sale of a type of product that has the effect of preventing the same of imported products can be seen as a zero quota.

Article XVI of the GATT 1947 forbids export subsidies – and can be used to attack any provisions of *domestic* tax law that even in an indirect manner treats income from export earnings more generously than domestic profits. This potentially enters quite deep into national sovereignty as the case brought by the EU against the US in the "Foreign Sales Corporation" case shows.[7]

Other provisions of the GATT 1947 dealt with state import and export monopolies requiring them not to discriminate against *or between* foreign goods.

Finally on the discipline side, Article XXIII says that a contracting party may bring a complaint against another if it believes that a new measure has been introduced which has the effect of "nullification or impairment" of market access that was provided for by the GATT agreement and the parties' schedules. This is known as the "non violation" because it applies when the accused party has introduced a measure that is *not* explicitly prohibited as such by the GATT and which would be perfectly legal if it did not have the effect of injuring the complainants exports. It is in fact very hard to win a case under this provision.[8]

Each of these disciplines contains its own defence: obviously one can claim that differences in treatment of imports and other goods do not afford protection to domestic good (Art III) and perhaps more significantly a if a foreign good is not a "like product" compared with your own then it can be treated differently.

In addition there is a general exception provision GATT 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;"

and

> "g) relating to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption."

This is the equivalent of article 30 of the revised EC Treaty which allows general public policy exceptions.But whereas the European Court of Justice had a means of enforcing the equivalent provisions against quotas and "measures of equivalent effect" the dispute settlement system of the pre-1994 GATT had no teeth. That is to say if a judgement was given against a GATT contracting party (now under WTO "member state") it was not binding unless approved by a consensus of all states including the respondent.

THE CREATION OF THE WTO

The creation of the WTO in 1994 had two important effects. It created a series of new obligations in addition to those above, and, less well understood, it gave teeth to the original obligations for the first time.

The Technical Barriers to Trade (TBT) Agreement

There had been long discussion on the role of technical barriers to trade in the GATT but in 1994 the conclusion of the Uruguay Round took this one step further with the creation of the WTO, a full-blown multilateral organisation which signatories of the GATT and a series of new texts became members of. The technical barriers to trade (TBT) agreement consolidated a number of agreements that GATT signatories had made.

Recalling the distinction between standards, regulations and testing and certification, the TBT agreement of the requires members to ensure that all of these are implemented in such a way as to minimise distortions to trade.

Key provisions are:

> Article 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."

and

Article 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."

The most significant elements are the requirement that there should be no unnecessary obstacles to trade, and that regulations should be based on international standards unless these would be "an ineffective or inappropriate means for the fulfilment of the legitimate objectives pursued." It is clear that these terms are somewhat ambiguous and it will be recurring theme of our essay that one cannot interpret the meaning of these WTO rules without looking at the jurisprudence of the dispute settlement body.

The basic meaning of this element of the TBT agreement is that countries can pursue their own national regulatory aims but there are bounds on the means that may be used to pursue them if these restrict trade. There is a natural economists' response to this, namely that we should use some sort of cost-benefit analysis to compare the value of the regulatory goal with the trade loss. This philosophy lies behind the use of Environmental Impact Assessment in the USA. However it is clearly inappropriate in the WTO context. The trade off is between gains for the importing countries and losses for exporters. the WTO Dispute Settlement Body (DSB)[9] does not have the authority to insist on a form of redistribution of income that may be implied by such a trade off. (We should recall that from the time of the GATT trade rules have been expressed in mercantilist terms in which the cost of an import

restriction is not viewed as the costs to consumers of inability to import; rather it is the cost of lost export revenue.)

The wording of the TBT agreement is ambiguous: it does not give countries total freedom to regulate as they wish, and implies there are circumstances in which regulations will be struck down if they are not based on international norms, but implies that there is considerable freedom to regulate if a "legitimate" aim is pursued.

It was left to the DSB to sort out the meaning of the terms here in more detail that is provided in the text itself and almost as important to settle the burden of proof.

The Agreement on the Application of Sanitary and Phytosanitary Measures (SPS)

The SPS agreement was a new addition to the GATT structure the time of the Uruguay Round (UR): it deals with regulations to protect human, animal or plant life or health.

It has basically the same structure as the TBT agreement but it is rather more precise. The SPS agreement was motivated by the Uruguay Round decision to liberalise agriculture. It was clear that reducing tariff barriers would be of no value if phoney health and safety regulations could be invoked with no scientific basis at all. It was motivated by a number of concerns: the US was particularly motivated by the desire to end an EU ban on the sale of beef treated with growth hormones (wherever produced); and the EU was aware of the desirability of preventing the US keeping out EU wines and cheeses.

Its preamble reaffirms that.

> *"no Member should be prevented from adopting or enforcing measures necessary to protect human, animal or plant life or health, subject to the requirement that these measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between Members where the same conditions prevail or a disguised restriction on international trade"*

It summarises the trade off: there is no curtailment of the right to protect health, but this must not be by "arbitrary measures" or a "disguised restriction on international trade".

But what is arbitrary? The agreement states that all SPS measures must be based on scientific evidence Art 2.2 including a scientific risk assessment (Article 5.1).
And it also goes somewhat further than the TBT agreement in requiring that regulations be based on international standards.
The agreement calls for measures to minimise distortions to trade; Article 5 footnote 3 states:

> *"For purposes of paragraph 6 of Article5, a measure is not more trade-restrictive than required unless there is another measure, reasonably available taking into account technical and economic feasibility, that achieves the appropriate level of sanitary or phytosanitary protection and is significantly less restrictive to trade."*

SPS creates a presumption that products that confirm to international food safety standards are safe.

The requirement to base food safety rules on scientific evidence contained one important qualification. Article 5.7 says

> *" In cases where relevant scientific evidence is insufficient, a Member may provisionally adopt sanitary or phytosanitary measures on the basis of available pertinent information…"*

This provision is closely related to the "precautionary principle" often invoked by the EU but it does not give *carte blanche* for bans unless there is *some evidence* of a risk. The SPS agreement did not however oblige countries to base their regulations on international standards *in all cases*, but it defined rather precisely the conditions under which countries could impose tighter standards. This was the heart of the Beef Hormone dispute. The spirit of both the TBT and SPS agreements is therefore that states should be allowed to choose any legitimate regulatory objective they like, and can introduce any measures that are necessary to achieve such goals, even if trade is affected. They cannot however introduce regulations that affect trade but have no connection to a legitimate regulatory aim.

But what is a legitimate aim? And what is *necessary*? The rules are clear that if a state introduces a measure that is demonstrably necessary to achieve the aim of increasing food safety or which falls into one of the other "legitimate aims" of TBT it is hard to argue that it

is illegal under the WTO, even if there is restriction to trade. But the problems arise when the aim is a TBT aim that is not on the list, when there is dispute abut the validity of the aim, or in the case of SPS measures whether there is enough scientific evidence to support it. We need to consider what the DSB has said on this.

WTO Jurisprudence on trade in goods

It is worth bringing together the case law that has emerged in these 3 areas. We have firstly the rules of the GATT: Article III (the non discrimination provision) and its own internal defences and the exception clause that is spelled out in article XX. Then we have the specific disciplines and gateways in the TBT and SPS agreements. We need to remember that the WTO dispute settlement process has a number of steps. A member brings a complaint to the WTO: there are first consultations and then if no settlement can be reached, a panel is appointed to decide. The panel judges whether the measure in question is compatible with WTO rules. If not it will ask the respondent member to brings its policy into compliance, but the will not usually say how this is to be done. They may observe that eliminating the measure in question is one way, but in general do not say that this is the only way.

The panel's judgement then becomes a binding decision of the WTO unless:

a) there is an appeal or:
b) a consensus of WTO members - including the winning complainant - reject the decision.

If there is an appeal the permanently constituted Appellate Body makes a final ruling, which is automatically binding, unless there is a consensus against it.[10] The respondent must then comply. If they do not do so, the complainant may then be authorised to take retaliatory action if a "compliance panel" judges that the respondent has not implemented the ruling.

One issue about how much sovereignty is lost is whether or not it is within the rules for a respondent to agree to pay compensation instead of complying. Practice has emerged that non-compliance with compensation is becoming "*de facto legal*" but all lawyers agree that this outcome is not ideal, as if formally recognised would give powerful players the ability to buy their way out of complaints.

It is actually worth noting that the some of the worst fears about the intrusiveness of the WTO have not materialised in the sense that there have not been a spate of dispute settlement vases about domestic regulation as was feared, though some of the most high profile cases, beef hormones and asbestos (see below) were about the regulatory part of the rules. The most controversial aspects of this have been where exporters have challenged national measures allegedly promoting food safety but other aims and measures to enforce them have come under scrutiny. As the ultimate arbiter the Appellate Body has tried to develop a consistent body of doctrine through its handling of Art III/Art XX , TBT and SPS cases.

The legal position has been summed up by Türk and Neuman and by Marceau and Trachtman.[11] The Appellate Body has adopted the position that it will normally accept the declared regulatory goal of any respondent member state, but it will be prepared to examine the link between the declared aim and the actual measure adopted, in particular to explore whether the measure is really necessary or "least trade restrictive" for the achievement of the aim.

Thus the thread which runs through the decisions is that a state may choose its own regulatory aims but the way its enforcement affects other countries' exports and the instruments to achieve the aims must be scrutinised.

The Beef Hormone case[12] under SPS was the most spectacular: in a nutshell the US and Canada claimed the EU had introduced a ban on sale of hormone treated beef without any scientific evidence at all that there were risks from such beef. (They argued that broccoli contained more of the hormones in question than treated beef).

After the signing of the SPS agreement the US had pushed at the international food safety standards authority the *Codex Alimentarius* for approval for a standard authorising the use of growth hormones during the raising of cattle. This meant that the EU's ban on their use would be illegal unless it had scientific evidence to show that there was some risk from their use which could be reduced by a regulation which did not allow their use for beef sold in the EU. The US set out to convince the WTO panel that there was no such evidence. It is in fact widely acknowledged that the EU had very little if any evidence of possible harm from hormone treated beef and the panel's ruling that the EU's measures were illegal came as little surprise. The Appellate Body however nuanced this outcome very significantly.

The Appellate Body ruled that under the SPS agreement the EU had the right to set safety standards at higher levels than the *Codex* standard, but it ruled that the US had shown that EU had no scientific evidence that its ban on hormone treated beef actually did reduce risk: the Appellate Body accepted the US case that the EU had not based its measure on a proper scientific risk assessment.

The Appellate Body overturned some elements of the initial panel decision to reaffirm the right of the EU to set the safety levels of its choice, and it ruled that the onus lay on US to prove that EU rules were not based on a scientific risk assessment, but accepted that the US had done so.

The Appellate Body made it clear that the EU did not have to show conclusively that there was a danger from hormone treated beef, merely that there was some evidence – any evidence – of a risk from even a "minority" scientist. Critics who argued that WTO had applied a naïve "right or wrong" view of science appear to have been mistaken. The Appellate Body said para 194:

> *"We do not believe that a risk assessment has to come to a monolithic conclusion that coincides with the scientific conclusion or view implicit in the SPS measure. The risk assessment could set out both the prevailing view representing the "mainstream" of scientific opinion, as well as the opinions of scientists taking a divergent view. Article 5.1 does not require that the risk assessment must necessarily embody only the view of a majority of the relevant scientific community. In some cases, the very existence of divergent views presented by qualified scientists who have investigated the particular issue at hand may indicate a state of scientific uncertainty."*

Oddly, the EU caused considerable confusion by invoking the relevance of the "precautionary principle"; it did not however give a firm definition of this and failed to invoke article 5.7 here (see above). That is to say the EU claimed there was an identifiable risk but did not reveal any evidence for this.

The Beef Hormone case set a number of core precedents: it established the right to set national safety levels as you wished and put the burden of proof more firmly on

complainants, but it established the right of the DSB to decide whether there was a rational link between the declared objective and the trade measure.

Subsequent cases have taken this further: the Appellate Body has ruled that similar rights and burdens apply in the case of TBT and SPS measures: that is to say it is up to the complainant to show that the measure in question is not based on an international standard where one exists *and* that such a departure is not needed to achieve a valid objective.

The Appellate Body has been fairly tolerant of regulatory objectives but intolerant of measures that clearly went well beyond what was needed to achieve the stated aim. One significant case was the Korean beef case[13] where Korean law demanded that all imported beef should be sold in separate shops to ensure no possibility of a Korean consumer unwittingly buying imported meat instead of local. The Appellate Body did not question the objective but said it could be achieved equally well by other means (eg labelling rules) that would be less of an obstacle to importers.

This immediately gives us an insight into how the DSB might approach a dispute over GM foods. If the EU were to ban the import of GMOs claiming them to be unsafe, it would risk losing the case unless it could show it had some scientific evidence of possible risk (even if *proof* of danger would not be required). On the other hand if the EU argued that it wanted to impose strict labelling and segregation rules to reflect the collective wish of the EU public not to eat GM foods involuntarily, then it would be much easier to defend the case. However the US could still argue that ultra strict segregation rules were more trade restricting than necessary.

The DSB does not however have moral authority to make an economic trade off between the welfare (as expressed by their subjective preferences) of EU consumers vs the profits of US cattle farmers as in a conventional Cost-Benefit analysis.

Another important case was the "Shrimp Turtle" case.[14] Here the US banned shrimp imports from certain Asian countries because they were not caught in US approved nets that had a "Turtle extractor device". The Appellate Body established the principle that the US *did* have a right to control the sale of products produced abroad in what it considered an environmentally unfriendly way: but it said the specific measure in question discriminated

against some countries whose fishermen did not harm turtles but achieved this aim without using US methods. Finally a new US proposal was introduced that had the same effect by other means and was approved by the WTO.

The Appellate Body has tried to avoid taking a position on the merits of the objective in question: in Korean Beef it established the position that if the regulatory objective was legitimate, there should be no compromising the aim, but it might be asked whether other ways could be found of achieving the aim. But even if there were a number of alternative ways of achieving the same target were possible, the Appellate Body would look sympathetically more sympathetically on a very trade restrictive measure in cases when the aim was a life and death matter. That is to say if the aim is legitimate and clearly of high political salience a measure will not be struck down just because there is a another hypothetical measure that is as effective but might restrict trade less.

On the other hand if the objective is considered to be legitimate but less vital the Appellate Body will be more sympathetic to demands that it be replaced by a less trade restrictive *but equally effective* measure (which would not be specified however).

So if the only way to achieve a legitimate aim involves banning all imports the WTO should allow that, but if the same aim can be achieved by more or less trade restrictive measures the AB will consider demands that an alternative be adopted. The Appellate Body has made it clear that they will be more willing to impose the administrative nuisance of ensuring that a measure is modified to restrict trade less whilst still achieving its aims in cases where the aim, whilst legitimate is somehow less vital.

An interesting hypothetical case concerns the new EU regulations on the maximum tolerable levels of Aflatoxin in peanut butter. World Bank economists[15] have estimated that the new tougher standards will only save two lives per billion peanut butter consumers, at a cost of many hundreds of millions of dollars to very poor peanut farmers in Africa, and perhaps deaths through economic crisis. It argues that the price per life saved is in some sense too high. If our understanding is correct, the Appellate Body would be unlikely to challenge the EU's right to set a very tight safety limit for lives saved. Aflatoxin is a genuine health risk, and the test would not be whether the loss of many livelihoods in Africa was a legitimate

trade off against a small improvement in public health in the EU, but rather whether the same improvement in public health could be achieved in another way.

On the other hand, the Appellate Body recently (Nov. 2003) upheld a US complaint against Japanese rules that made it impossible for apples to be sold to Japan from 48 of the 50 US states.[16] Here the panel and the appellate body, while not apparently questioning Japan's right to keep its orchards free of "fire blight" nevertheless concluded that there was in effect no risk that the "mature symptomless apples" which were being excluded could ever be infected and therefore any ban on their import was not rationally related to a legitimate goal.

But what if the issue is not life and death? The WTO is open to the charge that the Appellate Body is judging the merits of the aim. It can be argued from the "Korean Beef" case that the Appellate Body is asking what priority the respondent country places on the aim in question. Here the Koreans chose not to claim foreign beef was unsafe, but they claimed a need to inform consumers. The Appellate Body had to decide if insisting foreign beef was sold in separate shops was really necessary for Korea's aims. The Appellate Body report para 164 says:

> *"In sum, determination of whether a measure, which is not "indispensable", may nevertheless be "necessary" within the contemplation of Article XX(d), involves in every case a process of weighing and balancing a series of factors which prominently include the contribution made by the compliance measure to the enforcement of the law or regulation at issue, the importance of the common interests or values protected by that law or regulation, and the accompanying impact of the law or regulation on imports or exports."*

The Appellate Body observed that Korea did not require foreign seafood or foreign pork to be sold in separate shops, nor was the objective of the law to make the probability of fraudulent sale of foreign beef zero. In the light of these considerations they ruled that Korea could devise some alternative ways of minimising the risk of counterfeit beef being sold which was as effective but put less of the burden on foreign importers. The Appellate Body did not at any point investigate whether the Koreans had a protectionist aim here, only whether their measures had more protectionist *effects* than were needed to fulfil the aim.

This case was influential in the better known Asbestos case[17]: here Canada claimed that a French ban on the use of asbestos (all asbestos not just imports) was illegal because it discriminated against other building materials. The panel concluded that asbestos and other building materials were "like products" and hence France had violated Article III since there was protection for other materials that France might itself produce. However it said that this discrimination was justifiable under Article XX because there was clear evidence asbestos was dangerous. WTO analysts breathed a sigh of relief when the Appellate Body overturned the first part of this ruling: it declared that safe and unsafe products though otherwise similar were not "like products".

The asbestos case is in fact one of the relatively few where the complainant has lost. The propensity of respondents to win is not really a sign that the DSB is eager to overturn every domestic measure it can; rather that in general only the most egregious cases get to the WTO. Canadian officials generally squirm when asked why their government brought the asbestos case!

In general developing countries favour the use of tight controls on arbitrary food safety rules that prevent developed countries excluding their products for no good reason. An interesting case has occurred recently over fears that a cholera outbreak in East Africa might contaminate food exports to the EU. WHO representatives have argued in a WTO context that an import ban was inappropriate, but one can see the sensitivity that might be invoked:

> *"Although there is a theoretical risk of Cholera transmission associated with some food commodities moving in international trade, this has rarely proved significant and authorities should seek means of dealing with it other than by applying an embargo on importation."* [18]

But will the European public be happy to see products imported that carry even a "theoretical risk" of cholera infection?

OTHER AGREEMENTS

Trade related investment measures (TRIMS) & subsidies

The extent to which WTO rules undermine the scope for industrial policies for development is hotly debated. There is not space here to cover the whole issue, but it is useful to make a few points relating to the link between internal and external rules.

The WTO provisions to consider here are the "TRIMS" Agreement on "Trade related investment measures" and the "Agreement on Subsidies and countervailing measures" (SCM) agreement which governs what subsidies are allowed and what retaliation is allowed against them.

One rather surprising point is that we find (Bora 2002) that the text of the TRIMS agreement is extremely narrow in scope: it is about investment incentives of all kinds that affect firms' incentives to trade – it is not about foreign investment.

Article 2 implies that its only purpose is to clarify give effect to (and allow temporary derogations from) the existing articles III and XI of the GATT. The TRIMS agreement actually addresses rules about trade in goods not rules about foreign investment. In fact the text does not define a "TRIM" but it gives examples: it states that it would be inconsistent with the existing Article XI of GATT to give advantage to any firms which for example make access to foreign exchange for imports conditional on export performance; and that it would be inconsistent with article III to privilege in any way enterprises that limit their imports. These rule apply for domestic and foreign firms alike. The relatively narrow scope of the TRIMS agreement are of course behind the EU's drive to conclude a "trade and investment" agreement under the WTO (and the ill fated MAI talks).

The narrow scope of TRIMS does not mean that these provisions have no impact on freedom to make policy, and combined with the SCM agreement which limits export subsidies there is a real issue form development policy. In principle the SCM agreement does not limit all subsidies for development. It allows "non specific subsidies" strict limits on "specific subsidies". The latter are divided into "prohibited" and "actionable". Subsidies directly conditional on export performance or for import substitution are prohibited. In other aid are allowed unless another WTO member can show that they have suffered "injury" as a result of such policies.

The World Bank argues that the SCM agreement still leaves developing countries free to use the most effective instruments of industrial policy and the promotion of export competitiveness. This judgement is sensitive to the belief that selective subsidy schemes tend

to be ineffective and from an economic perspective a case can be made against the TRIMS rules.[19]

Trade in Services: The General Agreement on Trade in Services (GATS)

Whilst it is as controversial that GATS agreement is based on rather different principles from the GATT and other rules on trade in good so we need to look at it differently. The preamble states *"Recognizing the right of Members to regulate, and to introduce new regulations, on the supply of services within their territories in order to meet national policy objectives and, given asymmetries existing with respect to the degree of development of services regulations in different countries, the particular need of developing countries to exercise this right;"*

It cannot therefore be claimed that GATS takes away the right of developing countries to regulate: as with the rest of the WTO texts the big debate in the WTO literature is how would this be interpreted if a dispute arose.

What makes GATS special is that:

- virtually all the measures affected are domestic regulations: there are generally no tariffs on traded services
- the trade liberalisation and national treatment obligations only apply to sectors that countries have chosen to schedule

It is however not strictly correct to say that the GATS system only creates obligations for "scheduled" sectors. It is worth noting that GATS creates an MFN obligation for scheduled and unscheduled sectors alike: that is to say however restrictive your rules on entry of foreign service suppliers you must not discriminate *between* foreign countries.

More controversial have been the provisions for market access and national treatment. The contrast with trade in goods is striking: whilst in goods trade essentially all tariffs must be bound for WTO members, market access and national treatment commitments in services only cover those sectors and "modes of supply" that are explicitly scheduled by members of the WTO.

The GATS agreement is a "positive list" agreement: it is an opt-in arrangement. The agreement identified 4 "modes of supply":

- Mode 1 “from the territory of one Member into the territory of any other Member;”
- Mode 2 in the territory of one Member to the service consumer of any other Member;”
- Mode 3 “by a service supplier of one Member, through commercial presence in the territory of any other Member;”
- Mode 4 “by a service supplier of one Member, through presence of natural persons of a Member in the territory of any other Member.”

Mode 1 would be if a buyer uses the services of a company based elsewhere using the internet. Mode 2 includes tourism. Mode 3 is the classic example of establishment, ie FDI, abroad. Mode 4 is least discussed, but it is where developing countries have been pressing for liberalisation by the “North”; in effect it involves short term movement people to undertake specific service tasks, eg an Indian software engineer travels to the US to set up a piece of software.

The WTO has statistical categories for each service sector and member states declare which of the sectors and subsectors and modes they commit themselves to opening. If a sector is opened Article XVI 2 of the GATS lists a series of measures that cannot be applied in that sector *unless* there is a specific exemption taken:

> *“In sectors where market-access commitments are undertaken, the measures which a Member shall not maintain or adopt either on the basis of a regional subdivision or on the basis of its entire territory, unless otherwise specified in its Schedule, are defined as:*
>
> *(a) limitations on the number of service suppliers whether in the form of numerical quotas, monopolies, exclusive service suppliers or the requirements of an economic needs test;*
>
> *(b) limitations on the total value of service transactions or assets in the form of numerical quotas or the requirement of an economic needs test;*
>
> *(c) limitations on the total number of service operations or on the total quantity of service output expressed in terms of designated numerical units in the form of quotas or the requirement of an economic needs test;*

(d) limitations on the total number of natural persons that may be employed in a particular service sector or that a service supplier may employ and who are necessary for, and directly related to, the supply of a specific service in the form of numerical quotas or the requirement of an economic needs test;

(e) measures which restrict or require specific types of legal entity or joint venture through which a service supplier may supply a service; and

(f) limitations on the participation of foreign capital in terms of maximum percentage limit on foreign shareholding or the total value of individual or aggregate foreign investment."

Article XVII further requires that any domestic regulations that apply, (whether because not barred by Art XVI or because an exception has been scheduled), must be applied in a non discriminatory way – again unless a specific exemption is scheduled. It states that "*in the sectors covered by its schedule, and subject to any conditions and qualifications set out in the schedule, each member shall give treatment to foreign services and service suppliers treatment, in measures affecting supply of services, no less favourable than it gives to its own services and suppliers*."[20]

A typical GATS schedule starts of listing those sectors that are to be open to foreign suppliers; then it lists all the exceptions.

First these will be "horizontal exceptions" where the EU states for example:
"In all EC Member States services considered as public utilities at a national or local level may be subject to public monopolies or to exclusive rights granted to private operators."
Again critics claim that this and similar provisions in other countries' schedules might be too narrowly interpreted by a panel.

The we get sector by sub-sectoral exemptions from market access, eg measures banned under Article XVI that will nevertheless be used, and National Treatment exceptions where regulatory measures authorised in general terms or because of exemptions are to be applied

in a discriminatory way. A typical schedule will have the market access column showing many subsectoral rows simply marked “unbound”.

There are special sectoral sub-agreements eg in telecommunications where a “reference paper” on basic telecommunications sets out standard set of commitments that countries can sign up to. This text is somewhat more precise than the general GATS agreement.

From an economic perspective one of the key issues to be resolved – and there has been little jurisprudence on this – is what would be seen as discriminatory rules. If for example in insurance regulations a country requires all firms to keep funds deposited in local liquid assets then this natural behaviour for local firms may in fact deprive foreign firms who keep their assets elsewhere of part of their natural comparative advantage.

There has in fact been one major case brought to the dispute settlement system, concerning telecommunications policy in Mexico.[22] In this case, which was not appealed, so we only have the panel decision, the US claimed that Mexico was not fulfilling the obligations it had taken on in signing up to the Reference Paper. The Reference Paper[21] obliges signatories to prevent anti competitive behaviour by dominant firms, in particular those which deter entry. Signatories must allow foreign telecommunications operators access to the networks of major domestic service suppliers on “reasonable” and “cost based” terms and ban “anti competitive” practices by major supplies, normally former monopolists. In this case the Mexican government allowed the former state monopoly Telmex to set the inter-connection rates to be charged by all Mexican networks (including some foreign owned) for calls coming in from the US. The Mexicans argued that this was a way to prevent anti competitive predatory pricing by foreign networks, but the US argued it was an illegal state run cartel.

The decision rejected Mexico’s position making it clear that the Dispute settlement system may well decide for itself what is and is not an effective competition law under GATS.[23]

The panel decision makes quite a lot of economic sense but it is one of many factors making developing countries increasingly reluctant to sign on to further WTO disciplines in diplomatically ambiguous texts whose meaning might then become more constraining as legal precedents develop. The ruling surprised some analysts[24] who felt that the Reference Paper was intended primarily to deal with unfair cross subsidies

The Trade-Related Aspects of Intellectual Property Rights (TRIPS) Agreement

This agreement has been extremely widely debated. The present note will just comment on a few of the less commonly discussed elements.

Broadly speaking the TRIPS agreement requires all WTO members (with some initial transition period for developing countries) to adopt IPR laws very similar to those of the EU and the US. It defined minimum periods for patents and specifies what must be patentable and what exceptions may be allowed. Careful reading of the TRIPS text shows that there is actually more "wiggle room" than appears at first sight.

TRIPS allows countries to use their own definitions of non-obviousness and patent breadth. For example in patent literature it is now widely understood that there is not a simple trade-off between innovation and diffusion, with the former being helped by tough IPRs and the latter discouraged. Rather more and more innovation is seen as an incremental where strong rights for the first inventor will make it harder for the next generation of innovation to appear. Developing countries are likely to need rules that favour downstream rather than upstream innovators.[25]

TRIPS does not require a country to recognise patents of others that they consider invalid: for example the US may issue a patent to a US firm for a form of Basmati Rice, but it cannot demand that India recognise this within India.

In particular the provisions for compulsory licensing eg of pharmaceuticals, provide for compulsory licensing to be relatively freely usable in cases where an anti-competitive abuse can be shown to have taken place. (Article 31k). In particular this paragraph states that in such cases compulsory licenses can be issued for export as well as home production.[26]

And one of the most striking provisions of TRIPS is *Article 6:*

> "*Exhaustion*
>
> *For the purposes of dispute settlement under this Agreement, subject to the provisions of Articles 3 and 4 nothing in this Agreement shall be used to address the issue of the exhaustion of intellectual property rights*."

"Exhaustion" refers to the ability of an IPR holder to control the rights of the person who has bought a product affected by IPR to do what they like with it, eg to sell it on to someone in another country. Thus the TRIPS agreement excludes the possibility of disputes about parallel imports. It seems very likely that the US would have lost any case it might have brought against South Africa over Aids drugs which concerned re-import of drugs legally marketed elsewhere at lower prices. The TRIPS agreement cannot easily t be used to bring cases against countries for authorising parallel imports of products lawfully sold in another country, though it could be used to attack exports of generic drugs that might have been sold without patent holder's permission. The post-Doha negotiations have sought to clarify when public health emergencies can justify compulsory licensing for either home or export use.

The basic economics of TRIPS is well understood: or rather there is general agreement that this *no* general agreement about the optimal extent of IPR rules and there is no efficiency case for demanding a degree of harmonisation in this area that goes well beyond that of food safety or technical standards where the negative impact on trade of non-harmonised rules is obvious.

It is well know that global rules on IPRs are likely to generate rents for countries that possess stocks of existing patents: there is very much less evidence of any effect to promote innovation where it is not flourishing.

As a final note it can be said that the attempt to go further in TRIPS towards rule harmonisation where the case is very weak has done serious damage to the case for case for negotiating about the link between domestic regulations and trade. In all other areas the WTO rules have avoided harmonisation and have merely tried to prevent national autonomy having negative effects on others: in the case of IPRs developed countries had different rules for many hundreds of years and the Rome Treaty in 1958 did not attempt to harmonise them in the EU. So sadly for global governance the WTO has entered into the harmonisation of law in the wrong area.

CONCLUSIONS

The key conclusion from our review is that in technical standards, SPS measures and services there are comprehensive and specific rules governing the way domestic regulations must be implemented in ways that minimise the effect on trade. There are looser rules under the old

GATT non-discrimination provisions. All of these rules were the product of diplomatic negotiation and have an element of ambiguity. Their exact implications will emerge as they are tested in the DSB. For developing countries it is far from clear that they lose more in terms of regulatory autonomy than they gain by pinning developed countries down in terms of constraining arbitrary protectionism.

The Appellate Body has so far been extraordinarily adept at reconciling regulatory autonomy and trade needs. There had been few challenges to regulations in developing countries so far. If anything the complaint that developing countries have is that the Appellate Body has been too sympathetic to the wishes of developed countries to regulate the their home markets even when it made it harder for developing countries to sell. The Shrimp-turtle[27] dispute is a case in point: the US was given the right to address the environmental consequences of production methods in developing countries. Defenders of this view say that the US was addressed a global "externality", but many developing countries argued that it was not for the US to worry about natural resources in other people's home seas.

The problem is therefore not that WTO rule shave been enforced so as to prevent domestic regulation. Nevertheless the very ambiguity of the rules and the power of the Appellate Body will remain a major issue.

This problem cannot be made to go away: so long as domestic rules can affect market access we must have a framework for handling disputes about them at a multilateral level. The position of developing countries has become increasingly hostile to the EU's proposals for further international negotiations on "norms". But if the membership prefers not to negotiate the Appellate Body will intervene whenever disputes arise. The general provisions of GATT and the GATS already cover many aspects of domestic regulation and the meaning of these rules will be left to the dispute settlement system if it is not otherwise dealt with.

Notes

[1] Financial Times March 2 1998
[2] See for example Bhagwati and Hudec 1996
[3] See Brock and Magee as applied to tariffs.
[4] See Johnson Wonnacott and Shibata
[5] All GATT/WTO texts are available at www.wto.org and where cited have been downloaded from there.
[6] The present paper does not deal in detail with WTO rules affecting trade and competition. See Holmes (2002) or Holmes (forthcoming).
[7] United States - Tax Treatment for "Foreign Sales Corporations"
[8] The US brought a case against Japan known as “Kodak – Fuji” and lost heavily. Japan - Measures Affecting Consumer Photographic Film and Paper.
[9] This is the general term to cover the panels, the Appellate Body and the General Council.
[10] No decision has been rejected by such a consensus.
[11] See also Holmes and Young.
[12] EC Measures Concerning Meat and Meat Products (Hormones)
[13] Korea - Measures Affecting Imports of Fresh, Chilled and Frozen Beef -
[14] United States - Import Prohibition of Certain Shrimp and Shrimp Products
[15] Otsuki et al.
[16] Japan - Measures Affecting the Importation of Apples
[17] European Communities - Measures Affecting Asbestos and Asbestos-Containing Products
[18] The WTO agreements and Public health P. 60
www.who.int/emc-documents/ cholera/docs/whocddser9216rev1.pdf
[19] See Sutton 2004 for a nuanced view.
[20] WTO Secretariat October 1999 Trade in Services Division “An Introduction To The GATS”
[21] Mexico – Measures Affecting Telecommunications Services
[22] Telecommunications services: reference paper 24 April 1996
http://www.wto.org/english/tratop_e/serv_e/telecom_e/tel23_e.htm
[233] The imprecision of the GATS rules and the contrast between GATT and GATS on competition law provides a case for saying that WTO rules do create obligations on competition law already and that negotiations are needed to define the scope of these obligations. But this is beyond the present paper. See Holmes 2002 and forthcoming.
[24] See Marsden 2004
[25] See Dumont and Holmes (2002)
[26] Technically where an anti competitive practice is occurring a state is exempted from article 31f which states “any such use shall be authorized predominantly for the supply of the domestic market of the Member authorizing such use.”
[27] United States - Import Prohibition of Certain Shrimp and Shrimp Products

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