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IN DEFENSE OF THE WTO: WHY DO WE NEED A MULTILATERAL TRADING SYSTEM?

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In Defense of the WTO: Why Do We Need A Multilateral Trading System?

Weihuan Zhou*

Abstract

For more than seven decades, the multilateral trading system has played an essential role in promoting international cooperation on trade policymaking and dispute resolution. As the WTO is being pushed toward the verge of irrelevance, it falls upon us, who believe in the utility of the WTO and multilateralism in general, to defend its legitimacy and significance. Taking theoretical and doctrinal approaches as well as case studies, this article expounds the fundamental function of the system as being to discipline the use of protectionist policy instruments for trade or non-trade objectives and draws on the significance of the Theory of Distortions and Welfare in providing powerful economic guidance for how the system may operate to achieve a proper balance between the regulation of protectionist instruments and the preservation of policy space. Furthermore, this article shows how the WTO's dispute settlement mechanism, particularly the Appellate Body, has served the underlying function of the system by contributing to disincentivizing governments from responding to protectionist demands of special interest groups but leaving sufficient latitude of discretion for governments to accommodate non-trade interests. This article cautions that if the WTO does collapse and the potential economic and political ramifications materialize, then the political need for international trade cooperation and rules-based dispute resolution will quickly return. By then, the best way to address that need in pursuit of long-term peace and prosperity would be to rebuild a multilateral trading system.

I. INTRODUCTION

After over seven decades of international cooperation on the making of trade policies and settlement of trade disputes, the multilateral trading system, established under the auspices of the World Trade Organization (WTO) and its predecessor the General Agreement on Tariffs and Trade[1] (GATT), is facing unprecedented challenges. As a result of the radical development of U.S. trade policies in the past several years, unilateral and tit-for-tat actions have been on the rise globally as major trading nations, including U.S. allies, take steps to retaliate against U.S. unilateralism.[2] The most disastrous case so far has been the ongoing U.S.-China trade war which has led to a spiral of retaliatory tariffs, and increasingly, other forms

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[1] *General Agreement on Tariffs and Trade*, opened for signature 30 October 1947, 61 Stat. A-11, T.I.A.S. 1700, 55 U.N.T.S. 194.

[2] For a great summary of these actions, see Chad Bown and Melina Kolb, 'Trump's Trade War Timeline: An Up-to-Date Guide', Peterson Institute for International Economics (last updated 7 June 2019), available at: https://piie.com/blogs/trade-investment-policy-watch/trump-trade-war-china-date-guide.

of retaliation beyond trade in goods with the possibility of further escalation.[3] In the long run, these actions are likely to have destructive effects on not only individual economies but also the world economy as a whole.[4] The ongoing effects of these actions, however, have been dampening the pace of trade growth,[5] and, most significantly, pushing the WTO toward the verge of irrelevance. Indeed, if governments continue to resort to unilateralism, public confidence in and support for the WTO is doomed to evaporate over time.

U.S. concerns with the multilateral trading system are centred on three major issues: legislative failure, judicial overreach, and China. Since the foundation of the WTO in 1995, its legislative arm has constantly failed to develop the rulebook of world trade to address cutting-edge and sensitive issues.[6] To a large extent, this legislative failure has become the root cause of the other concerns. Indeed, the U.S. allegation that the WTO's Appellate Body (AB) has in many cases overstepped its judicial authority to create new rules not agreed by Members has much to do with a lack of progress in lawmaking while the AB had to clarify ambiguities or fill gaps in the existing rules in order to resolve disputes. In addressing this and other related issues,[7] the U.S. has been blocking the appointment of new AB judges, which would eventually paralyze the entire dispute settlement mechanism (DSM). The absence of a functioning DSM would trigger a vicious circle in which each Member takes the law into their own hands, consequently further jeopardizing the rules-based trading system. As far as China is concerned, the U.S. has blamed the WTO for a lack of rules to cope with what it sees as China-specific issues such as non-market-oriented policies and practices, state-owned enterprises (SOEs), industrial subsidies and forced technology transfers.[8] The perception that the WTO has failed to compel China to change behaviour on these issues has caused the U.S. to gradually lose confidence in the effectiveness of the multilateral system and shift to other strategies and approaches including unilateral sanctions against and bilateral negotiations with China.[9]

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[3] One of the most recent development was China's creation of an 'unreliable entities' blacklist targeting U.S. technology firms in response to a similar action taken by the U.S. which identified a list of Chinese technology companies including Huawei as a threat to U.S. national security. See Bureau of Industry of Security, Addition of Entities to the Entity List, 12 May 2019, available at: www.federalregister.gov/documents/2019/05/21/2019-10616/addition-of-entities-to-the-entity-list; CGTN, 'MOFCOM: China to Establish 'Unreliable Entities' List', 31 May 2019, available at: https://news.cgtn.com/news/3d3d674e3049444d35457a6333566d54/index.html.

[4] See eg. Pablo Fajgelbaum et al, 'The Return of Protectionism', VOX CEPR Policy Portal (12 April 2019), available at: https://voxeu.org/article/return-protectionism. For an excellent and timely collection on the various features and implications of the trade war, see Meredith A. Crowley (ed.), *Trade War: The Clash of Economic Systems Threatening Global Prosperity* (London: CEPR Press, 2019), available at: https://voxeu.org/content/trade-war-clash-economic-systems-threatening-global-prosperity.

[5] See WTO, 'WTO Trade Indicator Points to Slower Trade Growth into First Quarter of 2019', 19 February 2019, available at: www.wto.org/english/news_e/news19_e/wtoi_19feb19_e.htm.

[6] A notable exception has been the conclusion of the Trade Facilitation Agreement which entered into force on 22 February 2017. For more information on this agreement, see WTO, Trade Facilitation, undated, available at: www.wto.org/english/tratop_e/tradfa_e/tradfa_e.htm.

[7] See Office of the United States Trade Representative, '2018 Trade Policy Agenda and 2017 Annual Report of the President of the United States on the Trade Agreements Program', March 2018, at 22-8, available at: https://ustr.gov/about-us/policy-offices/press-office/reports-and-publications/2018/2018-trade-policy-agenda-and-2017.

[8] See Office of the United States Trade Representative, 'Joint Statement of the Trilateral Meeting of the Trade Ministers of the United States, European Union, and Japan', 23 May 2019, available at: https://ustr.gov/about-us/policy-offices/press-office/press-releases/2019/may/joint-statement-trilateral-meeting.

[9] See eg. United States Trade Representative, '2018 Report to Congress on China's WTO Compliance', February 2019, at 5-25, available at: https://ustr.gov/sites/default/files/2018-USTR-Report-to-Congress-on-China%27s-WTO-Compliance.pdf.

Many WTO Members have been taking collective actions to address the current crisis. For example, despite the WTO's legislative failure, Members have remained committed to the development of rules to tackle contemporary trade issues such as e-commerce.[10] Various joint proposals have been tabled to address U.S. concerns with the DSM and particularly the AB.[11] Interim solutions have been put forward to maintain a functioning DSM in case the appellate system actually becomes paralyzed.[12] These efforts to avoid the potential collapse of the multilateral trading system are a demonstration of continued faith in multilateral and collaborative trade policymaking and dispute resolution based on rules. Importantly, despite the foreseeable AB impasse, Members have continued to resort to the DSM for the resolution of disputes.[13] The fact that the U.S. has remained active in all sorts of WTO activities including the use of the DSM means that "it needs to keep the multilateral route open, even if it doesn't know what it wants to do with the system it created."[14]

At this critical point in time, what can we – academics and proponents of the multilateral trading system – do to defend it? Indeed, like-minded scholars and commentators have been making timely and quality contributions to the debate over the various U.S. concerns and WTO reforms.[15] Less work, however, has been dedicated to improving public understanding of the underlying function of the system. In December 2018, the WTO itself hosted a whole day event to revisit the economic justifications for trade liberalization and the value of a rules-based system of international cooperation.[16] Most recently, Professor Cohen conducted an excellent re-evaluation and re-interpretation of the economic, political and policy considerations that underpin the evolution of the international trade regime, searching for new directions for "integrating trade into broader policy debates and yoking trade's benefits to those policy

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[10] See eg. WTO, Joint Statement on Electronic Commerce, WT/L/1056 (25 January 2019).

[11] See WTO, Dispute Settlement Body, Minutes of Meeting on 27 August 2018, WT/DSB/M/417 (30 November 2018) 31-5; WTO, General Council, 'Informal Process on Matters Related to the Functioning of the Appellate Body', WT/GC/W/768/Rev.1 (26 April 2019).

[12] See WTO, 'Interim Appeal Arbitration Pursuant to Article 25 DSU', JOB/DSB/A/Add.11 (16 May 2019). For discussions of this proposal, see eg. William Alan Reinsch et al. 'Article 25: An Effective Way to Avert the WTO Crisis?', Centre for Strategic & International Studies (CSIS), 24 January 2019, available at: www.csis.org/analysis/article-25-effective-way-avert-wto-crisis.

[13] See WTO, *WTO Annual Report 2019* (Geneva: WTO, 2019) 116-21, available at: www.wto.org/english/res_e/booksp_e/anrep19_e.pdf.

[14] See Peter Draper, 'The US & The WTO: Taking Stock of Recent Trade Strategy Manoeuvres', Opinions, Institute for International Trade, University of Adelaide (11 June 2019), available at: https://iit.adelaide.edu.au/news/list/2019/06/11/the-us-the-wto-taking-stock-of-recent-trade-strategy-manoeuvres.

[15] See eg. Henry Gao, '*Dictum* on *Dicta*: *Obiter Dicta* in WTO Disputes', (2018)17(3) *World Trade Review* 509; Tetyana Payosova, Gary Clyde Hufbauer and Jeffrey J. Schott, 'The Dispute Settlement Crisis in the World Trade Organization: Causes and Cures', Peterson Institute for International Economics Policy Brief 18-5 (March 2018), available at: https://piie.com/system/files/documents/pb18-5.pdf; Robert McDougall, 'Crisis in the WTO: Restoring the WTO Dispute Settlement Function', CIGI Papers No. 194 (October 2018), available at: www.cigionline.org/sites/default/files/documents/Paper%20no.194.pdf; Jennifer Hillman, 'Three Approaches to Fixing the World Trade Organization's Appellate Body: The Good, The Bad and The Ugly?', Institute of International Economic Law, Georgetown University Law Center, IIEL Issue Briefs (10 December 2018), available at: www.law.georgetown.edu/wp-content/uploads/2018/12/Hillman-Good-Bad-Ugly-Fix-to-WTO-AB.pdf; Ernst-Ulrich Petersmann, 'How Should the EU and other WTO Members React to Their WTO Governance and WTO Appellate Body Crises?', EUI Working Paper RSCAS 2018/71 (December 2018), available at: http://cadmus.eui.eu/bitstream/handle/1814/60238/RSCAS_2018_71.pdf?sequence=1&isAllowed=y; Weihuan Zhou, Henry Gao and Xue Bai, 'China's SOE Reform: Using WTO Rules to Build a Market Economy', (2019)68(4) *International and Comparative Law Quarterly* (forthcoming October 2019) (A longer version of this paper is available on SSRN at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3209613).

[16] See WTO, 'Updating Trade Cooperation: An Economic View', 11 December 2018, available at: www.wto.org/english/res_e/reser_e/tradecoorporation111218_e.htm.

ends."[17] These efforts speak strongly for the growing need to re-explore the rationale for the WTO as well as the efficacy of its DSM to re-gain public support for the system and overcome the tide of anti-multilateralism. This paper pursues this objective. While this paper does not directly address the issues that are being debated among WTO Members as described above, it provides a strong argument for why the WTO and its DSM remain highly relevant to and essential for the resolution of these issues.

Section II explains the fundamental function of the WTO by drawing upon the classic theorems of free trade and public choice. It then expounds the Theory of Distortions and Welfare (Theory) and its significance to the world trading system. Section III studies six selected cases to show that the DSM, and particularly the AB's approaches to addressing trade and non-trade values, has consistently served the function of the system by disciplining the choice of policy *instruments* while leaving sufficient policy space for Members' pursuit of non-protectionist policy *objectives*. In the face of the ongoing crisis surrounding the WTO and the DSM, this paper underpins the vital importance of the multilateral trading system and the DSM in restraining protectionist behaviour and draws on the significant implications of the Theory for how to achieve a balance between free trade and local autonomy. This section concludes by elucidating the significance of the analysis and findings in this paper to the current debate over the efficacy and legitimacy of the system while pointing out the potential limitations of this study and hence the need for further studies on certain systemic issues. Section IV sets forth the conclusion.

II. THE FUNDAMENTAL FUNCTION OF THE WTO

Economists have developed broad schools of theories to explain the underlying rationale for a rules-based system of international cooperation on trade liberalization and regulation.[18] I do not intend to offer a comprehensive review of these theories.[19] Rather, I focus on expounding how the system serves to discipline the choice of trade policies and policy instruments by governments in pursuit of protectionist or non-protectionist policy objectives. This requires a brief review of the classic theorems of free trade and public choice.

II.A Choice of Trade Policies

The doctrine of free trade has "survived largely intact against the tide of repeated critical inquiry" and remains economically justified and superior to protection, "however widely rejected in the world of politics".[20] Nevertheless, the case for free trade is a case for unilateral liberalization, which provides no explanation for government cooperation transferring power to an international organization such as the WTO to discipline the behaviours and practices of Member states that affect international trade. Then, why is there a need for the WTO?

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[17] See generally Harlan Grant Cohen, 'What Is International Trade Law For?', (2019)113(2) *American Journal of International Law* 326.

[18] For example, one of the most widely accepted theories views the function of the WTO as being to restrain Members from manipulating terms-of-trade, see Kyle Bagwell and Robert W. Staiger, *The Economics of the World Trading System* (Cambridge, Mass., London: MIT Press, 2002). For critiques against the 'terms-of-trade' theory, see Wilfred J. Ethier, 'The Theory of Trade Policy and Trade Agreements: A Critique', (2007)23(3) *European Journal of Political Economy* 605 (arguing that the theory lacks empirical basis and that it does not reflect the WTO rules).

[19] For a comprehensive analysis of literature on an array of proposed rationale for the formation of the WTO, see WTO, *World Trade Report: Six decades of multilateral trade cooperation: What have we learnt?* (Geneva: WTO, 2007) 50-98.

[20] See generally Douglas A. Irwin, *Against the Tide: An Intellectual History of Free Trade* (New Jersey: Princeton University Press, 1996). Also see Frank Taussig, 'The Present Position of the Doctrine of Free Trade', (1905)6 *Publications of the American Economic Association* 25, 65.

Policymaking does not always follow economic guidance but is often subject to other considerations. In the area of international trade, the reality is that, first, governments do resort to protection for many products and many sectors and, second, governments do resort to many different policy instruments, never tiring of inventing new forms of trade barriers. To understand the underlying rationale for the need of the WTO, it is essential to consider the politics of trade not just the welfare economics. In this regard, the "public choice" theory offers an explanation of why governments are prone to choosing self-harming protectionist policies over economically beneficial policies.

In essence, the "public choice" theory characterizes elected officials as self-interested individuals who formulate policies to attract support and minimize opposition from domestic interest groups so as to maximize their chances of retaining power.[21] As the government choice of trade policies would likely change the payoff for these interest groups, they would be keen to make political contributions with an aim to influence government decision-making on trade policies for their own benefits. Governments tend to be much more responsive to the demands of import-competing producers than to the needs of consumers, given the significantly uneven influence of the two opposing forces in the political process. Thus, even though government officials are knowledgeable about the long-term economic costs of protection, they are highly tempted by short-term political gains obtainable from granting protection to influential constituencies (i.e. import-competing producers).

II.B Choice of Policy Instruments

The insight that the "public choice" theory offers is not limited to explaining the political preference for granting protection over liberalizing trade. The theory could also explain why, to protect a domestic industry, politicians would opt for policy instruments which tend to be less transparent and more trade-restrictive and distortive from an economist's perspective.

Trade economists rank various policy instruments according to their welfare effects.[22] Where protection is politically preferable, standard economic analysis shows that a production subsidy imposes a smaller burden on a national economy compared to trade policy instruments applied at the border (e.g. import tariffs and quotas). This is because while the production subsidy only entails a distortion on the production pattern of the economy, the tariff and the quota tend to cause net welfare loss associated with both domestic production and consumption. Furthermore, an import tariff is generally observed as a preferable trade policy to an import quota which tends to be more trade-restrictive and distortive and less transparent. The economic ranking of policy instruments remains valid in situations where the imposition of a policy instrument is intended for the correction of a domestic externality or for the pursuit of a domestic non-protective policy objective. This will be elaborated in Section II.D below.

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[21] The seminal work on "public choice" theory includes Anthony Downs, *An Economic Theory of Democracy* (New York: Harper & Brothers, 1957); James M. Buchanan and Gordon Tullock, *The Calculus of Consent: Logical Foundations of Constitutional Democracy* (Ann Arbor: University of Michigan Press, 1962); and Mancur Olson, *The Logic of Collective Action: Public Goods and the Theory of Groups* (Cambridge, Mass.: Harvard University Press, 1965). These three pieces of work form the foundation of subsequent development of modern political economy theories. See, eg. Robert E Baldwin, 'The Political Economy of Protectionism' in Jagdish N Bhagwati (eds.), *Import Competition and Response* (Chicago: University of Chicago Press, 1982) 263-286; Gene M. Grossman and Elhanan Helpman, 'Protection for Sale' (1994)84(4) *American Economic Review* 833; Gene M. Grossman and Elhanan Helpman, 'Trade Wars and Trade Talks' (1995)103(4) *Journal of Political Economy* 675; Kenneth W. Abbott, 'The Trading Nation's Dilemma: The Functions of the Law of International Trade' (1985)26(2) *Harvard International Law Journal* 501; Ernst-Ulrish Petersmann, *Constitutional Functions and Constitutional Problems of International Economic Law* (Fribourg, Switzerland: Westview Press, 1991) 95-138.

[22] Many publications contain an explanation of the economic ranking of policy instruments. See eg. Richard Blackhurst, 'The Economic Effects of Different Types of Trade Measures and Their Impact on Consumers' in OECD, International Trade and the Consumer (OECD, Paris, 1986) 94-111; Peter H. Lindert, *International Economics* (Illinois: Richard Irwin, 8th Ed., 1986) ch 6.

Ironically, the ranking in terms of political choice of the aforementioned policy instruments for protection would likely demonstrate a reverse order of the economic ranking.[23] An import quota, being the most trade-restrictive and distortive, tends to be the most favourable instrument from the perspective of producers while it attracts less awareness (and hence resistance) from consumers compared with a tariff. This makes an import quota politically attractive. In contrast, a production subsidy may be the least preferred politically as it involves matters subject to periodical parliamentary review and approval, such as raising taxes for the finance of the subsidy and the allotment of government budget. Comparatively, the imposition of a tariff does not involve budgetary transfers and therefore would generate less scrutiny. The administration of an import quota (i.e. the allocation of import licences) is an administrative activity which is not subject to parliamentary scrutiny and hence is relatively easy to maintain.

The brief overview of the literature above demonstrates the opposition of the rankings of policy instruments on the basis of economic efficiency and political likelihood. While it only covers three policy instruments, it shows the unwillingness of government officials to follow the guidance of economic theories on the choice between protection and trade liberalization and on the choice of policy instruments for protectionist objectives. Table 1 below summarizes the economic and political rankings of policy instruments.

Table 1: Economic and political rankings of policy instruments[24]

Policy Instruments	Economic Rankings	Political Rankings
Production subsidy	1	3
Import tariff	2	2
Import quota	3	1

II.C Disciplining the Selection of Trade Policies and Policy Instruments

The multilateral trade rules address the "government failure" discussed above and serve a "domestic policy function" by removing or reducing the constraints or pressure confronted by governments in formulating and implementing trade policies and policy instruments.[25] To do so, these rules impose an external influence upon domestic decision-making by making it politically costly to deviate from economically efficient and transparent policy instruments. The WTO performs this function by incorporating the interests of exporters into the domestic decision-making process, which counteracts the political influence of import-competing producers.[26] As the main beneficiary from a reciprocal trade

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[23] See Frieder Roessler, 'The Constitutional Function of the Multilateral Trade Order' in Meinhard Hilf & Ernst-Ulrich Petersmann (eds.), *National Constitutions and International Economic Law* (Deventer, The Netherlands: Kluwer, 1993) 53-62.

[24] This table is drawn from Roessler, above n 23, 'The Constitutional Function of the Multilateral Trade Order', at 59.

[25] Jan Tumlir, 'International Economic Order: Rules, Co-operation and Sovereignty' in Peter Oppenheimer (eds.) *Issues in International Economics* (Stocksfield, Northumberland, England: Oriel Press Ltd., 1980) 1-15; Frieder Roessler, 'The Scope, Limits and Function of the GATT Legal System', (1985)8(3) *The World Economy* 287; Ernst-Ulrish Petersmann, 'Trade Policy as A Constitutional Problem' (1986)41(II/III) Aussenwirtschaft 405; above n 21, Petersmann, *Constitutional Functions and Constitutional Problems of International Economic Law*; above n 23, Roessler, 'The Constitutional Function of the Multilateral Trade Order'.

[26] Robert E. Hudec, 'Circumventing Democracy: The Political Morality of Trade Negotiations' (1992-93)25(2) *N.Y.U. Journal of International Law & Politics* 311, 316; Kenneth W. Dam, 'Cordell hull, the Reciprocal Trade Agreement Act, and the WTO' in Ernst-Ulrich Petersmann (eds.) *Reforming the World Trading System: Legitimacy, Efficiency, and Democratic Governanc*e (Oxford, New York: Oxford University Press, 2005) 83, 96. Also see Arthur Dunkel, GATT Press Release No. 1312, March 5, 1982, cited in John H. Jackson, 'GATT Machinery and the Tokyo Round Agreements' in John H. Jackson, *The Jurisprudence of GATT and the WTO – Insights on Treaty Law and Economic Relations* (Cambridge, New York: Cambridge University Press, 2000) p 47. Arthur Dunkel, the former Director-General of GATT, addressed:

liberalization agreement, exporters have incentives to lobby for the opening-up of their own borders in exchange for the enhancement of market access in foreign markets. The requirement of reciprocity is fundamental as it creates lobbying incentives for exporters who know that the only way to secure lower tariff rates in a foreign importing country is to persuade the domestic government of their own to implement tariff reductions. Exporters tend to be more easily organized than consumers and more active contributors to lobbying activities, hence constituting a stronger opposition to trade protection. As the influence of exporters increases, domestic protectionist pressure is counterbalanced, at least to some extent. Moreover, in the face of increasing contributions and participation by exporters, more contributions must be made by import-competing producers so as to maintain their influence on government officials and secure their preferred trade policy and policy instruments. Finally, once a round of trade negotiation successfully leads to the reduction of the level of protection, the amount at stake under the remaining level of protection diminishes, thereby reducing the amount that import-competing producers would be prepared to expend in opposing a further round of reciprocal trade liberalization. Thus, at the same time that the WTO rules strengthen the force for liberal trade, they also have the effect of depleting the amount that protectionists would expect to gain from maintaining the gradually reduced levels of protection.

The GATT/WTO rules embody the underlying function of the system described above. As Professor Petersmann observes,

> GATT law ranks the various trade policy instruments according to their respective welfare costs in almost the same way as economic theory suggests: the less a policy instrument tends to distort trade, the less legal restraint GATT law places on its use.[27]

To understand this observation, a brief description of the basic GATT/WTO rules is warranted. Generally speaking, domestic measures are not regulated as strictly as trade measures. For example, domestic subsidies are not generally prohibited. A subsidizing Member is allowed to maintain domestic subsidies as long as it effectively removes the adverse effects to the interests of other Members or tolerates countervailing measures. Furthermore, non-specific subsidies (i.e. subsidies generally granted for all industries, say, in support of research and development) are permitted even though they may adversely affect trade. Finally, it is at the discretion of Members to impose domestic taxes and regulations so long as they do not entail discrimination against imports in favour of 'like' or competitive domestic products. Comparatively, trade measures such as tariffs and quotas are subject to stricter disciplines. Tariffs are allowed, but are subject to bound rates agreed in periodical trade negotiations. Quantitative restrictions such as an import quota are in principle prohibited.

Furthermore, provisions aiming to ensure transparency of government regulations and policies spread across almost all WTO agreements. The transparency provisions help ensure that exporters actually receive the market access that has been promised, which, in turn, help enhance the reliability of politicians receiving political support from exporters. Moreover, the requirement of transparency could effectively reduce information costs and assure the availability and accessibility of policy information for consumers.[28]

> … international economic policy commitments, in the form of agreed rules, have far-reaching domestic effects … They form the basis from which the government can arbitrate and secure an equitable and efficient balance between the diverse domestic interests: producers vs. consumers, export industries vs. import-competing industries, between particular narrowly defined industries.

[27] See Ernst-Ulrich Petersmann, 'National Constitutions and International Economic Law' in Meinhard Hilf & Ernst-Ulrich Petersmann (eds.) *National Constitutions and International Economic Law* (Deventer, Boston: Kluwer Law and Taxation Publishers, 1993) 3-52, 47-48.

[28] See John O. McGinnis and Mark L. Movsesian, 'The World Trade Constitution', (2000)114 *Harvard Law Review* 512, 547.

Finally, it is important to note what the WTO is not intended to do. One commonly accepted view is that the WTO does not require its Members to sacrifice "the pursuit of any economic or social policy goal" for the pursuit of free trade.[29] WTO tribunals have endorsed this view. In *US – Gasoline*, both the panel and the AB observed that Members should be free to pursue their own environmental objectives as long as the policy instruments they choose in pursuit of these objectives are not inconsistent with the WTO rules.[30] In *Australia – Salmon*, the AB highlighted the distinction between policy objectives and policy instruments, stating that what the WTO rules seek to regulate are the instruments, not the objectives.[31] Thus, WTO Members' freedom to pursue bona fide policy objectives is not circumscribed by the WTO rules. Accordingly, the WTO rules provide for a host of exceptions and recognize that non-protectionist policy objectives should take priority over trade liberalization and that WTO-inconsistent measures may be necessary to attain these objectives.

In summary, WTO rules are designed to impose different degrees of constraints upon various policy instruments in conformity with the suggestion of standard economic theories. This design ensures that the WTO effectively performs the function of disciplining Members' choice of policy instruments. By allowing the use of GATT-inconsistent instruments to pursue an array of policy objectives unrelated to trade, the WTO recognizes Members' freedom to pursue non-trade policy objectives.

II.D The Theory of Distortions and Welfare

The significance of the Theory[32] lies in its two key propositions. The first proposition is that in the presence of a domestic externality or non-economic objective, trade liberalization may either enhance or

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[29] See eg above n 21, Petersmann, *Constitutional Functions and Constitutional Problems of International Economic Law*, at 230; above n 23, Roessler, 'The Scope, Limits and Function of the GATT Legal System', at 294; Alan O. Sykes, 'Regulatory Protectionism and the Law of International Trade' (1999)66(1) *The University of Chicago Law Review* 1, 6-7, 23; Elsa Horn and Petros Mavroidis, 'Still Hazy After All These Years: The Interpretation of National Treatment in the GATT/WTO' (2004) 15(1) *European Journal of International Law* 39, 57.

[30] See Panel Report, *United States – Standards for Reformulated and Conventional Gasoline* (*US - Gasoline*), WT/DS2/R, adopted 20 May 1996, para. 7.1; Appellate Body Report, WT/DS2/AB/R, adopted 20 May 1996, p. 30.

[31] See Appellate Body Report, *Australia – Measures Affecting Importation of Salmon*, WT/DS18/AB/R, adopted 6 November 1998, paras. 199-200. The AB observed:

> The determination of the appropriate level of protection … is a prerogative of the Member concerned and not of a panel or of the Appellate Body … The "appropriate level of protection" established by a Member and the "SPS measure" have to be clearly distinguished. [footnote omitted] They are not one and the same thing. The first is an objective, the second is an instrument chosen to attain or implement that objective.

[32] The Theory of Distortions and Welfare is built up on a large number of works of many eminent economists. See eg. Gottfried Haberler, 'Some Problems in the Pure Theory of International Trade', (1950)60 *Economic Journal* 223; Max W. Corden, 'Tariffs, Subsidies and the Terms of Trade', (1957)24 *Economica* 235; Everett E. Hagen, 'An Economic Justification of Protectionism', (1958)72 *Quarterly Journal of Economics* 496; Harry Johnson, 'The Cost of Protection and the Scientific Tariff', (1960)68(4) *Journal of Political Economy* 327; Jagdish N. Bhagwati and V.K. Ramaswami, 'Domestic Distortions, Tariffs and the Theory of Optimum Subsidy', (1963)71(1) *Journal of Political Economy* 44; Harry Johnson, 'Optimal Trade Intervention in the Presence of Domestic Distortions' in Jagdish N. Bhagwati, *International Trade: Selected Readings* (Cambridge, Mass., London: MIT Press, 1981) 142-169; Jagdish N. Bhagwati, V.K. Ramaswami and T.N. Srinivasan, 'Domestic Distortions, Tariffs and the Theory of Optimum Subsidy: Some Further Results' (1969)77(6) *Journal of Political Economy* 1005; Jagdish N. Bhagwati and T.N. Srinivasan, 'Optimal Intervention to Achieve Non-Economic Objectives' (1969)36(1) *Review of Economic Studies* 27. In 1971, the Theory was consolidated by Professor Bhagwati, see Jagdish N Bhagwati, 'The Generalized Theory of Distortions and Welfare' in Jagdish N. Bhagwati et al. (eds.) *Trade balance of payments and growth: papers in International Economics in Honor of Charles P. Kindleberger* (Amsterdam London: North-Holland Publishing Co., 1971) 69-90. For a review of the historical development of the theory and its applications, see Jagdish N. Bhagwati, *Free Trade Today* (Princeton and Oxford: Princeton University Press, 2002).

diminish welfare but would remain welfare enhancing if the externality or objective is addressed separately with an optimal or first-best policy instrument. The second proposition is that in response to the externality or objective, policy instruments can be ranked according to their economic efficiency and an optimal policy instrument is one which strikes most directly at the source of the externality or objective; this is known as the "specificity rule" or "targeting rule".

Thus, in the pursuit of a domestic non-protectionist policy objective, the first-best policy would generally be a domestic tax or subsidy which strikes directly at the locus of the problem. When an import tariff is used, it tends to entail a by-product loss to the economy and hence may or may not enhance national welfare.[33] This is because the tariff does not tackle the problem at its source. In addition to comparing the welfare effects between a domestic instrument and a trade instrument, the Theory applies to the ranking of domestic policy instruments as well. For example, in the presence of a domestic production/output-related externality or a policy objective to bolster or curtail production/output, the first-best policy is a production subsidy or tax. The second-best policy is either a tax or subsidy on factor-use or a tariff. A tax or subsidy on consumption tends to make things worse as it adds a loss at the consumption side on the top of the existing distortion associated with the production activities. The same rule applies to a domestic consumption externality or a policy objective to encourage or discourage consumption, distortions in factor market or a policy objective to ensure optimal production feasibility and to alter the factor-use in a sector, etc.[34]

The Theory is subject to two standard assumptions. The first assumption is that there is only one externality in the domestic economy. However, the "specificity rule" stands valid even though this assumption is removed. That is, when two or more externalities (or domestic objectives) co-exist, the first-best policy would be the use of two or more domestic policy instruments attacking directly at the source of each externality (or addressing each objective specifically). An important extension of this proposition is that in the presence of two or more externalities, the reduction of the most extreme externality would be welfare-enhancing.[35]

The second assumption is that there are no by-product costs associated with the application of a first-best policy instrument. Professor Corden examined four principal by-product costs that the imposition of a subsidy or a tax may entail, including (1) the distortion costs associated with raising revenue to finance a subsidy, (2) the costs associated with collecting taxes, (3) the costs associated with disbursing a subsidy, and (4) the income distribution distortion costs associated with taxing and subsidising.[36] He concluded that only the costs in item (3) may affect the general applicability of the Theory. Particularly, Corden was concerned about the disbursement costs in developing or least-developed countries, especially in their underdeveloped industries. Such costs may be so high that the Theory suggesting direct subsidization no longer stands valid, and a tariff which incurs no disbursement costs may become a better solution. Nevertheless, Corden emphasized that empirical evidence related to the magnitudes of the disbursement costs is required in judging whether a subsidy remains preferable to a tariff.

The Theory has profound implications for the multilateral trading system, which are set out below:

- it reinforces the case for trade liberalization as opposed to protectionism. This is because in cases where domestic externalities/non-trade objectives are present, the effect of trade liberalization would remain welfare-enhancing if the externalities/objectives are addressed through first-best

[33] As Deardorff and Stern described, "Trade policy is like doing acupuncture with a fork: no matter how carefully you insert one prong, the other is likely to do damage." See Alan V. Deardorff and Robert M. Stern, 'Current Issues in Trade Policy: An Overview' in Robert M. Stern (eds.), *U.S. Trade Policies in a Changing World Economy* (Cambridge, Mass., London: MIT Press, 1987) 15-72 at 39.

[34] See generally above n 32, Bhagwati, 'The Generalized Theory of Distortions and Welfare'.

[35] See P. J. Lloyd, 'A More General Theory of Price Distortions in Open Economies' (1974) 4(4) *Journal of International Economics* 365, 379.

[36] See Max W. Corden, *Trade Policy and Economic Welfare* (Oxford: Clarendon Press, 2nd ed., 1997) 33-44.

policy instruments. This suggests that (1) international trade regulation and enforcement must not unduly limit the freedom of governments to tackle such externalities/objectives, and (2) in cases where more than one externality/objective exists, governments should be allowed to treat different externalities in a different manner and address the largest externality first. However, the existence of such externalities/objectives and the need for government intervention does not provide an economic justification for the resort to protectionist measures.

- it provides an approach to striking a balance between trade liberalization and domestic autonomy. It suggests that in determining whether a chosen policy instrument is justifiable by a non-protectionist purpose, WTO tribunals should, firstly, identify the genuine objective; and secondly, assess the appropriateness of the instrument.
- it provides economic guidance for the assessment of the appropriateness of a chosen policy instrument in the pursuit of a given objective. According to the "targeting rule", the more specifically a policy instrument addresses the objective, the more economically efficient it tends to be. This rule applies to situations in which two or more externalities/objectives exist. Given the political ranking of policy instruments, international cooperation on trade liberalization and regulation remains essential to effectively discourage the use of sub-optimal policy instruments for protectionist purposes.
- in disciplining the choice of policy instruments based on the "targeting rule", WTO tribunals must take into account whether the application of the first-best instrument would (1) be capable of reducing the externality or fulfilling the objective as effectively as the chosen instrument; and (2) give rise to by-product costs which render it economically inferior to the chosen instrument.

III. THE EFFECTIVENESS OF THE DISPUTE SETTLEMENT MECHANISM

The efficacy of WTO rules would be considerably weakened if they cannot be enforced. The DSM, in serving the function of clarifying and enforcing WTO rules, is commonly regarded as "the jewel in the crown" of the multilateral trading system. While the success of the DSM in resolving trade disputes and developing international trade rules is widely recognized, it has frequently been subject to criticisms. One of the longest-lasting and persisting criticisms has been the view that WTO tribunals, especially the AB, tend to promote trade liberalization at the sacrifice of Members' policy space in pursuing legitimate regulatory goals. This section examines a number of selected cases involving trade and non-trade values to show that the AB's rulings and the outcomes of these disputes have been largely consistent with the economic suggestions derived from the Theory. The AB's approaches and decisions have ensured that the DSM is effective in disciplining the choice of policy instruments by Member states while not unduly impairing their capacity to pursue non-protectionist policy objectives, thereby reaching a proper balance between trade liberalization and domestic autonomy. Accordingly, it is submitted that the DSM has served the underlying function of the WTO by imposing an external constraint on domestic protectionist pressure on regulatory decision-making without restraining the capacity of governments to respond to non-trade/non-protectionist interests of other domestic constituents.

III.A *US – Gasoline* (1996)

The *US – Gasoline* dispute concerned U.S. regulation of the composition and emission effects of gasoline for environmental purposes (i.e. air pollution control). The core issue of these measures was that they applied different rules for the establishment of benchmark gasoline emission levels between domestic and foreign refiners. Specifically, foreign refiners were not permitted to establish their own individual baselines in the same manner as that permitted for domestic refiners such that foreign refiners had to

comply with a statutory baseline.[37] This differential treatment was found to be in breach of the national treatment (NT) rule under GATT Article III:4 as it treated imported gasoline less favourably than domestic gasoline.[38] The U.S. invoked GATT Article XX(g) as a defense, claiming that the measures served the objective of conserving exhaustible natural resources.

In assessing the U.S. defense, the AB found that the baseline establishment rules had a substantial relationship with the environmental objective.[39] However, the discrimination at issue was unjustifiable within the meaning of the Chapeau of Article XX as the U.S. could attain the objective without discrimination. An alternative means may include the application of (1) the statutory baselines on both imported and domestic gasoline, or (2) the individual baselines on imported gasoline in the same way as they were applied to domestic gasoline.[40] The AB then rejected U.S. claims relating to certain administrative and financial difficulties in applying the alternative means. The AB held that the administrative problems associated with the application of the individual baseline to foreign gasoline may be resolved through the development of cooperative arrangements with foreign refiners and the relevant foreign governments.[41] With respect to the physical and financial costs and burdens that U.S. refiners would encounter if they are required to apply the statutory baseline, the AB ruled that the U.S. had failed to pay the same regard to the costs and burdens for foreign refiners to comply with the statutory baseline.[42]

To implement the WTO rulings, the U.S. revised the gasoline regulation to allow foreign refiners to use individual baselines.[43] Thus, the rulings effectively pushed the U.S. to use a less trade restrictive and more economically efficient measure to pursue the environmental goals. By removing the discriminatory treatment against imported gasoline, the revised regulation became less restrictive on trade. It allowed foreign refiners to avoid the considerable financial costs associated with the adjustments required to comply with the statutory baseline. Although compliance costs might still arise from the application of the individual baseline, these costs now fell equally on both domestic and foreign refiners.

With respect to the economic efficiency of the revised measure, the objective at stake was to address the negative externality associated with the use of environmentally-harmful gasoline ingredients. The first-best instrument to address the externality should directly target the use of polluting ingredients irrespective of the gasoline's origin. The design of the U.S. measures was in conformity with the "specificity rule" except for the discriminatory element. By forcing the U.S. to remove the discrimination, the AB did not prevent the U.S. from achieving the objective but effectively encouraged the use of a more efficient measure for accomplishing the objective. The AB stressed that its decision should not be interpreted as restraining "the ability of any WTO Member to take measures to control air pollution or, more generally, to protect the environment".[44] Rather, the AB elucidated that "WTO Members have a large measure of autonomy to determine their own policies on the environment (including its relationship with trade), their environmental objectives and the environmental legislation they enact and implement."[45] Accordingly, the AB paid due deference to U.S. choice of regulatory objectives while disciplining its choice of policy instruments. In assessing the appropriateness of the chosen instruments, the AB suggested that the reasonable availability of alternative means must be considered. Therefore,

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[37] See above n 30, Panel Report, *US – Gasoline*, paras. 2.5-8.

[38] Ibid., para. 6.16.

[39] See above n 30, Appellate Body Report, *US – Gasoline*, p. 19.

[40] Ibid., p. 25.

[41] Ibid., p. 27.

[42] Ibid.

[43] Raj Bhala, *Modern GATT Law: A Treatise on the General Agreement on Tariffs and Trade* (London: Sweet & Maxwell, 2005) 658. For an explanation of why the U.S. chose this way of implementation, see David Palmeter, 'National Sovereignty and the World Trade Organization', (1999) 2(1) *Journal of World Intellectual Property* 77, 85-6.

[44] See above n 30, Appellate Body Report, *US – Gasoline*, p. 29.

[45] Ibid., p. 30.

chosen instruments may remain valid if the application of alternative means would impose undue financial or administrative burdens on a regulating Member.

In short, in its very first report adopted under the DSM, the AB has drawn a line between policy objectives and policy instruments and endorsed Members' regulatory freedom in pursuing the former, but at the same time sought to encourage the use of more-trade-friendly and more efficient means for such objectives taking into account the by-product costs associated with the use of such means. These approaches are consistent with the economic guidance provided by the Theory which allows an appropriate balance between the disciplining of protectionist instruments and the deference to domestic autonomy to be achieved.

III.B *EC – Asbestos* (2001)

EC – Asbestos[46] involved a French ban on the import, export, and use of all varieties of asbestos fibres and any product containing asbestos fibres irrespective of their origin. Canada claimed that this formally origin-neutral ban had a disparate impact on certain imported fibres vis-a-vis "like" domestic fibres in breach of the NT rule. The panel found that the measure violated GATT Article III:4, but that it was justifiable under Article XX(b) as being necessary to protect human life and health.[47] On appeal, the AB reversed the panel's findings of violations under Article III:4,[48] meaning that the question of compliance with Article XX(b) effectively fell away. Despite this, the AB decided to go ahead and examine Canada's appeal under Article XX(b).

Before the AB, Canada questioned the stated level of protection as being to halt the spread of asbestos-related health risks.[49] The AB rejected Canada's claim, holding that the measure could contribute to the objective by "[p]rohibiting all forms of amphibole asbestos, and by severely restricting the use of chrysotile asbestos."[50] The AB then dismissed Canada's contention that "controlled use" was a less trade restrictive means that was reasonably available. It ruled:

> France could not reasonably be expected to employ any alternative measure if that measure would involve a continuation of the very risk that the Decree seeks to "halt". Such an alternative measure would, in effect, prevent France from achieving its chosen level of health protection … even in cases where "controlled use" practices are applied "with greater certainty", the scientific evidence suggests that the level of exposure can, in some circumstances, still be high enough for there to be a "significant residual risk of developing asbestos-related diseases."[51]

Thus, a proposed alternative means that may not be as effective as the chosen measure in pursuing a given objective or level of protection would not be accepted.

The AB's rulings confirmed that WTO Members are free to exercise their autonomy in the selection of policy objectives and that an import ban, the most trade restrictive means, may be necessary to pursue a chosen objective. *EC – Asbestos* involved a negative externality arising from the consumption of asbestos. Usually the first-best solution would have been for France to impose an internal tax on the consumption of asbestos. The size of the externality was so large, however, that had it been internalized into consumers' decisions, the equilibrium level of consumption would have been zero. In order to reach

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[46] Panel Report, *European Communities – Measures Affecting Asbestos and Asbestos-Containing Products* (*EC – Asbestos*), WT/DS135/R, adopted 5 April 2001; Appellate Body Report, *European Communities – Measures Affecting Asbestos and Asbestos-Containing Products*, WT/DS135/AB/R, adopted 5 April 2001.

[47] See above n 46, Panel Report, *EC – Asbestos*, para. 8.241.

[48] See above n 46, Appellate Body Report, *EC – Asbestos*, para. 148.

[49] Ibid., para. 165.

[50] Ibid., para. 168.

[51] Ibid., para. 174.

that equilibrium, France would have had to impose a prohibitive internal tax on the consumption of the product regardless of whether it was sourced from domestic production or imports. It would be administratively easier and no more restrictive to simply impose a prohibition on domestic sales of the product regardless of source. The AB accepted that the objective was to address a negative consumption externality and, further, in accepting that the French objective was to reduce consumption of asbestos to zero, it accepted that the size of the externality was so large as to make the desired equilibrium level of consumption zero. The AB's acceptance of the stated level of protection seems reasonable as does its rejection of the proposed alternative instrument. Thus, in spite of the trade restrictiveness of the ban, it tended to be the only means that France could undertake to achieve the chosen objective. Even if France had replaced the restriction with an internal tax, it would have been most likely to set the tax at a prohibitive rate (i.e. as a *de facto* ban) so that the externality could be adequately tackled.

In short, in allowing the EC to use the most trade restrictive instrument for the protection of public health, the AB's decision was evidently deferential to EC's policy space, sending a strong signal that the WTO does not prioritize trade values over non-trade values that a Member pursues genuinely.

III.C *Brazil – Retreaded Tyres* (2007)

Brazil – Retreaded Tyres arose out of a series of measures that Brazil adopted to reduce the health risks associated with the accumulation of waste tyres. The stated goal was to reduce the risks to the maximum extent possible.[52] To achieve that objective, Brazil imposed an import restriction on both retreaded tyres and used tyres. Furthermore, it established a scheme whereby domestic manufacturers and importers of new tyres were required "to collect and dispose of waste tyres to a proportion of five waste tyres for every four new tyres."[53] In order to encourage retreading activities, domestic retreaders were exempted from "disposal obligations, as long as they process tyres consumed within the country's territory."[54] However, there were two exceptions to the import restrictions. One was the MERCOSUR exemption: retreaded tyres originating in MERCOSUR countries were exempted from the import ban. This exemption was granted in response to the MERCOSUR arbitral award in favour of Uruguay as Brazil's import ban had violated MERCOSUR rules. The other was Brazil's court injunctions: the importation of used tyres was allowed for a number of Brazilian retreaders who had successfully obtained court injunctions.[55] The import ban on retreaded tyres was a clear breach of Article XI:1 of the GATT. Therefore, the critical issue in this dispute was whether the measure can be justified under Article XX.

The AB found that the import ban was justifiable under Article XX(b) as it constituted an essential element of Brazil's comprehensive scheme to reduce waste tyres, making a material contribution to the health-related objective.[56] It rejected all the proposed alternative means on the grounds that while some of these measures (such as landfilling and incineration) would pose other health or environmental risks, the implementation of others (such as material recycling) would involve "prohibitive costs or substantial technical difficulties" for Brazil.[57] The AB further explained that given the importance of the import ban to Brazil's comprehensive strategy for the reduction of waste tyres, it was not substitutable with the alternative means which were only complementary to the ban.[58] However, the AB was unhappy with the discriminatory elements in the Brazilian measure, finding that the MERCOSUR exemption (i.e. an MFN-

[52] Panel Report, *Brazil – Measures Affecting Imports of Retreaded Tyres* (*Brazil – Retreaded Tyres*), WT/DS332/R, adopted 17 December 2007, para. 7.108.

[53] Ibid., para. 7.137.

[54] Ibid.

[55] Ibid., paras. 7.239, 7.241. MERCOSUR stands for the Southern Common Market, an economic and political bloc among Argentina, Brazil, Paraguay and Uruguay.

[56] Appellate Body Report, *Brazil – Measures Affecting Imports of Retreaded Tyres* (*Brazil – Retreaded Tyres*), WT/DS332/AB/R, adopted 17 December 2007, paras. 153-4.

[57] Ibid., para. 171.

[58] Ibid., para. 172.

type discrimination) and the court injunctions (i.e. an NT-type discrimination) were unjustifiable and arbitrary within the meaning of the Chapeau because neither of them "had a legitimate cause or rationale in the light of the objectives".[59]

This case involved two externalities:

- a positive production externality associated with tyre-retreading in Brazil, in the sense that the retreading of used tyres by the Brazilian retreading industry could reduce the number of waste tyres in Brazil and consequently, contribute to the reduction of health and environmental harms arising from the generation of waste tyres. In this way, tyre-retreading could be seen to yield a benefit to the society as a whole. The need for government intervention could have arisen from the fact that the social benefit of tyre-retreading was not reflected in the market price of retreaded tyres and, hence, retreaded tyres were under-priced, which caused the production of retreaded tyres to be at a lower level than the socially desirable level; and
- a negative consumption externality associated with the consumption of all kinds of tyres (new and retreaded) in the form of increased risks to human health and the environment arising from increments to the pool of used tyres in Brazil. The need for government intervention could have arisen from the fact that the social costs of tyre-consumption were not taken into account by consumers in making their consumption decisions, thereby leading to an under-pricing of all tyres, and consumption in excess of the socially desirable level.

The first-best instrument to address the positive production externality would be for Brazil to subsidize domestic tyre-retreading so as to increase retreading to a socially desirable level. When a subsidy program is financially or administratively difficult to implement, an import tariff can be utilized for the same purpose of encouraging domestic tyre-retreading. The economically optimal solution to the negative consumption externality would be to impose an internal tax on the consumption of all tyres so as to reduce the consumption to a socially desirable level. Since there are two externalities, the subsidy/tariff and the consumption tax should be implemented simultaneously to tackle each externality respectively. And these instruments tend to be less-trade-restrictive and more economically efficient than the Brazilian import ban. By justifying the ban under Article XX(b), the AB approved the most trade-restrictive instrument for health and environmental reasons, showing great respect for local autonomy.

However, by virtue of the 'non-discrimination' standard of the Chapeau, the AB has arguably made the import ban a more efficient, though no less restrictive, means for achieving the chosen objective. After finding that the two elements of discrimination constituted "arbitrary or unjustifiable discrimination", the AB recommended that Brazil remove them. Brazil could take either of the following two remedial actions: (1) lifting the import ban to allow the importation of retreaded and used tyres from all countries; or (2) strictly applying the import ban to imports of tyres from all sources without exceptions. Given the Brazilian government's concern about the health and environmental problems at stake, it is unlikely the first option would be adopted. On 14 September 2009, Brazil notified that it had fully implemented the recommendations by promulgating a new regulation which "prohibits new licenses for the importation of used and retreaded tyres to be issued, irrespective of their origin."[60] Therefore, the AB's ruling made the import ban even more trade-restrictive than it was originally. However, the no-exceptions import ban may be more efficient in tackling the externalities than the import ban with exceptions. In essence, the removal of the two elements of discrimination which do not serve the chosen objective has made the import ban target more closely on the externalities. Specifically, the imports of retreaded tyres resulting from the MERCOSUR exemption would have led to a decrease in the price of

[59] Ibid., paras. 225, 228, 246.

[60] WTO, Status Report Regarding Implementation of the DSB Recommendations and Rulings in the Dispute *Brazil – Measures Affecting Imports of Retreaded Tyres*, WT/DS332/19/Add.6 (15 September 2009) 2.

retreaded tyres and, consequently, to a decrease in the production of retreaded tyres.[61] Meanwhile, as a substitute for domestic used tyres, the import of used tyres, by virtue of the court injunctions, would have increased the sum of used tyres, and, as a consequence, weakened "the incentive to retread" Brazilian used tyres.[62] The removal of the two exemptions, therefore, served to safeguard the welfare gains that could have flowed from the use of the ban to address the positive production externality and the negative consumption externality.

In short, the AB's condemnation of the discrimination is reasonable given the negative impacts of the discrimination on the fulfillment of the chosen objective. While the revised measure tended to be more trade restrictive, it became more economically efficient in achieving the objective. This outcome reinforces the observation that the AB paid due respect to Members' policy space in the choice of policy objectives. When deciding whether and how to discipline the choice of policy instruments, the AB's decision confirmed that a proposed alternative means must be equivalently effective as the chosen means as well as reasonably available to render the latter unjustifiable. These conditions provide WTO Members flexibility in deciding the policy instruments to be employed in pursuing a given objective.

III.D *China – Publications and Audiovisual Products* (2010)

China – Publications and Audiovisual Products[63] concerned the restriction of the right to import certain cultural goods – including reading materials, audiovisual products, sound recordings, and films for theatrical release – to certain Chinese SOEs. The panel found that these restrictions were incompatible with China's commitments to liberalizing trading rights for all entities, including foreign-invested enterprises (FIEs), as envisaged in the instruments on China's accession to the WTO.[64] China did not question the panel's findings of violations but sought to defend the measures under Article XX(a) which allows the use of WTO-illegal measures for the protection of public morals. For China, the measures served to maintain an effective and efficient content review mechanism which ensures that imports do not contain content that could have negative impacts on public morals.[65] Not persuaded by China, the WTO tribunal found that some of the measures did not materially contribute to the protection of public morals and further, there was a less-trade-restrictive alternative means that China could have employed to attain the objective.[66] In the eyes of the tribunal, an effective and reasonably available alternative means would be for the Chinese government to conduct the content review of the goods imported by FIEs and other non-state entities.[67] In this regard, the tribunal rejected China's argument that the alternative means was too financially and administratively burdensome. While acknowledging the extra burden and costs that China may have to undertake in switching from the chosen measure to the alternative means, the tribunal found that China failed to substantiate that these costs and burden were excessive, especially given that the Chinese government had already taken the responsibility of content review of most of the imported cultural goods.

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[61] Chad P. Bown and Joel P. Trachtman, '*Brazil - Measures Affecting Imports of Retreaded Tyres*: A Balancing Act', (2009)8(1) *World Trade Review* 85, 108.

[62] Ibid., 105-7.

[63] Panel Report, *China — Measures Affecting Trading Rights and Distribution Services for Certain Publications and Audiovisual Entertainment Products* (*China – Publications and Audiovisual Products*), WT/DS363/R, adopted 19 January 2010; Appellate Body Report, *China — Measures Affecting Trading Rights and Distribution Services for Certain Publications and Audiovisual Entertainment Products*, WT/DS363/AB/R, adopted 19 January 2010.

[64] These instruments are: *Protocol on the Accession of the People's Republic of China*, WT/L/432 (23 November 2001); and *Report of the Working Party on the Accession of China*, WT/ACC/CHN/49 (1 October 2001).

[65] See above n 63, Panel Report, *China – Publications and Audiovisual Products*, para. 7.713.

[66] Ibid., paras. 7.824-911. See also above n 63, Appellate Body Report, *China – Publications and Audiovisual Products*, paras. 269-337.

[67] See above n 63, Panel Report, *China – Publications and Audiovisual Products*, paras. 7.889-900; Appellate Body Report, *China – Publications and Audiovisual Products*, paras. 322, 327-31.

This dispute involved a negative consumption externality associated with the importation of cultural goods that contain contents contrary to China's fundamental social values. Government intervention is necessary as importers tend to ignore the social costs of such goods when determining whether to import them. However, despite the high level of protection that China intended to achieve,[68] the deprival of FIEs and other non-state entities of the right to import was at best a sub-optimal policy as it failed to address the externality directly. The first-best policy instrument would be a censorship mechanism which targets the content of imports rather than the right to import. The AB's rulings had the effect of pushing China to dissociate content review from importation[69] and to liberalize trading rights. As discussed above, the alternative means proposed by the U.S. and accepted by the AB was a mechanism whereby the Chinese government undertakes the content review through competent authorities or designated entities. China claimed that the financial and administrative burdens associated with the application of the alternative means would be too heavy. Some observers supported China's argument.[70] However, China failed to adduce evidence to substantiate this claim; and hence it was unclear whether the alleged by-product costs would render the alternative means sub-optimal. Given the fact that China had already entrusted a small number of SOEs with content reviews in practice,[71] the proposed means did not seem to be infeasible or too burdensome. More importantly, China was not required to use the proposed means but had the freedom to adopt a mechanism according to its own preference as long as it does not restrict trading rights. The AB did not second-guess the importance of censorship for China; nor did it ask China to reduce the desired level of censorship. This left the flexibility for China to continue to strictly enforce the censorship. While a rigorous content review mechanism may continue to effectively limit the volume of cultural imports,[72] it no longer deprives entities other than a handful of SOEs of the right to import cultural goods and hence removes the trade restrictiveness of the old mechanism and its anti-competitive effects against FIEs and other non-state entities vis-à-vis State import monopolies. By lifting the restriction on trading rights which arguably did not target the chosen objective directly, the new mechanism would also become more efficient in achieving the objective.

III.E *US – Tuna II (Mexico)* (2012-2019)

In *US – Tuna II (Mexico)*, the U.S. 'dolphin-safe' labelling scheme differentiated between tuna products based on the *technique* employed in tuna-harvesting and the *area* where tuna was harvested.[73] Tuna products containing tuna harvested in the Eastern Tropical Pacific Ocean (ETP) using purse seine nets must satisfy certain certification requirements to be eligible for a 'dolphin-safe' label. However, different and less onerous labelling requirements were applied to tuna products containing tuna harvested outside

[68] For further discussions of the policy objective at issue, see eg. Jingxia Shi and Weidong Chen, 'The 'Specificity' of Cultural Products versus the 'Generality' of Trade Obligations: Reflecting on 'China – Publications and Audiovisual Products'', (2011)45(1) *Journal of World Trade* 159, 161 (observing that cultural goods 'serve as essential instruments in disseminating government policy and shaping public opinion'); Julia Ya Qin, 'Pushing the Limits of Global Governance: Trading Rights, Censorship and WTO Jurisprudence – A Commentary on the *China – Publications* Case', (2011)10(1) *Chinese Journal of International Law* 271.

[69] See Panagiotis Demilatsis, 'Protecting Public Morals in A Digital Age: Revisiting the WTO Rulings on *US – Gambling* and *China – Publications and Audiovisual Products*', (2011)14(2) *Journal of International Economic Law* 257, 287.

[70] See eg. above n 68, Qin, 'Pushing the Limits of Global Governance: Trading Rights, Censorship and WTO Jurisprudence – A Commentary on the *China – Publications* Case', at 284.

[71] Ibid., at 276-77.

[72] See Paola Conconi and Joost Pauwelyn, 'Trading Cultures: Appellate Body Report on *China-Audiovisuals*', (2011)10(1) *World Trade Review* 95, 108.

[73] For a detailed review of the US scheme, see Panel Report, *United States – Measures Concerning the Importation, Marketing and Sale of Tuna and Tuna Products (US – Tuna II (Mexico))*, WT/DS381/R, adopted 13 June 2012, paras. 2.12-30; Appellate Body Report, *United States – Measures Concerning the Importation, Marketing and Sale of Tuna and Tuna Products*, WT/DS381/AB/R, adopted 13 June 2012, paras. 172-77.

the ETP using techniques other than setting on dolphins. The scheme provided for the possibility to use alternative 'dolphin-safe' labels rather than the official label. However, the use of the alternative labels was subject to not only the same requirements applicable to the official label but also some additional conditions. Finally, separate from the U.S. scheme, the Agreement on the International Dolphin Conservation Program (AIDCP), to which both the U.S. and Mexico are parties, also established a 'dolphin-safe' scheme. However, the AIDCP scheme is not compulsory and the parties have the right to decide whether to adopt it.

Mexico's major claim was a violation of the NT rule under Article 2.1 of the Agreement on Technical Barriers to Trade[74] (TBT Agreement),[75] contending that the U.S. scheme treated its tuna products less favourably than U.S. tuna products. This was because Mexico's tuna products were "almost exclusively caught in the ETP using purse seine nets set on dolphins", whereas U.S. ones were almost exclusively caught outside the ETP using other techniques.[76] Based on this evidence, the tribunal found that "the lack of access to the "dolphin-safe" label of tuna products containing tuna caught by setting on dolphins has a detrimental impact on the competitive opportunities of Mexican tuna products in the US market".[77] The next issue was whether the detrimental impact stemmed exclusively from a legitimate regulatory distinction rather than reflecting discrimination. The U.S. alleged that the policy objectives of the labelling requirements were to inform consumers and protect dolphins.[78] However, there was uncontested evidence showing that (1) the use of techniques other than setting on dolphins in tuna-fishing outside the ETP may cause harm to dolphins, and (2) the U.S. measures did not address these harms "even if dolphins have in fact been killed or seriously injured".[79] The AB held that even assuming that "the fishing technique of setting on dolphins is particularly harmful to dolphins", the risks associated with the use of other fishing methods were not addressed at all and should have been addressed at least "by imposing a different substantive requirement".[80] For the lack of even-handedness of the scheme in addressing the risks to dolphins, the AB found that the contested discriminatory treatment did not serve the declared objectives and hence ran counter to Article 2.1 of the TBT Agreement.[81] The AB then considered whether in pursuing the claimed policy objectives, the labelling requirements complied with the conditions contemplated under Article 2.2 of the TBT Agreement. The AB found in favour of the U.S. essentially on the ground that Mexico failed to identify a less trade restrictive alternative means that could achieve the level of protection pursued by the U.S. measures. The AB observed that the alternative means proposed by Mexico was for the U.S. to accept the AIDCP standard.[82] It held that the AIDCP scheme could contribute to the chosen objectives only to a lesser degree as it allowed tuna caught in the ETP by setting on dolphins to obtain the "dolphin-safe" label.[83]

To implement the WTO rulings, the U.S. amended its labelling scheme by strengthening the requirements applicable to tuna products containing tuna caught outside the ETP by techniques other than setting on dolphins.[84] However, the requirements applicable to tuna caught by large purse seine

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[74] Agreement on Technical Barriers to Trade, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, 1868 U.N.T.S. 120.

[75] For a discussion of the AB's assessment of whether the US measures were a technical regulation covered by the TBT Agreement, see Meredith Crowley and Robert Howse, '*Tuna-Dolphin II*: A Legal and Economic Analysis of the Appellate Body Report' (2014) 13(2) *World Trade Review* 321, 323-27.

[76] See above n 73, Panel Report, *US – Tuna II (Mexico)*, paras. 7.253, 7.279.

[77] See above n 73, Appellate Body Report, *US – Tuna II (Mexico)*, paras. 234-35.

[78] Ibid., para. 285.

[79] Ibid., paras. 251, 288.

[80] Ibid., paras. 289, 292.

[81] Ibid., paras. 297-99.

[82] Ibid., para. 328.

[83] Ibid., para. 330.

[84] WTO, Dispute Settlement Body, Minutes of Meeting held on 23 July 2013 (WT/DSB/M/334, 2 October 2013), para. 1.51.

vessels in the ETP remained different from those applicable to all other tuna, which led to the first compliance proceedings brought by Mexico.[85] The AB found that the amended scheme, by maintaining the regulatory distinction concerned, imposed more onerous requirements on "tuna products derived from tuna caught by setting on dolphins" and effectively "excluded most Mexican tuna products from access to the dolphin-safe label, while granting conditional access to such label to like products from the United States and other countries."[86] However, the AB could not determine whether the amended scheme had adequately remedied the lack of evenhandedness as the compliance panel did not conduct a proper assessment of the respective risks "associated with different methods of fishing for tuna in different areas of the oceans."[87] Merely to the extent that the risks were found to be comparable between large purse-seine fisheries within and outside the ETP, the AB concluded that certain provisions of the revised scheme still lacked un-evenhandedness.

The U.S. made further amendments to its labelling scheme through an interim rule on 22 March 2016 and requested the establishment of a compliance panel to determine the WTO-consistency of the revised measure.[88] In response, Mexico also resorted to the compliance proceedings to challenge the amended scheme.[89] The 2016 scheme did not modify the labelling requirements on ETP purse seine fisheries but further strengthened the requirements on all other fisheries.[90] In the second compliance proceedings, the panel conducted a detailed comparative assessment of both observable and unobservable harms of seven fishing methods in different parts of the ocean, reaching a conclusion that setting on dolphins causes higher observable harms compared with the other fishing methods and also unobservable harms which do not arise from the other methods.[91] Based on this risk assessment, the panel found that the various requirements of the 2016 labelling scheme were, individually and collectively, "calibrated to the risks to

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[85] Panel Report, *United States – Measures Concerning the Importation, Marketing and Sale of Tuna and Tuna Products (Recourse to Article 21.5 of the DSU by Mexico)* [*US – Tuna II (Mexico)(Article 21.5)*], WT/DS381/RW, adopted 3 December 2015, paras. 3.34-52; Appellate Body Report, *United States – Measures Concerning the Importation, Marketing and Sale of Tuna and Tuna Products (Recourse to Article 21.5 of the DSU by Mexico)*, WT/DS381/AB/RW, adopted 3 December 2015, paras. 6.7-34.

[86] See above n 85, Appellate Body Report, *US – Tuna II (Mexico)(Article 21.5)*, paras. 7.231-238.

[87] Ibid., paras. 7.239-266.

[88] *United States – Measures Concerning the Importation, Marketing and Sale of Tuna and Tuna Products*, Recourse to Article 21.5 of the DSU by the United States, Request of the Establishment of a Panel (WT/DS381/32, 12 April 2016). The US reacted quickly perhaps due to Mexico's request for authorization to retaliate the WTO-illegal labelling scheme in an amount of US$ 472.3 million annually. Amid the compliance proceedings, the arbitrator decided that the level of retaliation must not exceed "USD 163.23 million per annum". On 11 May 2017, Mexico requested authorization of retaliation in the goods sector according to the amount decided by the arbitrator, which was subsequently approved by the DSB. See *United States – Measures Concerning the Importation, Marketing and Sale of Tuna and Tuna Products*, Recourse to Article 22.2 of the DSU by Mexico (WT/DS381/29, 11 March 2016); Decision of the Arbitrator, *United States – Measures Concerning the Importation, Marketing and Sale of Tuna and Tuna Products*, Recourse to Article 22.6 of the DSU by the United States (WT/DS381/ARB, 25 April 2017); *United States – Measures Concerning the Importation, Marketing and Sale of Tuna and Tuna Products*, Recourse to Article 22.7 of the DSU by Mexico (WT/DS381/44, 12 May 2017).

[89] *United States – Measures Concerning the Importation, Marketing and Sale of Tuna and Tuna Products*, Second Recourse to Article 21.5 of the DSU by Mexico, Request for Consultations (WT/DS381/36, 19 May 2016).

[90] Panel Report, *United States – Measures Concerning the Importation, Marketing and Sale of Tuna and Tuna Products (Recourse to Article 21.5 of the DSU by the United States) & (Second Recourse to Article 21.5 of the DSU by Mexico)*, WT/DS381/RW/USA, WT/DS381/RW/2, adopted 11 January 2019, paras. 7.48-71; Appellate Body Report, *United States – Measures Concerning the Importation, Marketing and Sale of Tuna and Tuna Products*, *(Recourse to Article 21.5 of the DSU by the United States) & (Second Recourse to Article 21.5 of the DSU by Mexico)*, WT/DS381/RW/USA, WT/DS381/RW/2, adopted 11 January 2019, paras. 5.6-25. [hereinafter *US – Tuna II (Mexico)(Article 21.5 II)*] For a discussion of the revised scheme and the legal issues, see generally Cary Coglianese and Andre Sapir, 'Risk and Regulatory Calibration: WTO Compliance Review of the US Dolphin-Safe Tuna Labeling Regime', (2017)16(2) *World Trade Review* 327.

[91] See above n 90, Panel Report, *US – Tuna II (Mexico)(Article 21.5 II)*, paras. 7.164-525.

dolphins arising from the use of different fishing methods in different areas of the ocean."[92] On appeal, the AB dismissed various challenges raised by Mexico on the panel's comparative risk assessment and application of the "calibration" test, and upheld the panel's findings.[93]

This dispute can be seen to involve a negative production externality associated with the use of dolphin-harmful fishing methods in the course of tuna-harvesting. This externality might have arisen from the fact that the social costs of dolphin-unsafe tuna-harvesting were not taken into account by fishermen, such that the private use of these methods exceeded the socially desirable level. The optimal solution to the externality would be to impose a domestic tax or restriction on the use of dolphin-unfriendly fishing methods insofar as tuna-harvesting would be likely to cause incidental death or injury to dolphins.

The 'dolphin-safe' labelling scheme is just part of a comprehensive regulatory framework adopted by the U.S. to protect dolphins. This framework has involved other policy instruments which address the production externality more closely. These include, *inter alia*, the *Marine Mammal Protection Act of 1972*, which imposes restrictions on the importation of tuna harvested using dolphin-harmful methods (i.e. purse seine nets).[94] In response to overwhelming public pressure, the labelling scheme was introduced to strengthen the existing framework by targeting the consumption of tuna.[95] The goal of the scheme may be seen as tackling information asymmetries in the U.S. market by providing sufficient and accurate information to consumers as to whether tuna products are produced in a dolphin-friendly manner.[96] This measure could be effective in discouraging consumption of dolphin-unfriendly tuna products in the U.S. market because there was a group of American consumers highly concerned with animal welfare and "willing to pay a higher price in the market for a product that meets [their] higher ethical standards."[97] However, there was no evidence to show that *all* American consumers were dolphin-lovers or to exclude the possibility that other consumers may react more to factors (such as price or taste) other than the life and health of dolphins in making consumption decisions.[98] Despite the uncertainties about consumer preferences, the labelling requirements did lead to a significant change in the production practices of U.S. fisheries which switched to fishing methods other than setting on dolphins.[99] As dolphin-harmful tuna was gradually driven out of the market, consumers were forced to purchase dolphin-safe tuna.[100] These outcomes suggest that by setting a high bar for access to dolphin-safe labels, the U.S. scheme had the effect of changing the behavior of consumers and producers in a way that reduces the harms to dolphins.[101] As discussed above, the effectiveness of the scheme was recognized by the WTO tribunal. In particular, the AB paid due deference to the chosen level of protection by rejecting the proposed alternative means based on the use of the AIDCP scheme, which tended to be less effective in achieving the objectives.

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[92] Ibid., paras. 7.526-717.

[93] See above n 90, Appellate Body Report, *US – Tuna II (Mexico)(Article 21.5 II)*, paras. 6.33-258.

[94] Rodrigo Fagundes Cezar, 'The Politics of 'Dolphin-Safe' Tuna in the United States: Policy Change and Reversal, Lock-in and Adjustment to International Constraints (1984–2017)', (2018)17(4) *World Trade Review* 635, 642-43.

[95] Ibid., at 644-45.

[96] See above n 75, Crowley and Howse, '*Tuna-Dolphin II*: A Legal and Economic Analysis of the Appellate Body Report', at 343.

[97] Ibid.

[98] Lorraine Mitchell, 'Dolphin-Safe Tuna Labeling' in Golan, Kuchler and Mitchell (eds) *Economics of Food Labeling* (Washington DC: Agricultural Economic Report No. 793, US Department of Agriculture, 2000) at 22, 24-5.

[99] See above n 73, Panel Report, *US – Tuna II (Mexico)*, paras. 7.320-331.

[100] See above n 98, Mitchell, 'Dolphin-Safe Tuna Labeling', at 25.

[101] Economic studies have also shown that dolphin-safe labelling could affect consumer behaviour. See eg. Mario Teisl, Brian Roe and Robert Hicks, 'Can Eco-Labels Tune a Market? Evidence from Dolphin-Safe Labeling', (2002)43(3) *Journal of Environmental Economics and Management* 339.

However, the AB was unsatisfied with the asymmetric impact that the labelling scheme had on Mexican tuna products. This impact arose primarily from the regulatory distinction between tuna products based on fishing methods and locations. The WTO rulings pushed the U.S. to address the disparate impact by gradually narrowing the differences in the labelling requirements between the regulatory categories. To that extent, the revised scheme appears to have restored the conditions of competition between Mexican tuna products and tuna products of U.S. and other origins, although further evidence is required to determine whether the scheme would reduce the restrictiveness on the access of Mexican tuna products to the dolphin-safe label. Moreover, the scheme tends to be more efficient in addressing the policy objectives as it imposes more rigid requirements on fishing activities using techniques other than setting on dolphins. The remaining differences in the labelling requirements under the different regulatory categories seem to be necessary to address the significantly larger production externality with respect to the fishing activities of Mexican vessels as opposed to U.S. fisheries. Overall, the revised scheme tackles the information asymmetries concerned and consequently the production externality or the policy objectives more closely.

In short, the AB's decision was reasonably deferential to the regulatory autonomy of the U.S., leaving the flexibility for the U.S. to pursue its desired level of protection through a mix of policy instruments including the labelling scheme based on the regulatory distinction. The decision has also confirmed that the U.S. may choose to tackle the same production externality of different sizes in different ways and the larger ones through more onerous requirements. The decision was narrowly focused on the discriminatory elements of the labelling scheme and was solely aimed at counteracting the protectionist influence on environmental policies without impairing the capacity of the U.S. government to respond to the interests of environmental groups.[102]

III.F *EC – Seal Products* (2014)

EC – Seal Products involved a situation similar to *Brazil – Retreaded Tyres* in that the ban on the importation and sale of seal products in EU markets was coupled with several exceptions.[103] The major exception concerned seal products obtained from seals hunted by Inuit or indigenous communities (IC exception).[104] However, unlike *Brazil – Retreaded Tyres* in which the MERCOSUR exception and the court injunctions were not related to any legitimate policy objectives,[105] the EU seal regime was apparently designed with multiple objectives in mind. While the ban served to address public moral concerns about inhumane killing of seals and consumption of commercially-hunted seal products,[106] the IC exception sought to preserve the tradition and culture of indigenous people. The key weakness of the EU regime, in terms of WTO-consistency, was that it had a disparate impact on Canadian and Norwegian seal products vis-à-vis those originating in Greenland precisely due to the operation of the IC exception.[107] The panel found that the IC exception was made available exclusively to Greenlandic IC hunts which encompass

[102] For a detailed review and analysis of the politics behind the US labelling scheme, see generally above n 94, Cezar, 'The Politics of 'Dolphin-Safe' Tuna in the United States: Policy Change and Reversal, Lock-in and Adjustment to International Constraints (1984–2017)'.

[103] For a detailed review of the EU regime, see Panel Report, *European Communities – Measures Prohibiting the Importation and Marketing of Seal Products (EC – Seal Products)*, WT/DS400/R, WT/DS401/R, adopted 18 June 2014, paras. 2.1-7, 7.1, 7.7-56.

[104] The other two exceptions included the MRM exception relating to seal products obtained from seals hunted for the sustainable management of marine resources, and the Travellers exception which allowed travellers to bring seal products into the EU for personal/family use.

[105] Donald H. Regan, 'Measures with Multiple Purposes: Puzzles from *EC – Seal Products*' (2014) 108 *AJIL Unbound* 315, 319.

[106] See above n 103, Panel Report, *EC – Seal Products*, para. 7.375.

[107] Ibid., paras. 7.157-170, 7.592-609. The MRM exception was also found to have caused a breach of the NT rule treating Canadian and Norwegian seal products less favourably than EU seal products.

the largest commercial hunts comparing with other Inuit or indigenous communities.[108] Thus, the IC exception was not designed and applied in an even-handed manner and the discrimination had no rational connection with the objective of protecting seal welfare. Consequently, the panel ruled that the EU regime violated Article 2.1 of the TBT Agreement and GATT Article I:1 and did not satisfy the conditions of the Chapeau of GATT Article XX.[109] However, the panel did not accept the less trade restrictive means proposed by the complainants under Article 2.2 of the TBT Agreement on the grounds that the means may not be equivalently effective in addressing the seal welfare concerns and would be difficult and costly for the EU to implement.[110]

On appeal, the AB's analysis of the justifiability of the EU regime focused on the Chapeau.[111] Relying on the panel's findings, the AB observed that there was no evidence to show that the animal welfare conditions associated with IC and commercial hunts were different in the complainants vis-a-vis Greenland.[112] The AB agreed with the panel that the IC exception cannot be reconciled with the moral objective and that the EU could have done something further to address seal welfare in the context of IC hunts.[113] Furthermore, the AB found that the criteria of the IC exception were ambiguous and could result in arbitrary application which exempts commercial hunts.[114] Finally, the AB ruled that the EU failed to make "comparable efforts" to facilitate the access of Canadian Inuit to the IC exception as it did for the Greenlandic Inuit.[115] These deficiencies in the EU regime, collectively, constituted "arbitrary or unjustifiable" discrimination.[116]

To implement the WTO rulings, the EU imposed an additional condition for the application of the IC exception requiring that IC hunts be "conducted with due regard to seal welfare" so that the exception would exclude IC hunts "conducted primarily for commercial reasons".[117]

This dispute involved multiple and competing policy objectives.[118] The moral objective and the preservation objective are conflicting to the extent that the IC exception created "loopholes that might

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[108] Ibid., paras. 7.290-319.

[109] Ibid., paras. 7.618-651.

[110] Ibid., paras. 7.478-505. The proposed alternative means was essentially a labelling scheme based on the satisfaction of animal welfare requirements. Despite the actual effectiveness of the EU regime to the fulfilment of the seal welfare objective (which was diminished by the exceptions), the panel found that whether the alternative means may be equivalently effective would depend on the animal welfare requirements to be imposed. The panel further held that the proposed means would not be feasible due to the lack of generally applicable animal welfare requirements and standards, the difficulties for hunters to comply with stringent requirements, and the financial burdens and practical challenges for the EU to implement a certification scheme.

[111] The AB reversed the panel's finding that the EU regime constituted a "technical regulation" under the TBT Agreement and hence declared "moot and of no legal effect of the panel's decisions under the other provisions of the TBT Agreement. However, the AB upheld the panel's findings of violations under the GATT and dismissed various appeals against the panel's rulings under Article XX(a). Appellate Body Report, *European Communities – Measures Prohibiting the Importation and Marketing of Seal Products (EC – Seal Products)*, WT/DS400/AB/R, WT/DS401/AB/R, adopted 18 June 2014, paras. 5.8-70, 5.78-130, 5.184-290.

[112] Ibid., paras. 5.316-317.

[113] Ibid., para. 5.320.

[114] Ibid., paras. 5.321-328.

[115] Ibid., para. 5.337.

[116] Ibid., para. 5.338.

[117] Regulation (EU) 2015/1775 amending Regulation (EC) No 1007/2009 on trade in seal products and repealing Commission Regulation (EU) No 737/2010, OJ L 262/2, 6 October 2015. The revised regime also removed the MRM exception.

[118] For discussions of this issue, see Julia Y. Qin, 'Accommodating Divergent Policy Objectives under WTO Law: Reflections on *EC – Seal Products*', (2014)108 *AJIL Unbound* 308; above n 105, Regan, 'Measures with Multiple Purposes: Puzzles from *EC – Seal Products*'.

admit products of commercial hunts".[119] The critical issue is whether the discrimination may be justified by the EU's need to pursue these objectives.

In light of the function of the WTO and the Theory, the DSM should not unduly restrict the capacity of WTO Members to address domestic externalities or policy objectives. However, in this dispute, neither the moral objective nor the preservation objective could explain sufficiently why the IC exception was not applied in an even-handed manner. While the IC exception clearly reduced the effectiveness of the EU regime to the fulfillment of the moral objective,[120] it did not afford equal protection of the rights of indigenous communities in all the parties involved. Thus, even based on the preservation objective alone, the discrimination would be unjustifiable. As observed by Professor Mavroidis, the EU regime applied different standards to the different parties to accommodate the commercial interests of EU industries.[121] This suggests that the EU regime, particularly the design and application of the IC exception, was likely compromised by protectionist interests.

This dispute involved two externalities – a negative externality associated with the production and consumption of seals and a positive externality associated with the protection of the tradition and culture of indigenous communities. The EU regime sought to address these externalities through one measure, that is, the import and marketing ban with the IC exception.[122] However, while the ban tackled the production and consumption externality directly, the IC exception not only reduced the efficacy of the ban in attaining the moral goal but also was not the first-best policy to address the preservation goal. As some have suggested, the best solution would be for the EU to remove the IC exception and instead subsidize the Greenlandic Inuit community through decoupled income payments which would also lead to less killing of seals.[123] The WTO tribunal did not consider this alternative means as it was not requested to do so. Nor did the tribunal accept the alternative means proposed by the complainants. Thus, not only did the tribunal not question the EU's pursuit of multiple objectives, but it also did not question the EU's use of a sub-optimal means to pursue the preservation goal. The tribunal's concern was confined to the discriminatory application of the IC exception. This discrimination, as established empirically, had negative trade effects on Canada and Norway leading to "substitution of imports from Canada and Norway with imports from Greenland."[124] Moreover, it resulted in a less efficient position in which both the moral and preservation objectives were only partially addressed.

The WTO rulings had the effect of compelling the EU to (1) enhance the overall welfare effects of its seal regime by "minimizing the cost to seal welfare of achieving any specified amount of Inuit culture preservation",[125] and (2) take steps to ensure that Canadian Inuit hunts eligible for the IC exception have equal access to European markets as Greenlandic Inuit hunts.[126] Accordingly, the rulings would

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[119] Rob Howse, Joanna Langille and Katie Sykes, 'Sealing the Deal: The WTO's Appellate Body Report in EC – Seal Products' (2014) 18(12) ASIL Insights, available at: www.asil.org/insights/volume/18/issue/12/sealing-deal-wto%E2%80%99s-appellate-body-report-ec-%E2%80%93-seal-products.

[120] See above n 103, Panel Report, *EC – Seal Products*, paras 7.441-461.

[121] Petros C. Mavroidis, 'Sealed with a Doubt: EU, Seals, and the WTO', (2015)6(3) *European Journal of Risk Regulation* 388, 391-92. For an overview of the legislative history of the EU regime, see Katie Sykes, 'Sealing Animal Welfare into the GATT Exceptions: The International Dimension of Animal Welfare in WTO Disputes', (2014)13(3) *World Trade Review* 471, 475-77.

[122] Note that Professor Mavroidis has argued that it would be better to treat the ban and the IC exception as two separate measures each serving a different objective, see above n 121, Mavroidis, 'Sealed with a Doubt: EU, Seals, and the WTO', at 389, 391.

[123] Ibid., at 394. Paola Conconi and Tania Voon, '*EC – Seal Products*: The Tension between Public morals and International Trade Agreements', (2016)15(2) *World Trade Review* 211, 225.

[124] See above n 123, Conconi and Voon, '*EC – Seal Products*: The Tension between Public morals and International Trade Agreements', at 225.

[125] See above n 105, Regan, 'Measures with Multiple Purposes: Puzzles from *EC – Seal Products*', at 321.

[126] See above n 119, Howse, Langille and Sykes, 'Sealing the Deal: The WTO's Appellate Body Report in EC – Seal Products'.

contribute to making the regime less trade restrictive and more efficient in achieving the seal welfare goal. To the extent that the regime would now admit indigenous hunts from the other parties under the IC exception, it would also improve the protection of the rights of all indigenous communities concerned. However, the revised IC exception, which requires a consideration of seal welfare in Inuit hunts, may adversely affect the subsistence need of Greenlandic Inuit community to hunt for commercial purposes. The tribunal left the flexibility for the EU to adopt other instruments to address this subsistence need more specifically. As mentioned above, one way would be for the EU to subsidize the community directly. In practice, this could be done under the existing EU-Greenland Partnership whereby the EU has committed to financially support Greenland in various industries including the fisheries sector.[127] Overall, the WTO decision was effective in disciplining the discriminatory and protectionist element of the EU ban while not unduly impairing the EU's capacity to pursue the multiple objectives.

III.G Concluding Observations and Broader Implications

Two general observations can be drawn from the case studies above, which have significant implications for the ongoing debate over the efficacy and legitimacy of the multilateral trading system.

The first observation is that the DSM has been largely effective in discouraging the use of protectionist instruments in pursuit of non-trade objectives. This suggests that WTO Members should continue to use the DSM to resolve trade disputes and challenge national policies or measures which adversely impact on trade without justifications. In the context of the escalating U.S.-China trade war, this multilateral approach based on WTO litigation would be more effective in addressing the disagreement on various trade-related issues than the ongoing unilateral and confrontational approach which has proven to be counter-productive. To date, China has maintained a good record of compliance with adverse rulings of the WTO.[128] Therefore, continued use of the DSM to compel China to change WTO-illegal practices in relation to industrial policies, SOEs, technology transfer, etc. should be preferred. Thus, it is imperative for WTO Members to maintain a functional DSM and to strengthen its utility. Given its effectiveness on influencing China's domestic policymaking, it is also in the U.S.'s own interest to ensure that the DSM is not paralysed.

The second observation is that the AB's approaches and decisions in highly controversial cases have served the fundamental function of the WTO. Contrary to the widespread misleading criticism of the AB and the WTO as prioritizing trade values over non-trade values, the AB has demonstrated a good understanding of the underlying function of the system and ample competence in reaching a balanced decision which is both economically sound and politically savvy. Therefore, to the extent that judicial decisions are reasonably confined to fulfilling the overarching function of the WTO, the AB, and the WTO tribunals in general, should not be taken as overstepping its authority.[129]

One notable limitation of the studies and findings in this paper is that it does not elaborate on the relationship between the anti-protectionism function of the WTO and WTO rules which apparently have other goals.[130] Thus, further studies are needed to explore this relationship in important areas such as the use of trade remedies to tackle so-called "unfair" trade practices, the protection of intellectual property rights to promote innovation, and the creation of WTO-plus rules to impose extra and strict obligations

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[127] See generally European Commission, 'International Cooperation and Development: Greenland', available at: https://ec.europa.eu/europeaid/countries/greenland_en.

[128] See generally Weihuan Zhou, *China's Implementation of the Rulings of the World Trade Organization* (Oxford and Portland, Oregon: Hart Publishing, 2019).

[129] For a dedicated discussion on the issue of judicial overreach, see generally Weihuan Zhou and Henry Gao, " 'Overreaching' or 'Overreacting'? Reflections on the Judicial Function and Approaches of WTO Appellate Body", (2019)53(6) *Journal of World Trade* (forthcoming 2019). A SSRN version of this article is available here: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3418737.

[130] I thank Profs Andrew Lang and Andrew Mitchell for this observation.

on certain Members such as China without providing the same policy space as generally enjoyed by WTO Members under WTO exceptions.[131]

IV. CONCLUSION

The current crisis in the multilateral trading system has reminded us of the U.S.'s resort to protectionism and unilateralism in the 1920s and early 1930s in response to enormous pressure from domestic farmers, which led to the rise of trade barriers and protectionist sentiment worldwide, severe contraction of world trade and deterioration in trade relations.[132] History, however, is also a great reminder that it was economic cooperation that brought prosperity and peace after the Great Depression and World War II. Amongst other efforts, the conclusion of the GATT in 1947 as the new order for world trade represented a dramatic shift in U.S. domestic politics from isolation and self-interests to cooperation and mutual benefits in order for "the removal of economic causes of friction".[133] Now, the disturbing period of the history seems to be repeating itself to some extent as a result of U.S. unilateralism and deviation from international cooperation. For all stakeholders, the question is whether a change of domestic politics may occur without pushing the WTO over the cliff and triggering all economic and political ramifications as a result. To a large extent, this change relies on the American people. For Americans, the words of Clair Wilcox, U.S. chief negotiator and a key architect of the GATT, remain illuminating. In his book published right after the successful reconstruction of the world trade order in 1948, Wilcox sent the following prescient warning to U.S. people:

> It is the first condition of effective foreign policy that this nation put away *forever* any thought that America can be an island to herself. No private program and no public policy, in any sector of our national life, can now escape from the compelling fact that if it is not framed with reference to the world, it is framed with perfect futility.
>
> The logic of our position allows us no alternative. We must go on, in international cooperation, from politics to economics, from finance to trade. World organization for security is essential; but if it is to succeed, it must rest upon continuous international participation in economic affairs… If political and economic order is to be rebuilt, we must provide, in our trade relationships, the solid foundation upon which the superstructure of international cooperation is to stand.[134]

As part of the growing efforts to defend the significance of the multilateral trading system, this article makes a number of contributions. Drawing upon the classic international trade theories, this paper has shown that the WTO is designed to play a critical role in disciplining the use of protectionist policy instruments for trade or non-trade objectives. The rules-based system of international cooperation has performed that function by imposing an external constraint on domestic protectionist influence on regulatory decision-making and incorporating the interest of exporters into the decision-making process to counterbalance the protectionist pressure on governments. In the meantime, and quite contrary to the widespread public (mis)understanding of the WTO, the system is not intended to and does not pursue trade interests at the sacrifice of Members' regulatory autonomy in trade-unrelated matters. In this regard, the Theory is so significant as to not only reinforce the economic justifications for trade liberalization but also provide powerful guidance for how the system may operate to fulfill its underlying function and

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[131] See eg Appellate Body Report, *China – Measures Related to the Exportation of Various Raw Materials*, WT/DS394/AB/R, WT/DS395/AB/R, WT/DS398/AB/R (adopted 22 February 2012) paras. 280-307.

[132] For a detailed examination of the history, see Douglas A Irwin, *Clashing over Commerce: A History of U.S. Trade Policy* (Chicago; London: University of Chicago Press, 2017) 371-410.

[133] William Adams Brown, *The United States and the Restoration of World Trade – An Analysis and Appraisal of the ITO Charter and the General Agreement on Tariffs and Trade* (Washington, D.C.: The Brookings Institution, 1950) 1.

[134] Clair Wilcox, *A Charter for World Trade* (New York: The MacMillan Company, 1949) xvi-xvii.

achieve a proper balance between the disciplining of protectionist policy instruments and the preservation of Members' policy space. The DSM, as the "crown jewel" of the system, has largely served the underlying function of the WTO. In particular, the approaches and decisions of the AB in disputes involving non-trade issues have arguably followed the economic guidance derived from the Theory and have narrowly focused on tackling the protectionist elements of a contested measure without impairing Members' capacity in pursuing any chosen non-trade objectives or desired levels of protection. By doing so, the DSM has contributed to changing domestic political dynamics in a way that disincentivizes governments from responding to protectionist demands of special interest groups but leaves the flexibility for governments to adequately accommodate non-trade interests.

Given the history of the 1930s and the ongoing escalation of trade tensions today, the fate of the world economy, without the WTO, is not unforeseeable. However, if the WTO does collapse and the potential economic and political consequences materialize, then the political need for trade cooperation and non-discrimination and rules-based dispute resolution will quickly re-emerge and become a common policy priority. By then, it will not take long for governments to realize that the best way to pursue that policy priority for long-term peace and prosperity would be to rebuild a multilateral trading system.