

CHAPTER 9

The World Trade Organization: Basic Legal Principles

In Chapter 8, we saw the spiral of high tariffs and protectionism of the early 1930s. Our story left off with the worldwide Great Depression and the everlasting reminder that protectionist attitudes in one country, with unbridled tariff increases and quotas on imports, will only be met by retaliation by other countries. The result was disastrous to national economies. Realizing this, the United States and other nations began the process of negotiating a reduction of tariff rates. It was a slow bilateral process, with countries bargaining with each other over the reciprocal reduction of tariffs on thousands of items. By the end of the decade, there had been some success in lowering tariff rates overall, but it was a process that could not be completed before the world entered World War II.

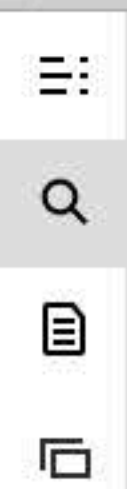
This chapter picks up the story after the war, as nations sought a faster and better means of reducing tariff rates and other protectionist barriers to international trade. The postwar period saw the growth of multilateralism: multilateral trade agreements that set agreed-to rules governing trade, multilateral negotiations to reduce tariffs and nontariff barriers to trade, and the rise of multilateral organizations with dispute settlement mechanisms—first the GATT organization and later the World Trade Organization. This chapter covers these trade agreements, the WTO dispute resolution process, and introduces regional free trade issues. The chapter concludes with end-of-chapter questions that give readers the chance to explore new populist and nationalistic calls for protectionism and the potential for new trade wars, and to look ahead at some trade issues on the near-horizon.

Why we are studying “trade agreements?” Is that not the stuff of foreign relations, diplomats, and international lawyers? It is, but it also affects everyone involved in international business. A trade agreement is a nation’s commitment to other nations to conform its national laws and regulations to the terms of that agreement. A trade agreement is a legal framework for national

laws. It may be a commitment to lower the tariff rate on certain goods imported from specific countries, or it may be a change in the rules for delivering services to consumers or customers in foreign countries. The trade agreement is the mold from which national laws are cast. In turn, these laws govern the day-to-day international business transactions of companies doing business in those countries. And it does not matter if they are small exporters or importers, larger service-oriented companies such as those in telecommunications or insurance, technology companies managing their intellectual property rights, or multinational industrial giants with goods moving through global supply chains. In other words, this chapter explains how the rules are made that govern individual firms that move goods and services from one country to another.

INTRODUCTION TO TRADE REGULATION

Every country establishes its own trade policies according to its own national interests. Domestic politics heavily influences trade policies. Left to its own devices, any nation would want to protect its industries from foreign competitors by erecting a maze of import trade barriers. These might include high tariffs, quotas, or complex regulations designed to keep out foreign goods and services. A **trade barrier** is any impediment to trade in goods or services. An **import trade barrier** is any impediment, direct or indirect, to the entrance or sale of imported goods or services existing in the country of importation. Typically, trade barriers are tariffs or taxes on imported goods or laws, government regulations, or national industrial standards that make importing or selling foreign-made goods or services more difficult or that make imported goods or services more expensive to produce, market, or sell.



Many nontariff barriers are permitted under international agreements. For instance, we are all familiar with laws requiring foreign goods to be labeled with the country of origin, requirements that instruction manuals for consumer goods be written in the language of the importing nation, or that metric sizes appear on the product or packaging. Manufacturers and exporters with a global marketing vision must learn to adapt to the regulatory hurdles of nontariff barriers in foreign markets.

Consider this overly simplistic story: Assume that all passenger cars sold in the United States have wheel assemblies with either four or five lug nuts. U.S. tests show that this number is adequate for safety. But the Bureau for the Protection of Wheel Assemblies of the Government of Zimbabwe passes a rule requiring that all wheels be assembled with at least six lug nuts. It just so happens that all Zimbabwean automobile manufacturers already use six nuts. Zimbabwean tests show that six nuts are safer than five. The cost of redesigning, retooling, and testing U.S.-made cars for shipment to Zimbabwe may be tens of millions of dollars. Do you think that the U.S. firms can justify the expenditures? Probably not, and Zimbabwean drivers will have to be content with driving Zimbabwean cars. While this may appear to be a perfectly legitimate safety regulation on its face, it also has the effect of being a nontariff barrier to trade.

Case Example: Large-Scale Retail Stores in Japan. A well-known example of an indirect nontariff barrier is the 1974 *Japanese Large-Scale Retail Stores Law*. Japan has always had many small, neighborhood retail shops and grocers, many of which are “mom and pop” owned. Small local shops existed in an atmosphere that fit into the Japanese consumer’s cultural expectations of quality, freshness, and personal attention. The law limited the number, location, and operations of large retail stores and supermarkets in Japan with over 500 square meters in floor space, and gave a voice to existing small shops in the approval process. The process often took seven or eight years to complete and usually required the large store operator to make many concessions to the small store owners to obtain their approval. If the government found that the proposed store posed a risk of adversely affecting nearby shops, it could require the large store to reduce its floor space or limit days and hours of operation. Of course, large retailers in the United States and Europe were not very happy about the law. After all, for a foreign retail chain to justify its investment in Japan, it

would have to be a “big-box” store. Small stores are not economically feasible. In addition to protecting politically powerful small business owners, the law also perpetuated the vertically integrated distribution system in Japan by giving large Japanese manufacturers greater control over the distribution of their products being sold through many small retail stores. Large foreign retail chains, on the other hand, might favor purchasing from U.S. exporters accustomed to selling to high-volume purchasers.

The law was an excellent example of a nontariff barrier that on its face was completely neutral. It was enacted for many economic, political, and cultural reasons, and it did not discriminate against products because they were of foreign origin. However, it did have the effect of limiting access to the Japanese retail market by American and other foreign big-box and discount chains. As a result of negotiations in the 1980s and 1990s, the law was eventually repealed and replaced with laws focused more on environmental and city planning policies. After the law’s repeal, large-scale American and European volume discounters entered the Japanese market and almost immediately began to transform retailing in Japan.

BRETTON WOODS AND THE HISTORY OF GATT

Even while World War II was being fought, the United States and its allies were charting a course to rebuild and revitalize the world’s economy and to ensure that the economic mistakes of the 1930s would not be repeated. In 1944, the Allied nations met at the Bretton Woods Conference in New Hampshire to create several important international economic and political institutions, including the **International Monetary Fund**, and the International Bank for Reconstruction and Development, also called the **World Bank**. The **United Nations** was created at about the same time. In addition to these economic and political institutions, world leaders had a vision of another international organization dedicated to preventing the kinds of protectionism and rising tariffs seen in the 1930s. So, a third specialized organization, the **International Trade Organization**, was planned to promote and stabilize world trade by reducing tariffs.

At international meetings held in 1947, a multilateral trade agreement was reached between 23 nations.



Called the *General Agreement on Tariffs and Trade* (GATT 1947), it reflected a more international view of the world's economic and trading system than had existed, and would become the most important trade agreement of the twentieth century. However, the International Trade Organization never materialized, due in part to the lack of support in the U.S. Congress for yet another international organization. But eventually a professional staff was needed to administer the GATT 1947 agreement, and a headquarters was established in Geneva. Thus, ironically, a GATT organization arose by default in the place of the aborted International Trade Organization and functioned successfully for nearly 50 years. Interestingly, although GATT 1947 was never ratified by the U.S. Congress as a treaty, it was consistently accepted as a binding legal obligation of the United States under international law.

Trade negotiations were conducted on the basis of agreed-upon international rules, with common objectives and greater transparency, or openness, than ever before. Disagreements and trade disputes were handled through consultations at the GATT headquarters in Geneva, and a nonbinding dispute settlement process was put in place to prevent trade wars before they occurred.

GATT Multilateral Trade Negotiations

One of the cornerstones of the GATT system was a commitment by member countries to conduct **multilateral trade negotiations**, and on a regular basis, under the auspices of the GATT organization. Negotiating sessions are called "rounds." The following is an overview of the most important **negotiating rounds** from 1947 to the present. Although the focus of each round was different, they all had the same goal of **trade liberalization**—the process of reducing tariffs and removing artificial barriers and restrictions on trade.

1. Geneva, Switzerland, 1947
2. Annecy, France, 1949
3. Torquay, England, 1951
4. Geneva, Switzerland, 1956
5. Geneva, (Dillon Round) 1960–1961
6. Geneva, (Kennedy Round) 1964–1967
7. Tokyo Round, 1973–1979
8. Uruguay Round, 1986–1994
9. Doha Development Round (a WTO round), 2001–present (as of 2016)

In the early rounds, from 1947 to 1961, countries negotiated on a product-by-product basis by presenting lists of tariff reductions they desired from other countries. These rounds resulted in a lowering of *ad valorem* tariffs from roughly 40 percent in 1945 to approximately 20 percent in 1961. The Kennedy Round, which took place from 1964 to 1967, resulted in even larger across-the-board tariff cuts, particularly in manufactured goods, averaging nearly \$40 billion in trade. Sixty-two nations participated in the Kennedy Round. During this period, many developing countries joined the GATT organization.

By the 1970s, GATT's efforts had proven so successful that tariffs ceased to be the world's greatest barrier to trade in goods. Indeed, without GATT, decades of bilateral negotiations may have been necessary to achieve the reductions that multilateral negotiations reached within a few years. In the Tokyo Round, more than 100 participating nations agreed to tariff cuts averaging 34 percent and covering \$300 billion in trade, which effectively lowered the average level of tariffs to about 5 percent. In addition, the parties established a number of GATT codes that called for the removal of nontariff barriers and forms of protectionism that are considered to be "unfair."

The Uruguay Round negotiations lasted from 1986 to 1994. It resulted in international agreements that have had a caused worldwide tariff cuts averaging 35–40 percent on merchandise, agricultural products, and industrial goods. Tariffs were eliminated in many industry sectors: agricultural equipment, medical equipment, construction equipment, beer, distilled spirits, chemicals, furniture, paper and printed matter, pharmaceuticals, and toys. Tariffs on a range of then-existing information technology products were largely eliminated. In addition to tariff cuts, tariffs were bound, or capped, on most products at the rate effective at the time of the agreement. The round also eliminated many nontariff barriers to trade.

Transition from GATT to the WTO. The most important work of the Uruguay Round was in devising solutions to the deficiencies of GATT 1947. The first dealt with coverage: GATT 1947 applied only to trade in goods. Even though the service sector had become the fastest growing sector of the world's economy, it was not subject to GATT rules. Trade in services, such as banking, insurance, telecommunications, or professional services, was specifically excluded. In addition, GATT 1947 failed to regulate agricultural trade, an area



of constant dispute among nations, especially between developed and developing countries. Until 2005, trade in textiles and apparel was also outside the scope of GATT because of the politically sensitive nature of these industries. GATT 1947 did little or nothing to address trade-related aspects of intellectual property or the use of restrictions on foreign investment that interfered with the free movement of goods. Finally, the process used to resolve trade disputes between countries was nonbinding, filled with loopholes, and often ineffective.

The Uruguay Round ushered in a new era of international trade regulation. It replaced the original GATT organization with the World Trade Organization (WTO). It modernized and expanded the scope of the world trade agreements and instituted a binding dispute settlement process. The Uruguay Round resulted in the conclusion of over 60 major trade agreements that make up a large part of "WTO law."

THE WORLD TRADE ORGANIZATION AND WTO LAW

The year 1995 was one of the most important in the modern history of international trade law. It saw the birth of the World Trade Organization and the conclusion of more than 60 multilateral trade agreements that provide the framework by which we regulate much of world trade today.

The five major agreements:

1. *Agreement Establishing the World Trade Organization*;
2. *General Agreement on Tariffs and Trade, 1947* (GATT 1947), the original agreement;
3. *General Agreement on Tariffs and Trade, 1994* (GATT 1994), the WTO agreement that incorporates GATT 1947, including the additional multilateral agreements covering trade in goods, shown below;
4. *General Agreement on Trade in Services* (GATS), opens domestic markets to foreign service providers (covered in Chapter 10);
5. *WTO Dispute Settlement Understanding*.

There are additional or "side" agreements that apply to miscellaneous trade subjects and to specific industry sectors. Some of the most important are discussed in this and later chapters of this book:

- *WTO Dispute Settlement Understanding*
- *Agreement on Agriculture*
- *Agreement on Sanitary and Phytosanitary Measures* (animal and plant safety)
- *Agreement on Technical Barriers to Trade*
- *Agreement on Trade-Related Investment Measures*
- *Agreement on Implementation of Article VI* (the Anti-Dumping Agreement)
- *Agreement on Import Licensing Procedures*
- *Agreement on Subsidies and Countervailing Measures*
- *Agreement on Safeguards* (Import Relief)
- *Agreement on Trade-Related Aspects of Intellectual Property Rights*
- *Agreement on Government Procurement*
- *Agreement on Trade Facilitation* (2017)

Functions of the WTO

The WTO is the most important intergovernmental organization for world trade today, with 164 member-nations as of 2017. Two of the more controversial admissions to WTO membership were China (2001) and Russia (2012) due in part to their history of lacking free market economies and political tensions. The WTO is headquartered in Geneva, Switzerland, and cooperates with the UN as well as the IMF and World Bank and other international organizations. The functions of the WTO are (1) to facilitate cooperation between member-nations on trade issues, (2) to administer the WTO agreements, (3) to provide a forum for future trade negotiations, (4) to monitor national trade policies, (5) to assist developing countries in complying with WTO agreements by giving technical assistance, and (6) to provide a forum for the settlement of trade disputes between members.

The WTO is overseen by the Ministerial Conference, made up of trade representatives from all WTO member countries. They meet at least once every two years to direct the policies, activities, and future direction of the WTO and to consider new applications for membership. The U.S. ambassador to the Ministerial Conference is the United States Trade Representative or his or her delegate.

The WTO monitors and periodically reviews the trade policies and practices of member countries to help assure adherence to the rules and commitments of the agreements. It provides an important forum for negotiating new agreements on trade issues that are of mutual concern, and provides a forum for member countries to either settle or dispute their trade arguments. It also provides technical assistance to developing and least developed countries as they try to integrate into world markets.



The WTO and U.S. Law

The United States negotiated the Uruguay Rounds and adopted the WTO agreements under “fast-track” trade promotion authority. The agreements are not treaties, but were enacted into U.S. law through the “congressional-executive” process discussed in Chapter 8. The agreements were submitted to Congress by President Clinton in the U.S. *Uruguay Round Agreements Act*, and became effective in 1995.

The WTO agreements do not provide individual rights and remedies to private parties. Private litigants cannot use them to assert rights or claims for compensation in lawsuits against the U.S. government or to challenge the legality of a tariff or federal statute. The *Uruguay Round Agreements Act* states: “No provision of the Uruguay Round agreement . . . that is inconsistent with any law of the United States shall have effect. Nothing in this Act shall be construed to amend or modify any law of the United States relating to the protection of human . . . life, the protection of the environment, or worker safety.”

If a private firm or industry in the United States believes that its rights under the WTO agreements are being violated by a foreign company or foreign government, it may seek redress either with the appropriate federal administrative agency or in the courts on the basis of a U.S. statute, but not at the WTO. Of course, it can also communicate its grievance to the U.S. government, which can, at its discretion, negotiate with the foreign government under WTO rules in an attempt to resolve the trade dispute nation to nation. Similarly, by federal law, the U.S. states may not bring WTO actions for violations of the agreements or lawsuits in the courts of the United States to enforce the agreement.

MAJOR PRINCIPLES OF WTO TRADE LAW

We can summarize the basic principles of WTO trade law found in GATT and the major WTO agreements, as follows:

- 1. *Multilateral trade negotiations:* Nations commit to meet periodically to reduce tariffs and nontariff barriers to trade.
- 2. *Transparency and predictability of trade opportunities:* A nation’s laws and regulations affecting trade in goods and services must be published and made

publicly available so companies understand in advance the rules for doing business there.

- 3. *Reciprocal tariff reductions and bound commitments:* Nations commit to maximum bound tariff rates on specific products and to publish these in their tariff schedules.
- 4. *Nondiscrimination and unconditional most-favored-nation trade:* Members will not give any import advantage or favor to products coming from one member over the goods of another member.
- 5. *National treatment:* Members will not discriminate in favor of domestically produced goods and against imported goods or treat the two differently under their internal tax laws, regulations, and other national laws.
- 6. *Elimination of quotas and other nontariff barriers:* Nations must first “convert” their nontariff barriers to tariffs (through a process called **tariffication**) and then engage in negotiations to reduce the tariff rates.
- 7. *Consultations and dispute resolution:* An agreement to resort to the WTO consultation and dispute settlement process and not to engage in unilateral retaliation against countries that violate WTO rules.

In addition, developing countries are given additional time and assistance in complying with WTO agreements. Other special rules allow restrictions on imports to protect public health and safety or to protect domestic firms from unfair trade practices or increased levels of imports that might cause serious economic injury to domestic industries.

Transparency

The term **transparency** refers to the degree to which a foreign government’s import laws or regulations are made readily available to the public, including foreign firms. When a foreign government’s import regulations are not readily available to the public or are hidden or disguised in bureaucratic rules or practices, the regulations are not transparent. For instance, government procurement policies “lack transparency” when the requirements for bidding on a project are made available only to select domestic firms. Government regulations that require a license to import a product, or to conduct local business, are not transparent if the “rules of the game” are not made known to foreign firms trying to apply for that license. When a nation’s import regulations or procedures lack transparency, foreign firms cannot easily gain entrance to its markets.

The WTO agreements require that a country's trade rules be transparent and that they publish all laws, regulations, administrative determinations, and judicial decisions that generally apply to imports and exports. For example, U.S. Customs and Border Protection provides public online access to its ruling requests, customs rulings, weekly bulletins and decisions, and its directives and handbooks. Customs rules are also published in the Federal Register.

Tariff Concessions, Bound Rates, and Tariff Schedules

The GATT agreement calls for member nations to cooperate in lowering tariffs through tariff concessions. A **tariff concession** is each country's promise to reduce tariffs on imports of a given item in return for tariff concessions from other countries. Most concessions are made during the major negotiating rounds. In negotiating tariff concessions, each country takes into account the total economic effect of a concession on its national economy. For example, if Honduras wants the United States to lower the tariff rate on U.S. imports of Honduran coffee beans, then the United States could request that Honduras reciprocate by lowering duties on, say, U.S.-made medical devices in an amount equivalent to the value of the tariff reduction granted to Honduran coffee. Concessions can be on a single product, by entire product categories, or across the board.

Tariff Bindings. The agreed tariff rates are known as **tariff bindings** because the rates become *bound*, or capped, at that rate. The **bound rate** is the maximum tariff rate a country may charge on an item, although tariff rates may be reduced below the bound rate.

A country's tariff bindings are recorded in that country's **schedule of concessions** at the WTO. The schedules are legal commitments considered part of the GATT agreement itself. Bound rates are published in each country's **tariff schedules**, which are the detailed product-by-product listings of all tariffs for that country. Tariff schedules for the United States are found in the *Harmonized Tariff Schedule of the United States*, available online from the United States International Trade Commission. If a country later wishes to **modify or withdraw a concession** and raise its bound rate on an item, it must negotiate directly with the countries most affected (those countries which are the major suppliers of that item) and by agreement reduce or offset tariffs on other items equal to an equivalent amount in trade.

The case *GATT Report on European Economic Community—Import Regime for Bananas* (1995) illustrates the importance of countries honoring their tariff rates granted by concession to foreign countries. The GATT Panel (pre-WTO) ruled that the change in European Economic Community (now EU) tariff schedules had "nullified and impaired" the rights of foreign banana exporters who should have been able to rely on the existing tariff structure.



European Economic Community—Import Regime for Bananas

Report of the Dispute Settlement Panel, 34 I.L.M. 177 (1995)
General Agreement on Tariffs and Trade, Geneva

BACKGROUND AND FACTS

Since 1963, the European Economic Community (EEC) had negotiated tariff rates with the developing countries that export bananas, and these concessions were bound in the tariff schedules at 20 percent *ad valorem*. In 1993 the EEC took over banana import regulation from the individual countries. The EEC set up uniform rules on quality, marketing standards, and tariffs. Under the EEC regime, the tariff rates on bananas from the Latin American countries were increased between 20 and 180 percent. A complex licensing scheme was also set up to limit the access of foreign banana traders (e.g.,

Chiquita, Dole, and Del Monte) to sell in the EEC. The Latin American countries claimed that the regulations impaired their Article II tariff concessions and violated Article I, MFN principles, and other GATT provisions. Notice that prior to the WTO's founding in 1995, countries that were party to the GATT agreement were called "contracting parties," while in the WTO system they are called "members."

REPORT OF THE PANEL

Article II—Schedules of Concessions: [Central and South American] banana producers had assessed their

continues



continued

competitive position on the basis of the bound tariff level. They had made strategic decisions and investments on that basis; they had cultivated substantially more land specifically for this export trade; and they had pursued marketing ties with European importers. The new tariff quota undermined the legitimate expectations upon which these actions were based and severely disrupted the trade conditions upon which these producers had relied, regardless of the actual protective effect of the new regime.

The Panel noted that Article II required that each contracting party “accord to the commerce of the other contracting parties treatment no less favourable than that provided for in the . . . *Schedule of Concessions*.” The Panel then considered whether the introduction of a specific tariff for bananas in place of the *ad valorem* tariff provided for in its *Schedule* constituted “treatment no less favourable” in terms of Article II . . . The Panel consequently found that the new specific tariffs led to the levying of a duty on imports of bananas whose *ad valorem* equivalent was, either actually or potentially, higher than 20 percent *ad valorem* . . .

The Contracting Parties had consistently found that a change from a bound specific to an *ad valorem* rate was a modification of the concession. A working party examining a proposal by Turkey to modify its tariff structure from specific to *ad valorem* had stated:

“The obligations of contracting parties are established by the rates of duty appearing in the schedules and any change in the rate such as a change from a specific to an *ad valorem* duty could in some circumstances adversely affect the value of the concessions to other contracting parties. Consequently, any conversion of specific into *ad valorem* rates of duty can be made only under some procedure for the modification of concessions.”

Decision. The panel held that the EEC had deprived the complaining Latin American countries of the benefits to which they were entitled under the schedule of concessions.

Case Questions

1. What is a tariff concession?
2. What is a tariff binding? What was the EEC’s bound rate?
3. What action did the EEC take that violated its tariff concessions?
4. Why is it important that countries maintain their tariff commitments? If not for tariff commitments, what do you think the impact would be on foreign banana exporters, or on exporters in any industry?
5. What is the legal basis for Latin America’s objections?

Nondiscrimination, Most-Favored-Nation Trade, and National Treatment

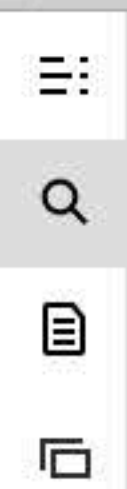
The principle of nondiscrimination has long been a guiding concept of international economic relations and of trade liberalization. **Nondiscrimination** is one of the basic rights of membership in the WTO. It means that every WTO member country must treat the goods and services from all other WTO member countries equally and without discrimination. Simply put, nations should not “play favorites” with each other’s goods or services. The principle of nondiscrimination is embodied in two important principles of international trade law: the principle of unconditional most-favored-nation trade and the concept of national treatment.

Most-Favored-Nation Trade. When one country grants **most-favored-nation trading status** to another country, it is agreeing to accord items imported from that country the most favorable treatment or the lowest tariff rates that it gives to like products imported from other MFN trading nations. In the United States, MFN trading status is granted to a foreign country by an act

of Congress. According to the WTO agreements, all countries that are members of the WTO should automatically be entitled to MFN trading status with other WTO countries (although in reality this may not be the case—Cuba is a WTO member but as of early 2017 had not received MFN trading status from the United States). Although MFN trade has been in use for at least 300 years, it has long been a basic principle of GATT and WTO law. It is found in Article I of GATT, which reads,

With respect to customs duties and charges of any kind imposed on or in connection with importation or exportation . . . and with respect to the method of levying such duties and charges, and with respect to all rules and formalities in connection with importation and exportation Any advantage, favour, privilege, or immunity granted by any other member to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties [countries].

MFN principles also apply to trade in services under Article II of the *General Agreement on Trade in Services*.



With respect to any measure covered by this Agreement, each Member [country] shall accord immediately and unconditionally to services and service suppliers of any other Member treatment no less favourable than that it accords to like services and service suppliers of any other country.

Unconditional MFN Trade. Unconditional MFN trade requires that if a nation negotiates a reduced tariff rate on a certain product imported from one WTO member, that rate of duty automatically becomes applicable to like products imported from any and all other WTO members. This means that if country A agrees to reduce its tariff rate to 5 percent on a particular product imported from WTO country B, that new rate becomes applicable to like products imported from all other WTO member countries. Moreover, if country A later agrees to reduce the same tariff to a rate of 3 percent on like products coming from nation C, then like products originating in country B will automatically be entitled to the lower 3 percent rate.

Many people erroneously think that MFN trade is some “special treatment” applied as a favor to products coming from a foreign country. That is not the case. Actually, under WTO rules, most-favored-nation treatment is the norm. All WTO member countries must, under normal trading circumstances, apply MFN tariff rates to products being imported from any and all other WTO member countries. WTO member countries normally give MFN status (and thus MFN tariff rates) to all countries except those that abuse human rights, support terrorism, engage in acts of aggression toward their neighbors, attempt to spread weapons of mass destruction, or are otherwise in violation of international law. Moreover, as we will see later in the chapter, many countries grant better-than-MFN tariff rates to developing countries or to countries within a free trade area.

In the United States, the term “most favored nation” is now referred to as **normal trade relations** or NTR because Congress considers it to more accurately describe the “normal” tariff treatment for most countries. The term “most favored nation” is still in use in international documents and in other countries. For additional discussion on MFN/NTR trade, refer to Chapter 8.

National Treatment

The principle of national treatment is found in Article III (GATT 1947 and incorporated into GATT 1994), titled “National Treatment on Internal Taxation and Regulation.” A central concept is that once goods enter a

nation’s stream of commerce, they may not be subjected to greater or different taxes, charges, or regulations than those applied to domestic goods. Article III provides in brief (paragraph numbering retained from original),

1. [Internal taxes, charges, laws, and regulations] affecting the internal sale, offering for sale, purchase, transportation, distribution or use of products . . . should not be applied to imported or domestic products so as to afford protection to domestic production.
2. [Imported products] shall not be subject, directly or indirectly, to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products. Moreover, no contracting party (nation) shall otherwise apply internal taxes or other internal charges to imported or domestic products in a manner contrary to . . . paragraph 1. ***
3. [Imported products] shall be accorded treatment no less favourable than that accorded to like products of national origin in respect of all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution, or use.

Article III therefore prohibits the use of discriminatory internal taxes or fees on imported products as a tariff in disguise. It also prohibits discrimination against imports resulting from a wide range of nontariff barriers to trade, including discriminatory customs procedures and product standards. In the following case, *WTO Report on Japan—Taxes on Alcoholic Beverages* (1996), the WTO Appellate Body undertook a thorough analysis of the *Japan Liquor Tax Law* and found that the Japanese tax was in violation of GATT Article III. As you read, look not only for its interpretation of national treatment but also look at the Appellate Body’s reflections on GATT as international law.

Quotas and Quantitative Restrictions on Imports and Exports

GATT favors the use of tariffs over any other method of regulating imports, while specifically prohibiting most other restrictions on trade. GATT Article XI reads as follows:

No prohibitions or restrictions other than duties, taxes, or other charges, whether made effective through quotas, import or export licenses, or other measures, shall be instituted or maintained . . . on the importation of any product . . . or on the exportation or sale for export of any product . . . (emphasis added)



Japan—Taxes on Alcoholic Beverages

Report of the Appellate Body, WT/DS11/AB/R (1996) World Trade Organization

BACKGROUND AND FACTS

The *Japan Liquor Tax Law*, or *Shuzeiho*, taxes liquors sold in Japan based on the type of beverage. There are ten categories of beverage (the categories are *sake*, *sake compound*, *shochu*, *mirin*, beer, wine, whiskey/brandy, spirits, liqueurs, and miscellaneous). *Shochu* is distilled from potatoes, buckwheat, or other grains. *Shochu* and vodka share many characteristics. However, vodka and other imported liquors fall in categories with a tax rate that is seven or eight times higher than the category for *shochu*. Foreign spirits account for only 8 percent of the Japanese market, whereas they account for almost 50 percent of the market in other industrialized countries. The United States, the European Union, and Canada called for consultations and brought this complaint at the WTO. The panel held that the Japanese tax law violated GATT, and Japan appealed to the Appellate Body.

REPORT OF THE APPELLATE BODY

The WTO Agreement is a treaty—the international equivalent of a contract. It is self-evident that in an exercise of their sovereignty, and in pursuit of their own respective national interests, the Members of the WTO have made a bargain. In exchange for the benefits they expect to derive as Members of the WTO, they have agreed to exercise their sovereignty according to the commitments they have made in the WTO Agreement. One of those commitments is Article III of the GATT 1994, which is entitled *National Treatment on Internal Taxation and Regulation*.

The broad and fundamental purpose of Article III is to avoid protectionism in the application of internal tax and regulatory measures. More specifically, the purpose of Article III is to ensure that internal measures not be applied to imported or domestic products so as to afford protection to domestic production. Toward this end, Article III obliges Members of the WTO to provide equality of competitive conditions for imported products in relation to domestic products. “[T]he intention of the drafters of the Agreement was clearly to treat the imported products in the same way as the like domestic products once they had been cleared through customs. Otherwise indirect protection could be given.” *Italian Discrimination Against Imported Agricultural Machinery*, BISD 7S/60, para. 11. Moreover, it is irrelevant that “the trade effects” of the tax differential between imported and domestic products, as reflected in the volumes of imports, are insignificant or even nonexistent. Article III protects expectations not of any particular trade volume but rather of the equal competitive relationship between imported and domestic products. Members of the WTO are free to pursue their own domestic goals through internal taxation or regulation

so long as they do not do so in a way that violates Article III or any of the other commitments they have made in the WTO Agreement. * * *

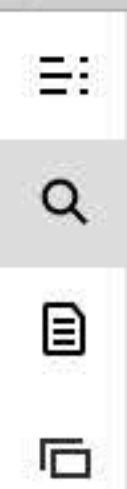
[I]f imported products are taxed in excess of like domestic products, then that tax measure is inconsistent with Article III . . . [We must determine first] whether the taxed imported and domestic products are “like” and, second, whether the taxes applied to the imported products are “in excess of” those applied to the like domestic products. If the imported and domestic products are “like products,” and if the taxes applied to the imported products are “in excess of” those applied to the like domestic products, then the measure is inconsistent with Article III:2.

We agree with the Panel also that the definition of “like products” in Article III:2 should be construed narrowly. How narrowly is a matter that should be determined separately for each tax measure in each case. [A 1970 GATT Report] set out the basic approach for interpreting “like or similar products”:

[T]he interpretation of the term should be examined on a case-by-case basis. This would allow a fair assessment in each case of the different elements that constitute a “similar” product. Some criteria were suggested for determining, on a case-by-case basis, whether a product is “similar”: the product’s end-users in a given market; consumers’ tastes and habits, which change from country to country; the product’s properties, nature and quality. *Report of the Working Party on Border Tax Adjustments* 18S/97, para. 18. * * *

The concept of “likeness” is a relative one that evokes the image of an accordion. The accordion of “likeness” stretches and squeezes in different places as different provisions of the WTO Agreement are applied. [The definition of “likeness” must be narrowly interpreted.] The Panel determined in this case that *shochu* and vodka are “like products.”

A uniform tariff classification of products can be relevant in determining what are “like products.” Tariff classification has been used as a criterion for determining “like products” in several previous adopted panel reports . . . There are risks in using tariff bindings that are too broad as a measure of product “likeness” . . . It is true that there are numerous tariff bindings which are in fact extremely precise with regard to product description and which, therefore, can provide significant guidance as to the identification of “like products.” Clearly enough, these determinations need to be made on a case-by-case basis. However, tariff bindings that include a wide range of products are not a reliable criterion for determining or confirming product “likeness” under Article III:2.



The only remaining issue under the first sentence of Article III:2 is whether the taxes on imported products are “in excess of” those on like domestic products. If so, then the Member that has imposed the tax is not in compliance with Article III. Even the smallest amount of “excess” is too much. The prohibition of discriminatory taxes in Article III is not conditional on a “trade effects test” nor is it qualified by a *de minimis* standard.

If imported and domestic products are not “like products” . . . those same products may well be among the broader category of “directly competitive or substitutable products” that fall within the domain of the second sentence of Article III:2. How much broader that category of “directly competitive or substitutable products” may be in any given case is a matter for the Panel to determine based on all the relevant facts in that case. In this case, the Panel emphasized the need to look not only at such matters as physical characteristics, common end-uses, and tariff classifications, but also at the “market place.” This seems appropriate. The GATT 1994 is a commercial agreement, and the WTO is concerned, after all, with markets. It does not seem inappropriate to look at competition in the relevant markets as one among a number of means of identifying the broader category of products that might be described as “directly competitive or substitutable.” Nor does it seem inappropriate to examine elasticity of substitution as one means of examining those relevant markets. In the Panel’s view, the decisive criterion in order to determine whether two products are directly competitive or substitutable is whether they have common end-uses, *inter alia*, as shown by elasticity of substitution. We agree.

Our interpretation of Article III is faithful to the “customary rules of interpretation of public international law.” WTO rules are reliable, comprehensible and enforceable. WTO rules are not so rigid or so inflexible as not to leave room for reasoned judgments in confronting the endless and ever changing ebb and flow of real facts in real cases in the real world. They will serve the multilateral trading system

best if they are interpreted with that in mind. In that way, we will achieve the “security and predictability” sought for the multilateral trading system by the Members of the WTO through the establishment of the dispute settlement system.

Decision. The *Japan Liquor Tax Law* was found to violate the national treatment provisions of GATT Article III. *Shochu* is a “like product” and is “directly competitive and substitutable” with other imported spirits. The imported spirits were taxed higher than the *shochu*. The decision of the panel was upheld and Japan was requested to bring its tax law into compliance with the WTO agreements.

Comment. In 1997, the United States was forced to seek binding arbitration when it became apparent that Japan did not intend to bring its liquor tax into WTO compliance within a “reasonable period” as required by WTO rules. The arbitration ruling supported the U.S. position. Japan agreed to revise its tariff system in stages and to eliminate tariffs on most spirits. The U.S. distilled spirits industry reported that, as expected, the change in taxation has increased exports of U.S. distilled spirits to Japan.

Case Questions

1. What is the purpose of GATT’s Article III and how is that purpose served?
2. Is it necessary that the complaining party show that a discriminatory tax has a negative effect on trade? Is a remedy possible even where the discrimination has no adverse impact on the sales volume of the imported products?
3. How does a WTO panel determine whether two products are “like products” for purposes of the first sentence of Article III:2 or “directly competitive or substitutable products” that fall within the domain of the second sentence of Article III:2?

Types of Quotas. Article XI reflects a general policy in the GATT agreement against the use of quotas to protect domestic companies. A **quota** is a quantitative restriction on imports. **Absolute quotas** are those that strictly prohibit imports of an item above a predetermined limit, based either on the value or quantity of specific goods (weight, number of pieces, etc.), or as a percentage of the domestic market for that item.

There are different types of absolute quotas. **Global quotas** are imposed by an importing nation on a

particular product regardless of its country of origin. An **allocated quota** is one in which the total limit is “allocated” among several specific countries. The term **zero quota** is sometimes used when referring to a complete ban on the import of a product in that it permits *zero* quantities to be imported. An **auctioned quota** is one in which a country sells the quota rights through bidding.

Arguments against Quotas. Historically, countries that wanted to protect domestic industries used



absolute quotas because it worked quickly to block imports. The impact was immediate, while tariffs took time to take effect. But GATT prohibits absolute quotas because of the many economic arguments against them, including the following. Economists argue that quotas distort the free market, deprive consumers of their choice, and causes dramatic price increases due to the lack of foreign competition. Moreover, protected domestic companies tend to become “lazy”—or inefficient—producers. Unlike tariffs, quotas provide no tariff revenue and require a complex licensing scheme to administer.

Despite the provisions in GATT prohibiting quotas, many countries continued to use them for decades. Quotas were used to regulate trade in textiles and apparel worldwide for many years prior to 2005 (including in the United States), when the quota system on textiles was abolished. The WTO was instrumental in removing many quotas by converting them to tariffs, which can then gradually be reduced through reciprocal tariff concessions.

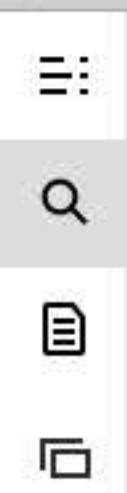
Tariff-Rate Quotas. A **tariff-rate quota** is not really a quota at all, but a tariff rate that increases according to the quantity of goods imported. It is a limitation or ceiling on the quantity of goods that may be imported into a country at a given tariff rate. Unlike absolute quotas, tariff-rate quotas leave the price mechanism in effect in regulating imports. They are also allocated to specific supplying countries without discrimination. Consider bedspreads as an example. A country that wants to protect its domestic textile industry might impose a tariff rate of, say, 7 percent on the first 500,000 bedspreads to be imported into the country in a given year; 14 percent on the next 500,000; and an even higher rate, perhaps 25 percent, on all bedspreads imported above 1,000,000 pieces. The use of tariff-rate quotas is quite common worldwide. After 1994 and the Uruguay Rounds, many absolute quotas were converted to a system of tariff-rate quotas. In the United States, for example, tariff-rate quotas have been used to limit imports of raw cane sugar, tuna, dairy products, peanuts, brooms, olives, and some cotton and wool products. A similar system exists in Canada. Some tariff-rate quotas are determined by obligations under free trade agreements. Quotas on agricultural products are administered by the U.S. Department of Agriculture and, like other tariff-rate quotas, are enforced by U.S. Customs and Border Protection.

Quotas in a Balance-of-Payments Emergency

When a nation’s outflow of foreign exchange exceeds receipts, a **balance-of-payments** (BOP) deficit can arise. This can be due to normal inflows and outflows of foreign currencies and is usually never a problem. When it is, countries wanting to preserve their foreign exchange reserves are tempted to resort to some extreme controls that limit their trade and financial transactions.

Theoretically, the fastest way to halt the outflow of foreign exchange would be for a country to place quantitative restrictions on imports of goods and services through quotas or licensing schemes, or for its central bank to refuse currency exchange (tariffs would take much longer to have the same effect). But because quotas are so trade and free-market distorting, GATT Article XII permits quotas to be used only in severe national BOP emergencies, only where tariffs or other lesser restrictive alternatives would not be adequate, and only for a very limited time. It is unlikely that a modern developed country would (legitimately) have a BOP crisis, or that it could justify quotas as a result. But despite today’s international monetary system for stabilizing currency markets, a BOP emergency can still occur in a developing country.

Historically, the international transactions of developing countries had to be denominated in one of the major currencies, not with their own. Many developing countries were agrarian economies, some with only a few “cash crops” that could be sold for export. Others were able to develop basic industries in steel or textiles that provided export revenues. Often this was their only source of scarce foreign exchange, which was needed to purchase essential foreign goods, such as medicine, fertilizer, or farm equipment or to repay international debts. After all, dollars, pounds, or yen could be used for trade anywhere on the globe, but the currency of a developing country usually could not. So, it is still possible that a developing country in a financial crisis could either put quotas on imports, or refuse to release its reserves of foreign exchange to importers or foreign companies. Today, however, this is unlikely to happen in newly emerging market and newly industrialized countries. Yet anyone who does business in a financially unstable developing country should always be aware of the possibility of a BOP payments crisis and be sure that their access to funds is secured.



In the following *WTO Panel Report on India—Quantitative Restrictions on Imports of Agricultural Textile, & Industrial Products*, the United States sought to have India remove a complex scheme of import restrictions that had existed for almost 50 years. The panel addressed the Indian licensing scheme as a prohibition on imports under Article XI and the BOP exception.

Quantitative Restrictions on Exports and the Case of Rare Earth Elements

GATT Article XI also prohibits quantitative restrictions on exports. One might wonder why a country would restrict an export—after all, it generates jobs and revenue. But consider materials that are invaluable



India—Quantitative Restrictions on Imports of Agricultural, Textile, & Industrial Products

Report of the Dispute Settlement Panel, WT/DS90/R (1999) World Trade Organization

BACKGROUND AND FACTS

For 50 years prior to this case, India had placed complex restrictions on the import of agricultural, industrial, and consumer goods from other countries. Goods placed on the “negative list” could only be imported by special license, which was generally only granted to the “actual user,” rather than to firms in the normal chain of distribution. Many goods could only be imported by state agencies. The restrictions were, in many cases, applied arbitrarily and in the discretion of Indian government officials on a case-by-case basis. As a result, it was often impossible to know at any given time what goods might be allowed into the country. Goods imported with a license were subject to confiscation or a fine of five times the value of the goods. In 1997, the United States brought this complaint at the WTO against India requesting that restrictions on thousands of products be removed. India claimed that without restrictions its foreign exchange would leave the country, upsetting its balance of payments and inhibiting its economic development.

REPORT OF THE PANEL

The United States contended that . . . persons wishing to import an item on the Negative List had to apply for a license and explain their “justification for import”: the authorities provided no explanation of the criteria for judging applications, and no advance notice of the volume or value of imports to be allowed. In fact, licenses were routinely refused on the basis that the import would compete with a domestic producer. The leading item on the Negative List was consumer goods (including many food items), and for many consumer goods inclusion on the Negative List had amounted to an import ban or close to it.

The United States considered that the restrictiveness of India’s licensing of consumer goods imports was demonstrated by the trade statistics . . . zero imports for 1995/96, including meat; fish; cereals; malt and starches; preparations of meat or fish; cocoa, chocolate and cocoa preparations; nuts, canned and pickled vegetables and fruits, and fruit juices; wine, beer, spirits and vinegar; leather articles; matting and baskets; carpets; knitted fabrics; clothing; headgear; umbrellas; and furniture. [Imports of hundreds of other products were allowed in only minute quantities for a population of 1 billion.] Thus, in many cases import licensing amounts to an import ban, or close to it.

The United States noted that . . . the “Actual User condition” ruled out any imports by wholesalers or other intermediaries, and itself was a further quantitative restriction on imports. * * *

Thus, according to the United States, the generally applicable import licensing process was a complete black box for the importer and for the foreign exporter. No information was provided on the Government’s sectoral priorities with respect to products or on what its views of “merit” might be. All that the United States knew was that the Indian licensing authority generally refused to grant import licences for “restricted” items when it was considered prejudicial to the state’s interest to do so.

The United States added that the broad definition of “consumer goods,” and the fact that some goods were *only* restricted if they were consumer goods, created considerable confusion, commercial uncertainty and distortion of trade. * * * The 1996 study on *Liberalisation of Indian Imports of Consumer Durables* by the Export-Import Bank of India had noted that the only two commonly used consumer durable goods that were freely importable were cameras and nail cutters. * * * India said that it needed to use discretionary licensing on a case-by-case basis for the following reasons. India’s economy had been almost totally closed to imports barely 15 years ago. Because of the size and structure of the economy, it was impossible for India to estimate precisely the

continues



continued

level of demand for imports, the import elasticity of demand for a huge number of products, as well as the elasticity of substitution of domestic products by consumers, and the effective rate of protection for all these products. Accordingly, India considered recourse to discretionary licensing to be unavoidable. Further, India was progressively phasing out its import restrictions. As part of its autonomously initiated programme of economic liberalization, India had already reduced the number of items on which there were import restrictions to just 2,296 as of 1998, from about 11,000 HS-lines in 1991. * * *

The United States stated that India's quantitative restrictions and licensing regimes had damaged and continued to damage U.S. trade interests . . . In 1996, the United States exported \$1.3 billion to India in goods subject to quantitative restrictions. However, while the ASEAN area had a population half the size of India's, U.S. exports to ASEAN were eight times the value of U.S. exports to India. As the panel on *Japanese Measures on Imports of Leather* noted, "the fact that the United States was able to export large quantities of leather to other markets [than Japan] . . . tended to confirm the assumption that the existence of the restrictions [on leather imports] had adversely affected [the] United States' exports."

The nature and operation of India's import licensing regimes also damaged and continued to damage U.S. trade interests. The uncertainty and limitations imposed by India's licensing regime deterred or prevented exporters from undertaking the investments in planning, promotion and market development necessary to develop and expand markets in India for their products. No exporter would put resources into developing a product's market in India without some assurance that it would be able to export some minimum amount per year, and the Indian system provided no such assurance—only a guarantee of continuing uncertainty—if the product in question was on the Negative List of Imports. * * *

In light of the foregoing, we note that it is agreed that India's licensing system for goods in the Negative List of Imports is a discretionary import licensing system, in that licences are not granted in all cases, but rather on unspecified "merits." We note also that India concedes this measure is an import restriction under Article XI: 1. * * *

Having determined that the measures at issue are quantitative restrictions within the meaning of Article XI:1 and therefore prohibited, we must examine . . . India's defence under the balance-of-payments provisions of GATT 1994. * * *

In this connection, we recall that the IMF reported that India's reserves as of 21 November 1997 were \$25.1 billion and that an adequate level of reserves at that date would have been \$16 billion. While the

Reserve Bank of India did not specify a precise level of what would constitute adequacy, it concluded only three months earlier in August 1997 that India's reserves were "well above the thumb rule of reserve adequacy" and although the Bank did not accept that thumb rule as the only measure of adequacy, it also found that "[b]y any criteria, the level of foreign exchange reserves appears comfortable." It also stated that "the reserves would be adequate to withstand both cyclical and unanticipated shocks." * * *

For the reasons outlined . . . we find that . . . India's monetary reserves of \$25.1 billion were not inadequate as that term is used in Article XVIII:9(b) and that India was therefore not entitled to implement balance-of-payments measures to achieve a reasonable rate of growth in its reserves. * * *

The institution and maintenance of balance-of-payments measures are only justified at the level necessary to address the concern, and cannot be more encompassing. Paragraph 11, in this context, confirms this requirement that the measures be limited to what is necessary and addresses more specifically the conditions of evolution of the measures as balance-of-payments conditions improve: at any given time, the restrictions should not exceed those necessary. This implies that as conditions improve, measures must be relaxed in proportion to the improvements. The logical conclusion of the process is that the measures will be eliminated when conditions no longer justify them. * * *

In conclusion . . . we have found that India's balance-of-payments situation was not such as to allow the maintenance of measures for balance-of-payments purposes under the terms of Article XVIII:9, that India was not justified in maintaining its existing measures under the terms of Article XVIII: 11, and that it does not have a right to maintain or phase-out these measures on the basis of other provisions of Article XVIII: B which it invoked in its defence. We therefore conclude that India's measures are not justified under the terms of Article XVIII:B. * * *

This panel suggests that a reasonable period of time be granted to India in order to remove the import restrictions which are not justified under Article XVIII:B. Normally, the reasonable period of time to implement a panel recommendation, when determined through arbitration, should not exceed 15 months from the date of adoption of a panel or Appellate Body report. However, this 15-month period is "a 'guideline for the arbitrator,' not a rule," and . . . "that time may be shorter or longer, depending upon the particular circumstances."

Decision. India's quantitative restrictions and the licensing scheme violated Article XI because they were discriminatory and not "rules based," and were no longer justified to preserve its balance-of-payments.



The panel's decision was upheld by the WTO Appellate Body in its report of August 1999 and later adopted by the Dispute Settlement Body.

Comment. Complex licensing restrictions like the one used by India for decades following World War II were not uncommon in developing countries. While it protected domestic producers, many of which were state-owned enterprises, it also kept their markets closed to foreign technology, innovation, capital, and the many benefits of competition. But consider how life in many developing countries has changed since the 1980s and 1990s. Most developing countries, including India, have dramatically opened their markets to foreign competition and foreign investment (although certainly not in all industry sectors). Many are no longer totally dependent on an agricultural economy. And many that once feared imports because

they did not have the foreign currency to pay for them, now have vibrant export-based manufacturing industries.

Case Questions

1. Compare the system of import licensing in effect in India during that time to what you know in the United States today. Are there any industries you can think of in the United States that are subjected to import licensing? What industries are so highly regulated?
2. Why did the licensing scheme violate Article XI?
3. What causes a balance-of-payments problem, and why can this be a critical problem for many developing countries?
4. Why did the panel not accept India's balance-of-payments argument?

to some industries and yet scarce and in short supply—for in that case restrictions on supply by the exporting country can cause export price increases and windfall profits at home. Such has been the case with minerals known as “rare earth elements,” used in cellphones and other advanced electronics and defense products. China has controlled almost all of the world’s production in what is environmentally hazardous mining. It decided to impose export quotas, arguing that it was necessary to preserve an exhaustible resource and reduce pollution from mining. That caused price increases for foreign firms, while the Chinese government was controlling and subsidizing lower prices to Chinese firms. The United States, Canada, the European Union, and Japan requested dispute settlement at the WTO. In 2014 the WTO Appellate Body upheld a panel decision that China had violated WTO rules. It held that although countries are rightly allowed to conserve their own natural resources, China’s quotas actually had no effect on conservation, but merely diverted supply to its own companies and allowed China to control the international market for a scarce resource. *China—Measures Related to the Exportation of Rare Earth Tungsten and Molybdenum*, WT/DS431-433/AB/R (2014).

Import Licensing and Customs Procedures as Trade Barriers

Look again at the language of Article XI, which prohibits “prohibitions or restrictions other than

duties, taxes, or other charges.” This prohibits a country from using an import license as a protectionist measure in disguise. In the years after World War II, many governments, particularly in developing countries, required importers to apply for permission to import products, subjecting them to many complex and often discriminatory requirements. The licensing was often an expensive, time consuming, regulatory maze. Rather than being “rules-based,” they often gave the ultimate discretion to government bureaucrats to decide which license applications to accept and which to deny. In many cases license applications were lost in government red tape and endless delay. Paperwork and inspection requirements caused delays and expense. Complex licensing schemes are still frequently used by countries as a barrier to trade throughout the world. For instance, in the 1990s, the United States accused Korea of protectionism by using delaying tactics in the form of “inspections” that held shipments of U.S.-grown fresh produce on the docks for an excessive time—until the produce had rotted. Argentina has required advance government approval for all imports, imposing stringent and often difficult bureaucratic red tape. A WTO Appellate Body decision required Argentina to end that practice. In 2016, the United States accused Argentina of other unjustifiable licensing schemes. For instance, imported used machinery cannot be resold for four years, and refurbished and remanufactured goods are often completely prohibited. Examples from other countries fill entire reports.



A country that is determined to restrict imports might very well point to legitimate reasons for licensing controls. But it would seem that there is no end to ingenious ways of circumventing international rules.

The United States has also been called to answer for its own import restrictions. Article XI was used against the United States in the Report of the Appellate Body in *United States—Import Prohibition of Certain Shrimp and Shrimp Products*, WT/DS58/ AB/R (1998). The United States banned imports of shrimp harvested by vessels of foreign nations that had not been certified by the United States as using methods that would not kill sea turtles. Although it was an import ban for good reason, conservation, it was not implemented in a fair, open, and transparent manner. The U.S. approval process was so informal, arbitrary, and discretionary, that foreign shrimpers found it very difficult to obtain approval. The U.S. restrictions were held to violate Article XI, much to the chagrin of environmental groups. When faced with foreign licensing schemes, exporters around the world use local agents and attorneys to advise them on import regulations and customs procedures in the foreign market.

Exceptions Permitting Trade Restrictions

GATT Article XX provides that countries may restrict or regulate trade when necessary to meet the following public policy goals (if not arbitrary or an unjustifiable restriction on trade):

- Protection of public morals
- Protection of human, animal, or plant life or health
- Regulation of gold or silver
- Customs enforcement
- To stop infringement of patents, trademarks, and copyrights
- Prevention of deceptive practices
- Prohibitions on trade in products made by prison labor
- Protection of national artistic, historic, or archaeological treasures
- Conservation of exhaustible natural resources

GATT Article XXI allows countries to restrict trade or traffic in armaments, ammunition, or nuclear materials, and to protect its security in time of war.

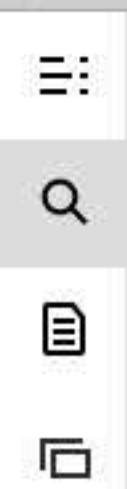
WTO DISPUTE-SETTLEMENT PROCEDURES

The WTO agreements can only work when national legislatures and governments choose to comply with WTO principles when setting tariff rates and

regulating imports. When one WTO member nation acts contrary to its commitments in a WTO agreement, such as raising a tariff above the bound rate or imposing an unjustified quota on imports, that country is said to have “nullified or impaired” the rights of other WTO member countries that are affected by that country’s action. Consider this example: Assume that under domestic pressure from local chair makers, Australia raises the tariff rate on imported beach chairs above the bound rate. WTO countries whose companies ship beach chairs to Australia may file a complaint with the WTO for **nullification or impairment** of their national rights under a trade agreement. These governments must first engage in **trade consultations** with Australia at the WTO, and if no resolution is possible they may request binding dispute resolution before the **WTO Dispute Settlement Body** (WTO-DSB).

The WTO agreements envision that nations will not take unilateral retaliatory action against any other nation in a trade dispute, but will instead rely on WTO dispute-settlement procedures to avert a trade war. These procedures are a quasi-judicial process for resolving trade disputes when attempts by the countries involved to reach a settlement become deadlocked. Dispute resolution is intended to resolve a conflict before a “trade war” erupts. For instance, if nation A imposes a quota on nation B’s products, then nation B may file a complaint with the WTO-DSB. In the meantime, nation B may not unilaterally retaliate with quotas or tariffs on A’s products and, in fact, it needs approval of the WTO-DSB to do so. Only a member government can bring a complaint for nullification and impairment against another government. Complaints are not filed by or against firms or individuals (although, as a practical matter, WTO cases are often brought by nations upon the instigation of private industry). WTO-DSB decisions are released to the public and available online. WTO-DSB decisions are binding, and unlike the previous GATT panels, the parties cannot “block” or veto a panel’s decision. Countries generally want to support and abide by the decisions because they might want to rely on the process in the future. Furthermore, WTO decisions carry the voice of world opinion and serve as an international conscience for determining which trade practices are acceptable and which are not.

The following provisions are from the *WTO Understanding on Rules and Procedures Governing the Settlement of Disputes*, also known as the *WTO Dispute-Settlement Understanding* (DSU):



- The WTO-DSB appoints panels, adopts panel decisions, and authorizes the withdrawal or suspension of concessions.
- A government requests consultations to seek a solution. If no solution is found within 60 days, the complaining party may request that a panel hear the case. (Historically, most disputes are resolved in the consultation stage, which in some cases can last for years.) The panel consists of three to five individuals nominated by the WTO Secretariat.
- Other member nations with a "substantial interest" in the case often join in a complaint, make written submissions, and appear at the oral argument before the panel.
- A panel determines the facts of the case and whether there have been violations of the terms of a WTO agreement. It may call on experts for advice on scientific and technical matters. All panel deliberations are confidential. The panel must submit a written report to the parties and to other members within six months (three months in urgent cases).
- Unless the parties file for an appeal to the Appellate Body, the panel's report goes to the WTO-DSB where it will automatically be upheld unless there is a consensus of all member countries to reject the decision. A WTO-DSB vote to reject must be by consensus. Thus the "losing" nation in a dispute settlement case cannot block the decision of a panel without a unanimous vote of all members (including getting the "winning" party in the dispute to agree to block a decision it just won). The process takes about one year, from the beginning of consultations to adoption of a report by the WTO-DSB.
- Panel decisions may be appealed to the WTO Appellate Body on issues of law related to interpretation of the relevant provisions of the WTO agreement in question. Each case is heard by three judges (out of a permanent body of seven judges). They may uphold, modify, or reverse a panel decision. Judges serving on the Appellate Body will be chosen on the basis of their expertise in international trade law to serve for four-year terms. They usually come from government, universities, or international law practices. Appeals are limited to issues of law covered in the panel report and legal interpretations considered by the panel. The appellate report is final unless the WTO-DSB rejects it by consensus vote within 30 days.
- If the panel report finds that the offending party has violated a WTO agreement, the WTO-DSB can recommend ways for the offending party to come into compliance. The offending party has 30 days in which to respond how it plans to comply with the panel's ruling. Compliance must be within a reasonable time. If no immediate solution is available, the offending party can voluntarily make compensatory adjustments to the complaining party as a temporary measure.
- If no settlement is reached or if the trade violation is not removed, the panel may recommend that the General Council authorize the withdrawal or suspension of a concession by the complaining party. This is the equivalent of a trade sanction. Sanctions should be in an amount equal to the impact that the breach of agreement had on the complaining party. Sanctions are to be temporary and remain in force only until the offending party's violation is removed.

The following case, *WTO Report of the Appellate Body on European Communities—Regime for the Importation, Sale and Distribution of Bananas* (1997) involves a long-running trade dispute among the European Community, Latin America, and the United States. It addresses the issue of who may request a WTO panel in a trade dispute.

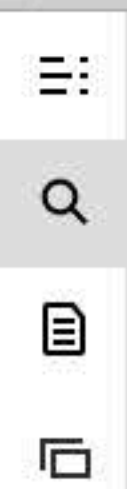
WTO Reports as Legal Precedent

WTO panel or Appellate Body reports do not have the same precedential value as judicial decisions do in common-law courts, and they are not binding in future cases. However, it is common for panels to quote, cite, and discuss relevant prior decisions, and they clearly have persuasive value—thus giving international lawyers some idea of how future panels might rule. The *WTO Report of the Appellate Body on Japan—Taxes on Alcoholic Beverages* (1996) addressed the status of a report that had been adopted by the WTO-DSB:

We do not believe that [WTO member nations], in deciding to adopt a panel report, intended that their decision would constitute a definitive interpretation of the provisions of GATT 1947. Nor do we believe that this is contemplated under GATT 1994 . . . Adopted panel reports can play an important part of the GATT *acquis*. They are often considered by subsequent panels. They create legitimate expectations among WTO members, and, therefore should be taken into account where they are relevant to any dispute. However, they are not binding . . .

This statement is reaffirmed in the actual language of GATT 1994, which states that interpretations of the agreement may only be made by the Ministerial Conference and the General Council. Nevertheless, WTO Appellate Body reports continue to cite prior reports for their persuasive value.

WTO Reports and Decisions and U.S. Law. In the United States, WTO Panel and Appellate Body decisions are not binding on the courts. However, there are several cases in which the federal courts have cited WTO decisions for their persuasive authority. For example, in *Hyundai Electronics Co., Ltd. v. United States*, 53 F. Supp. 2d 1334 (1999), the Court of International Trade stated, "Thus, the WTO panel report does not constitute binding precedential authority for the court. Of course, this is not to imply that a panel report serves no purpose in litigation before the court. To the contrary, a panel's reasoning, if sound, may be used to inform the court's decision." This means that a U.S. court cannot strike down a U.S. law or regulation merely because a WTO decision has ruled that it is in



European Communities—Regime for the Importation, Sale & Distribution of Bananas

Report of the Appellate Body, WT/DS27/AB/R (1997) World Trade Organization

BACKGROUND AND FACTS

The European Community (EC) had been the world's largest importer of bananas, two-thirds of which were grown in Latin America. A large percentage came from developing countries that were once colonies of Britain, Spain, and France, located in Africa, the Caribbean, and the Pacific (known as ACP countries). Growers in the ACP countries could not compete with the highly efficient non-ACP producers, most of which are operating in Latin America. In order to encourage the import of ACP-grown bananas and to aid in the development of ACP economies, the EC devised a host of tariff and nontariff barriers aimed at non-ACP bananas. For example, a complex quota scheme was used permitting only a limited quantity of non-ACP bananas to be imported each year, while licenses to import ACP bananas were granted routinely. Whereas most ACP bananas entered duty free, other bananas had a very substantial tariff rate. Several Latin American countries requested consultations, claiming that the EC regulations violated GATT by discriminating against bananas grown in their countries. The United States joined with them, arguing that the United States also had a substantial interest in the issue because U.S. companies that grew and exported Latin American bananas would lose business. The EC maintained that the United States had no grounds for complaining about the EC regulations because it was not a producer and grower. A WTO panel was convened, and its decision was appealed to the WTO Appellate Body.

REPORT OF THE APPELLATE BODY

The EC argues that the Panel infringed Article 3.2 of the Dispute Settlement Understanding (DSU) by finding that the United States has a right to advance claims under the GATT 1994. The EC asserts that, as a general principle, in any system of law, including international law, a claimant must normally have a legal right or interest in the claim it is pursuing. . . . The EC asserts that the United States has no actual or potential trade interest justifying its claim, since its banana production is minimal, it has never exported bananas, and this situation is unlikely to change due to the climatic and economic conditions in the United States. In the view of the EC, the panel fails to explain how the United States has a potential trade interest in bananas, and production alone does not suffice for a potential trade interest. The EC also contends that the United States has no right protected by WTO law to shield its own internal market from the indirect effects of the EC banana regime. . . .

We agree with the Panel that no provision of the DSU contains any explicit requirement that a member must have a "legal interest" as a prerequisite for requesting a panel. We do not accept that the need for a "legal interest" is implied in the DSU or in any other provision of the WTO Agreement . . . [We believe] that a member nation has broad discretion in deciding whether to bring a case against another member nation under the DSU. . .

The participants in this appeal have referred to certain judgments of the International Court of Justice and the Permanent Court of International Justice relating to whether there is a requirement, in international law, of a legal interest to bring a case. We do not read any of these judgments as establishing a general rule that in all international litigation, a complaining party must have a "legal interest" in order to bring a case. Nor do these judgments deny the need to consider the question of standing under the dispute settlement provisions of any multilateral treaty, by referring to the terms of that treaty.

We are satisfied that the United States was justified in bringing its claims under the GATT 1994 in this case. The United States is a producer of bananas, and a potential export interest by the United States cannot be excluded. The internal market of the United States of bananas could be affected by the EC banana regime, in particular, by the effects of that regime on world supplies and world prices of bananas. We also agree with the Panel's statement that: ". . . with the increased interdependence of the global economy . . . member nations have a greater stake in enforcing WTO rules than in the past since any deviation from the negotiated balance of rights and obligations is more likely than ever to affect them, directly or indirectly."

Accordingly, we believe that a member nation has broad discretion in deciding whether to bring a case against another member under the DSU. The language of Article XXIII: 1 of the GATT 1994 and of the DSU suggests, furthermore, that a member is expected to be largely self-regulating in deciding whether any such action would be "fruitful."

Decision. The Appellate Body held that the United States could call for the convening of a WTO panel to question EC import barriers even though its exports were not directly affected.

Comment. The United States sought WTO authorization to "suspend concessions" (i.e., impose retaliatory tariffs) on a wide range of EU products, the value of which was equivalent to the nullification or



impairment sustained by the United States. Consider the impact of a trade war over bananas: In 1999 the Dispute Settlement Body authorized the United States to impose 100 percent *ad valorem* duties on a list of EU products with an annual trade value of \$191.4 million. The range of European products included bath preparations, handbags of plastic, paperboard, lithographs not over 20 years old, certain cotton bed linens, lead-acid batteries, electric coffee-makers, and other products. In 2001, an agreement was reached to end the trade dispute. The EU restrictions were dismantled, and U.S. tariffs were lifted. The “Banana Wars” were the largest

trade war to date with tremendous economic and political ramifications.

Case Questions

1. When may a member bring a complaint against another member of the WTO?
2. What was the basis for the EC’s argument in this case?
3. The EU-Latin America banana dispute did not end until 2012. What was the ultimate conclusion to this WTO issue?

violation of an international agreement. For instance, if a WTO panel rules that a U.S. Department of Energy regulation regarding the sale of imported oil is held to be in violation of GATT’s nondiscrimination provisions, a U.S. court cannot rely on that decision in striking down the regulation. It would be a matter for the U.S. Congress or the executive branch of government, and not the judiciary, to bring that regulation into compliance with a WTO decision.

EXCEPTIONS TO NORMAL WTO TRADE RULES

Earlier we said that most-favored-nation tariff rates, which must be granted to goods coming from all WTO member countries, were not the lowest rates, nor a type of special treatment for “favored” nations. Since 1947 the GATT and WTO agreements have provided for two categories of trading arrangements that provide better-than-MFN tariff treatment. These are (1) trade preferences for developing countries and (2) free trade areas, customs unions, and common markets.

Trade Preferences for Developing Countries

The WTO agreements permit the granting of **trade preferences**, or preferential tariff treatment, to developing countries to help further their social and economic developments. Most developed nations, including the United States, Canada, Japan, the European Union, and the Scandinavian countries grant trade preferences to developing countries, not only in their own hemispheres but also around the world. Three important U.S. programs for developing countries are the *Generalized System of Preferences*, the

Caribbean Basin Initiative, and the *African Growth and Opportunity Act*.

The Generalized System of Preferences. The most well-known trade preference is the *Generalized System of Preferences* (GSP). This program permits certain approved imports from specified developing countries to enter the United States at reduced rates of duty, or duty-free. This aids in the economic development of poorer countries while decreasing the cost of many imported goods for U.S. business and consumers. These goods are often most efficiently produced in lower cost countries and in many cases from raw materials they have in abundant supply. Congress enacted the GSP legislation in 1974 and has renewed it regularly. Those developing countries that are eligible for preferential treatment under the program are known as **beneficiary developing countries**. In 2016 there were approximately 120 countries and territories eligible for GSP status. Even more liberal rules apply to some products from *least developed beneficiary countries*.

Eligibility for GSP Status. Some of the specific requirements for importers wanting to take advantage of the GSP program are (1) the item must qualify for a GSP tariff preference in the U.S. tariff schedules; (2) it must be imported directly from an eligible country; (3) the country must be eligible for GSP treatment for that particular item; and (4) the item must be the “growth, product, or manufacture” of the eligible country (as strictly defined in U.S. law).

Eligibility for the GSP is determined by statute and administrative regulation. The President makes the final determination of both country and product eligibility based on the recommendation of the U.S. Trade Representative, who conducts an annual review. The



USTR must consider the benefit of GSP status, as well as how this would affect U.S. producers of similar or competitive products.

To be eligible, a GSP country must cooperate with the enforcement of narcotics and antiterrorism laws, recognize internationally accepted standards for worker rights and safety, and prohibit child labor. In addition, the president has wide authority to deny duty-free treatment on political and economic grounds. For instance, the president can deny GSP status to any country that does not protect the patents, trademarks, and copyrights of U.S. citizens, or that maintains unreasonable restrictions on U.S. investment. A developing country may lose GSP benefits when it reaches a higher level of per capita gross national income, or is sufficiently competitive without the GSP preference. It is said to then “graduate” out of the GSP program.

Another requirement for GSP eligibility is that a product must be one of approximately 5,000 items approved under U.S. law for duty-free treatment. A few examples are sugar, jewelry, building stone, leather shoe uppers, wooden furniture, Christmas tree lighting, certain fish, generators, touch displays, golf carts, and motor vehicle parts. Certain import-sensitive products, such as most textiles and apparel, footwear, steel, and some electronic items, are not eligible. A list of products is available directly from the USTR or in the *Harmonized Tariff Schedules of the United States*. There is a quantitative limit on imports from each beneficiary country, called a **competitive need limitation** although these can be waived (and are not applicable to “least developed” countries). The GSP programs of most developed countries are very similar to those of the United States.

The U.S. Caribbean Basin Initiative. America’s imports from the Caribbean are petroleum products, chemicals, natural gas, textiles and apparel, agricultural products, such as coffee and tropical fruits, electrical parts, and many others. The *Caribbean Basin Initiative* (CBI) is the name collectively given to several laws that grant trade preferences to goods imported from the Caribbean. The most important is the *Caribbean Basin Economic Recovery Act*, or CBERA. These are several special programs allowing duty-free imports of textiles and other products from impoverished Haiti. These statutes give the president the authority to grant tariff reductions or duty-free status to imports from eligible countries in order to encourage trade and investment in the Caribbean. A few of the products benefiting from the preferences are cane sugar, communications equipment, electrical and nonelectrical machinery, medical

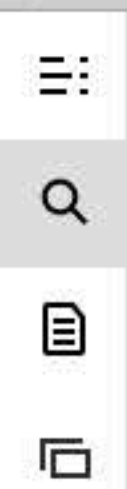
appliances, orange juice, bananas, ethyl alcohol, baseballs, and rum. Countries must meet the same mandatory criteria as under the GSP. Many CBI countries, but not all, also qualify for benefits under the GSP. However, the CBI covers a wider range of products, there is no annual review, and countries do not “graduate” out of the program. In 2017 there were 17 countries benefiting from Caribbean preferences.

U.S. Preferences for Africa. The *Africa Growth and Opportunity Act* (AGOA) aids in the economic growth and the establishment of political freedom in 48 poor countries in sub-Saharan Africa where the per capita annual income averages about \$500 per year. The law encourages U.S. trade and investment there and improves access for African products to U.S. markets. To qualify for the benefits of the act, the African countries must try to improve their own conditions through progressive economic and social policies. The country must abide by human rights standards, eliminate abuses of child labor, not support terrorism, enforce laws against corruption, and move toward a free-market economy. Forty-seven countries are now eligible for AGOA. AGOA preferences are even more favorable than the GSP. Almost all of the 6,500 eligible products enter the United States duty free. The largest AGOA sectors are petroleum, minerals (including platinum and diamonds), motor vehicle parts, steel, textiles, jewelry, fruit and nuts, leather, and cocoa.

Free Trade Areas and Customs Unions

Another exception to normal MFN rules applies to goods traded within free trade areas and customs unions. A **free trade area** consists of two or more countries that are party to a free trade agreement that reduces or eliminates tariffs on goods, removes trade barriers, and usually addresses other common concerns affecting trade between them. For example, goods traded between Canada, Mexico, and the United States qualify for better-than-MFN tariff rates, or may pass duty free, under the *North American Free Trade Agreement*. In 2012, the United States and South Korea signed the *U.S.-Korea Free Trade Agreement* (KORUS FTA). In 2015, KORUS was America’s second largest free trade area after NAFTA.

In 2005, the United States entered into the *United States-Central America-Dominican Republic Free Trade Agreement* (CAFTA-DR) with Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, and the Dominican Republic. Unlike the GSP, CAFTA-DR is not a trade preference program, but a free trade agreement based



on reciprocity and mutual agreement. The agreement phased out all tariffs on goods over a 5- to 10-year period (15 years for agricultural products). The agreement also addresses many collateral issues, such as corruption, labor standards, environmental protection, and the protection of intellectual property.

A **customs union** is a free trade area with a common external tariff. A **common market** takes the integration one step further: it is a customs union that also removes restrictions on the free movement of money, labor, and factors of production. The European Union is a common market and monetary union that functions at a high level of economic, legal, and political integration. Because both the North American and European trading blocs are so highly integrated and economically important, each has its own chapter later in this book. Here we discuss some of the smaller trade blocs in Latin America, Africa, and Asia.

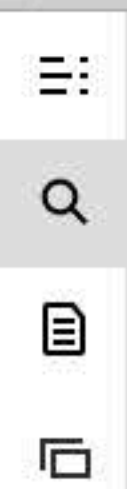
- **Caribbean Community.** The Caribbean Community (CARICOM) is a highly integrated political and economic common market of 20 member developing countries of the Caribbean. It has executive and legislative bodies and its own *Caribbean Court of Justice* that resolves disputes over the treaty and hears civil and criminal appeals from national courts in member nations. CARICOM is transitioning into a fully integrated "single market" economy similar to what Europe has done. CARICOM countries are trying to diversify their traditional agricultural economies through tourism and financial services.
- **Common Market of the South.** The Common Market of the South (*Mercado Común del Sur* or MERCOSUR) includes Argentina, Brazil, Paraguay, and Uruguay. Bolivia is expected to join soon. Venezuela was suspended from membership for failing to abide by trade and human rights standards. Its associate members are Chile, Colombia, Ecuador, Guyana, Peru, and Suriname. MERCOSUR is one of the world's largest economic trading areas.
- **Andean Community of Nations.** The Andean Community of Nations (*Comunidad Andina* or CAN) includes Bolivia, Colombia, Ecuador, and Peru. Its associate members are the MERCOSUR nations (see above) with whom the Andean Community has favorable trade preferences. There has been some significant progress in permitting the free movement of people among the CAN member nations. Citizens of one member country can enter the other member countries without a visa and only a national identity card.
- **African Regional Economic Communities.** Africa consists of many small trading blocs in Africa, including the world's oldest customs union, the *South African Customs*, founded in 1910. The *Common Market for Eastern and Southern Africa* (COMESA) is the largest free trade area in Africa, with 20 member nations and a population of 390 million. Civil war, violence, and internal corruption affect several COMESA

countries. There are also subregional customs unions in Africa. The *African Economic Community* is an ambitious, long-term plan to unite the various regional economic communities into a larger pan-African union. The *African Union* is the most important intergovernmental organization in Africa, not a free trade area, comprised of over 50 member countries. Its role is to unify Africa through economic, social, and political development.

- **Asian Free Trade Initiatives.** Economic integration in the Asia-Pacific region has usually taken the form of enhanced cooperation rather than free trade initiatives. The *Association of South East Asian Nations* (ASEAN) is comprised of Brunei Darussalam, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand, and Vietnam. There is an inter-ASEAN common preferential tariff on goods; however, unlike the treaties underlying the EU and CARICOM, ASEAN does not have a legal mechanism to harmonize laws or enforce the rules of a common market. ASEAN does negotiate as a whole with major economic players for common tariff agreements and has free trade agreements with China and Japan on goods and services.
- **Middle East Economic Integration.** The *Gulf Cooperation Council* (GCC) is comprised of the Persian Gulf states of Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates. All of the countries are oil-wealthy monarchies, sharing a similar language, culture, religion, and political interests. It is a broad political, defense, and security organization, as well as a customs union, and it is progressing to a common market. Some members have hopes of it becoming a monetary union with a single currency. The *Greater Arab Free Trade Area* (GAFTA) is an agreement developed out of the broader intergovernmental organization of Arab countries called the *Arab League*. GAFTA has 17 member countries and spans the Middle East and North African regions. All internal tariffs have been eliminated, and other barriers to trade reduced.

CONCLUSION

The GATT/WTO system has provided a multilateral framework for regulating international trade since the close of World War II. It established the principles of international trade law on which most national trade laws are based. The GATT agreement and its principles of trade liberalization prevented reactionary forces from drawing the world back into the isolationism and protectionism of the 1930s. Multilateral trade negotiations have resulted in tariff concessions and a worldwide lowering of duties. Today, tariffs are at reasonable levels compared to the 1930s, and rates no longer act as a barrier to trade in most products. Many nontariff barriers have also been reduced or eliminated.



Since 1995, the WTO has also had some success in reducing nontariff barriers on technology goods and services. For example, there has been work on a proposed WTO agreement on environmental goods, covering wind, solar, carbon capture, and similar products. The WTO has also had success in bringing new information and communications technologies into the WTO. In 2015, the *WTO Information Technology Agreement* was expanded to include tariff reductions on well over \$1 trillion in IT products.

Not all of the work of the WTO since 1995 can be viewed as a success. The *Doha Development Round* (2001–present, as of 2017) has been the only negotiating round held under the auspices of the WTO. Its goal has been to address trade issues not resolved in 1994, to further lower tariffs and trade barriers, and to address trade issues affecting developing countries. Unfortunately, by the end of 2016, the drawn-out negotiations seemed to have stalled. Many commentators use the term “deadlocked.” The most polarizing negotiations involved the subsidizing of agriculture by developed countries in the form of government price supports and export financial incentives for farmers. This is an area of great disagreement because subsidies by rich countries to their farmers make it more difficult for poorer developing countries to compete in world markets. After all, if the U.S. government pays its cotton farmers billions of dollars every year in subsidies (as do the European countries), it makes it hard for poor farmers in West Africa to compete in selling their cotton to China, the world’s largest cotton importer.

One can only speculate whether the inability of the WTO to move more quickly in liberalizing trade has pushed the United States and other countries to

work more on a bilateral and regional basis. Clearly, many countries have been able to find more common trade interests at the regional level than they have at the multilateral level. Since 1995, there has been an almost explosive growth in the number of bilateral and regional trade agreements. Some economists worry that this “regionalism” actually undermines the larger efforts of multilateral free trade.

Some issues not covered here will have to wait for later chapters: How is trade regulated within a customs and monetary union like the European Union? How has the WTO addressed national technical regulations, product standards, and licensing schemes that make it difficult or impossible to sell your products or services in foreign countries? How do the rules governing trade within the North American free trade area differ from the WTO’s global rules? What types of “unfair trade” are regulated by the WTO agreements? What specific tariff and customs regulations are necessary to import goods into the United States? These chapters await.

Keep in mind that not all future political leaders may continue believing in free trade, as has been so widely accepted since World War II. Indeed, there has always been a populist tendency toward protectionism and isolationism. Whatever economic theory you subscribe to, it’s truly hoped that your study here will better prepare you to evaluate the issues.

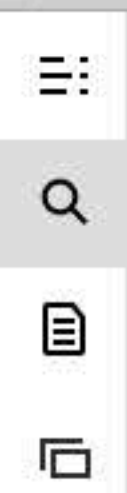
Finally, as you read on, remember that the “global rules” for trade in goods and services presented here will ultimately set many of the rules for how your products and services will be delivered to, or purchased from, your foreign business partners.

Chapter Summary

1. Nations regulate trade for several important reasons, including collection of revenue, regulation of import competition, retaliation against foreign trade barriers, implementation of foreign policy or domestic economic policy, national defense, protection of natural resources and the environment, protection of public health and safety, and protection of cultural values or artifacts.
2. The terms *tariff* and *import duty* are used interchangeably. Tariffs are a tax levied on goods by

the country of importation. A nontariff barrier is broadly defined as any impediment to trade other than a tariff. The most severe form of import restriction is the embargo. Countries usually use it as a drastic measure for reasons of foreign policy or national security.

3. An import licensing scheme is a form of nontariff barrier to trade that is often hidden in administrative regulations and bureaucratic red tape. Exporters faced with foreign licensing schemes often have



- to retain local agents and attorneys to advise them on import measures in the foreign market. Import regulations that are not made readily available to foreign exporters are said to lack *transparency*.
4. The *General Agreement on Tariffs and Trade*, or GATT, includes the original 1947 agreement as it has been incorporated into the 1994 agreement. The original agreement only covered trade in goods. In 1994, a *General Agreement on Trade in Services* was also added, as well as numerous sectoral agreements. More than a dozen miscellaneous WTO agreements, intended to reduce nontariff barriers to trade and open access to markets for foreign goods and services, will be covered in this book.
 5. GATT's major principles include a commitment to multilateral trade negotiations, tariff bindings, transparency, nondiscrimination, unconditional MFN trade, national treatment, and the elimination of quotas and other nontariff barriers.
 6. Through multilateral trade negotiations at the WTO, countries make reciprocal tariff concessions that bind tariff rates. The bound rate is the maximum rate that can be charged on an item and is in the schedule of concessions, which is kept on record at the WTO. This rate then appears in that country's tariff schedules. The schedules are made available to all exporting and importing countries.
 7. WTO dispute-settlement procedures provide a legal forum for nations to resolve trade disputes. No single country can veto the decisions of a WTO panel. If a settlement is not reached, the WTO Dispute Settlement Body may authorize countries whose rights have been nullified and impaired to impose retaliatory tariffs against another that has violated a WTO agreement. Decisions have no precedential value as do common law court decisions.
 8. The principles of most-favored-nation (MFN) trade mean that a nation must accord products imported from any country with which it has MFN trading status the most favorable treatment or the lowest tariff rates that it gives to similar products imported from other MFN countries. Unconditional MFN treatment means that if a country negotiates a lower tariff rate with one MFN country, that rate is automatically applicable to all MFN countries. The United States applies MFN tariff rates to those countries that qualify for "normal trade relations." The MFN/NTR rate is considered the normal tariff rate for goods coming from most developed countries. Goods imported from developing countries or within free trade areas often qualify for better-than-MFN rates.
 9. Under the national treatment provisions of GATT Article III, imported products must not be regulated, taxed, or otherwise treated differently from domestic goods once they enter a nation's stream of commerce.
 10. GATT outlaws most quantitative restrictions on imports and exports, such as quotas. Quotas on imported products are permitted only in certain situations, such as when a nation has insufficient foreign exchange to meet its foreign payment obligations.
 11. Many developed countries grant trade preferences to beneficiary developing countries around the world.
 12. The WTO agreements permit countries to form free trade areas, customs unions, and common markets. Although the largest are in Europe and North America, important free trade areas and customs unions exist in Africa, Asia, and Latin America. Some economists criticize the concept of regional economic integration as distracting from the benefits of a globalized world trading system.

Key Terms

trade barrier 233	trade liberalization 236	modify or withdraw a concession 239
import trade barrier 233	negotiating rounds 236	nondiscrimination 240
tariff 234	tariffication 238	most-favored-nation (MFN) trading status 240
ad valorem tariffs 234	transparency 238	unconditional MFN trade 241
specific or flat tariffs 234	tariff concession 239	normal trade relations (NTR) 241
global tariffs 234	tariff binding 239	quota 243
nontariff barriers (direct and indirect) 234	bound rate 239	absolute quota 243
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allocated quota 243	trade consultations 248	competitive need limitation 252
zero quota 244	withdrawal or suspension of a	customs union 253
auctioned quota 244	concession 249	common market 253
tariff-rate quota 244	trade preferences 251	global e-commerce 256
balance-of-payments 244	beneficiary developing country 251	global digital trade 256
nullification or impairment 248	free trade area 252	

Questions and Case Problems

1. Global e-commerce and digital trade are quickly becoming key issues in the future of international trade. There are no clearly accepted definitions of the two terms. However, **global e-commerce** generally refers to online transactions for the cross-border sale of goods or services. **Global digital trade**, on the other hand, seems to refer to international transactions in which the goods, services, or information *are delivered* online. Thus, global digital trade might include something as simple as an Internet search, search engine advertising, or social media. Or it might include the international online sale *and delivery* of books, films, music, financial and professional services, online education, and many other examples. For instance, in the health care industry, it might include the reading of an x-ray or MRI for a patient in the United States by a physician-radiologist in India. It also includes the cross-border transmission of communications, international transportation management, the online transfer of financial services, online collaboration in research and business, and the digital infrastructure connecting business to business, such as international supply chain management.
- a. Consider this document: *Digital Trade in the U.S. and Global Economies, Part 1*, Investigation No. 332-531, USITC Pub. No. 4415, July 2014; *Digital Trade in the U.S. and Global Economies, Part 2*, Investigation No. 332-540, USITC Pub. No. 4485. Based on your reading, what are the most digitally intensive U.S. industries? What countries comprise the largest markets for U.S. digital goods? What trade barriers have been identified to U.S. e-commerce and digital trade and what are the estimated economic effects?
- b. Explain how the Internet has transformed international business for small and medium enterprises.
- c. E-commerce and digital trade are creating new challenges for business and governments alike. How do you think countries will cooperate on issues such as cybersecurity, safeguarding of cross-border credit card payments, nondiscrimination, and freedom in the location of Internet servers? Explain these issues, and discuss how they might be addressed in international legal agreements.
2. A 1990 Korean law established two distinct retail distribution systems for beef: one system for the retail sale of domestic beef and another system for the retail sale of imported beef. A “Specialized Imported Beef Store” could sell only foreign beef. Other small retailers could sell only Korean beef, but large supermarkets could sell both imported and domestic beef, as long as each was sold in separate sales areas. Imports of U.S. beef declined. Korea argued that the dual system was necessary to protect consumers from deception. Does Korea’s dual retail system for beef violate GATT Article III:4? The United States argued that there were less restrictive alternatives available to Korea. Do you agree or not agree? Why? Next, is Korea’s action justified under Article XX? Why or why not? How did the Appellate Body rule? *WTO Report on Korea—Measures Affecting Imports of Fresh, Chilled and Frozen Beef*, World Trade Organization. Report of the Appellate Body, WT/DS161/AB/R, WT/DS169/AB/R (11 December 2000).
3. The controversial *Trans-Pacific Partnership Agreement* was negotiated and signed by President Obama on the basis of trade promotion authority from Congress. It includes 12 countries of Asia and the Pacific Rim, but not including China. The TPP includes provisions on trade, enforcement of labor and environmental laws, currency manipulation, IP protection, investment protection, and new rules to promote e-commerce and digital trade. President Obama argued that the TPP would boost exports and increase U.S. jobs by opening markets for American products. He also saw it as a way of increasing ties between U.S. and Asian companies while offsetting China’s growing economic, military, and geopolitical influence in the Pacific region. However, during 2016 the TPP came under great popular criticism from politicians and labor groups that argued that the tariff reductions would cause losses in U.S. manufacturing jobs. In 2017, President Trump said he believed in “fair trade” rather than “free trade,” and called the TPP a “bad deal.” Three days after his inauguration, he used a presidential memorandum to withdraw the United States as a signatory to the agreement. Those in favor of the agreement responded that if the United States did not join, that the other



signatories might enter into their own agreement without the United States. Moreover, China added that it would consider entering the TPP if the United States withdrew.

- What is the status of the TPP today?
- What are the key arguments for and against the United States increasing trade ties with Asia? As a beginning, consider this research document: *The Trans-Pacific Partnership (TPP): Key Provisions and Issues for Congress*, Congressional Research Service, Report by Ian F. Fergusson and Brock R. Williams, R44489, June 14, 2016.
- The TPP came under question at a time of rising populism, nationalism, and anti-immigration sentiment in many countries, including the United States, the United Kingdom, and others. How do you see these forces as affecting global trade relations at the time of your reading or in the foreseeable future?

4. Every year, the U.S. Trade Representative issues a report on foreign government trade barriers to U.S. goods and services, known as the *National Trade Estimate Report on Foreign Trade Barriers*. Locate the most recent report, choose three countries, and describe the nature of trade barriers facing U.S. export firms. What industries are most affected?

5. In early 2017, some key members of the U.S. Congress were seriously considering a major revision of the U.S. corporate income tax code, instituting a tax based on where products are consumed—not where profits are earned. It is an idea developed by Alan J. Auerback of the University of California, Berkeley. A set tax rate would be imposed on the sales revenue of a product less than the cost of materials used (and possibly a deduction for U.S.-only labor costs), with few or none of the deductions currently available in the tax code. The plan is said to be “destination-based” and “border adjusted” because *revenue from domestic sales is counted toward profits, but the revenue from export sales is not, and while the cost of domestic materials is a deductible cost, the cost of imported*

materials is not. Thus, there is no tax on U.S. products destined for export. On the other hand, a U.S. manufacturer would receive no tax deduction for the cost of imported materials used in manufacturing. Similarly, a U.S. retailer would pay tax on the full amount of its domestic sales of imported products, without any deduction for the cost of the imported materials. The likely result is a lower price for U.S. exports, and higher prices paid by American consumers for imported products. Large U.S. exporters support the plan and American retailers and consumer groups do not. The arguments of economists are far-ranging.

- Do you think the tax plan is permissible under GATT Article III? Why or why not?
- The *WTO Agreement on Subsidies and Countervailing Measures* prohibits, “The . . . exemption, remission or deferral specifically related to exports, of direct taxes. . . .” It defines “direct taxes” as “. . . taxes on wages, profits, interests, rents, royalties, and all other forms of income” Do you think this tax plan might be a prohibited subsidy? Why or why not?

6. The WTO is a multilateral trade organization with member nations from all regions of the world. The majority are developing countries. The WTO agreements permit countries to enter into bilateral or regional trade pacts, or to create free trade areas and customs unions. Yet a free trade area only has free trade between the countries that belong to it.

- How does the concept of a free trade area, such as the *North American Free Trade Agreement (NAFTA)* or any other regional FTA, fit into the WTO global framework? Do bilateral pacts or regional free trade areas violate the principles of nondiscrimination and MFN trade? Do they violate the spirit of the WTO, or do they actually contribute to its goals?
- Why do you think many countries have entered into bilateral and regional trade agreements since the inception of the WTO in 1995, thus bypassing the WTO structure?

Managerial Implications

Your firm designs, manufactures, and markets children’s toys for sale in the United States. Almost 90 percent of your production is done in the People’s Republic of China. During the 1990s, U.S. relations with China improved. Even though there were many disagreements between the two countries, the United States granted normal trade status to China and supported China’s membership in the WTO in 2001. Your firm invested heavily in China during that time. You have developed close ties to Chinese suppliers and have come to depend greatly on inexpensive Chinese labor and the lower costs of doing business there.

You are now concerned about increasing political tension between China and the United States over a variety of issues: Reports of the use of prison labor in China to manufacture goods for export, accusations of China engaging in industrial espionage in the United States to obtain scientific and trade secrets, and of hacking into corporate and government computer networks. There are disagreements over China’s censorship of Internet search providers, over the protection of U.S. intellectual property rights in China, and over China’s relations with communist North Korea. The United States also accuses China of currency manipulations of the yuan, making



Chinese goods unfairly cheap in foreign markets and imports into China artificially expensive. China's geopolitical and military expansion in the South China sea is of concern to the United States. Most worrisome is the potential for conflict over Taiwan, with which the United States has had a mutual defense pact for 60 years. China claims Taiwan under its "One China" reunification policy, while accusing the United States of fostering "independence" there. Despite the issues, both countries recognize their deep economic reliance on each other. With that background, consider the following:

1. Describe the impact that a trade dispute between the United States and China would have on your firm.
2. Describe the impact on your firm if China were to lose its MFN trading status. Do you think that is likely to happen? Why or why not?
3. What strategic actions might you consider to reduce your firm's exposure to political risk?
4. What are the current areas of agreement or disagreement between the United States and China, and how do you think they will affect future trade relations between the two countries?
5. The United States often links its trade policy with its foreign policy. Do you agree with this? What do you think of U.S. trade policies toward China being linked to foreign policy issues?
6. Although both mainland China and Taiwan are "Chinese," doing business in Taiwan differs greatly from doing business in China. Investigate and describe that difference. How do business opportunities differ on the mainland versus the island?
7. Explain the importance of sound country risk analysis in doing business abroad. What sources of information do you think you would use to evaluate your international business strategies in China?

Ethical Considerations

How do you reconcile free trade with the protection of cultural diversity? Free trade in goods and services means that a country will necessarily open itself to foreign influences. Just look at the impact of American fast-food restaurants, hotels, and large retail outlets on the American landscape and on small-town America. Now imagine the influence of American companies and American culture in foreign countries. Consider the long-term impact of American music and film on the indigenous culture of a foreign country. Despite these impacts, free trade agreements mandate the opening of local markets to foreign goods, services, and advertising, including music and film. The French, as well as French-Canadians, are notorious for trying to manipulate trade rules to preserve their French language and French culture. Examples might include limits on foreign advertising, television programming, or films. Consider the *Convention on the Protection and Promotion of the Diversity of Cultural Expressions*, which has been ratified or approved by 144 nations and entered into force in 2007. The Convention states:

Nations may adopt measures aimed at protecting and promoting the diversity of cultural expressions within its territory. Such measures may include (a) regulatory measures aimed at protecting and promoting diversity of cultural expressions; (b) measures that, in an appropriate manner, provide opportunities for domestic cultural activities, goods and services among all those available within the national territory for the creation,

production, dissemination, distribution and enjoyment of such domestic cultural activities, goods and services, including provisions relating to the language used for such activities, goods and services.

In addition, a country may take "all appropriate measures to protect and preserve cultural expressions" that are "at risk of extinction, under serious threat, or otherwise in need of urgent safeguarding."

The United States is not a party to the Convention. In response to the Convention, the U.S. State Department stated, "The United States is a multicultural society that values diversity . . . Governments deciding what citizens can read, hear, or see denies individuals the opportunity to make independent choices about what they value."

1. Do you feel that countries should limit the influence of foreign cultures in their communities? How should they do that? Do you think that a country should restrict the foreign content of advertising, television, music, or film?
2. Do you think that this Convention might be used as a means of restricting trade in the guise of protecting cultural expressions and national identity?
3. Reconcile the terms of this convention with principles of free trade. What will be the effect on trade in audiovisual products? How would American industry respond?



CHAPTER 10

Laws Governing Access to Foreign Markets

In Chapter 9, you learned that one of the pillars of world trade law is that companies should have non-discriminatory access to foreign markets and customers, unimpeded by artificial import barriers or local regulations that discriminate against foreign goods or services without justification. However, few of us would disagree that governments have an important role in protecting public health, safety, and welfare, and in the economic well-being of their people and of certain critical industries. We accept government's role in preventing the spread of human disease; in setting standards for occupational health and safety; in protecting plant, animal, and marine life; in protecting air, water, and natural resources; in protecting its public utilities, and its defense and health industries; and in assuring viable farms and an agricultural base that feeds a nation. But, consider what happens when national laws or regulations, intended for the public welfare, are used instead as a barrier to foreign goods and services to protect domestic industry from foreign competition. Consider how this might affect your firm's "market access" to foreign customers and business partners, and how are these conflicts resolved? These are the questions covered in this chapter.

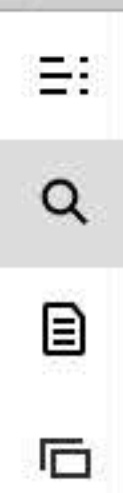
We will look at specific WTO **market access agreements**—agreements that provide exporters of goods and services with market access to foreign countries in the following areas: (1) technical barriers to trade, including local or national standards that products must meet before they can be sold in a market; (2) government procurement of goods and services; (3) trade in services, including consulting, engineering, banking and financial services, insurance, telecommunications, and the professions; (4) trade in agricultural products; (5) trade-related investment measures; and (6) trade-related aspects of intellectual property rights. As you read, consider how a nation balances its sovereign right to protect the public welfare through government regulation while abiding by world trade

rules that cede some of its authority to international dispute resolution panels. The chapter concludes with a look at the U.S. response to foreign trade barriers that deny access to U.S. products and services or that treat U.S. firms unfairly. This includes U.S. laws that permit retaliation against illegal foreign trade barriers, the legal authority granted to the president of the United States by statute, and to the role of government departments and agencies.

THE GENERAL PRINCIPLE OF LEAST RESTRICTIVE TRADE

We begin with one of the broadest and most important legal concepts in the body of international trade law: the principle of **least restrictive trade**. The principle states that WTO member countries, in setting otherwise valid restrictions on trade, shall make them no more onerous than necessary to achieve the goals for which they were imposed. For example, if a country requires inspections of foreign fruit arriving from countries affected by a plant disease, the inspection procedures must be no more arduous, rigorous, or expensive than is needed to achieve those ends. They may not be a trade barrier in disguise.

A corollary is that national laws and regulations passed for purely internal purposes, such as the protection of the general health, welfare, and safety, must also pose the fewest barriers to trade as possible. This principle is relevant to all types of regulations: health codes, environmental regulations, worker safety laws, and uniform technical specifications for a wide range of industrial or consumer products. Examples might include laws regulating the sale of alcohol or tobacco or banning the sale of beef containing growth hormones, genetically modified foods, or toxic lead paint. It might include testing requirements for the fire resistance of fabrics or



the safety of children's toys or set mandatory standards for the practice of law or medicine. The list is endless; the concept is the same. Countries may protect their citizens to the extent they deem necessary but must choose those methods that do not unduly burden international trade and/or single out foreign goods or service providers for unfair or discriminatory treatment.

The WTO Appellate Body has stated that this is a balancing test: nations must weigh the necessity of protecting the public against restrictions on free trade.

The principle of least restrictive trade appears throughout the *General Agreement on Tariffs and Trade* (GATT) and other WTO agreements, and applies to most of the discussions in this chapter.

The following case, *Thailand—Restrictions on Importation of Cigarettes* (1990), is an early GATT panel decision that the WTO Appellate Body still cites. It considers Thailand's options for reducing tobacco use. As you read, consider reviewing the GATT/WTO national treatment provisions in Chapter 9.



Thailand—Restrictions on Importation of Cigarettes

Report of the Dispute Settlement Panel, DS10/R, BISD, 37th Supp. 200 (1990)
General Agreement on Tariffs and Trade, Geneva

BACKGROUND AND FACTS

The Royal Thai government maintains restrictions on imports of cigarettes. The *Tobacco Act of 1966* prohibited the import of all forms of tobacco except by license of the director-general of the Excise Department. Licenses have only been granted to the government-owned Thai Tobacco Monopoly, which has imported cigarettes only three times since 1966. None had been imported in the ten years prior to this case. The United States requested the panel to find that the licensing of imported cigarettes by Thailand was inconsistent with GATT Article XI and could not be justified under Article XX(b) since, as applied by Thailand, the licensing requirements were more restrictive than necessary to protect human health. Thailand argued that cigarette imports were prohibited to control smoking and because chemicals and other additives contained in American cigarettes might make them more harmful than Thai cigarettes.

REPORT OF THE PANEL ADOPTED ON
7 NOVEMBER 1990

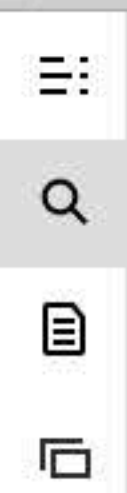
The Panel, noting that Thailand had not granted licenses for the importation of cigarettes during the past ten years, found that Thailand had acted inconsistently with Article XI:1, the relevant part of which reads: "No prohibitions or restrictions . . . made effective through . . . import licenses . . . shall be instituted or maintained by any [country] on the importation of any product of the territory of any other [country]. . ."

The Panel proceeded to examine whether Thai import measures affecting cigarettes, while contrary to Article XI:1, were justified by Article XX(b), which states in part:

[N]othing in this Agreement shall be construed to prevent the adoption or enforcement by any [country] of measures: . . . (b) necessary to protect human, animal or plant life or health.

The Panel then defined the issues which arose under this provision . . . [The] Panel accepted that smoking constituted a serious risk to human health and that consequently measures designed to reduce the consumption of cigarettes fell within the scope of Article XX(b). The Panel noted that this provision clearly allowed [countries] to give priority to human health over trade liberalization; however, for a measure to be covered by Article XX(b) it had to be "necessary" . . .

The Panel concluded from the above that the import restrictions imposed by Thailand could be considered to be "necessary" in terms of Article XX(b) only if there were no alternative measure consistent with the GATT Agreement, or less inconsistent with it, which Thailand could reasonably be expected to employ to achieve its health policy objectives. The Panel noted that [countries] may, in accordance with Article III:4 of the GATT Agreement, impose laws, regulations and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use of imported products provided they do not thereby accord treatment to imported products less favourable than that accorded to "like" products of national origin. The United States argued that Thailand could achieve its public health objectives through internal measures consistent with Article III:4 and that the inconsistency with Article XI:1 could therefore not be considered to be "necessary" within the meaning of Article XX(b). The Panel proceeded to examine this issue in detail. * * *



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

The Panel then considered whether Thai concerns about the quantity of cigarettes consumed in Thailand could be met by measures reasonably available to it and consistent, or less inconsistent, with the GATT Agreement. The Panel first examined how Thailand might reduce the demand for cigarettes in a manner consistent with the GATT Agreement. The Panel noted the view expressed by the World Health Organization (WHO) that the demand for cigarettes, in particular the initial demand for cigarettes by the young, was influenced by cigarette advertisements and that bans on advertisement could therefore curb such demand. At the Forty-third World Health Assembly a resolution was approved stating that the WHO is: "Encouraged by . . . recent information demonstrating the effectiveness of tobacco control strategies, and in particular . . . comprehensive legislative bans and other restrictive measures to effectively control the direct and the indirect advertising, promotion and sponsorship of tobacco."

A ban on the advertisement of cigarettes of both domestic and foreign origin would normally meet the requirements of Article III:4 . . . The Panel noted that Thailand had already implemented some non-discriminatory controls on demand, including information programmes, bans on direct and indirect advertising, warnings on cigarette packs, and bans on smoking in certain public places.

The Panel then examined how Thailand might restrict the supply of cigarettes in a manner consistent with the GATT Agreement. The Panel noted that [countries] may maintain governmental monopolies, such as the Thai Tobacco Monopoly, on the importation and domestic sale of products. The Thai Government may use this monopoly to regulate the overall supply of cigarettes, their prices and their retail availability provided

it thereby does not accord imported cigarettes less favourable treatment than domestic cigarettes or act inconsistently with any commitments assumed under its Schedule of Concessions. * * *

For these reasons the Panel could not accept the argument of Thailand that competition between imported and domestic cigarettes would necessarily lead to an increase in the total sales of cigarettes and that Thailand therefore had no option but to prohibit cigarette imports.

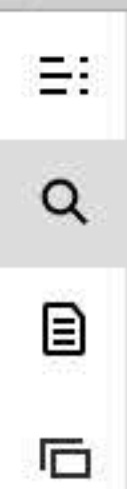
In sum, the Panel considered that there were various measures consistent with the GATT Agreement which were reasonably available to Thailand to control the quality and quantity of cigarettes smoked and which, taken together, could achieve the health policy goals that the Thai government pursues by restricting the importation of cigarettes inconsistently with Article XI:1. The Panel found therefore that Thailand's practice of permitting the sale of domestic cigarettes while not permitting the importation of foreign cigarettes was an inconsistency with the GATT not "necessary" within the meaning of Article XX(b).

Decision. The licensing system for cigarettes was contrary to Article XI:1 and is not justified by Article XX(b). The panel recommended that Thailand bring its laws into conformity with its obligations under the GATT.

Comment. GATT Article XVII permits a country to create state agencies and "marketing boards" that have the authority to import and export goods. The Thai Tobacco Monopoly is an example. Developing countries often use state trading enterprises that often have the exclusive right to import or export certain classifications of goods. Products traded by state enterprises might include foodstuffs, medicines, liquor, or, as in this case, tobacco. Article XVII requires that state enterprises not discriminate against the purchase of foreign goods or treat them differently than domestic goods.

Case Questions

1. What reasons did Thailand give for restricting imports of cigarettes? What GATT provision did Thailand rely on to restrict cigarette imports?
2. The panel states that GATT permits countries to give priority to human health over trade liberalization only under certain conditions. What are those conditions?
3. How was the doctrine of "least restrictive trade" used in this case?
4. What alternative means could Thailand have used to achieve its objectives that would have not singled out imported cigarettes for discriminatory treatment?



TECHNICAL BARRIERS TO TRADE

A **technical regulation** is a law or regulation affecting a product's characteristics—such as its performance, design, construction, chemical composition, materials, packaging, or labeling—that must be met before a product can be imported or sold in a country. A **product standard**, also called a “standard” in this chapter, is usually used when referring to a voluntary guideline for product characteristics established by a recognized private or industry organization or association. However, even when a standard is voluntary, many consumers may look for the seal of compliance in making a purchasing decision. We caution against over reliance on the differences between the terms “technical regulation” and “standard” as they are sometimes used interchangeably. In some countries “standards” can also be mandatory. Technical regulations and standards that apply to imported foreign products, even if they also apply equally to domestic products, are called **technical barriers to trade**.

The Protection of Public Health, Safety, or Welfare

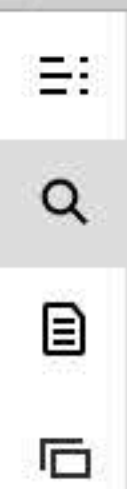
Almost all products are subject to technical regulations or standards set by either government regulators or private standard-setting groups. They are generally imposed for the protection of public health, safety, or welfare to promote uniform design, engineering, and performance standards or to ensure product quality or purity. Examples are standards for the safe design of consumer goods, for automotive safety, vehicle emissions, or fuel economy, for safe foods and pharmaceuticals, standards of weights and measures, or worker safety standards for machinery and industrial equipment. Other standards protect consumers from fraud or deception (such as labels that disclose the product's content or warn of safe uses); impose environmental criteria on appliances and other products, such as restrictions on ozone-damaging refrigerants or eliminating dangerous formaldehyde or heavy metals from bed linens, carpeting, or construction materials; set packaging requirements for products such as plastic bottles that aid in recycling or for energy efficiency; require technical specifications standardizing electrical power and telecommunications, building and construction standards, such as common sizes for lumber and building materials, standards for barcodes and barcode readers, and many others. Imagine multinational

companies such as Ford, General Electric, Electrolux, or Bosch-Siemens and the incredibly diverse product standards they must meet in each country in which their products are sold.

Product Testing, Inspections, and Certifications. Most countries require some type of testing, inspection, or certification of regulated products. There are two major regulatory approaches: **prior approval** and **prior certification**. In “prior approval” countries, regulated products must undergo testing and inspection by an approved laboratory, receive a certification of compliance with technical standards, and then receive prior regulatory approval before sale. In other countries, regulated products need only undergo testing or inspection and certification. The testing lab's certification remains on file with the manufacturer or importer, and no regulatory approval is needed prior to import or domestic sale.

Different countries have different philosophies and thus take different approaches. For instance, in the United States, the *U.S. Flammable Fabrics Act* places technical restrictions on the sale of all bed mattresses. The law is administered through regulations of the Consumer Products Safety Commission. Six prototypes of a given mattress are subjected to a controlled cigarette burn test under laboratory conditions to determine whether they meet federal safety requirements. If the length of the char is longer than allowed or if the mattress ignites, then it does not pass. Manufacturers usually arrange to have independent laboratories perform the tests. They are required to keep photographs and records of the results at their places of business and to make them available to retailers, customers, or agency regulators who request them. Importers are also subject to these regulations; any of their products entering into the United States must meet these standards. If they cannot produce the certification, their goods will be denied entry or removed from stores. Thus, certification and compliance are required, but advance regulatory approval is not. Foreign manufacturers and importers alike must be familiar with the regulatory systems of the countries where their products will be sold.

Foreign inspection and testing requirements can prove to be a tremendous barrier to trade. This is especially true if the product has a short shelf-life, as with produce or other food products, or a short technological life (semiconductors or computer parts). In 1989, the European Communities complained that the United States was delaying the inspection of perishable products by



making them wait in turn behind nonperishable goods such as steel products, causing the perishables to spoil in the process. It was necessary to dump entire shipments of citrus fruit from Spain without any compensation to the importer. Any company that does business internationally must constantly be aware of changes in technical regulations and standards affecting their products.

Transparency. When something is said to be “transparent,” it is clear, visible, and open to sight. In the regulatory context, **transparency** refers to the extent to which government regulations (including customs and import procedures, as well as technical regulations, product standards, and others) are made readily available to the public, including foreign firms. A government regulation that is not published in a form where the public has fair and equal access, or that is made available only to select companies or individuals, or that is based on the arbitrary “whim” of a government employee, is not transparent. Without transparency, foreign firms are often unable to comply or compete. Indeed, many foreign firms never learn of foreign technical barriers or other regulations until it is too late—only after their shipments to customers are turned away by foreign customs inspectors, tax authorities, or regulators. Another problem is that foreign companies are generally not involved in the standard-setting process. Domestic firms often participate in local public hearings, in developing and writing regulations or standards, but without local branches or subsidiaries foreign firms are not. Thus, they are often delayed in learning of regulatory changes, or in adapting their products for foreign sale until they run into difficulty in transporting goods across national borders. Some countries also require inspections of the foreign factories where products are made (e.g., food or drugs), or advance approval of certifying laboratories. This creates an extremely expensive and lengthy design, manufacturing, marketing, and distribution process.

Exporters and multinational firms must constantly be alert for regulatory changes wherever they do business. The U.S. Department of Commerce maintains a collection of international standards so that U.S. exporters will have access to foreign technical regulations and standards applicable to their industries. Foreign government websites offer guidance and information on import procedure, technical regulations, tax regulations, customs clearance, and more. The WTO and other organizations, including industry trade groups, can be a source of additional information.

European Union Standards and Technical Regulations

The problem of technical barriers is critical to firms operating in the European Union (EU), where national standards vary tremendously. Consider the impact of national standards on a firm such as Phillips, a Dutch multinational electronics company, which has had to manufacture products to conform to dozens of different standards. The standards policy of the EU is designed to balance the health and safety interests of member countries with the need for the free flow of goods. Despite decades of work by the EU Commission to reduce technical barriers to trade, thousands of new national standards have arisen. Even after years of debating, detailed standards for thousands of products, companies wishing to sell their products in Europe still face a maze of complex regulations, applicable to a wide range of products from beer to hair dryers and automobiles to plywood. However, EU countries understand that uniform standards are essential to a unified market.

It is interesting that technical regulations imposed in a large, important market and considered popular by consumers can have global consequences. For example, in 2013 the EU instituted a ban on the import or sale of all cosmetics that were tested on animals (for cruelty reasons). That move seems to have spurred a change in practices by many global cosmetic firms affecting the sale of their products worldwide.

Many opinions of the European Court of Justice reflect the EU’s effort to reduce technical barriers. In one case, arising over the sale of liquor made in France and sold in Germany, the Court ruled that an EU member country could not prohibit the sale of a product produced in another EU member country when that product had already met the technical specifications of the producing country.

In decisions handed down in the 1980s, the Court rejected attempts by two EU countries to protect centuries-old industries. Disregarding consumer protection arguments, the Court of Justice struck down Germany’s beer purity law, which had kept out foreign beers containing preservatives and required that beer only be made from wheat, barley, hops, and yeast (beer made in other European countries often contains rice and other grains). The Court also struck down Italy’s pasta content regulations. In one long-standing dispute with the United States, the EU prohibited the import of beef containing growth hormones. Because these hormones are widely used in the United States, U.S. beef was kept out of European markets.



Standard setting in the EU for nonelectrical products is a focus of the European Committee for Standardization. This intergovernmental agency works with manufacturers, including some European subsidiaries of U.S. firms, and with scientists to develop workable product standards. When adopted by directive of the European Council, the standards become legally binding for products sold in Europe.

The EU has attempted to increase its standardization through the **CE Mark** (CE means *Conformité Européenne*). The CE Mark is an internationally recognized symbol for quality and product safety for many different types of products, such as children's toys, gas appliances, machinery, and medical and electrical equipment. European manufacturers seeking the mark are inspected and audited by an EU-authorized body, and an independent laboratory must test their products. Once a European manufacturer receives the mark, it may sell its products throughout the EU without undergoing inspections in each individual country. Manufacturers outside the EU may submit their products to independent laboratories for testing before attaching the CE Mark. The U.S. government estimates that soon half of the U.S. products shipped to Europe will require CE Mark compliance.

Japanese Standards and Technical Regulations

U.S. and other non-Japanese firms have lodged many complaints against Japan's technical barriers to trade, most of which involve unreasonable and burdensome inspection procedures or import licensing requirements and the arbitrary enforcement of overly strict standards. Japan maintains complex technical regulations on thousands of important products, including electrical appliances, telecommunications and medical equipment, lumber, electronic components, pharmaceuticals, and food. The prolific use of technical requirements in Japan is rooted in Japan's protective attitude toward consumers, the historical role of the Japanese government in economic life, and the Japanese people's acceptance of governmental regulation of business. Product standards in Japan have generally taken the form of **design standards**—characteristics that govern how a product should be designed. U.S. standards, by contrast, are usually based on **performance standards** that describe how products should function. It is usually more cost-effective for a manufacturer to meet foreign

performance standards than design standards. Thus, it is easier for Japanese manufacturers to meet U.S. performance standards than for U.S. manufacturers to meet Japanese design standards. In Japan, products capable of inflicting injury on consumers or products that affect public health are more highly regulated than other products. For example, for many years Japan banned the import of cosmetics containing colorants and preservatives for health reasons, despite the approved use of the ingredients in the United States.

Japanese agencies that enforce technical regulations include the Japanese Ministry of Economy, Trade, and Industry, which has the widest authority, and the ministries that oversee the health, agriculture, and transportation sectors. Many products require testing and prior approval before they can be sold in Japan. For instance, prior to the mid-1980s, foreign products could not be inspected for preclearance at the foreign factory but could only be inspected, shipment by shipment, as they arrived in Japan. Items had to be individually inspected and tested for compliance with the applicable technical regulations or standards. Legal changes have now made it possible for a foreign firm to register with the appropriate regulatory ministry and to obtain advance product approval without going through a Japanese importer or intermediary.

Another problem occurs when Japanese technical regulations and standards lack transparency. Their agencies still generally do not permit foreign input into the drafting of the regulations, although on occasion U.S. industry groups, under pressure, have succeeded in being heard by Japanese standard-setting groups. The Japan External Trade Organization (JETRO) maintains an online database of standards and technical regulations in the areas of food and plant safety, electronic products and electrical appliances, household goods, consumer and industrial products, chemicals, food imports, and others. The Japanese Standards Association works to develop and disseminate standards in many areas.

The symbol of an approved product in Japan is the government-authorized **Japan Industrial Standards Mark or JIS Mark**. Its appearance on a product, although voluntary, indicates that the manufacturer has submitted to on-site inspections by the appropriate Japanese ministry and has met accepted standards for quality control, production techniques, and research methods. Because of this mark's wide recognition, foreign products without it are often not competitive in the Japanese market.



Chinese Standards and Technical Regulations

China has a complex regulatory system governing product quality, safety, and other standards and technical regulations. As a socialist country, the enormous bureaucracy dwarfs any similar agencies in Western countries. China's General Administration of Quality Supervision, Inspection, and Quarantine (AQSIQ) has 19 major departments, 15 national institutes and research centers, 35 inspection and quarantine bureaus in 31 provinces, 500 branches and local offices across the country, and over 30,000 employees at Chinese seaports, airports, and other ports of entry. Over 180,000 employees work for provincial or municipal bureaus in developing and enforcing quality and standards laws. These bureaus are also responsible for enforcing Chinese laws against counterfeit products. Ten industry trade associations are allied with AQSIQ in setting standards and technical regulations. Just imagine the difficulties a Western company might have in trying to navigate the Chinese market, move goods through China, or work with a Chinese government agency without local representation.

China enforces its product quality standards through compulsory product testing, factory inspections and certifications, and by the accreditation of testing laboratories. The country's compulsory certification and inspection system covers thousands of consumer and industrial products. Chinese rules require that covered products receive certification prior to import. Companies must ship product samples to approved laboratories in China for inspection and testing for compliance with Chinese quality, safety, and environmental standards. Chinese inspectors must then visit the foreign plants, whether they are in the United States, Canada, or Europe, that produce goods destined for China. Products that meet the quality and safety requirements for certification may receive the **China Compulsory Certification Mark or CCC Mark**. China will not accept imports of covered products without the mark. Under the regulations, fines may be imposed for falsification of marks. Anyone who plans to export goods to China should check the AQSIQ and CCC Mark websites to determine whether Chinese regulations cover their products. The Chinese certification process can be expensive and time consuming. Follow-up supervision and reviews are

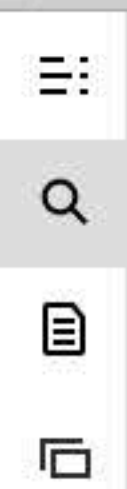
conducted annually. Many companies wishing to ship to China find that they must employ a consulting firm to manage the certification process. Many of the regulations, such as those related to human health, apply to all travelers to China.

The **American National Standards Institute (ANSI)** maintains an online "standards portal" that gives firms access to English translations of standards and technical regulations in China, India, and Korea, as well as various U.S. standards in English, Mandarin Chinese, and Korean.

The WTO Agreement on Technical Barriers to Trade

The *WTO Agreement on Technical Barriers to Trade (TBT Agreement)* is one of the 1994 Uruguay Round agreements. It governs the use of technical regulations, product standards, testing, and certifications by WTO member countries. The *TBT Agreement* is binding on all WTO member countries. Remember that this agreement does not contain standards of its own. It makes no attempt to say how a product should perform or be designed or when a product is safe or unsafe. These are matters for nations and governments to decide. But the *TBT Agreement* does prohibit countries from using their regulations or standards to discriminate against the import of foreign goods.

Harmonization, Equivalence, and Mutual Recognition. The primary goal of the *TBT Agreement* is to minimize technical barriers to trade. It sets out three methods of achieving this goal. The first is *harmonization*, by which nations attempt to bring their standards and technical regulations into harmony with internationally accepted standards. The second is *equivalence*, by which nations agree to accept foreign standards that are functionally equivalent to their own. The third is *mutual recognition*. Nations are encouraged to enter into mutual recognition agreements, whereby they recognize the certifications, or **conformity assessments**, of foreign inspection firms and laboratories approved in the country where the article is manufactured. For example, if a manufacturer ships telephones to several different markets, it would be far cheaper if all countries accepted the certification of an inspection firm in the manufacturer's country that the device conforms to the telecommunications standards in the importing country. This avoids the expense of having to perform multiple tests.



Main Provisions of the TBT Agreement. The WTO *Agreement on Technical Barriers to Trade* applies to all products, including agricultural, industrial, and consumer goods. An outline of the agreement's main provisions follows:

1. All technical regulations shall be applied on a non-discriminatory basis, without regard to the national origin of the products.
 2. Technical regulations must not be made or applied to create an unnecessary obstacle to trade, and they must not be more trade restrictive than necessary to fulfill a legitimate objective such as national security, preventing fraud or deception of consumers, protecting public health or safety, or protecting the environment.
 3. Countries should take into account available scientific and technical information in writing their standards. This provision is intended to ensure that standards are not just made to keep out foreign goods, but have some scientific foundation.
 4. Wherever possible, performance abilities of the product rather than on design or descriptive characteristics should be the basis for product requirements. For example, there are several different mechanisms in use to hold automobile doors securely closed. Government regulations that require industry to use a mechanism of a certain type or design are creating a barrier to trade. Instead, the agreement encourages governments to set a performance standard requiring that the door remain securely closed during certain collisions, leaving the design up to the manufacturer.
 5. Countries should develop and use internationally accepted standards where they exist. International standards will be presumed to be in compliance with the *TBT Agreement*.
 6. Countries should work toward the goals of harmonization of standards and equivalence.
 7. Proposed standards must be published and made available to foreign countries, and those countries must be given an opportunity to make written comments prior to adoption.
 8. Final regulations must be published a reasonable time before they become effective so that foreign producers have time to adapt their products.
 9. Testing and inspection procedures should restrict trade as little as possible and should not discriminate. The agreement encourages on-site factory inspections instead of port-of-entry inspections for foreign goods.
 10. Nations should accept the testing reports and certifications from approved foreign inspection firms and laboratories (mutual recognition of conformity assessments).
 11. Countries should try to ensure that state and local governments, as well as private standard-setting groups, comply with the agreement.
 12. Disputes between countries may be referred to the WTO for negotiation and settlement.
- The following case, *WTO Report of the Appellate Body on Measures Affecting the Production and Sale of Clove Cigarettes*, discusses the nondiscrimination provisions of the *TBT Agreement*, and pits one nation's effort to protect public health with its commitments to follow international trade rules.



United States—Measures Affecting the Production and Sale of Clove Cigarettes

Report of the Appellate Body WT/DS406/AB/R (2012) World Trade Organization

BACKGROUND AND FACTS

The United States has long sought ways to reduce smoking by children. In 2009 the United States enacted the *Family Smoking Prevention and Tobacco Control Act* [the Act] that prohibited the import or sale of cigarettes with any flavor, herb, or spice, including fruit, chocolate, cinnamon, and clove. Of course, menthol cigarettes are produced primarily in the United States, whereas clove cigarettes are produced primarily in Indonesia. This is a complaint by the government of Indonesia

that the ban on clove-flavored cigarettes unlawfully discriminated against flavored tobacco products made in other countries. The United States claimed that it had excluded menthol from the regulations, despite the fact that menthol is also known to make cigarettes more appealing to adolescents, because it feared withdrawal by menthol smokers, and by the likely creation of a black market in menthol cigarettes. After consultations at the WTO, Indonesia requested dispute panel resolution. The panel held that the United States had acted in



violation of Article 2.1 of the *Agreement on Technical Barriers to Trade* (TBT Agreement), and the United States appealed to the Appellate Body.

REPORT OF THE APPELLATE BODY

Article 2.1 of the *TBT Agreement* provides that, with respect to their central government bodies:

Members shall ensure that in respect of technical regulations, products imported from the territory of any Member shall be accorded treatment no less favourable than that accorded to like products of national origin and to like products originating in any other country.

Article 2.1 of the *TBT Agreement* contains a national treatment and a most favoured nation treatment obligation. In this dispute, we are called upon to clarify the meaning of the national treatment obligation. For a violation of the national treatment obligation in Article 2.1 to be established, three elements must be satisfied: (i) the measure at issue must be a technical regulation; (ii) the imported and domestic products at issue must be like products; and (iii) the treatment accorded to imported products must be less favourable than that accorded to like domestic products. The United States’ appeal concerns only the second and the third elements of this test . . . [T]he determination of likeness under Article 2.1 of the *TBT Agreement* is a determination about the nature and the extent of a competitive relationship between and among products, and that the regulatory concerns that underlie a measure may be considered to the extent that they have an impact on the competitive relationship. * * *

[W]here the technical regulation at issue does not *de jure* discriminate against imports, the existence of a detrimental impact on competitive opportunities for the group of imported vis-à-vis the group of domestic like products is not dispositive of less favourable treatment under Article 2.1. Instead, a panel must further analyze whether the detrimental impact on imports stems exclusively from a legitimate regulatory distinction rather than reflecting discrimination against the group of imported products. In making this determination, a panel must carefully scrutinize the particular circumstances of the case, that is, the design, architecture, revealing structure, operation, and application of the technical regulation at issue, and, in particular, whether that technical regulation is even-handed, in order to determine whether it discriminates against the group of imported products.

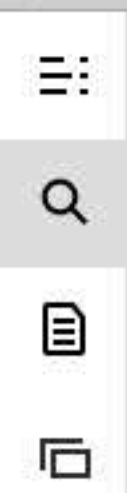
Given the above, the design . . . and application of [the Act] strongly suggest that the detrimental impact on competitive opportunities for clove cigarettes reflects discrimination against the group of like products imported from Indonesia. The products that are prohibited under [the Act] consist primarily of clove cigarettes imported from Indonesia, while the like products that are actually permitted under this measure consist primarily of domestically produced menthol cigarettes.

Moreover, we are not persuaded that the detrimental impact of [the Act] on competitive opportunities for imported clove cigarettes does stem from a legitimate regulatory distinction. We recall that the stated objective of [the Act] is to reduce youth smoking. One of the particular characteristics of flavoured cigarettes that makes them appealing to young people is the flavouring that masks the harshness of the tobacco, thus making them more pleasant to start smoking than regular cigarettes. To the extent that this particular characteristic is present in both clove and menthol cigarettes, menthol cigarettes have the same product characteristic that, from the perspective of the stated objective of [the Act], justified the prohibition of clove cigarettes. Furthermore, the reasons presented by the United States for the exemption of menthol cigarettes from the ban on flavoured cigarettes do not, in our view, demonstrate that the detrimental impact on competitive opportunities for imported clove cigarettes does stem from a legitimate regulatory distinction. The United States argues that the exemption of menthol cigarettes from the ban on flavoured cigarettes aims at minimizing: (i) the impact on the U.S. health care system associated with treating “millions” of menthol cigarette smokers affected by withdrawal symptoms; and (ii) the risk of development of a black market and smuggling of menthol cigarettes to supply the needs of menthol cigarette smokers. Thus, according to the United States, the exemption of menthol cigarettes from the ban on flavoured cigarettes is justified in order to avoid risks arising from withdrawal symptoms that would afflict menthol cigarette smokers in case those cigarettes were banned. We note, however, that the addictive ingredient in menthol cigarettes is nicotine, not peppermint or any other ingredient that is exclusively present in menthol cigarettes, and that this ingredient is also present in a group of products that is likewise permitted under [the Act], namely, regular cigarettes. Therefore, it is not clear that the risks that the United States claims to minimize by allowing menthol cigarettes to remain in the market would materialize if menthol cigarettes were to be banned, insofar as regular cigarettes would remain in the market.

Therefore, even though [the Act] does not expressly distinguish between treatment accorded to the imported and domestic like products, it operates in a manner that reflects discrimination against the group of like products imported from Indonesia. Accordingly, despite our reservations on the brevity of the Panel’s analysis, we agree with the Panel that, by exempting menthol cigarettes from the ban on flavoured cigarettes [the Act] accords to clove cigarettes imported from Indonesia less favourable treatment than that accorded to domestic like products, within the meaning of Article 2.1 of the *TBT Agreement*. * * *

While we have upheld the Panel’s finding that the specific measure at issue in this dispute is inconsistent with Article 2.1 of the *TBT Agreement*, we are not saying

continues



continued

that a Member cannot adopt measures to pursue legitimate health objectives such as curbing and preventing youth smoking. In particular, we are not saying that the United States cannot ban clove cigarettes; however, if it chooses to do so, this has to be done consistently with the *TBT Agreement*. Although [the Act] pursues the legitimate objective of reducing youth smoking by banning cigarettes containing flavours and ingredients that increase the attractiveness of tobacco to youth, it does so in a manner that is inconsistent with the national treatment obligation in Article 2.1 of the *TBT Agreement* as a result of the exemption of menthol cigarettes, which similarly contain flavours and ingredients that increase the attractiveness of tobacco to youth, from the ban on flavoured cigarettes.

Decision. The U.S. regulation is not justified. The *TBT Agreement* prohibits technical regulations that treat imported products less favorably than "like products" of domestic origin. Clove-flavored cigarettes and menthol-flavored cigarettes are "like products" due to their competitive relationship in the marketplace. The less favorable treatment accorded flavored cigarettes from Indonesia was not justified by a "legitimate regulatory distinction."

Comment. The Dispute Settlement Body requested the United States to remove the ban on clove cigarettes, and if

it did not, Indonesia was authorized to impose \$15 million in trade sanctions on U.S. exports to Indonesia.

Case Questions

1. Did the U.S. prohibition on clove cigarettes prohibit the import of Indonesian cigarettes on its face, or did it merely prohibit a flavor of cigarette that happens to be produced primarily in Indonesia? Was this *de facto* or *de jure* discrimination in this case? How did this affect the Appellate Body's decision?
2. The report (not reproduced here) noted the similarities between Article 2.1 of the *TBT Agreement*, under which this dispute was decided, and Article III.4 of GATT 1994. Review Article III.4 of GATT 1994 in the last chapter and explain the differences between the two articles. The *TBT Agreement* applies to "technical regulations" but GATT 1994 applies to a broader range of discriminatory measures. Explain.
3. What were the options left to the United States after this report? What action did the United States take in response to the report?
4. How well do you think the report balances trade liberalization with a country's need to protect public health? How well suited do you think a WTO panel is to determining matters of public health?

International Organization for Standardization

The **International Organization for Standardization** (ISO), based in Geneva, is a nongovernmental organization comprising the national standards institutes of 163 countries. It has developed over 21,000 standards for goods, services, manufacturing and technology in many industries. ISO standards are voluntary and not legally binding, and the organization has no legal authority to enforce them. However, the standards have been accepted by businesses and entire industries worldwide and are legally enforceable in countries where they have been incorporated into a treaty or into national law. In general, the standards are intended to ensure product quality, safety, efficiency, and interchangeability, although some standards have been adopted to minimize the impact of manufacturing or the use of products on the environment. Generally speaking, standards foster international business and trade, because they make it easier and cheaper to design and build products that comply with one international standard than to design products that comply with dozens of local standards. Consider the impact of ISO standards that set the

dimensions of screw threads and other fasteners, the size and dimensions of international freight containers, methods of storing data on credit cards, warning and information symbols for signs and labels, ergonomics, computer protocols, food safety management, life vests, and inflatable boats.

One of the most commonly known ISO standards is ISO 9000. Since 1987, ISO 9000 has become the standard for ensuring product quality through the product design and manufacturing process. Companies become ISO 9000-certified through a costly and rigorous inspection of their facilities and documentation of their quality control systems. They are audited on a regular basis for compliance. To sell in Europe, many U.S. firms have obtained ISO certification. By meeting ISO requirements, firms no longer have to certify each product individually in every European country.

EU law requires ISO certification for certain regulated products, such as medical devices and construction equipment. Market demands make compliance for other products equally essential. In the United States, a number of firms offer assistance to U.S. companies seeking ISO certification.



Another standard, known as ISO 14000, provides guidelines for environmental management. It does not set criteria for pollution or environmental impact. Rather, it requires that a firm establish a management system for setting its own environmental objectives, complying with national or local environmental laws, and continuing to improve its environmental performance.

GOVERNMENT PROCUREMENT

Government procurement is the purchase of goods and services by government agencies at all levels. Governments are among the largest business customers in the world. GATT contains an exception to its national treatment provision that permits government agencies to favor domestic suppliers when making purchases.

Most nations require their government agencies to give a preference to domestically made products. The laws often apply to goods purchased by defense-related agencies or by the military. Other laws might require that the purchased product contain a certain proportion of domestically made component parts or raw materials.

In the United States, the *U.S. Buy American Act* (enacted in 1933 during the Great Depression) requires federal agencies to purchase goods of U.S. origin rather than foreign-made goods. There are several exceptions. The restrictions do not apply if U.S.-made goods are not available in sufficient quantities or quality, if the U.S.-made goods are unreasonably more expensive (generally 6–12 percent higher), to purchases under \$2,500, to goods purchased for use outside the United States, where purchasing domestic goods would not be in the public's best interest, or where the terms of a trade agreement provide for nondiscrimination in procurement. There are also specific buy-American provisions in the other statutes applicable to procurement for mass transit projects and to procurement by the U.S. Department of Defense that must purchase domestic products unless those products are more than 50 percent more expensive than competing foreign goods. Most food, textiles, and apparel purchased by the Defense Department and the Department of Homeland Security must be grown or produced in the United States of entirely U.S. components.

The WTO Agreement on Government Procurement

As a general rule, large-scale procurement by governments or government agencies is exempt from the normal WTO rules for trade in goods and services. Instead, the *WTO Agreement on Government Procurement* (1994, as amended in 2014), known as AGP, governs most large-scale government procurement.

The AGP brought about many changes in procurement practices in the United States and other countries. The agreement requires fair, open, and nondiscriminatory procurement practices and sets up uniform procurement procedures to protect suppliers from different countries. It applies to the purchase of goods or services by national governments worth more than 130,000 SDR (IMF **special drawing rights**) and to construction contracts (buildings, dams, power plants, etc.) worth more than 5 million SDRs. (The SDR is the International Monetary Fund's international "reserve asset" with a value pegged to the value of a "basket" of five major currencies. The value fluctuates daily and can be obtained on the IMF's website. The SDR can be readily exchanged by governments for national currencies and lends stability to currency markets. It is a useful designator for values in international agreements like the AGP.) The AGP does not bind all WTO countries, but only to those countries that have signed and ratified it (47 countries as of 2016), including the United States, Canada, Japan, and the EU.

The AGP applies to almost 90 U.S. federal agencies, large and small—from the Department of Labor to the American Battle Monuments Commission, for example—and to the executive branch departments. There are several exclusions from the procurement rules, including purchases to be sent to foreign countries as foreign aid; purchases by the Department of Agriculture for food distribution or for farm support programs; and some purchases made by the Federal Aviation Administration, the Department of Energy, and the Department of Defense related to national security. In the United States, many states are also bound by the AGP.

Procurement Rules. The AGP reverses the general WTO rules that allow government agencies to favor domestic products. It brings the principles of MFN trade, nondiscrimination, and transparency to government procurement. A procuring agency must treat foreign suppliers equally with domestic suppliers. Moreover, a government agency may not discriminate against



local suppliers just because they are foreign-owned. The agreement also prohibits a procuring agency from awarding a contract to a foreign firm on the basis of certain conditions, called **procurement offsets**. For example, an offset might be a condition that the foreign firm awarded the contract must use local subcontractors, domestically made materials, or local labor; that the firm agree to license its technology to local firms; that the firm make local investments; or that the firm engage in countertrade. Offsets can be complex. For instance, assume that Aeroflop, a U.S. firm, wants to sell several million dollars' worth of airplanes to a government-owned airline in a European country famous for cheese. To get the contract, the firm agrees to pay a 5 percent kickback to another U.S. company, Cheezy, if Cheezy agrees to buy all of its cheese from a seller in that European country. If the cheese-producing country requires Aeroflop to make the offset, it violates the AGP.

To ensure that the procurement rules are applied fairly, the AGP sets up procedures for governments to follow. Agencies must give adequate notice to potential bidders when a procurement contract is announced and must disclose all the information necessary for foreign bidders to participate. In the event of a disagreement between a supplier and a procuring agency, a country must allow the supplier to challenge the contract before either an independent administrative review board or the courts.

In 2014, the AGP was revised to include electronic procurement as well as new provisions addressing bribery and corruption in the procurement process.

Procurement Rules in the United States. According to Congress, the responsibility for implementing the AGP lies with the president. The president may waive the requirements of the *Buy American Act* for suppliers from any country that is party to the AGP and complies with the AGP's terms in its own procurement practices. Suppliers from least-developed countries also receive the waiver, which entitles them to nondiscrimination and equal treatment with U.S. domestic suppliers.

The president must compile an annual report of those countries that have adopted the AGP but do not abide by it. The U.S. Trade Representative (USTR) negotiates with violating countries to get them to end their unfair practices and give equal access to U.S. firms. If no agreement is reached, then the USTR must present the case to the WTO for dispute settlement. If an agreement or resolution is still not reached, the president must revoke the waiver of the *Buy American Act*, and preferences for domestic suppliers will be allowed.

TRADE IN SERVICES

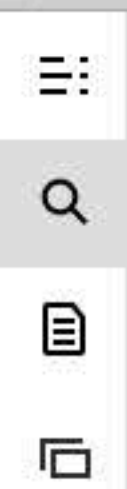
Trade in services includes areas such as global communications, travel, tourism, professional services (law, accounting, architecture, engineering, management consulting, and others), health care, transportation and distribution, finance and banking, insurance, computer and IT services, research and development, advertising, market research, entertainment, repair and maintenance, education, environmental engineering, and waste management. Trade in services could be as large as a billion-dollar contract to install a telecommunications system in a country, or as small as a professional model's appearance at a foreign fashion show.

According to the *WTO Report on International Trade Statistics 2015*, exports of commercial services exceeded \$4.8 trillion in 2014. That represents about 20 percent of total world trade in merchandise and services. The United States has been the leading exporter of commercial services, having a net surplus in service exports over service imports. Other leading service suppliers are Germany, the United Kingdom, Canada, Japan, and India. Services account for the majority of the gross domestic product in the United States and most developed countries, as well as in India. Although the GATT agreement regulated trade in goods for more than 45 years, it did not regulate trade in services until the Uruguay Round agreements. The *North American Free Trade Agreement* governs the free flow of services among Canada, Mexico, and the United States.

The WTO General Agreement on Trade in Services

The *WTO General Agreement on Trade in Services (1994)*, or GATS, establishes rules for international trade in services. The agreement is largely patterned after the concepts that GATT applies to trade in goods. GATS defines four different ways of providing an international service:

1. Services supplied from one country to another (e.g., international telephone calls), officially known as **cross-border supply**.
2. Consumers or firms making use of a service in another country (e.g., tourism), officially known as **consumption abroad**.
3. A foreign company setting up subsidiaries or branches to provide services in another country (e.g., foreign banks setting up operations in a country), officially known as **commercial presence**.



4. Individuals traveling from their own country to supply services in another (e.g., teachers or consultants), officially known as **presence of natural persons**.

GATS principles are similar to the GATT principles studied in Chapter 9. Rules affecting service providers must be transparent and made readily available. Signatory countries to the agreement can place no limit on the number of foreign service providers or on the number of people they may employ. The agreement also prohibits countries from imposing a requirement that local investors own any percentage of the service company (leaving that up to the parties). These are known as the GATS “market access” provisions. Like the rules for trade in goods, the GATS agreement also contains MFN trade and nondiscrimination provisions. Countries may not treat foreign service providers less favorably than they treat domestic providers. Laws and regulations must be reasonable, objective, and impartial. Also, countries may not unreasonably restrict the international transfer of money by service industries or the movement of people across borders for the purpose of providing a service.

GATS contains a set of schedules, or commitments, that lists each country’s specific provisions related to each type of service. For instance, if you want to find out if Japan has separate requirements for foreign lawyers, or perhaps package delivery services, as opposed to the requirements for Japanese lawyers or Japanese couriers, you can consult the schedules. Of course, for the specific regulations you must research the issue with the appropriate Japanese authority. The schedules are available online from the WTO in its searchable *WTO Services Database*.

Licensing of Foreign Professionals. Most governments license professionals at some level, and in the United States that is generally done by the states. GATS has special provisions governing how national or local governments set the qualifications for licensure—such as those for accountants, attorneys, engineers, or physicians. Countries can continue to set educational, ethical, and other qualifications bearing on the quality of service and protection of the public, provided that licensing is not made overly burdensome to foreign providers. Licensing must be based on objective criteria, such as education, experience, or ability. It must not discriminate on the basis of the person’s citizenship. Countries may, if they choose, recognize licenses granted by other countries.

India illustrates the patchwork nature of professional licensing. Here are a few examples according to the U.S. International Trade Administration: U.S. accountants must license in India or have an Indian accounting firm as an affiliate. U.S. construction engineers may work there, but not on government projects if local firms can do the work. Architects may only work through an Indian joint venture, with an Indian architect signing off on plans. U.S. attorneys cannot practice there, but may give some temporary legal advice.

The WTO Agreement on Trade in Financial Services. Over 100 nations, including the EU and the United States, have joined the *WTO Agreement on Trade in Financial Services*, a part of the GATS agreement. The purpose of the agreement is to open commercial banking, securities, and insurance industries to foreign competition. The agreement is intended to promote efficiency, reduce costs, and provide consumers with a greater choice of service providers, while still permitting countries to regulate these industries for the protection of investors, depositors, and consumers.

The WTO Agreement on Basic Telecommunications. The *WTO Agreement on Basic Telecommunications* is also part of the larger GATS agreement. It includes regulation of voice and data (land and cellular) systems, satellite systems and services, paging and others. The agreement binds 108 countries to MFN trade and to open their telecommunications markets to foreign competitors.

TRADE IN AGRICULTURE

Agriculture has always been a contentious trade issue because both large scale farming conglomerates and family farmers represent politically powerful constituencies in most countries. Moreover, no country wants to completely lose its self-reliance for food if its farmers were put out of business by foreign competitors. So, to protect farm interests, many governments provide market stability and price supports by controlling domestic prices through subsidies and large purchases of excess agricultural products and food. Some countries impose import restrictions on raw and processed food products. Some countries provide guaranteed incomes to farmers or provide payments to leave land unfarmed. Some provide aid for weather-related disasters. One goal of these



programs is to promote national exports of farm and agricultural products. However, these programs usually lead to consumer prices that are much higher than they would be in a free market, and that contributes to the buildup of food surpluses. Although GATT Article XI prohibits quotas, it does contain a loophole allowing quotas on agricultural imports to protect government price support programs.

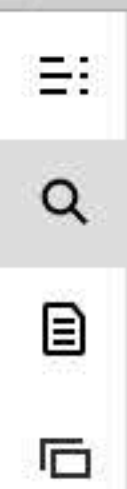
Some Agricultural Trade Issues in the EU and Japan

The United States, Japan, and the EU provide subsidies to farmers and controls on agricultural prices through a morass of complex legislation and government programs. In the United States, federal farm legislation (commonly called the *Farm Bill*) started during the Great Depression of the 1930s and is renewed every five years. It establishes U.S. agricultural and food policies, programs, and funding for that period. The latest program is found in the *Agricultural Act of 2014*. The following agricultural issues in the European Union and Japan are of special interest to all students of world trade law.

The EU Common Agricultural Policy. Agricultural policies in the EU are governed by its *Common Agricultural Policy*. The policies are rooted in the period following World War II, when a war-devastated continent needed government policies that assured adequate food supplies by promoting food production and aiding farmers. Today, expenditures for agricultural subsidies and price supports cost billions of euros each year, constituting over one-third of the annual total budget of the EU. The system has long been very controversial, and has become unpopular with consumers, taxpayers, and free-market economists. Of course, farmers are a powerful political force in Europe, as they are in all countries. In more recent years, the EU Common Agricultural Policy has undergone many changes. While expensive subsidies, cash payments to farmers, and some quotas still exist, there is a new focus on helping farmers deal with natural disasters, controlling plant and animal disease, promoting ecological standards, assuring food quality and safety, improving land and water management, and support for renewable energy sources in rural areas. Subsidies are usually no longer dependent on crop production. The United States has generally demanded that EU farm subsidies, including direct payments to European farmers, be reduced.

Japanese Rice: A Trade Dilemma. An excellent example of how nations feel about their agricultural trade is the Japanese treatment of rice imports. Rice has long been considered the staple food of Japan, and rice farming lies at the center of its agricultural community. Rice is a food that is symbolic of Japanese culture. The Japanese government's objective is to maintain self-sufficiency in rice production by ensuring the economic health of rice farmers. Since World War II, Japanese laws have been placing strict limitations on rice imports and imposed governmental controls on rice pricing and distribution. As a result, the domestic price of rice in Japan has often been many times higher than the price of rice in international markets. One small but vivid example of protectionism occurred in 1991, when U.S. rice exhibitors at a Japanese trade fair were threatened with arrest for merely exhibiting American-grown rice products there. The American rice had to be removed from the show.

Today, Japan permits rice imports, although they are subject to strict tariff-rate quotas and nontariff barriers. Rice illustrates the dilemma facing protectionist nations. The Japanese are self-sufficient in rice production; they produce enough for their own needs. There is also some reduced demand because the Japanese diet is becoming more Westernized and is incorporating more grains other than rice. But for decades, other rice-producing nations, including the United States, have been pressuring Japan to reduce tariffs and to accept more rice imports. Of course, any economist will tell you that these forces should combine to reduce the price of rice in Japan. But the Japanese government had feared that this would lead to a loss of self-sufficiency in rice, and an end to family rice farming. In the 1990s, other governments put pressure on Japan to purchase a minimum quantity of foreign rice annually. According to Japanese government and industry sources, and to reports of the U.S. Trade Representative, the government now purchases about three-quarters of a million tons of foreign rice each year. Most of it is unneeded, warehoused, and sold for food processing, animal feed, or re-exported as foreign aid to poorer countries (leaving the government with regular annual surpluses). Only a tiny portion of American rice is consumed at the Japanese dining table. In addition, private farmers have stockpiled millions of tons more of surplus rice. As prices fall, the government then is forced to artificially maintain them, through import barriers, cash subsidies to farmers, market controls, and a system of incentives and disincentives for rice farmers. In all, it is a "perfect storm" of market disruption from excessive government intervention.



The WTO Agreement on Agriculture

The 1994 Uruguay Round called for many significant changes in government control of agricultural trade. The *WTO Agreement on Agriculture* began the process of removing government intervention in the farming sector and ending government programs that distort normal market conditions. The agreement has three main objectives:

1. Cutting domestic subsidies and other direct payments to farmers. **Domestic subsidies** distort markets by causing overproduction and suppressing prices while protecting the incomes of farmers. The agreement prohibits domestic subsidies, except for research, disease control, environmental protection, and rural development. It also permits cash payments to farmers during emergencies.
2. Cutting programs that subsidize exports of farm products. **Agricultural export subsidies** are payments or other benefits given to farmers that directly encourage, or are conditional upon, the export of food or agricultural products. Government subsidized food exports that are part of a foreign aid program to needy countries are not considered illegal subsidies under the agreement.
3. Assuring greater market access for imported farm products by converting quotas and other nontariff barriers into tariffs.

SANITARY AND PHYTOSANITARY MEASURES: FOOD, ANIMAL, AND PLANT SAFETY

Trade in agricultural goods has been impeded because some countries use food safety as an excuse for blocking agriculture imports. No one doubts the right of a government to take extraordinary measures to protect its citizens from contagious disease or to protect food or agricultural products from infestation. If a blight, fungus, or insect were found in orange groves in Mexico, no one would argue against the right of the United States to keep out Mexican oranges to protect the U.S. crop. A **sanitary and phytosanitary measure** is a government rule or regulation that protects or enhances food, animal, or plant safety or quality, including preventing the spread of pathogens and disease. The *WTO Agreement*

on the Application of Sanitary and Phytosanitary Measures (the *SPS Agreement*) is specifically designed to allow governments to protect human, animal, and plant life from infestations, contaminants, pesticides, toxins, harmful chemicals, or disease-carrying organisms. However, governments may not use restrictions as excuses to keep out foreign goods.

The *SPS Agreement* opens markets for agricultural exports by requiring that the protective measures taken by nations (1) may not be more trade-restrictive than required and may be applied only to the extent necessary for the protection of human, animal, or plant life; (2) may not be a disguised restriction on trade; (3) must be based on a risk assessment made according to scientific principles and scientific evidence; (4) may not unjustifiably discriminate between countries where similar threats prevail; and (5) must ensure that inspections of imported products are fair and reasonable and are completed without delay. Consider an example: A country that sets an unreasonably short shelf-life for dairy products may actually be discriminating against foreign-produced dairy products whose shelf-life expires during the time it takes for shipment. Under the *SPS Agreement*, the shelf-life restriction cannot stand unless based on scientific evidence. A novel example is the strict Japanese law prohibiting thoroughbred racehorses from entering Japan. This prohibition might violate the agreement if the restriction is unnecessary, discriminatory toward the United States, or not based on scientific evidence. Citing the *SPS Agreement*, the U.S. Department of Agriculture in 1995 repealed an 81-year-old prohibition against the import of Mexican avocados.

Developing countries have particular difficulties meeting SPS standards. They often do not have the scientific or technical resources or know-how to interpret existing scientific evidence, to set evidence-based standards, and to develop testing programs. Examples come from all areas of biological science—testing and diagnosing infectious veterinary disease, setting limits on pesticide residues in the environment, or evaluating and setting limits on antibiotic use in animal feed. They will require technical help from developed countries, corporate research, universities, and international organizations.

Codex Alimentarius

Whenever possible, countries must rely on internationally accepted standards or recommendations for the protection of their plants, animals, and food-stuffs. The most notable are found in the *Codex Alimentarius*. This “food code” for the protection of



the world's food supply developed slowly over most of the last century. Today, the *Codex Alimentarius* Commission develops these important standards on the basis of worldwide scientific studies and disseminates them to government agencies and lawmakers. The commission is based in Rome and is made up of countries that belong to the UN World Health Organization and the UN Food and Agricultural

Organization. If a country's national standards are based on the *Codex Alimentarius*, they are deemed to be in compliance with the *SPS Agreement*.

In the following 1997 WTO panel decision, *WTO Report on EC Measures Concerning Meat & Meat Products (Hormones)*, the panel held that the European ban on the sale of beef containing residues of growth hormones violated the *SPS Agreement*.



European Communities—Measures Concerning Meat and Meat Products (Hormones)

Report of the Dispute Settlement Panel,
WT/DS26/R/USA (1997) World Trade Organization

BACKGROUND AND FACTS

Throughout the 1970s, European consumers became more concerned over the use of hormones to speed the growth of livestock. Their fears were in part based on the fact that some people had been injured by the illegal use of certain banned hormones. Some consumer organizations boycotted meats. By 1986, the EC had banned the sale of beef from cattle given growth hormones. The EC maintained that such measures were necessary to protect public health (primarily from hormone-related illnesses and cancer) and necessary to restore confidence in the meat industry. The United States began contesting the hormone ban in 1987 at GATT. In January 1989, the United States introduced retaliatory measures in the form of 100 percent *ad valorem* duties on a list of products imported from the European Communities. The United States, together with Australia, Canada, New Zealand, and Norway, maintained that the ban was unlawful under the 1994 *Agreement on the Application of Sanitary and Phytosanitary Measures (SPS Agreement)* and brought this complaint. The United States argued that the ban was not based on an assessment of risk, not based on scientific principles, more trade-restrictive than necessary, and a disguised restriction on trade. [T]he European Communities requested the establishment of a panel to examine this matter, and the United States terminated its retaliatory action entirely. Prior to the ban, U.S. firms had exported hundreds of millions of dollars of goods annually to Europe. After the ban, exports plummeted to nearly zero. The European Communities argued that its measures offered equal opportunities of access to the EC market for all third-country animals and meat from animals to which no hormones had been administered for growth promotion purposes.

REPORT OF THE PANEL

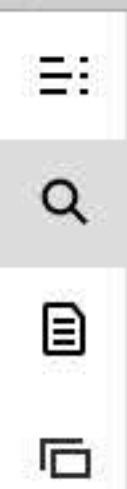
Article 3.1 requires Members to base their sanitary measures on international standards, guidelines or recommendations [where they exist]. We note, therefore, that even if international standards may not, in their

own right, be binding on Members, Article 3.1 requires Members to base their sanitary measures on these standards . . . We shall therefore, as a first step, examine whether there are international standards, guidelines or recommendations with respect to the EC measures in dispute and, if so, whether the EC measures are based on these standards, guidelines or recommendations in accordance with Article 3.1 [of the *SPS Agreement*]:

To harmonize sanitary and phytosanitary measures on as wide a basis as possible, Members shall base their sanitary and phytosanitary measures on international standards, guidelines or recommendations, where they exist, except as otherwise provided for in this Agreement . . .

For food safety . . . the *SPS Agreement* defines "international standards, guidelines or recommendations" as "the standards, guidelines and recommendations established by the *Codex Alimentarius* Commission relating to food additives, veterinary drug and pesticide residues, contaminants, methods of analysis and sampling, and codes and guidelines of hygienic practice." We note that [there are] five Codex standards . . . relating to veterinary drug residues . . . with respect to five of the six hormones in dispute when these hormones are used for growth promotion purposes . . . We find, therefore, that international standards exist with respect to the EC measures in dispute. * * *

The amount of residues of these hormones administered for growth promotion purposes allowed by these Codex standards is . . . higher than zero (a maximum level of such residues has not even been prescribed). The EC measures in dispute, on the other hand, do not allow the presence of any residues of these three hormones administered for growth promotion purposes. The level of protection reflected in the EC measures is, therefore, significantly different from the level of protection reflected in the Codex standards. The EC measures in dispute are . . . therefore, not based on existing international standards as specified in Article 3.1. * * *



[For those sanitary measures for which no international standards exist] . . . a Member needs to ensure that its sanitary measures are based on an assessment of risks. The obligation to base a sanitary measure on a risk assessment may be viewed as a specific application of the basic obligations contained in Article 2.2 of the *SPS Agreement* which provides that “Members shall ensure that any sanitary . . . measure is *applied only to the extent necessary to protect human, animal or plant life or health, is based on scientific principles and is not maintained without sufficient scientific evidence . . .*” (emphasis added). Articles 5.1 to 5.3 sum up factors a Member needs to take into account in making this assessment of risks . . . [A]n assessment of risks is, at least for risks to human life or health, a scientific examination of data and factual studies; it is not a policy exercise involving social value judgments made by political bodies. * * *

We recall that under the *SPS Agreement* a risk assessment should, for the purposes of this dispute, identify the adverse effects on human health arising from the presence of the specific hormones at issue when used as growth promoters in meat or meat products and, if any such adverse effects exist, evaluate the potential or probability of occurrence of these effects. We further recall that a risk assessment should be a scientific examination of data and studies and that the *SPS Agreement* sets out factors which need to be taken into account in a risk assessment.

[The panel conducted a review of the scientific studies.] All of the scientific studies outlined above came to the conclusion that the use of the hormones at issue for growth promotion purposes is safe; most of these studies adding that this conclusion assumes that good practice is followed. We note that this conclusion has also been confirmed by the scientific experts advising the Panel. Accordingly, the European Communities has not established the existence of any identifiable risk against which the EC measures at issue . . . can protect human life or health.

Decision. The EC’s ban on the sale of beef containing residues of growth hormones was found to violate the *Agreement on the Application of Sanitary and Phytosanitary Measures*. Where an existing internationally accepted standard permits beef to contain a residue of a certain growth hormone, an EC regulation permitting zero residue is in violation of the agreement. Where no internationally accepted standard exists on the residue of a certain hormone, the EC ban on that hormone is not permitted because it is not based on a risk assessment made using scientifically accepted principles.

Comment. The panel’s decision was upheld by the WTO Appellate Body and accepted by the WTO Dispute Settlement Body. The United States and Canada were authorized to impose retaliatory tariffs on EU imports. The United States imposed 100 percent duties on a range of European products valued at \$116 million per year (Canada at CDN\$11.3 million). An agreement was finally reached in which the EU would allow increased duty free imports of U.S. beef produced without hormones in return for the United States eliminating the retaliatory tariffs over a period of several years.

Case Questions

1. What was the role of the panel in settling this dispute under the *SPS Agreement*? Did it make its own determination and draw its own scientific conclusions about the effect of beef hormones on human health, or did it give total deference to the conclusions of the EU scientists?
2. What factors were taken into account to determine whether a sanitary measure violates the *SPS Agreement*?
3. It is an interesting irony in this case that today many scientists, environmentalists, and consumer groups in the United States are calling for a similar domestic ban on beef growth hormones. How do you feel about the use of hormones in beef cattle?

OTHER WTO “TRADE-RELATED” AGREEMENTS

Two other agreements that will have an effect on world trade are the *WTO Agreement on Trade-Related Investment Measures* and the *WTO Agreement on Trade-Related Aspects of Intellectual Property Rights*. While we only mention them briefly here, we discuss these issues more fully in Part 4 of this book.

Trade-Related Investment Measures

There is no question today that trade and foreign direct investment are interrelated. To be competitive in a global

market, firms must do more than just produce in one country and sell in another. They must be able to supply services or conduct procurement, manufacturing, assembly, and distribution operations on a global scale. This requires the freedom to build foreign factories, open new foreign subsidiaries, or merge with foreign firms. The link between investment and trade becomes even more obvious when looking at the volume of trade between related companies. According to UNCTAD, trade between foreign affiliated companies or between subsidiaries and their parent companies—accounts for over one-third of world trade. Government controls that hamper the freedom of firms to acquire or merge with foreign firms or to make critical investment decisions



will have an adverse effect on trade in goods and services, especially between these multinational affiliates.

The 1994 Uruguay Round agreements resulted in the *WTO Agreement on Trade-Related Investment Measures* (commonly called *TRIMS*). A **trade-related investment measure** is a national rule or regulation on foreign investment that has a direct or indirect effect on trade in goods. The agreement does not set broad rules for local investing, such as rules affecting domestic stock exchanges. It does attempt to reduce restrictions on foreign investment that might restrict cross-border trade in goods and services. It also eliminates discrimination against foreign firms and their goods and services to the extent that those restrictions distort or restrict trade. For example, TRIMS prohibits **trade balancing requirements**—laws that condition a company’s right to import foreign goods on the basis of the volume of goods that company exports. TRIMS also prohibits **local content requirements**—regulations dictating that a foreign company or other producer must use a certain minimum percentage of locally made parts or components in the manufacture of a product. For instance, Argentina may not say to a U.S. multinational corporation, “We will finance the construction of a new automobile factory for you, but only if you guarantee us that 25 percent of the component parts used in assembling cars are made in this country,” or “You may only import foreign raw materials on the condition that you export an equal volume of finished goods from our country.” These requirements would violate the prohibition of quantitative restrictions of GATT Article XI. Also prohibited are laws that condition the receipt of foreign exchange on the company’s foreign exchange revenues. Thus, Argentina may not demand, “Our central bank will only permit you to transfer U.S. dollars out of the country if you have brought into the country an equivalent amount this year in dollars, yen, or other hard currency.”

Trade-Related Aspects of Intellectual Property Rights

Because intellectual property rights (IPRs) are not “goods,” they did not fall within the bounds of the 1947 GATT agreement. However, IPRs are often attached to goods and used to sell them. Thus, if IPRs are not protected from unauthorized use, then trade in goods and services will suffer. For this reason, the Uruguay Round negotiations focused on IPRs and resulted in the *WTO Agreement on Trade-Related Aspects of Intellectual Property Rights*, or TRIPS. **Trade-related aspects of**

intellectual property rights refers to government rules or regulations on IPRs that have a direct or indirect effect on trade in goods.

TRIPS sets new, comprehensive standards for the protection of IPRs in all member countries of the WTO. It requires every WTO country to abide by the most important international intellectual property conventions and then calls on countries to grant even greater protection to inventors, authors, and trademark owners. The agreement requires that all domestic and foreign IPR owners, regardless of their citizenship, be treated the same under a country’s IPR laws. It prohibits countries from imposing requirements on foreign firms in exchange for being granted trademarks, patents, or copyrights. For instance, a WTO country may not condition the award of a patent on the inventor’s promise to manufacture the item in that country. Countries must publish all laws, regulations, and administrative rulings that pertain to the availability, application, protection, or enforcement of IPRs. Enforcement efforts will be strengthened worldwide to reduce the billions of dollars’ worth of losses every year due to counterfeit and pirated goods (e.g., fake Rolex watches or unauthorized copies of Microsoft software). WTO member countries will bring their IPR laws into compliance with TRIPS, as the United States has already done. For example, in 1995 the United States increased the patent period from 17 to 20 years to comply with TRIPS’ longer period. The TRIPS Council of the WTO monitors compliance with TRIPS. TRIPS disputes are settled by the WTO Dispute Settlement Body.

TRADE ENFORCEMENT AND RETALIATION

What can the United States government do if a foreign country denies fair market access to U.S. goods and services, discriminates against U.S. products, or violates its trade agreements? As we’ve seen, a president may try negotiations or may seek dispute settlement through the WTO (or through another trade agreement such as NAFTA). However, the president and the executive departments also have statutory authority to take direct trade enforcement action against offending countries, including the power of trade retaliation. One of the most important legal weapons in the U.S. arsenal against foreign trade barriers and unfair trade practices is commonly known to businesspeople and lawyers alike as “Section 301.”



U.S. Section 301

Section 301 of the *Trade Act of 1974*, as amended (19 U.S.C. 2411), is the primary statute that permits the United States Trade Representative (USTR), on direction of the president, to take retaliatory trade action against other countries whose acts or trade policies toward the United States (or its companies or products) are unreasonable or discriminatory, or in violation of a trade agreement.

Basic Section 301. This statute sets two different standards for when the U.S. government may retaliate against foreign trade barriers. The first defines when retaliatory action by the USTR is mandatory, and the second defines when it is discretionary.

The USTR is required to take action against a foreign country that is found to have violated its trade agreement with the United States (such as raising tariffs above its bound commitment or denial of MFN status) or whose policies or actions are unjustifiable and burdens or restricts U.S. commerce. Thus, if another country unreasonably restricts access of U.S. goods or services to their markets in violation of a trade agreement, they could face punitive U.S. tariffs or risk losing access to the U.S. market. A foreign government's policy or action could be considered unjustifiable if it is in violation of a broad range of international legal rights of the United States. Mandatory retaliation is not required if a WTO panel has upheld the foreign government action—such as having authorized the foreign country to raise tariffs on U.S. goods, if the USTR believes that a negotiated solution is imminent, or, in extraordinary cases, if the USTR believes that the adverse effects of retaliation on the U.S. economy would exceed the benefits.

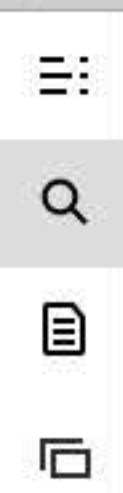
The statute also gives broad discretionary power to the president, to retaliate against any foreign country whose acts or policies are found to be *unreasonable or discriminatory and burdens or restricts U.S. commerce*. A foreign country acts unreasonably if its policies toward U.S. firms are unfair or inequitable, even if they are not in violation of any international agreement. The statute could be interpreted and used according to the president's views on trade and what acts or policies of a foreign country might be deemed to be unreasonable or discriminatory. For example, a president could use this statute against a country who fails to stop its companies from hacking American computer networks or stealing the trade secrets of U.S. firms. By having this statutory authority, the president's negotiating leverage with foreign countries is enhanced.

Petitions for Section 301. A Section 301 action can be initiated by petition of any interested party or firm, or by the USTR. The USTR must conduct a formal investigation into the foreign trade practices and immediately begin negotiations for a solution. The USTR must request consultations and dispute settlement at the WTO if there is an alleged violation of a WTO agreement. Once a petition is filed, the USTR must follow the statutory time limits required for the investigation and negotiations.

Trade sanctions are for the purpose of ending an illegal foreign practice, not to compensate the petitioning U.S. firm. No benefits accrue directly to the petitioning firm other than those that affect all U.S. companies or industries in a similar position. The president has the authority to place additional tariffs on imports from the offending nation in an amount equal in value to the burden placed on U.S. firms. The products affected are said to be placed on the USTR's "retaliation list" or "hit list." The tariffs may be imposed on a wide range of products imported from the offending country, not just those affected by the foreign country's actions. For example, if a foreign country puts quotas on U.S. food products, the United States can retaliate against imports from that country of any type, such as electronic parts. When the United States threatened trade sanctions against Japan for unfairly keeping out U.S. auto parts, the USTR proposed 100 percent import duties on imports of Japanese luxury automobiles. When China refused to protect U.S. copyrights, the United States threatened to impose over \$1 billion a year in trade sanctions on all Chinese imports. When the EU refused to comply with a WTO panel decision and lift its ban on U.S. beef containing growth hormones in 1999, the United States imposed 100 percent duties on \$117 million in European imports. Tariffs of this magnitude are calculated to temporarily raise prices on imported goods and to discourage their purchase, until such time as foreign trade barriers are lifted and the trade dispute is resolved.

Unilateralism, U.S. Trade Enforcement, and the WTO

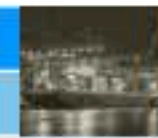
The manner in which the United States, or any country, takes retaliatory action in a trade war has long been a subject of argument. Some commentators and politicians have argued for **unilateralism**: the policy that a nation should retaliate unilaterally against another country that discriminates against its products or firms rather than relying on an established international or multilateral framework for resolving trade



disputes. Those who favor unilateralism usually do so because they believe it furthers a nation's self-interest. Those opposed to unilateralism believe that a nation's self-interest is best furthered by gaining support from other nations. Unilateralism is in direct conflict with the principles of the WTO system. After the creation of the WTO in 1995, the United States, like other member countries, became obligated to seek consultations at the WTO and approval from the WTO Dispute Settlement Body before imposing retaliatory measures. During

President Obama's two terms, his administration brought 23 complaints against foreign countries at the WTO and no unilateral Section 301 actions were taken.

In the 1990s, the EU argued that *Section 301* violated WTO dispute settlement procedures. In the following case, *WTO Report on United States—Sections 301–310 of the Trade Act of 1974* (1999), a dispute settlement panel held that *Section 301* does not violate U.S. obligations under GATT if it is applied in accordance with WTO dispute settlement provisions.



United States—Sections 301–310 of the Trade Act of 1974

Report of the Panel, WT/DS152/R (1999) World Trade Organization

BACKGROUND AND FACTS

The European Communities requested a WTO panel to decide whether U.S. Sections 301–310 [the Act] violated GATT dispute settlement procedures. The Act permits the USTR to investigate possible violations of GATT or other international trade agreements, to negotiate a settlement of the dispute, and to request a WTO dispute settlement panel if necessary. The Act also permits the USTR to impose retaliatory tariffs or other trade sanctions either unilaterally or if authorized by the WTO Dispute Settlement Body. The EC argued that the Act violated WTO rules.

REPORT OF THE PANEL

The European Communities argues that [WTO rules] prohibit unilateralism in the . . . dispute settlement procedures. Members must await the adoption of a panel or Appellate Body report by the Dispute Settlement Body, or the rendering of an arbitration decision . . . before determining whether rights or benefits accruing to them under a WTO agreement are being denied. * * *

The European Communities . . . took the position in the Uruguay Round that a strengthened dispute settlement system must include an explicit ban on any government taking unilateral action to redress what that government judges to be the trade wrongs of others.

The United States argues that nothing in Sections 301–310 requires the U.S. government to act in violation of its WTO obligations. To the contrary, the Act requires the USTR to undertake WTO dispute settlement proceedings when a WTO agreement is involved, and provides that the USTR will rely on the results of those proceedings when determining whether U.S. agreement rights have been denied. Likewise, [the Act] explicitly indicates that the USTR need not take action when the DSB has adopted a report finding no denial of U.S. WTO rights.

Under well-established GATT and WTO jurisprudence and practice which the European Communities appears to accept, a law may be found inconsistent with a Member's WTO obligations only if it precludes a Member from acting consistently with those obligations.

The European Communities must therefore demonstrate that Sections 301–310 do not permit the United States government to take action consistent with U.S. WTO obligations—that this legislation in fact mandates WTO-inconsistent action. The European Communities has failed to meet this burden. Its analysis of the language of Sections 301–310 ignores pertinent statutory language and relies on constructions not permitted under U.S. law. Sections 301–310 of the *Trade Act of 1974* are fully consistent with U.S. WTO rights and obligations. * * *

If a law does not make it compulsory for authorities to act so as to violate their international obligations, that law may not be said to command such action. This can be illustrated through a simple example. A law which provides, "the Trade Representative shall take a walk in the park on Tuesdays, unless she chooses not to" does not oblige the USTR to walk in the park on Tuesdays. She has complete discretion not to take a walk in the park on Tuesdays; the law in no way obliges or commands her to do so. This remains true despite the use of the word "shall" in that law.

Decision. Sections 301–310 of the U.S. *Trade Act of 1974* were found to be valid under the GATT 1994 agreements. The panel clarified that the United States may impose retaliatory trade sanctions against other WTO members only where the United States strictly followed WTO dispute settlement rules and when authorized by the Dispute Settlement Body.

Comment. Upon entering the WTO, the United States had filed a binding "Statement of Administrative Action," in which it committed to abide by all WTO dispute settlement procedures and to not act unilaterally. That was noted by the panel in its report and was a factor in the panel's decision.

Case Questions

1. What does the panel mean by "unilateralism"?
2. If a trade dispute arises, what is the proper procedure under WTO rules for settling that dispute?

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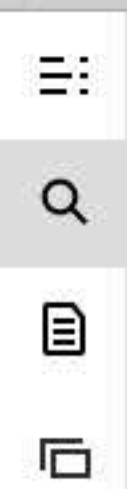
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U.S. “Special 301” and Intellectual Property Rights

The United States uses so-called *Special 301* to assure that American-owned intellectual property rights (IPRs) are adequately protected in foreign countries. Each year, the USTR must identify and report on those **priority foreign countries** that continue to deny adequate protection to American IPRs. (Coverage was extended to include foreign protection of trade secrets of U.S. firms in the *U.S. Trade Facilitation and Enforcement Act of 2015*.) A country is not placed on the list if it is making substantial progress in protecting IPRs or engaged in good faith negotiations, bilaterally or through the WTO. There were no priority foreign countries in the USTR’s 2016 *Special 301 Report*. To help in administering the statute, the USTR has created a **watch list** and **priority watch list**. This helps to focus U.S. IPR negotiations and helps U.S. companies identify countries where their IPRs might be in jeopardy. The following countries were placed on the priority watch list in the 2016 report: Algeria, Argentina, Chile, China, India, Indonesia, Kuwait, Russia, Thailand, Ukraine, and Venezuela. Twenty-three countries were on the watch list. The USTR holds public hearings and solicits written comments on which it bases its decisions. Private companies, nongovernmental organizations, and even foreign governments are regularly part of the decision-making process. It should be noted that the USTR’s efforts and reports, which are required by Congress, are not without criticism from foreign governments and some industries who view it as “strong arming” and politically motivated.

U.S. Section 338

This section of the *Tariff Act of 1930* should be mentioned, although its legal status under today’s WTO agreements is doubtful. When it was passed, the statute gave broad and somewhat vague authority to the president to impose additional punitive import duties of up to 50 percent of the value of an import on products arriving from any country that the president believes has “disadvantaged” or discriminated “against the commerce of the United States.” It also allowed the president to bar import of products from that foreign country. The statute could be called “dormant” because it has long been unused. It became legally questionable and unnecessary as the United States and other countries set their bound tariff rates on products by agreement and virtually eliminated the use of quotas. Many

international trade lawyers believe that the president’s use of the statute would today violate WTO rules unless the tariff increase was in relation to the harm actually done to U.S. exports.

CONCLUSION

The “market access” provisions of WTO law resulted from years of negotiations and consensus agreement by nations determined to move from economic protectionism to freer and fairer trade. In the United States, as elsewhere, these efforts have been widely promoted and supported by exporting firms—from “high tech” industries to agricultural exporters, and by multinational companies. As U.S. firms became more dependent on export sales, they also became more vulnerable to foreign trade barriers that denied them access to export markets. For this reason, almost all Americans have agreed that trade should be “fair,” and that barriers to the sale of U.S. goods and services abroad should be removed. Readers, who hear calls for “fair” trade, should remember that what you studied in this chapter is all about fair trade—leveling the playing field as goods and services move across national borders. This has been supported by most economists and government leaders going back to the Great Depression of the 1930s. On the other hand, protectionist ideas are understandably appealing to those whose jobs are displaced in the process of globalization. There has always been protectionist talk from lawmakers representing organized labor and states with older, traditional manufacturing industries. And there have always been some news commentators, “think tanks,” and economists who will support these views. But during the 2016 election and in the earliest days of his administration, President Trump embraced new-found populist protectionist ideas. He called for “America First,” withdrew the United States from the *Trans-Pacific Partnership* free trade agreement, promised to renegotiate the *North American Free Trade Agreement*, and showed support for the UK “Brexit” vote withdrawing from the European Union. No one can predict how any president will use the statutory trade enforcement powers discussed in this chapter, or how U.S. trade policies will actually change. But there is no doubt that foreign governments will respond by doing what they perceive to be in their best interests. So too will American manufacturing, agricultural, and service firms do what is in their interests. We can only wait and see who will be the “winners or losers” in the global economy of the future.

Chapter Summary

1. The Uruguay Round trade negotiations resulted in many important trade agreements designed to remove trade barriers and improve access to foreign markets, including agreements on technical barriers, import licensing, government procurement, trade in services, agriculture, and textiles.
2. The *WTO Agreement on Technical Barriers to Trade* does not set standards of its own for product performance, design, safety, or efficiency, but it guides nations in the application of their own regulations and standards through legal principles of nondiscrimination, transparency, and MFN trade. The agreement applies broadly to regulations imposed to protect the public health, safety, and welfare, including consumer and environmental protection. Health and safety regulations may not be used unless they are “trade neutral” and restrict trade no more than necessary, according to the principle of least restrictive trade.
3. Governments are some of the largest consumers of goods and services in the world. *The WTO Agreement on Government Procurement* requires that countries “free up” their procurement policies and practices by giving foreign firms equal access to bidding on government contracts and by providing transparent and easily obtained rules for submitting bids.
4. About 20 percent of world trade is in services. The *General Agreement on Trade in Services* (1995) applies basic GATT principles to service industries for the first time since 1947. This agreement has already opened access to foreign markets in construction, engineering, health care, banking, insurance, securities, transportation, and the professions.
5. Trade in agriculture has been distorted by billions of dollars’ worth of government subsidies granted to farming interests worldwide that artificially lower the cost of agricultural exports. In turn, importing nations artificially raise the price of agricultural imports with trade restrictions and tariffs. Attempts to limit government support and manipulation of agriculture have been met by attacks from politically powerful farm groups, particularly in France and other European countries.
6. Under the *WTO Agreement on Sanitary and Phytosanitary Measures*, countries cannot impose restrictions to protect animal and plant life from pests or contagious diseases unless those restrictions are applied fairly and equally to goods from all countries that present a risk of infection. Restrictions must be supported by scientific evidence and be as unrestrictive of trade as possible. These issues are critical to all humankind, as we face potential scourges like “mad cow” disease and hoof-and-mouth disease.
7. The *U.S. Trade Act of 1974* (notably *Section 301*) provides the USTR, under the direction of the president, with the tools needed to retaliate against foreign government trade barriers that breach trade agreements with the United States or that deny fair and equal access of U.S. goods and services to foreign markets. The United States has been committed to only using *Section 301* retaliation after it has unsuccessfully resorted to negotiations or to the dispute settlement process at the WTO.
8. Commonly called “Special 301” requires the USTR, under direction of the president, to investigate foreign threats to U.S. intellectual property rights, including to trade secrets, and to identify priority foreign countries for retaliation, or to place countries on either the priority watch list or watch list. U.S. films, book publishing, music, patents, and other scientific and artistic innovations are dependent on these protections worldwide.

Key Terms

market access agreements 259	prior approval 262	performance standard 264
least restrictive trade 259	prior certification 262	Japan Industrial Standards or JIS Mark 264
technical regulations 262	transparency 263	China Compulsory Certification or CCC Mark 265
product standards 262	CE Mark or <i>Conformité Européene</i> 264	
technical barriers to trade 262	design standard 264	

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special drawing rights 269	sanitary and phytosanitary measures 273	unilateralism (in trade relations) 277
procurement offsets 270	<i>Codex Alimentarius</i> 273	priority foreign country 279
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consumption abroad 270	trade balancing requirements 276	priority watch list 279
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Questions and Case Problems

1. There has long been debate over whether countries should take unilateral action to redress foreign trade barriers or seek to resolve the issue through negotiations. What do you see as the advantages or disadvantages of the U.S. pursuing trade remedies through the WTO system as opposed to initiating unilateral administrative investigations and sanctions?
2. British Columbia, Canada, requires grocery stores to sell imported wine only within a “store within a store,” although it allows domestic BC wine to be sold on regular store shelves. The rule is contained in policy directives of the *BC Liquor Control and Licensing Act*. In 2017, the United States sought consultations at the WTO claiming a violation of WTO agreements. What provisions of the WTO agreement do you think may or may have not been violated? Should the type of product involved be considered in a decision? See, *Canada—Measures Governing the Sale of Wine in Grocery Stores*, Request for Consultations, WT/DS520/1 (23 January 2017).
3. In 2001, an outbreak of hoof-and-mouth disease threatened the meat supply of Europe. This virus is spread through the air or by contact. To control its spread, millions of cattle, sheep, and pigs were slaughtered and burned; export and transportation of British livestock, meat, and dairy products were halted; and many areas of Great Britain were placed off limits to travelers. Certain areas of the country were quarantined, with “Keep Out” notices posted on the roads. Officials sprayed chemicals to kill the virus on the soles of shoes and automobile tires. The virus quickly spread to continental Europe, and even the United States banned the import of meat from Europe. Explain the application of the *WTO Agreement on Sanitary and Phytosanitary Measures* to this issue. Does the agreement tell countries specifically what actions to take? What action does the agreement permit nations to take to fight a disease like this? Do you think that the agreement gave sufficient latitude to countries to fight the disease? For additional information, see the website for the World Organization for Animal Health, a Paris-based government organization comprising 178 nations.
4. Businesses and consumers in China process more than \$1 trillion (U.S. equivalent) in electronic payments every year. The United States claimed that the Chinese government used several regulatory requirements that had the effect of only allowing one company, the government-owned China Union Pay, to process all electronic payment services (EPS) in the country denominated in Chinese currency, the *renminbi* or yuan. The world leaders in EPS, however, are U.S. firms, and they were virtually locked out of the China market. The United States brought a complaint before a WTO panel claiming that the Chinese government violated its obligations under Article XVI of GATS by granting one company a monopoly on clearing credit card transactions denominated in Chinese currency. Did China violate GATS Article XVI:2 (a) that prohibits a country from limiting the number of service suppliers in service sectors where it has made commitments? Did this violate the principle of nondiscrimination? How was the dispute resolved? *China—Certain Measures Affecting Electronic Payment Services*, Report of the Panel, WT/DS413/R (2012).
5. Each year the USTR publishes an annual report to Congress entitled the *National Trade Estimate Report on Foreign Trade Barriers*. The report details trade barriers, by country and industry sector, U.S. firms face in exporting goods, and services to foreign markets. The *Special 301 Report* is an annual assessment of the effectiveness of foreign intellectual property rights laws and enforcement efforts in foreign countries. Find these reports, and select several countries of interest. What is the USTR’s position with regard to trade barriers in those countries? What is the estimated impact of those barriers on U.S. foreign trade?

Managerial Implications

1. Which vehicle is more “American”—a Chevrolet Silverado assembled in Mexico or a BMW made in South Carolina? Today, the typical motor vehicle sold in North America is made of components and assemblies imported from many countries. A vehicle assembled in the United States may have an engine from Canada or Hungary or a transmission built in China, plus a body, chassis, interior and subsystems coming from yet other countries. For vehicles made and sold in North America, component parts and assemblies can cross borders several times. Each of these examples is real, and they are endless. The country-of-origin does not depend on whether you view the manufacturer as an “American” company or not (after all Chrysler/Ram is owned by the Italians, Volvo by the Chinese, Jaguar and Land Rover by the Indians, “Italian” Lamborghini by the Germans, and many global automakers have an ownership interest in a foreign partner). Every company thinks and acts globally, is relying more on “global platforms” for its vehicles, and builds its factories accessible to international supply chains and close to its customers. This is evident in the trend away from smaller, local or regional “original-equipment manufacturers” and toward a reliance on large global OEM companies that supply parts, assemblies, and automotive systems on a worldwide basis.
 - a. What factors do you think might influence a modern automotive company in determining a location for a new plant? Access to low wages? A productive labor force? Shipping costs? Political risk? Trade barriers? Discuss.
 - b. Assume the United States and Japan are unable to resolve a trade war over trade in automobiles and auto parts. Acting unilaterally, the United States imposes a 35 percent tariff, or higher, on imported components and on vehicles with a final assembly outside the United States. What do you think the reaction would be by foreign governments?
 - c. In the above question, who is being affected? Local manufacturers? Dealers? Consumers?
 - d. Given that it can take billions of dollars and several years to build a modern automotive plant, how might global manufacturers respond? Who might bear the immediate costs?
 - e. If U.S. tariffs were high enough to protect U.S. automotive manufacturers over a long period of time, how do you think this might affect the long-term health and competitiveness of the industry? Could you see any impact on the U.S. lead in innovation, design, and quality? Discuss.
2. Your company is a U.S. multinational corporation with a 40 percent share of the world market for its product. Over the past decade, management has invested heavily trying to get its products into the Japanese market. Despite all of its efforts, the company still has less than a 10 percent share of the Japanese market, and only a small fraction of relevant Japanese stores carry its products. Company investigations show that its major Japanese competitor has a virtual monopoly there and has violated Japanese antitrust laws by fixing prices and refusing to sell to any store that carries your firm’s products. Most distributors and retailers are linked to your competitor through *keiretsu* relationships. Management believes that by having the Japanese market all to itself, the competitor is able to maintain sufficiently high prices in Japan to permit them to undersell your company in the United States. Apparently, the Japanese government simply “looks the other way.” Moreover, your firm has been effectively restrained by the bureaucracy that administers government procurement contracts in Japan. As a result, management estimates that it has lost several billion dollars in exports since the company first entered the Japanese market. Your competitor responds that it is not the only producer in Japan, that the market there is very competitive, and besides, it also outsells your firm’s products in several other Asian countries.
 - a. Explain what is meant by “Keiretsu” practices in Japan. How did they develop and what cultural and societal forces may have been at work? How have Keiretsu practices affected the Japanese distribution system for domestic and foreign products?
 - b. If you petition for a *Section 301* action, do you think the USTR will begin an investigation? What political factors in the United States might affect the USTR’s decision to investigate? Are the market share statistics relevant to your case? What other data or information will be important? What is the attitude of the current U.S. administration toward the use of *Section 301*?
 - c. How do you think joint ventures with foreign firms and strategic alliances between Japanese and foreign firms might have affected the traditional keiretsu system?



Ethical Considerations

Many proponents of environmental safety and public health are concerned about the creation, spread, and potential impact of genetically modified foods. The United States, Canada, and Argentina are some of the leading producers of genetically modified foods made from bioengineered organisms (GMOs). The U.S. government believes that GMOs are important for the world's food supply because they can boost food production and nutrition and lead to both disease-resistant crops and better-tasting foods. Many respected scientific studies vouch for the safety of GMOs for human and animal consumption and on the Earth's environment. GMOs are important to U.S. agriculture economically. According to the U.S. Department of Agriculture, approximately three-quarters of U.S. soybean and cotton production and over one-third of corn production are genetically modified. However, many consumer groups and countries argue that the dangers to humans, wildlife, and the environment are unknown. Genetically modified corn and soy were approved for sale in the EU prior to 1998, but the European countries ceased new approvals after that time.

In addition, the EU and several other countries have adopted regulations requiring the tracing of biotech crops through the chain of distribution, and they imposed strict labeling requirements on all foods and animal feed containing more than 1 percent GMO. European consumers who fear GMO foods will not purchase products with these labels. The United States claims that the requirements are expensive and unnecessary and have cost U.S. farm exporters hundreds of millions of dollars in lost revenues. In 2003, the United States requested a WTO panel to decide whether the moratorium and labeling requirements violate the *WTO Sanitary and Phytosanitary Agreement*. Research the history of the WTO's deliberations. What was the outcome? Can you find any decisions of the European Court of Justice on GMOs? What is the current state of EU legislation on GMOs? What is your opinion? Do you think that GMOs should be permitted, or do you think they present some possible harm to the environment or to public health?